

2.5.3 Retailer Business Model

The following sections focus on the five core components of a retailer’s business model. These sections highlight the critical means by which a retailer functions within the market and how other organizations within the market can best collaborate with a retailer.

OPPORTUNITY STATEMENT: Retailers can be valuable partners in building a sustainable residential energy efficiency market. They have well-established brand names and central store locations that provide partner contractors and programs with credibility and better access to customers. This access comes at the cost of having to work around retailer profitability requirements, pilot processes, and project timelines. It is critical that anyone seeking to partner with a retailer come prepared with a well-thought-out business plan that addresses these concerns and highlights estimated demand for the market in question.

2.5.3.1 Governance

Retailers are private-sector companies that have a range of governance models. These can impact how a retailer makes decisions with regard to its business strategy, service offerings, and financial structure, including partnering with other market actors. The retailer governance models are described in Figure 2-26.

Retailer Governance Models			
	Big Box Retailers	Wholesale/Distributor/Franchiser Retailers	Small Privately-Owned Retailers
Description	<ul style="list-style-type: none"> ▪ Publicly traded ▪ National chain of retail outlets 	<ul style="list-style-type: none"> ▪ Privately held local operations with public parent ▪ Franchises are dealer owned 	<ul style="list-style-type: none"> ▪ Privately held ▪ Regionally/locally focused ▪ Owned by individual or investors
Key Decision-Makers	<ul style="list-style-type: none"> ▪ Shareholders ▪ Board of directors ▪ Management 	<ul style="list-style-type: none"> ▪ Owners ▪ Parent’s shareholders based on franchise rules and guidelines 	<ul style="list-style-type: none"> ▪ Owners
Financial Structure	<ul style="list-style-type: none"> ▪ Offer entire product and service value chain ▪ High bargaining power with suppliers ▪ Successful growth occurs through acquisition and organic expansion 	<ul style="list-style-type: none"> ▪ Cooperative structures are common ▪ Growth depends on local opportunities for expansion ▪ Local management manages operations and is responsible for revenue generation ▪ Local management has limited input into strategies at the franchise level 	<ul style="list-style-type: none"> ▪ Small number of stores ▪ Successful firms will consolidate to gain a larger footprint ▪ Smaller firms find niches to stay viable

Source: Booz Allen research

Figure 2-26: Retailer Governance Models

Big box retailers typically are publicly traded companies with multiple layers of decision-makers that determine corporate strategy, service offerings, and partnering opportunities. In this type of organization, the decision-making process can be difficult to navigate for those within a company seeking to expand its service offerings into the energy efficiency market and those outside the company seeking to work alongside it. Identifying the right personnel within the big box retailer’s chain of command who can speak on behalf of the company becomes critically important in seeking approval for a new project. As a general rule, a big box retailer’s store manager has significant discretion over the store’s promotions. If the store manager is amenable, it may not be necessary to forge a partnership with corporate management. Where store

managers are not amenable, or for programs seeking to partner with more than one store, it is essential to engage corporate management to get their support and buy-in while negotiating partnership options. For small box or franchise retailers, this process is much simpler. The store owner has unlimited discretion to engage in partnerships that he/she deems best for his/her company. Due to the highly competitive nature of the retail market, both store managers and corporate representatives are very sensitive to their competition. As such, a partnership or promotion endorsed by one retailer will be strongly considered by its competitors.

Big box retailers and other investor-owned firms have very specific profit targets that must be reached to meet corporate and investor requirements. A good understanding of an investor-owned retailer’s sales, costs, and potential profits is critical to the ability to approach in approaching the retailer about long-term partnership opportunities. Program administrators must identify the right person within the big box retailer’s chain of command. This person is typically the vice president of business development or their equivalent, as they are authorized to develop new product or service lines on behalf of the company. Wholesaler, distributor, and franchiser retailers are difficult to influence on a national or regional level because there is little centralized control over store operations outside of branding. However, individuals seeking to engage with these retailers find success with specific individual stores that exercise greater control over what service offerings they wish to provide and partnerships they wish to form.

Small privately owned retailers may be easier to collaborate with than larger companies from a decision-making standpoint. However, these small companies typically have difficulty operating at scale and may face competitive pressures from big box retailers in their region.

Key Insights

Retailer Insights		
	Observations	Impact on Potential Entry into Residential Energy Efficiency Market
Governance	<ul style="list-style-type: none"> Big box retailers are typically publicly traded and have multiple layers of decision-makers that determine corporate strategy, service offerings, and partnering opportunities. Franchised retailers are difficult to influence because there is little central control over store operations outside of branding. Small private companies may be easier to collaborate with from a decision-making standpoint. However, these companies typically have difficulty operating at scale and may face competitive pressures from big box retailers in their region. Retailers are highly sensitive to their competition’s marketing and promotion strategies. 	<ul style="list-style-type: none"> Organizations that wish to partner with a retailer may find the decision-making process difficult to navigate. Managers of individual stores may be willing to collaborate, but the decision is at their discretion. To engage multiple stores, partners need to work with corporate management. Smaller retailers may have an advantage in expanding rapidly into new services at the local level, as they have shorter, more streamlined decision-making chains. If one retailer is willing to collaborate, its direct competitors are likely to as well to remain competitive.

2.5.3.2 Financial Model or Structure

Understanding a retailer’s financial model or structure is critical to being able to engage with that retailer. A retailer’s financial model or structure is highly focused on profit. Entry into the home performance retail market typically does not require a heavy up-front investment. Consequently, profits are largely driven by variable factors, such as revenues from sales and cost of goods sold (COGS).



Investors evaluate a big box retailer on its ability to maintain its gross profit margin (approximately 35 percent), which is a function of revenues and COGS.²⁹ While this profit margin is important for corporate management and shareholders, long-term revenues ultimately are the primary concern of the individual store managers. Long-term revenues give them some flexibility in setting their product and service mix because it allows them to stock lower-margin goods (or provide lower-margin services) as long as they serve as gateways to future customer purchases (hopefully of more profitable or larger-ticket items). Where a retailer is willing to sacrifice on profit margin, the goal is often to increase the overall store customer traffic, build positive customer relationships, and ensure that they return to purchase additional goods or services at the store in the future. In this manner, individual big box store managers are very similar to franchises or small box store owners who have high flexibility in setting their target profit margins and determining their service offerings.

On account of this, the need to identify new sources of sales is critical to all retailers' operational models. Up until recent years, new sources of sales largely were acquired through the addition of new stores in untapped locations. However, given the rapid expansion of big box retailers, options for the addition of new stores have diminished. Consequently, retailers need to look for new product and service offerings—such as home energy upgrades—that could drive growth within their existing locations. If a program administrator or private contractor wishes to partner with a retailer to drive the sales of home energy upgrades, the administrator or contractor must understand, and establish for the retailer, that a large enough local demand exists for home energy upgrades and that these upgrades can prove to be a significant driver of sales.

While sales are the primary driver of revenues, the types of goods and services offered are the primary drivers of the COGS. For example, while insulation is typically a low-cost product, the labor cost to install may be high. This could reduce a retailer's profit margin if it must provide insulation installation as a service. Instead, many retailers sell insulation to contractors and “do-it-yourself” (DIY) consumers rather than install the insulation themselves. An understanding of the COGS that lower profit margins represents an opportunity for potential partners who can add value.

Key Insights

Retailer Insights		
	Observations	Impact on Potential Entry into Residential Energy Efficiency Market
Financial Model or Structure	<ul style="list-style-type: none"> Big box and wholesale/distributor/franchiser retailers have high profitability targets, with a typical gross margin target of 35 percent. Small retailers have less determined profit targets. All retailers may be willing to provide goods or services at a lower profit margin if by doing so they can increase store traffic, build customer loyalty, and drive future sales. Retailers are focused primarily on sales and revenue implications of launching a new service line rather than up-front cost. 	<ul style="list-style-type: none"> Big box retailers may seek similar profit margins for home energy upgrades as with their traditional services. Energy-efficient goods and services do not have to meet profit targets if they can create a wider customer base. A good understanding of the sales, cost, and potential profit implications of home energy upgrade services is critical to approaching an investor-owned retailer about long-term partnership opportunities.

²⁹ Source: Booz Allen research.

2.5.3.3 Assets and Infrastructure

While an understanding of a retailer’s financial model is key to the ability to engage with that retailer, understanding a retailer’s assets is critical to identifying how the retailer can influence a market. Brand identity, inventory, real estate, and other assets, such as cash and account receivables, all constitute a retailer’s assets.

A retailer’s brand can account for 70 to 90 percent of its market value, due to its ability to drive future revenue through repeat sales. Customer loyalty tracked through same-store sales revenues is a key aspect of a brand’s value and can be leveraged to develop sustained interest in home energy efficiency over time. To program administrators and private companies seeking to partner with retailers, this is a valuable tool. A customer’s comfort with the retailer selling the goods and services can drive energy efficiency market sales. Retailers possess a unique ability to leverage their established brand names to build consumer confidence in what they are offering. For example, a name-brand product may cost more, but consumers will buy it because they are familiar with its general level of quality. This tendency to gravitate toward comfort could easily apply to home energy upgrades, but only if the retailer is confident that the work being done under its name is up to its standard of quality. Consequently, the retailer might opt to partner with established contractors whose management has a proven track record of success rather than with newly created home performance contractors.

A retailer’s real estate, or physical location, can provide partners with a steady source of leads for new work and a means of interacting with consumers in person. A centrally located piece of real estate can be valuable in terms of generating new walk-in business, and also in building consumer confidence that customer assistance is readily available if needed. This effect on consumer confidence is, in large part, the reason why retailers have sought the widest possible range of physical locations in their expansion efforts. Thus, the ability to leverage a retailer’s prime location is another reason why remodelers, home performance contractors, and others might seek to engage a retailer in a partnership.

Finally, retailers use a metric known as “inventory turnover” to evaluate how well specific goods are selling. A shorter average time on shelves indicates a high sales rate. Goods that spend longer periods on shelves are costly to retailers. The average inventory turnover for a retailer is 75 days.³⁰ A partner that can demonstrate an ability to reduce this turnover period (i.e., drive sales) can add value to the retailer.

Key Insights

Retailer Insights		
	Observations	Impact on Potential Entry into Residential Energy Efficiency Market
Assets and Infrastructure	<ul style="list-style-type: none"> ■ A retailer’s brand is one of its most critical assets. It is highly valuable in driving consumer demand and promoting consumer confidence in the retailer’s goods and services. ■ Retailers on average recycle their inventory every 75 days. Finding more efficient ways to reduce this time leads to increased revenues and is at the core of the retailer’s business model. ■ Retailers’ physical locations are critical to driving walk-in sales. This is a major reason 	<ul style="list-style-type: none"> ■ There is significant benefit to using a retailer’s brand. Organizations seeking to leverage a retailer’s brand name through a partnership must have an established track record within the industry. ■ Retailers’ physical locations can provide partners with a steady source of leads for new work, as well as a means of interacting with consumers in person.

³⁰ Source: Booz Allen research.

Retailer Insights		
	Observations	Impact on Potential Entry into Residential Energy Efficiency Market
	why retailers have raced to reach the widest possible range of physical locations in their initial expansion efforts.	

2.5.3.4 Service Offering

Retailers offer various products and services for their customers, depending on the type of retailer. The full range of these service offerings is listed in Figure 2-27.

Retailer Service Offering

		Big Box Retailer	Wholesale/Franchise	Small Private Company
Products	Building Materials	✓	✓	✓
	Appliances	✓	✓	✓
	Heating and Cooling	✓	✓	
	Computers and Electronics	✓	✓	
	Lighting and Fans	✓	✓	✓
	Plumbing	✓		✓
	Paint and Flooring	✓		✓
	Technology Systems	✓	✓	
	Lumber and Millwork	✓		✓
Financing and Incentives	Consumer Credit Cards	✓	✓	
	Contractor Credit Cards	✓		
	Contractor Lending Services		✓	
	Contractor Bonding and Insurance		✓	
Services	Online Services and Resources	✓	✓	
	Installation and Services	✓	✓	✓
	In-store Technical Advice	✓	✓	✓
	Specialty Orders and Services	✓		
	Energy Efficiency Specific Offerings	✓	✓	

Source: Booz Allen research

Figure 2-27: Retailer Service Offering

As a general rule, retailers generate the majority of their revenue through the sale of products to homeowners and contractors. Due to this heavy reliance on product sales, manufacturers have a very strong influence over the goods a retailer stocks. However, heavy customer or contractor demand can help shape a retailers product mix as well. This has implications for energy-efficient products, which are a

relatively new niche of potential product sales. Most services provided under the brand of the retailer are subcontracted out to private firms, with the retailer handling only the sales aspect of the transaction.

A retailer's service offerings tend to become more comprehensive as it increases in size. For example, big box retailers typically offer a wide range of products for various market segments that are common across geographies. They also offer consumer credit and contractor credit options in-house or through a partner financial institution.

Small privately owned retailers, including local hardware stores, have the advantage of consumer familiarity and strong local networks, but they may provide more limited products and services than larger retailers. These smaller retailers may be willing to expand into energy efficiency goods and services if the demand for those goods and services is adequately demonstrated.

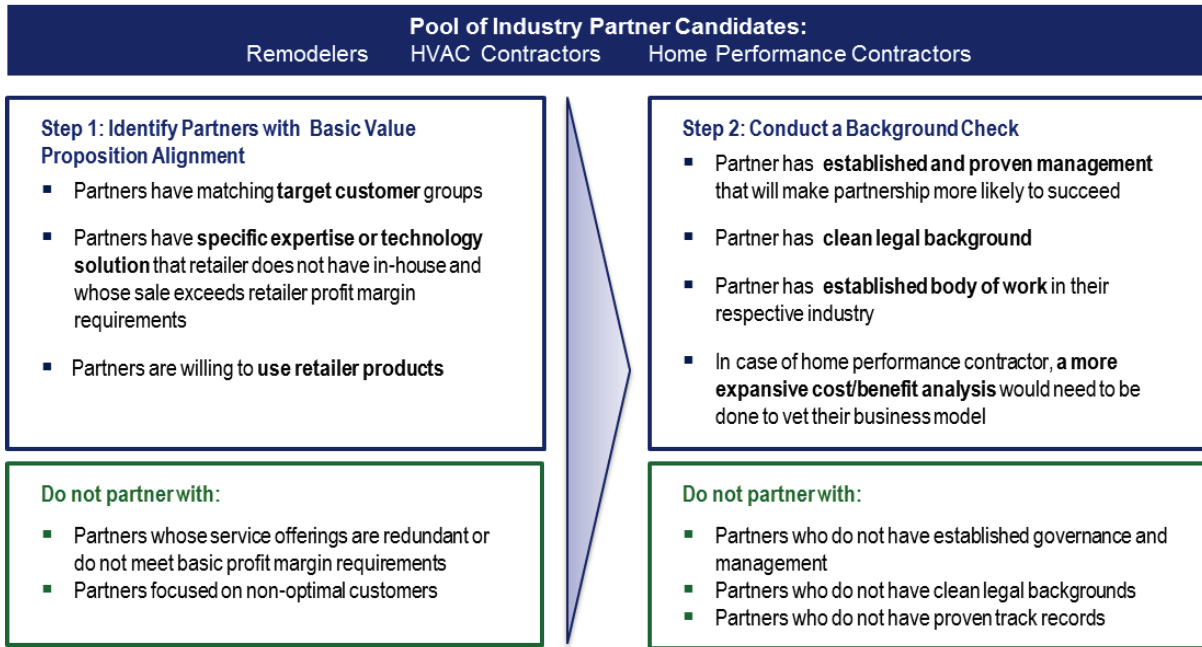
Specialty retailers are increasing their "footprint" through new lines of energy efficiency products (e.g., Sears and Best Buy energy-efficient appliances and home control systems) and through sustainable products (e.g., Green Depot's focus on environmentally friendly and energy-efficient products and services).

2.5.3.4.1 Partnerships

Partnerships can provide an opportunity for a retailer to expand its service offerings. Retailers offer various partnership opportunities for other diverse entities such as remodelers, contractors, home performance contractors, and program administrators. To date, these partnerships have been mostly in the form of pilot programs, but opportunities exist for longer-term partnerships if a strong business case can be made.

A program administrator seeking to develop a partnership with a retailer should be prepared to present a business plan based on more than just short-term incentives that will regularly expire or change. The program administrator should also demonstrate how the collaboration will drive retail sales and, ultimately, increase revenues. Given that retailers primarily consider themselves to be sellers of goods, rather than services, program administrators should also understand the basic pathways a retailer uses to deliver goods and services to its customers to ensure the partnership proposal is reasonable. For example, a big box retailer generally trains its staff to sell its goods and service packages but subcontracts out the actual service work to partner contractors. In this type of service model, the contractor has no means of selling to the customer but simply executes work that is defined by the retailer and customer beforehand. Thus, a partnership focused on training the contractors to conduct home energy upgrades is very unlikely to gain traction. In this case, the store also would need to train its sales staff to sell home energy upgrades in addition to its standard services. This training alteration would need to be made at a corporate level and would be costly, limiting the benefit of such a partnership to the retailer. Figure 2-28 presents a retailer's partnership screening criteria for remodelers, HVAC contractors, and home performance contractors. Figure 2-29 presents a retailer's partnership screening criteria for program administrators.

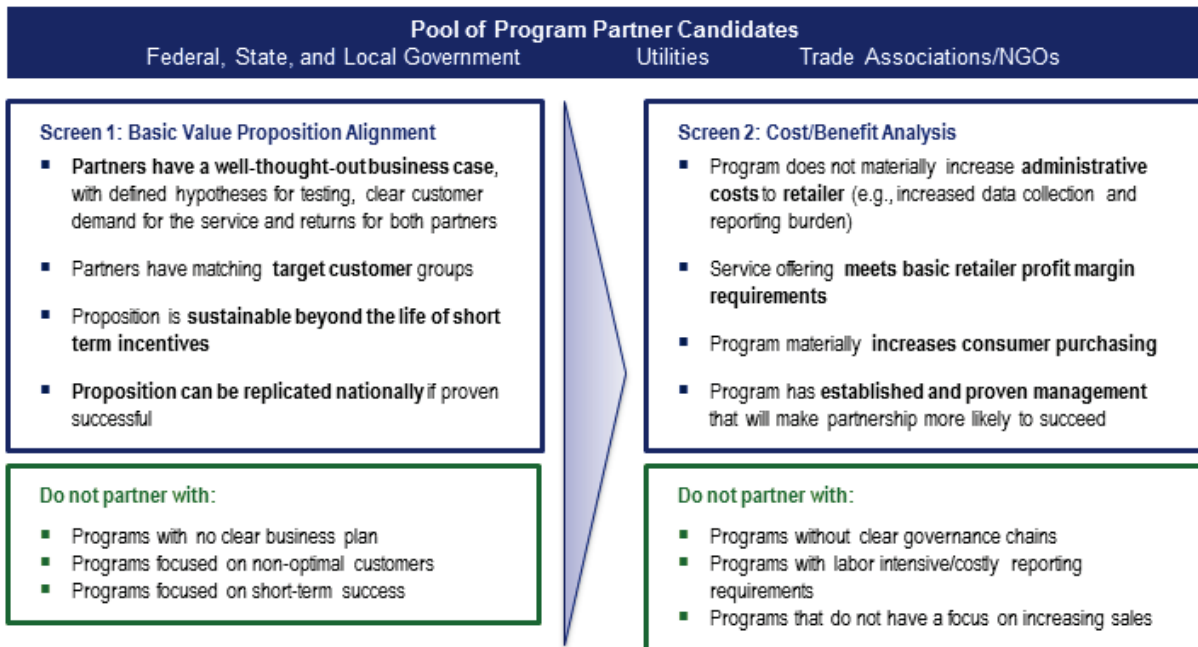
Retailer Partnership Criteria for Industry Partners



Source: Booz Allen research

Figure 2-28: Retailer Partnership Criteria for Industry Partners

Retailer Partnership Criteria for Program Administrators



Source: Booz Allen research

Figure 2-29: Retailer Partnership Criteria for Program Administrators

Partnerships with retailers and private companies generally consist of the partners working under the retailer's brand name to deliver home energy upgrades. However, as noted in Figure 2-29 above, established big box retailers will often use specific criteria in screening potential private-sector partners, including the following:

- A common customer demographic
- A well-established track record of performance in the industry
- Proven management, especially in the case of the home performance contractor
- A well-thought-out business plan that demonstrates the viability of a sustainable home performance practice in the local market (most retailers are very familiar with remodeler and HVAC contractor service viability already, but home performance contractors, as a relatively non-established niche of the market, may need to demonstrate their value as a potential partner)

Many benefits are associated with forming a partnership with retailers, although partnerships are still in their early stages. A home performance contractor that chooses to work with a retailer could receive a steady source of leads generated through the retailer's physical location and online presence. These contractors can also benefit from having their work quality validated through the retailer's brand name. However, if the contractor accepts the retailer's brand name, then quality assurance standards will be imposed by the retailer, possibly resulting in the loss of control over job selection and management of quality-related complaints.

Examples of successful partnerships that retailers have executed in conjunction with program administrators include:

- **Small-scale store demonstrations** to highlight the value of energy efficiency and market program services (note: these are most effective on weekends from May to October when retailer store traffic is highest).
- **Cross-promotion between programs and retailers** to refer customers for each. This could include:
 - Discounts for energy-efficient products (valid only at partner retail stores) to customers that join the program. (This can be coordinated with bulk purchasing strategies.)
 - Program logo usage in retailer marketing materials for energy-efficient products (excluding product packaging).
 - Coupons for energy-efficient products (e.g., appliances) upon redemption of program energy efficiency rebates.
 - Advertising for program services on retailer receipts.

Some options that have not proven successful include:

- **Centralizing energy-efficient products** in one location within the store (there are just too many varieties to organize them in a manner that makes sense to the consumer).
- **Upselling customers at the store level.** Most retail customers typically already know what they want prior to entering the store and are not going to make large impulse buys.
- **Training store staff to sell energy-efficient services directly to consumers.** Retailers generally find that the additional training costs do not result in a large increase in home energy upgrade service sales, as customers largely make their purchasing decisions before entering the store. However, retailers have

indicated that they are comfortable training staff to refer customers to partner programs for further information on home energy upgrade services should the customer show an interest.

2.5.3.4.2 Pilots

Organizations seeking to collaborate with a retailer on a long-term basis should understand how the retailer manages its pilot program and testing process for new partnerships and service offerings. For example, many retailers have defined schedules for when to start and how long to operate specific pilot projects. Entering into a partnership midway through an established pilot will make it much more difficult to demonstrate the viability of the partnership model, thus limiting its chance of being sustained or replicated.

Most retailers will want to test a new partnership or service offering for six months before formally establishing the partnership or before rolling out the service offering. The retailer will run a cost-benefit analysis to measure the pilot’s performance. If the performance is good, the retailer may seek to extend the life of the pilot to apply it to a longer-term service line. If the pilot does not produce the expected returns, the retailer may forgo the partnership entirely.

Key Insights

Retailer Insights		
	Observations	Impact on Potential Expansion into Energy Efficiency
Service Offering	<ul style="list-style-type: none"> ■ Retailers provide goods and services directly to consumers and small contractors. These include: <ul style="list-style-type: none"> - Materials such as insulation and appliances - Information on energy efficiency options, installation of equipment, or other home remodeling through retailer-certified contractors - Financing directly to consumers in-house and through partnerships with financial organizations, such as credit card companies ■ Retailers may use pilot programs to evaluate home performance contractors and test the demand for their services in a local market before rolling these services out on a broader scale. ■ Retailers generally train staff to sell their goods and service packages, but subcontract out the actual service work to partner contractors. ■ Retailers are generally willing to cross-promote with program administrators to drive sales. 	<ul style="list-style-type: none"> ■ Partnering with local remodelers, HVAC contractors, and financial institutions helps retailers expand their ability to provide a wide range of services to the market. ■ Program administrators and other organizations seeking to work with retailers must demonstrate a strong track record and that there is strong local demand for home energy upgrades. ■ Home performance contractors, as a relatively non-established niche of the market, may have a higher burden to illustrate their value to retailers as a potential partner. ■ Program administrators seeking to work with a retailer should create a detailed business plan focused around the retailer’s pilot process and timelines, in order to ensure pilot success and expansion in the long run. ■ Partnership options that require training partner contractors or upselling customers directly are difficult to structure and implement effectively. ■ Retailers generally prefer partnership options focused on marketing and referrals between programs and retailers.

2.5.3.5 Customers and Customer Acquisition

2.5.3.5.1 Customer Breakdown

Retailers expend a significant amount of resources evaluating their customer base and aligning their service offerings to customer demand in a manner that will result in the greatest amount of sales, revenues, and profits. While many smaller retailers do not collect customer purchase data, larger firms track purchases at the point of sale to determine market trends that will help them manage their inventories. Generally, this information is not made public for legal reasons. However, tracking purchases gives the retailer excellent



insight into their local and regional customer interests. While partnership strategies that require a high degree of customer data can be difficult to implement, there are many ways in which retailers can use these data to assist program partners indirectly (e.g., by providing overall market information or allowing a program to track the number of customers that redeem coupons for energy-efficient goods at retailer locations). This type of market research has helped retailers to segment their customer base into three fundamental customer types: professional contractors, DIY consumers, and a new growing segment of “do-it-for-me” (DIFM) consumers. Figure 2-30 highlights the rough distribution of these groups and their fundamental characteristics.

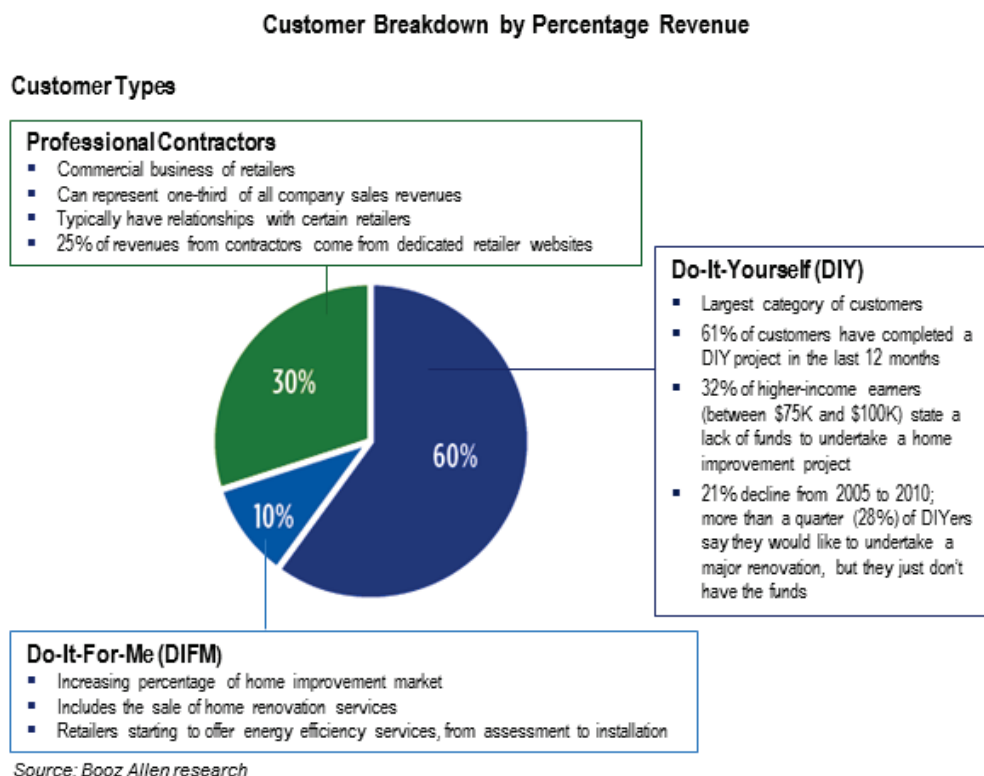


Figure 2-30: Customer Breakdown by Percentage Revenue

A recent study showed that 28 percent of DIY-ers would like to undertake a major remodel, but do not have the funds to do so.³¹ In this economic environment, those seeking to sell home performance products and services to homeowners must be flexible in adapting marketing and sales strategies to consumers who can afford only one or two home improvement projects per year. The ability to work with homeowners to make systematic investments in home performance (e.g., one improvement per year) is critical to retailers being able to maintain a stable, profitable customer base.

In confirmation of this trend, a major retailer detailed its overall customer purchasing patterns and explained that the majority of DIY-ers and DIFM-ers do not have the funds for whole-home remodels. Instead, they undertake individual projects over a longer period (e.g., countertops one year, lights the next year, and HVAC the following year). The best means for a retailer to market its products and services is through follow-on sales over the course of this process.

³¹ Mintel Oxygen Reports. *Consumers Have the Motivation—But Lack the Money for Home Improvement*. (2011). <http://www.mintel.com/press-centre/press-releases/683/consumers-have-the-motivationbut-lack-the-money-for-home-improvement>.

While contractors generally represent the second largest percentage of total sales, they are also the most active in requesting specific goods and services from retailers. This gives contractors influence over a retailer’s product mix (but only second to a product manufacturer’s influence). When working with a retailer, it is critical that the local contractor base be engaged not just as a potential service provider but as a potential retailer customer.

Key Insights

Retailer Insights		
	Observations	Impact on Potential Expansion into Energy Efficiency
Customers and Customer Acquisition	<ul style="list-style-type: none"> ■ A retailer’s brand and physical locations are its primary drivers of customer sales. ■ Retailers reach a wide range of consumers, including both DIY-ers and customers who prefer access to a one-stop-shop for home upgrades (DIFM-ers). ■ Customers visiting retailers typically cannot afford to invest in a whole-home energy upgrade, but prefer instead to make smaller home investments over time. ■ Contractors represent a large and vocal segment of the retailer customer base. 	<ul style="list-style-type: none"> ■ Retailers have larger marketing budgets than most building contractors and use mass-media advertisements to help build their brand image with customers. ■ Retailers focus on driving future sales by using the initial point of sale to highlight additional investments a consumer can make in their home in the future. ■ Working with contractors to help influence a retailer’s product and service mix is one way to help build a local energy efficiency marketplace.

2.5.3.5.2 Marketing

In terms of initial outreach to customers, many solid marketing methods are employed by retailers. These methods are focused primarily on the retailers leveraging their established brand names (in the case of big box retailers) or local presence and customer relationships to promote their goods and services. Advertising plays a key role in creating demand for services and promoting customer awareness. Some examples of advertising strategies employed by grantees include social media, radio, television, and print ads. Retailers also leverage partnerships with local entities, such as contractors, utilities, and program administrators, to expand their customer base within a local market, regardless of whether the partner organization is a new entrant to the marketplace. The responses from several retailers on the effectiveness, cost, and sustainability of various marketing channels are summarized in Figure 2-31.



Source: Booz Allen research

Figure 2-31: Retailer Marketing Channels

Many of these methods revolve around the effectiveness of retailers in leveraging their established brand names (in the case of big box retailers) or local presence and customer relationships to promote their goods and services. **Brand awareness** is very useful in building customer trust, and generating **customer referrals**, which are a highly cost-effective way of creating new sales. Having a **local and geographic presence** in the community is also an excellent means of generating “walk-in” sales (i.e., customers who enter the store as they are passing by, rather than making a dedicated trip to the store), as well as building a positive reputation in the community. **Advertising** plays a key role in creating demand for services and promoting customer awareness for retailers. Some examples of advertising strategies employed by retailers include: social media, radio, television, and print ads. Large retailers have an incredible advantage in their ability to mass-market their services; many smaller firms cannot afford to support a marketing team and paying for ad space on a regular basis. Retailers may also leverage partnerships with local entities, such as contractors, utilities, and program administrators to expand their customer base within a local market.