

Residential building supplies market study

Draft report

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Glossary

Builders	Market participants who conduct the onsite and/or offsite construction of residential buildings including, for example, developers, group home builders and sole traders.
Building Code	The Building Code is contained in Schedule 1 of the Building Regulations 1992 and continues in force under the Building (Forms) Regulations 2004 and the Building Act 2004. The Building Act governs the building sector and sets out the rules for the construction, alteration, demolition and maintenance of new and existing buildings in New Zealand.
BCA	Building Consent Authority, the function contained within each Territorial Authority or private organisation permitted to perform building consenting and Building Code compliance certification functions under the Building Act 2004.
Clear compliance pathways	Pathways for building products to comply with the Building Code through Acceptable Solutions and/or Verification Methods, and referenced Standards.
Designer	Designers (including architects, draughtspersons, engineers and quantity surveyors) prepare plans and specifications for building work. They also provide advice on compliance of building work with the Building Code.
Distributors	Companies who distribute key building supplies to builders (eg, merchants).
Importers	Market participants who import building supplies used in the construction of residential buildings.
Key building supplies	The products and product systems used to build the major components of residential buildings. See the definition of “major components of residential buildings” below and Table 1.1 for the general type of building supplies within the scope of study.
Major components of residential buildings	For the purposes of this study, the major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural, interior and exterior) and insulation.
Manufacturers	Market participants who produce in New Zealand the building supplies used in the construction of residential buildings.
MBIE	Ministry of Business, Innovation & Employment.

Merchants	<p>Market participants who act as intermediaries purchasing building supplies from manufacturers or importers and selling to builders or other end users. These include:</p> <ul style="list-style-type: none"> • Major merchants (eg, Bunnings, Carters (operated by Carter Holt Harvey (CHH)), Independent Timber Merchants (ITM), Mitre 10 and PlaceMakers (operated by Fletcher Building); and • Smaller merchants and specialist retailers.
OSM	<p>Offsite Manufacturing, the process by which any part of a building is made away from the final site of the building. OSM can also be referred to as prefabrication, which is sometimes shortened colloquially to 'prefab'.</p>
Residential	<p>For, or directly related to, the housing of people.</p>
Suppliers	<p>Manufacturers and importers who supply merchants and other parts of the distribution chain. This includes intermediary manufacturers of prefabricated building supplies.</p>
Vertical arrangements	<p>Arrangements between market participants at different levels of the supply chain including contractual arrangements. For example, arrangements reached by suppliers to provide rebates to merchants if a certain volume is purchased.</p>
Vertical integration	<p>A firm operating two or more levels of the supply chain. For example, one firm with ownership interests in entities operating as both a manufacturer and merchant.</p>

Chapter 1 Introduction and purpose

Introduction

- 1.1 Our draft report sets out the preliminary findings of the New Zealand Commerce Commission (Commission) market study into residential building supplies (this study).
- 1.2 We have received submissions and evidence from a wide range of parties to assist with preparation of our draft report. We invite further submissions from all interested parties to help us refine our preliminary findings and prepare our final report.

Purpose of this chapter

- 1.3 This chapter describes the purpose of this study and the process we have followed.
- 1.4 Topics covered are:
 - 1.4.1 the scope of the study and our approach to it;
 - 1.4.2 our framework for analysing competition;
 - 1.4.3 the structure of our draft report;
 - 1.4.4 our process so far; and
 - 1.4.5 next steps and how you can have your say.

Scope of the study and our approach to it

The Minister issued terms of reference for a market study into key residential building supplies

- 1.5 On 22 November 2021, the Hon Dr David Clark, Minister of Commerce and Consumer Affairs (Minister), published a notice under section 51(1) of the Commerce Act 1986 (the Commerce Act) requiring us to undertake a study into any factors that may affect competition for the supply or acquisition of key building supplies used to build the major components of residential buildings.
- 1.6 We must carry out this study in accordance with the terms of reference issued by the Minister. However, we may also consider any ancillary matters that are related to, but not explicitly covered by, the terms of reference.¹

¹ Section 51A(4)(b) of the Commerce Act.

1.7 The terms of reference for this study are set out in the box below.²

Notice for Commerce Commission Competition Study into Residential Building Supplies

I, Dr David Clark, Minister of Commerce and Consumer Affairs, pursuant to section 51(1) in Part 3A of the Commerce Act 1986, require the Commerce Commission to carry out a competition study into any factors that may affect competition for the supply or acquisition of key building supplies used to build the major components of residential buildings.

Matters to be considered in the study must include, but are not restricted to:

- The industry structure for key building supplies covered by this study.
- The nature of competition for these key building supplies, including any industry pricing practices or acquisition requirements that impact on competition.
- Impediments to the entry or expansion of new or innovative building supplies, such as “green” building supplies or novel prefabricated products.

For the purposes of this study, major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural interior and exterior) and insulation.

The Commerce Commission should make its final report for this study publicly available by **6 December 2022**.

1.8 In asking us to undertake this study, the Minister stated that it is critical that Kiwis have access to fairly-priced building materials, because good housing underpins a range of social, economic and health outcomes.³

Key building supplies

- 1.9 The terms of reference direct the study to examine any factors that may affect competition for the supply and acquisition of key building supplies used to build the major components of residential buildings – the foundation, flooring, roof, walls (structural and non-structural, interior and exterior) and insulation.
- 1.10 The terms of reference are neutral as to the style of residential building structure and define the scope of study by reference to the “building envelope”.
- 1.11 Table 1.1 below describes the general type of building supplies that are within the scope of the study.

² New Zealand Gazette “Notice for Commerce Commission Competition Study into Residential Building Supplies” (22 November 2021) (Gazette Notice), available at: <https://gazette.govt.nz/notice/id/2021-au4934>.

³ Hon Dr David Clark “Govt to review high cost of residential building supplies in market study” (21 November 2021) <https://www.beehive.govt.nz/release/govt-review-high-cost-residential-building-supplies-market-study>.

Table 1.1 List of building supplies in scope

Major components of residential buildings	Key building supplies in major components
Foundation	Concrete, timber, steel reinforcing
Flooring	Concrete, particleboard, strandboard
Roof	Steel roofing, other sheet metal roofing, metal and concrete tiles, shingle and membrane roofing
Walls (structural/framing)	Timber framing, laminated veneer lumber (LVL), steel framing, concrete masonry, polyblock, rammed earth framing
Walls (exterior/cladding)	Weatherboard (timber/fibre-cement/uPVC), clay and concrete bricks, metal cladding, non-weatherboard fibre cement, plywood, stucco, sheet steel
Walls (interior)	Plasterboard, wet lining
Walls (interior/exterior)	Window/door framing (aluminium, timber, composite, uPVC, fibreglass, and steel), glazing, doors
Insulation	Walls and ceiling: Glass wool and polyester Floor: Underslab, polystyrene, glass wool, polyester, perimeter edge, under footing

Sources: Commission review of BRANZ (2020), Trends in materials used in new houses; Deloitte Access Economics (2018), Cost of residential housing development; BRANZ (2008), New house price modelling.⁴

- 1.12 The scope and duration of the study are prescribed by the terms of reference. Competition for the supply or acquisition of building supplies other than key building supplies used in the major components of residential building falls outside the scope of the study contemplated by the terms of reference. So too do the services associated with residential building such as professional services (for example, architectural, design or engineering services) trades and other labour except where these are relevant to competition for key building supplies. The study is not directed to consider additional inputs contributing to the overall cost of residential construction such as financing costs or the cost of land.

⁴ BRANZ "Trends in materials used in new houses" (July 2020), available at: https://d39d3mj7qio96p.cloudfront.net/media/documents/BRANZ_RN_Physical_characteristics_1.pdf; Deloitte Access Economics "Cost of residential housing development: A focus on building materials" (December 2018), available at: <https://www2.deloitte.com/content/dam/Deloitte/nz/Documents/2020Economics/nz-en-DAE-Fletcher-cost-of-residential-housing-development.pdf>; BRANZ "New house price modelling" (2008), available at: https://d39d3mj7qio96p.cloudfront.net/media/documents/SR196_New_house_price_modelling.pdf.

- 1.13 The terms of reference for the study focus upon competition for key building supplies. The study asks whether competition is working to benefit consumers through the prices they pay for key building supplies, the quality and range available, and the level of innovation relating to them. It does not extend to a full examination of the cost of residential building.
- 1.14 The study considers whether competition for the supply or acquisition of key building supplies is working effectively and, if not, how competition could be improved to work better for the benefit of New Zealand consumers over the long term. It considers how competition is operating at all levels of the supply chain for key building supplies and the relevance, for competition, of the legislative change envisaged by the programme of Building Reform being led by the Ministry of Business, Innovation & Employment (MBIE).⁵
- 1.15 Some commentators and submitters have described challenging conditions at present, globally and domestically, including acute supply chain pressures, materials shortages and price increases. We discuss these conditions in Chapter 2. These conditions are expected by many to continue in the short to medium term. Some have also suggested that the study's findings may be skewed by short-term impacts of these conditions and the COVID-19 pandemic.
- 1.16 While we have considered some issues that have emerged from, or been exposed by, changing global conditions in recent times, we have not closely examined factors affecting the international supply chain or short-term impacts of the COVID-19 pandemic on competition given the focus of this study is on the broader factors affecting competition.⁶ We have considered supply chain resilience more generally when exploring the extent to which competition is working well.

The two complementary approaches we are taking to this study

- 1.17 As we signalled in our [additional paper on the scope of this study](#), we are taking two complementary approaches to this study:
- 1.17.1 We have examined the factors affecting competition across the range of key building supplies, such as the regulatory and standards systems.
- 1.17.2 We have examined more closely the factors affecting competition for three key building supplies, as case studies.

⁵ We note in this respect both MBIE's Building for Climate Change (BfCC) programme and MBIE's announced review of the building consent system, see: <https://www.mbie.govt.nz/have-your-say/building-consent-system-review/>. MBIE is the central regulator of building and construction and is the steward of the Building Code. The review of the building consent system is a part of MBIE's ongoing programme of Building Reform.

⁶ We note MBIE's urgent actions on plasterboard and the Government taskforce established recently to examine the shortages in plasterboard, Hon Dr Megan Woods "Plasterboard taskforce set up to ease shortages" (21 June 2022) <https://www.beehive.govt.nz/release/plasterboard-taskforce-set-ease-shortages>.

Factors affecting competition across the range of key building supplies

- 1.18 We have examined the factors affecting competition across the range of key building supplies used to build the major components of residential buildings, as directed by the terms of reference. These include the industry structure and the nature of competition, including any pricing practices or acquisition requirements that impact on competition.
- 1.19 This has included examining:
- 1.19.1 how concentrated the supply of different key building supplies appears to be and the extent to which other supplies may be viewed as substitutes;
 - 1.19.2 the distribution options available to suppliers of key building supplies and how decisions to stock key building supplies are made by the major merchants; and
 - 1.19.3 the arrangements between the suppliers of key building supplies and the major merchants, such as rebate arrangements.
- 1.20 We have also sought to identify the conditions of entry and expansion for key building supplies including, but not restricted to, new or innovative building supplies, as directed by the terms of reference. This has included:
- 1.20.1 examining whether or not the regulatory and standards systems create any impediments to competition and innovation;
 - 1.20.2 considering 'new or innovative' supplies, such as 'green' building supplies and novel prefabricated products, in the context of the broader themes of building for climate change and standardisation (offsite manufacturing and prefabrication); and
 - 1.20.3 seeking to understand how decisions to specify and purchase key building supplies are made, the factors that influence those decisions, and how those factors may affect competition for key building supplies.

Factors affecting competition for three key building supplies

- 1.21 In parallel to considering the factors affecting competition across the range of key building supplies as discussed above, this study has considered three key building supplies in more detail as case studies.
- 1.22 We have used a case study approach because it is not feasible for this study to examine in depth the factors affecting competition for each of the individual supplies in the categories described in Table 1.1 above. There are hundreds of, possibly several thousand, different building supplies within the scope of the study.

- 1.23 These case studies are not ‘mini market studies’. The purpose of these case studies is to assist us to more closely consider the factors that may be affecting competition for key building supplies – such as the industry structure, nature of competition, pricing practices or acquisition requirements, strategic, behavioural or regulatory barriers to entry or expansion – through particular examples, and to enable us to consider observations, findings or recommendations that may be able to be applied across key building supplies more generally.
- 1.24 The three key building supplies we selected for closer study are:⁷
- 1.24.1 concrete (including cement);
 - 1.24.2 plasterboard; and
 - 1.24.3 structural timber.
- 1.25 We selected the three case study supplies based primarily on:
- 1.25.1 the relatively high proportion of the cost of residential building that these materials represent, compared to other supplies;⁸
 - 1.25.2 the relatively high concentration of suppliers for these materials;⁹ and
 - 1.25.3 responses from submitters highlighting these materials as important and as having limited alternative suppliers.¹⁰

⁷ Commerce Commission “Residential building supplies market study – Additional paper on the scope of this study” (31 March 2022) at [24].

⁸ In our Additional paper on the scope of the study (31 March 2022) we described (in footnote 5 of that paper) the basis for selecting the case study supplies in part by reference to analysis (by us) of a Deloitte Access Economics report (2018). Our analysis involved averaging across the building typologies in the Deloitte report, focusing only on key building supplies within the scope of study. Deloitte Access Economics objected to the reference to their report in footnote 5. We have acknowledged the objection and that it would have been more accurate to have stated in footnote 5 that our observation was based on Commerce Commission analysis of Deloitte’s report. Set out below are the costs contributions of our case study supplies, without adjustment for “out of scope” supplies and referencing the typologies separately (as set out in Deloitte’s report (pages 8 and 73-78)), as a % of the total cost of building materials for residential housing development: - Framing timber was estimated to represent 8% of (in each case, Auckland) double storey house, 8% of a townhouse, 8.2% of a low-rise apartment, 4.6% of a concrete high-rise apartment and 7% of a timber high-rise apartment; - Concrete represented 7.4% of a double storey house, 10.7% of a townhouse, 4.3% of a low-rise apartment, 23.9% of a concrete high-rise apartment and 5.5% of a timber high-rise apartment; - Plasterboard represented 2.5% of a double storey house, 3.7% of a townhouse, 4.6% of a low-rise apartment, 3.4% of a concrete high-rise apartment and 4.2% of a timber high-rise apartment).

⁹ The Cabinet Paper identified concrete, glass wool insulation, and plasterboard as supplies with high levels of concentration. Deloitte Access Economics’ December 2018 report discussed plasterboard, cement, insulation, and structural timber as supplies with relatively high levels of concentration. Our initial analysis indicated that plasterboard, cement and structural timber are likely highly concentrated.

¹⁰ Plasterboard was the material most commonly highlighted in response to our Preliminary Issues paper as having limited choice of suppliers.

Our framework for analysing competition

Competition that works well for consumers

- 1.26 This study considers whether competition is working well for consumers of key building supplies. Its purpose is to identify and assess factors that may affect competition for the supply or acquisition of key building supplies used to build the major components of residential buildings, and to make any recommendations that we consider may improve competition.¹¹
- 1.27 This study does not enquire into compliance with the provisions of the Commerce Act relating to anti-competitive conduct. Therefore, a conclusion that particular conduct affects competition, and may be the subject of a recommendation, is not a conclusion that it breaches provisions of the Commerce Act. We retain the ability to separately investigate anti-competitive conduct if information collected during this study, or outside of it, gives us reason to believe that anti-competitive conduct may be occurring. Similarly, we may separately investigate conduct which we consider could breach the Fair Trading Act 1986 (FTA).
- 1.28 The overriding aim of this study is the same as the purpose of the Commerce Act itself: to promote competition in markets for the long-term benefit of consumers within New Zealand.¹²
- 1.29 Competition is defined in the Commerce Act as meaning “workable or effective competition”.¹³ It does not mean the theoretical concept of perfect competition. The High Court has noted that there is no consensus on precise conditions that define workable competition, rather:¹⁴

... workable competition is a practical description of the state of an industry where government intervention to make the market work better is not justified because the socially desirable outcomes generated by competition already exist to a satisfactory degree.

A workably competitive market is one that provides outcomes that are reasonably close to those found in strongly competitive markets...

The degree of rivalry is critical. In a workably competitive market no firm has significant market power and consequently prices are not too much or for too long significantly above costs...

¹¹ Sections 48, 51A and 51B of the Commerce Act and our terms of reference.

¹² Section 1A of the Commerce Act. This was emphasised by the Transport and Infrastructure Select Committee in its report back to Parliament on the draft market studies legislation – Commerce Amendment Bill 2018 (45-2) (Select Committee report) at 1, available at: https://www.parliament.nz/en/pb/sc/reports/document/SCR_80263/commerceamendment-bill.

¹³ Section 3(1) of the Commerce Act.

¹⁴ *Wellington International Airport Ltd and Others v Commerce Commission* [2013] NZHC 3289 at [13]-[15], [18] and [22], available at: <https://forms.justice.govt.nz/search/Documents/pdf/jdo/53/alfresco/service/api/node/content/workspace/SpacesStore/1c117dea-b8ba-491e-ba1d-d4cd30dbe522/1c117dea-b8ba-491e-ba1d-d4cd30dbe522.pdf>.

In our view, what matters is that workably competitive markets have a tendency towards generating certain outcomes...

...the tendencies in workably competitive markets will be towards the outcomes produced in strongly competitive markets.

- 1.30 We have developed [Market Studies Guidelines](#) to assist interested parties to understand our approach to a market study.¹⁵ Our Market Studies Guidelines describe characteristics of competitive markets that are working well and those that may be observed in markets that are not working well. They also describe market features that could affect competition and that are relevant to this study.¹⁶

Our approach to assessing competition in this study

- 1.31 We present a series of preliminary findings and draft recommendations for improvements to the factors affecting competition that, in turn, we would expect to produce better long-term market outcomes for consumers, including in respect of prices, quality, range and service.
- 1.32 The suite of draft recommendations seeks to identify feasible options that will provide tangible improvements in competition for key building supplies without undermining the other key policy objectives of the building regulatory system. The aim is to produce better long-term outcomes for consumers – safe, healthy and durable homes, that can be built with a wider range of cost-effective key building supplies, including those that are new or innovative.
- 1.33 Cost-benefit analysis may be useful as part of a policy decision-making process. We have not undertaken cost-benefit analysis as part of developing our recommendations. Due to the interrelationships of the recommendations, the effects on the functioning of the supply chain and competition need to be considered in aggregate.

Structure of our draft report

- 1.34 In Chapter 2 we begin with background information on the residential building supplies industry in New Zealand. We cover the importance of building supplies to New Zealanders and introduce the main participants, including Māori, in the industry. We provide an overview of the characteristics of residential building in New Zealand and note the acute demand and supply chain pressures the industry currently faces. This chapter provides context for the discussion that follows.
- 1.35 In Chapter 3 we discuss the role that regulation plays in the industry. We cover the relevant regulatory and standards systems, how the regulatory and standards systems operate in practice, and the extent to which the regulatory and standards systems may be acting as barriers to the entry and expansion of key building supplies.

¹⁵ Referred to as Competition Studies in Part 3A of the Commerce Act.

¹⁶ Commerce Commission “Market Studies Guidelines” (19 November 2020) at [12]-[20].

- 1.36 In Chapter 4 we discuss how key building supplies are specified and purchased, and consider the incentives, preferences and potential biases of the parties involved in selecting building supplies for residential building projects. We also discuss the implications for competition for key building supplies which flow from the way decisions to choose building supplies are made.
- 1.37 In Chapter 5 we discuss competition between suppliers of key building supplies. We look at market concentration and explore the impact on competition of the number and types of suppliers for different categories of key building supplies.
- 1.38 In Chapter 6 we discuss competition at the merchant level, including the degree of market concentration, conditions of entry and expansion, and the impact of vertical integration on competition.
- 1.39 In Chapter 7 we discuss arrangements between market participants at different levels of the building supplies industry supply chain and whether they appear to affect competition for key building supplies. In particular, we consider the likely effect of rebates, loyalty schemes, and other vertical arrangement.
- 1.40 In Chapter 8 we discuss impediments to the entry of 'new or innovative' building supplies, such as 'green' building supplies or novel prefabricated products. We consider this in the context of the broader themes of building for climate change and standardisation (offsite manufacturing and prefabrication).
- 1.41 In Chapter 9 we set out draft recommendations that may improve competition and produce better long-term market outcomes for consumers.
- 1.42 We have included additional information in the attachments to our draft report:
- 1.42.1 *Attachment A: Next steps and how you can have your say* provides information on how you can have your say on our draft report, and details about our consultation conference.
 - 1.42.2 *Attachment B: Plasterboard case study* discusses the preliminary findings of our plasterboard case study.
 - 1.42.3 *Attachment C: Structural timber case study* discusses the preliminary findings of our structural timber case study.
 - 1.42.4 *Attachment D: Concrete and cement case study* discusses the preliminary findings of our case study into ready-mix concrete and cement.
 - 1.42.5 *Attachment E: Supplier survey* provides further information about our supplier survey.
 - 1.42.6 *Attachment F: Builders/specifiers survey* provides further information about our builders/specifiers survey.

- 1.42.7 *Attachment G: Regulatory and standards systems survey* provides further information about our regulatory and standards systems survey.
- 1.42.8 *Attachment H: Additional maps of merchant stores* provides additional maps showing the locations of the major building supplies merchants' stores.
- 1.42.9 *Attachment I: Rebates – stylised example* sets out examples of the way different rebate structures can impact merchant decisions.

Our process so far

Papers we have published

- 1.43 On 22 November 2021, we released a [statement of process](#), outlining the process we intended to follow over the course of this study.¹⁷
- 1.44 On 17 December 2021, we released a [preliminary issues paper](#), seeking responses from interested parties on the preliminary issues we intended to explore during this study.¹⁸ We received 25 submissions on our preliminary issues paper – public versions of submissions are published [on our website](#).
- 1.45 On 25 February 2022, we sought cross-submissions on our preliminary issues paper. We received cross-submissions from four parties – public versions of cross-submissions are also published [on our website](#).
- 1.46 On 31 March 2022, we released an [additional paper on the scope of this study](#), and sought submissions from interested parties regarding any regulatory barriers to the entry or expansion of key building supplies.¹⁹ Public versions of the submissions we received are published [on our website](#).

Information collection

- 1.47 The residential building supplies industry services a diverse range of participants. We have therefore sought to collect information from a wide range of sources and to meet with a wide range of parties. These parties have included building supplies merchants, manufacturers and importers of key building supplies, building industry representatives, government agencies, and a range of industry peak bodies with differing perspectives on the industry. We have met with over 70 parties to date.
- 1.48 We thank all these parties for the information they have provided, and for their ongoing engagement in this study.

¹⁷ Commerce Commission “Market Study into Residential Building Supplies – Statement of Process” (22 November 2021).

¹⁸ Commerce Commission “Residential building supplies market study – Preliminary Issues paper” (17 December 2021).

¹⁹ Commerce Commission “Residential building supplies market study – Additional paper on the scope of this study” (31 March 2022) at [32].

- 1.49 We asked interested parties to complete surveys between March and May 2022 to assist us to understand how competition is working at different levels of the residential building supplies industry.²⁰ We received:
- 1.49.1 105 responses to our survey on specifying and purchasing key building supplies; and
 - 1.49.2 136 responses to our survey on the regulatory and standards systems.
- 1.50 The feedback we received was valuable for informing this study and has contributed to the preliminary findings set out in our draft report.
- 1.51 We also distributed a supplier survey to around 500 suppliers of key building supplies, but did not get a large response. The small sample size of responses was insufficient to draw any generalised conclusions. However, some of the qualitative responses raised relevant themes and, where that was the case, we have considered those alongside the other material we have received.

Advice and report by industry expert John Gardiner

- 1.52 We engaged an industry expert, John Gardiner, to provide his views and opinions to assist us to assess whether there are regulatory barriers to the entry or expansion of key building supplies and, if so, what those barriers are.
- 1.53 We engaged Mr Gardiner for his expertise and experience working both within the building regulatory systems and as a consultant to suppliers seeking to navigate these systems. We asked Mr Gardiner to identify, from his expertise and experience, any features that make it difficult for suppliers of building products to navigate and use those systems in practice.
- 1.54 We have considered whether the features Mr Gardiner identified amount to regulatory, behavioural, or other impediments to the entry and expansion of key building supplies.
- 1.55 We also asked Mr Gardiner to propose possible improvement measures to address the practical difficulties he identified. We have considered those improvement measures when developing our draft recommendations where we identify factors affecting competition.
- 1.56 Mr Gardiner's report has been published alongside our draft report.²¹

²⁰ See Attachments E, F and G.

²¹ John Gardiner "Practical issues with the building regulatory system for suppliers of building products – An assessment" (3 August 2022).

How we have engaged with Māori

- 1.57 As an Independent Crown Entity, we are committed to engaging with Māori and supporting future-focused Māori-Crown relationships, through taking a good-faith, collaborative approach to engaging with Māori on our work.²² To achieve this, we are continuing to build our understanding of our role as a Treaty partner under Te Tiriti o Waitangi and doing work to better understand Te Ao Māori and what this means for our work.²³
- 1.58 Our commitment extends to engaging with Māori to acknowledge and strengthen our relationship with Māori, and to better understand, and reflect, Māori perspectives in our work. We acknowledge that effective engagement with Māori is key to realising the potential of this partnership, which will enable us to support better quality outcomes for Māori.²⁴
- 1.59 We are committed to genuine engagement with Māori and acknowledge rangatiratanga and the status of Māori as Treaty partners. We also acknowledge the important role mātauranga Māori has in finding solutions to challenges we face as a nation.
- 1.60 Prior to our draft report we sought to hear and understand specific perspectives from Māori on the residential building supplies industry. On 4 May 2022 we held an initial hui, inviting a range of Māori partners and stakeholders to share their insights on the residential building supplies industry. A range of individuals and organisations attended the hui from iwi and Māori business owners.
- 1.61 We also heard from representatives of Kāinga Ora and Ministry of Housing and Urban Development.
- 1.62 A few parties who had registered to attend this hui were not able to join on the day. We followed up with those parties after the hui and were able to connect with two of them to hear their further perspectives.
- 1.63 Hearing from Māori about their perspectives on the residential building supplies industry has enabled us to better understand Māori perspectives, concerns, and aspirations regarding the industry. We acknowledge the diversity in views and perspectives we heard. Hearing a range of Māori voices necessarily means there was a variety of perspectives expressed. We also acknowledge that the comments we heard do not represent the views of all Māori.

²² Hon. Grant Robertson “Enduring Letter of Expectations” (15 October 2019), available at: <https://www.publicservice.govt.nz/assets/SSC-Site-Assets/System-and-Agency-Performance/Enduring-Letter-of-Expectations-to-statutory-Crown-entities-2019.pdf>.

²³ The Treaty of Waitangi/Te Tiriti o Waitangi is a founding document of government in New Zealand and is one of the major sources of New Zealand’s constitution.

²⁴ Te Arawhiti “Guidelines for engagement with Māori” (1 October 2018), available at: <https://www.tearawhiti.govt.nz/assets/Maori-Crown-Relations-Roopu/6b46d994f8/Engagement-Guidelines-1-Oct-18.pdf>.

- 1.64 A summary of the views expressed at the hui has been published on our website.²⁵ We have also set out the key themes from the hui under the heading 'Te Ao Māori perspectives' in Chapter 2. As well, we have incorporated information shared with us in the hui in the relevant sections of our draft report.

Confidential information shared with us

- 1.65 We have endeavoured to make our draft report as accessible to interested parties as possible. However, some information within our draft report must out of necessity be redacted from view, as is indicated by the use of square brackets like this: [].
- 1.66 Much of the information we have collected in the course of this study is considered confidential or commercially sensitive by the supplying party.
- 1.67 It is important that interested parties and others providing us with relevant information continue to feel confident participating in this study and supplying us with information that we can use to develop our views.
- 1.68 Accordingly, when deciding whether information provided to us is commercially sensitive and/or confidential or can be published, we consult with the party who has provided it and balance these considerations against our obligations to adhere to the principles of natural justice in the course of this study, operate as transparently as practicable, and comply with our legal obligations under the Official Information Act 1982 (OIA).
- 1.69 If we receive a request for any information referred to or collected in connection with this report, we will consider whether to make the information available in accordance with the OIA.
- 1.70 Our Market Studies Guidelines contain further information about how we protect confidential information provided to us during this study and how we respond to OIA requests related to this study.²⁶

Next steps and how you can have your say

Consultation on our draft report

- 1.71 We invite interested parties to provide written submissions on our draft report. This includes providing comment on any aspect of our draft report, including any issues you consider relevant that have not been covered.
- 1.72 We will have regard to any submissions received on our draft report within the time allowed.

²⁵ Commerce Commission "He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes" (4 August 2022).

²⁶ Commerce Commission "Market Studies Guidelines" (19 November 2020).

- 1.73 We are seeking feedback on our draft report in the following ways:
- 1.73.1 Written submissions on our draft report are due **4pm, Thursday 1 September 2022.**
 - 1.73.2 We have scheduled a consultation conference to be held in central Wellington in the week commencing **Monday 26 September 2022.**²⁷
 - 1.73.3 Final submissions, including cross-submissions on matters raised at the conference and in published submissions made by others, are due **4pm, Thursday 13 October 2022.**
- 1.74 Please see Attachment A for further information about how to provide written submissions and on our consultation conference.

Publishing our final report

- 1.75 In accordance with the terms of reference, we must publish our final report by **6 December 2022.**²⁸
- 1.76 Our final report will set out the findings of this study, and any recommendations that we make to the Minister to improve competition, having had regard to comments we have received on our draft report.
- 1.77 We are not obliged to recommend that any actions be taken by the Government or any other person.²⁹ The types of recommendations that we may make are described in section 51B(3) of the Commerce Act. These include:
- 1.77.1 changes to legislation or other instruments;
 - 1.77.2 changes to the policies or practices of central or local government;
 - 1.77.3 changes to the policies or practices of a person or an organisation responsible for the oversight or regulation of a specified industry;
 - 1.77.4 changes to the amount or type of information made available by a person or an organisation in relation to a specified industry;
 - 1.77.5 that a person or an organisation research or monitor a specified matter; and
 - 1.77.6 that persons within a specified industry change their behaviour.

²⁷ There will also be an opportunity to join the conference online.

²⁸ We are required to make our final report available to the Minister at least five working days prior to publishing our final report on 6 December 2022 (see section 51D(1) of the Commerce Act).

²⁹ Section 51B(2) of the Commerce Act.

- 1.78 The Minister is required to respond to our final report within a reasonable time after it is made publicly available.³⁰

³⁰ Section 51E of the Commerce Act.

Chapter 2 Overview of the building supplies industry

Introduction

- 2.1 This chapter provides background information on the residential building supplies industry, as context for the rest of the chapters in this draft report.
- 2.2 Topics covered are:
- 2.2.1 the importance of building supplies to New Zealanders;
 - 2.2.2 Te Ao Māori perspectives on the importance of building supplies;
 - 2.2.3 key building supplies used in residential construction can vary;
 - 2.2.4 the industry supply chain and the construction process;
 - 2.2.5 the main participants in the industry;
 - 2.2.6 characteristics of residential building in New Zealand;
 - 2.2.7 the acute demand and supply chain pressures the industry currently faces;
 - 2.2.8 climate change and implications for the future of building supplies; and
 - 2.2.9 legislative reform and other policy processes.

The importance of building supplies to New Zealanders

- 2.3 Residential construction is an important part of the New Zealand economy, and has significant implications for the wellbeing of New Zealanders. Housing and household utilities is the single biggest expenditure incurred by most New Zealand households.³¹ Maintaining, improving and expanding our housing stock is a critical part of providing for New Zealand’s growing population.
- 2.4 As shown in Figure 2.1 below, residential building activity has increased since 2012. Consents for new residential homes are at record high levels in 2022, with 50,583 being issued in the year ended April 2022 (up 33% from the previous year).³² The value of residential building work was estimated at \$21.2 billion in the year ended December 2021 (about 6.1% of GDP), up from \$6.2 billion in the year ended December 2012.³³

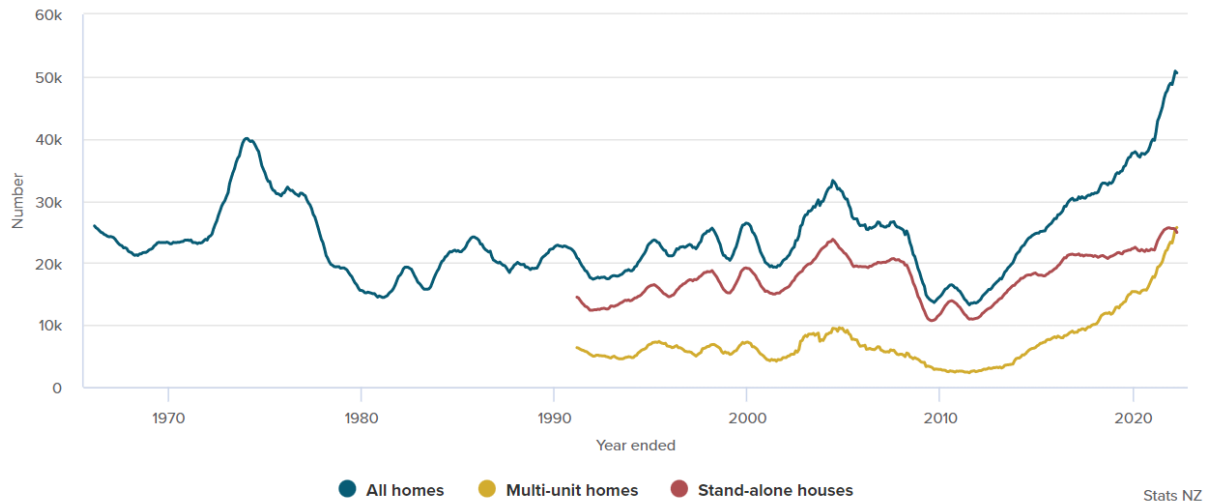
³¹ Statistics NZ “Household expenditure statistics: Year ended June 2019” (March 2020), available at: <https://www.stats.govt.nz/information-releases/household-expenditure-statistics-year-ended-june-2019>.

³² Statistics NZ “Multi-unit homes lead rise in home consents” (31 May 2022), available at: <https://www.stats.govt.nz/news/multi-unit-homes-lead-rise-in-home-consents/>.

³³ Statistics NZ Infoshare “Building activity by region (Annual-Dec)”, available at: <https://infoshare.stats.govt.nz/default.aspx?AspxAutoDetectCookieSupport=1;>

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**Figure 2.1 New residential homes consented, 12-month rolling totals
March 1966 to April 2022**



Source: Statistics NZ.³⁴

- 2.5 The value of alterations and additions to residential buildings was \$2.4 billion in the year ended December 2021, comprising over 11% of the total value of consented work.³⁵ This has increased from \$1.2 billion in the year ended December 2012.
- 2.6 Figure 2.1 shows that the majority of growth in new consents in the last 10 years has come from multi-unit homes. This intensification of New Zealand’s housing stock impacts the types of building methods employed and materials used.
- 2.7 Building materials have been estimated to comprise 16 to 24% of the total cost of residential housing development in New Zealand, and 23 to 33% if the costs of land and infrastructure are excluded.³⁶ Labour, GST and professional services make up the bulk of the remaining costs.
- 2.8 However, product or process innovation, the structure of the supply chain and services associated with the supply of building materials, will impact on construction costs in ways that are not captured by the cost of building materials alone. Products or processes that increase the speed of construction, for example, should contribute to lower labour costs.

³⁴ Statistics NZ “Multi-unit homes lead rise in home consents” (31 May 2022), available at: <https://www.stats.govt.nz/news/multi-unit-homes-lead-rise-in-home-consents/>.

³⁵ [].

³⁶ These estimates vary depending on location and construction typology. Further detail can be found in Deloitte Access Economics “Cost of residential housing development: A focus on building materials” (December 2018) at 13, available at: <https://www2.deloitte.com/content/dam/Deloitte/nz/Documents/Economics/nz-en-DAE-Fletcher-cost-of-residential-housing-development.pdf>.

- 2.9 Currently, the average cost to build residential homes in New Zealand is approximately \$2,696 per square metre.³⁷ However, the cost varies depending on the region, building typology, and the higher or lower specification of house.³⁸
- 2.10 Building supplies and building methods contribute to the quality of a residential home, which is of critical importance to the wellbeing of New Zealanders. Warmer and drier homes offer long-term health and social benefits, and energy efficient homes cost less each month to keep warm and dry.
- 2.11 The Building Code provides minimum standards that new buildings must meet or exceed. Some of the minimum standards in the Building Code appear to be behind international standards (particularly in relation to warm, dry and healthy homes), and the energy performance of our existing housing stock is generally low.³⁹
- 2.12 Programmes such as Homestar promote building to higher standards than the standards in the Building Code, and Healthy Homes standards have introduced requirements to improve the quality of existing rental housing.⁴⁰

³⁷ As of 2022 Q1, Residential building consent analysis tables, available at: <https://www.interest.co.nz/property/residential-building-consent-analysis>.

³⁸ We have heard examples of significantly higher costs. Kiwi Infrastructure estimates that New Zealand developers build at \$3,800 per sqm for the average residential development, Kiwi Infrastructure “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 3. We have also heard of instances of building costs materially exceeding this figure in particular regions because of regionally specific factors, Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022).

³⁹ [];
[]; [];
OECD Better Life Index states that the energy performance of New Zealand’s building stock is generally low, see: <https://www.oecdbetterlifeindex.org/topics/housing/>.

⁴⁰ The Homestar standard is approximately 30% higher than the minimum requirements in the Building Code, though this will vary depending on the specific Homestar rating,
[].

Te Ao Māori perspectives on the importance of building supplies

- 2.13 Māori are participants right across the industry, both before and following on from Treaty Settlements, are fast becoming major developers and landlords, particularly through Iwi and Post-Settlement Governance Entities.⁴¹ The issues that the industry faces and factors that may affect competition, also impact heavily on Māori, which may face less equitable outcomes, because Māori:
- 2.13.1 are less likely to own homes and are more reliant on social housing;⁴²
 - 2.13.2 live in lower quality houses (eg, dampness, mould and cold);⁴³ and
 - 2.13.3 a high proportion of Māori are employed in the construction sector.⁴⁴
- 2.14 The construction sector is a significant employer of Māori, with over 19,000 Māori working in the sector, construction is the fourth largest employer of Māori, and a large proportion of Māori labour in the construction sector are self-employed.⁴⁵ The construction sector is a significant proportion of Māori value-add (GDP), being the fourth largest contributor of GDP from the Māori sector at \$1.5 billion.⁴⁶
- 2.15 We met with Māori industry participants, including some iwi, to hear their views on ways of working, and the challenges they were facing relating to building supplies. Common themes that came through included challenges with consenting, rising building costs, and supply chain disruption.

⁴¹ Westpac New Zealand, BERL and OpinioNative “Mahi tahi tatou, kaha ake tatou. The Maori economy – obstacles and opportunities.” (October 2021) at 3, available at: <https://www.westpac.co.nz/assets/About-us/sponsorship/The-Maori-economy-obstacles-and-opportunities-Westpac-NZ-Oct-2021.pdf>.

⁴² StatsNZ “Te Pā Harakeke: Māori housing and wellbeing 2021” at Figure 1, available at: <https://www.stats.govt.nz/reports/te-pa-harakeke-maori-housing-and-wellbeing-2021>; Westpac New Zealand, BERL and OpinioNative “Mahi tahi tatou, kaha ake tatou. The Maori economy – obstacles and opportunities.” (October 2021) at 4.

⁴³ Statistics NZ “Te Pā Harakeke: Māori housing and wellbeing 2021” at Figure 7.

⁴⁴ BERL and Reserve Bank of New Zealand “Te Ōhanga Māori 2018 - The Māori Economy 2018” (2018) at 13, available at: <https://www.rbnz.govt.nz/-/media/0212182a319f481ea4427bcf5dd703df.ashx>.

⁴⁵ Ministry of Business, Innovation & Employment “Building a Future Māori in the Construction Sector” (February 2015) at 11, available at: <https://www.mbie.govt.nz/dmsdocument/1065-hkkr-construction-report-february-2015-pdf>.

⁴⁶ BERL and Reserve Bank of New Zealand “Te Ōhanga Māori 2018 - The Māori Economy 2018” (2018) at 17.

- 2.16 Participants told us that Māori are significantly represented in the labour component of the industry,⁴⁷ but there is very little representation at the decision-making and Board level and few pathways into those roles. Throughout our hui, we heard examples of how this affected outcomes for Māori involved in the building industry.⁴⁸
- 2.17 We heard that Treaty partner obligations, across government, require the challenges in the residential construction sector to be addressed: that key to this is enabling Māori to do things for themselves.⁴⁹ One participant noted that there was a need to challenge councils to take action to deal with Māori in accordance with their Treaty obligations, including relationship building with Māori to support issues when they arise.
- 2.17.1 One example described the challenges related to building papakāinga on communally owned Māori land, which includes requirements for houses to be relocatable (limiting options for building supplies) and difficulties in raising finance (currently only one bank finances the papakāinga model).⁵⁰
- 2.17.2 Some Māori also told us their views have not been heard through Resource Management Act (RMA) and Council spatial planning processes with an example given that some councils haven't listened to the Māori perspective relating to issues such as Māori land ownership, and the importance to Māori of developments having a community focus.
- 2.18 Māori we talked to said they face challenges with regulatory systems and consenting processes. We heard from Māori that BCAs are restrictive. Examples given included: that building consents can be costly and take a long time to issue; that there are differences between individual consent officers of a BCA, and the various interpretations of the rules; that Māori find it difficult engaging and communicating with BCAs; and that some consent officers do not understand the trade, which can lead to unnecessary increased costs.

⁴⁷ Ministry of Business, Innovation & Employment “Māori in the Labour Market – December 2020 Quarter (unadjusted)”, available at: <https://www.mbie.govt.nz/dmsdocument/13559-maori-in-the-labour-market-december-2020-quarter-unadjusted/>.

⁴⁸ Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022).

⁴⁹ Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 2.

⁵⁰ Te Puni Kōkiri “Supporting new homes and papakāinga” (4 July 2022) <https://www.tpk.govt.nz/en/whakamahia/maori-housing-support/supporting-new-homes-and-papakāinga>.

- 2.19 We also heard about the impacts of building in rural areas. This related to the cost of transport, frequency of supply, and limited competition (often a single supplier, who controls the market) leading to higher costs. Issues relating to rural supply and cost issues are of particular importance to Māori as Māori have a higher proportion of the population living in small urban areas (14.7% of the Māori population) and rural areas (18.0%), compared with the total population (10.0% and 16.3% respectively).⁵¹

Key building supplies used in residential construction can vary

- 2.20 Table 1.1 in Chapter 1 sets out the general types of key building supplies that are within the scope of this study. Key building supplies within scope are a subset of all building supplies used for residential building. For example, plumbing and electrical supplies are excluded, as are building supplies for commercial construction or infrastructure (such as roads).
- 2.21 The mix of key building supplies is likely to vary depending on the type of residential building being built, and/or the building method (for example, onsite or offsite construction).
- 2.22 Residential housing in New Zealand can take many forms but can be broadly categorised into standalone houses, townhouses, and apartments. Differences between these typologies affect the relevant set of materials and their contribution to overall cost.⁵²
- 2.23 Recently there has been an increase in higher density housing in New Zealand, supported by Government initiatives to enable greater housing density.⁵³ This trend is likely to continue with the Resource Management (Enabling Housing Supply and Other Matters) Amendment Act 2021 expected to impact planning rules.

Industry supply chain and the construction process

- 2.24 Residential building supplies pass through a series of levels of the supply chain before they are used in construction. Most key building supplies are supplied through merchants, though there are differences in the supply chain between building supplies, for example:
- 2.24.1 some products exhibit a much greater degree of direct sales than others (eg, window joinery is almost entirely direct to market sales);⁵⁴ and

⁵¹ Environmental Health Intelligence New Zealand “Urban-rural profile”

<https://www.ehinz.ac.nz/indicators/population-vulnerability/urbanrural-profile/>.

⁵² For example, we understand construction of high-rise apartments is generally a more specialised process than the construction of low-rise apartments and can involve different materials (timber framing is generally only used in buildings of three storeys or less).

⁵³ Te Tūāpapa Kura Kāinga (Ministry of Housing and Urban Development) “Enabling Housing Density”

<https://www.hud.govt.nz/urban-development/enabling-housing-density/>.

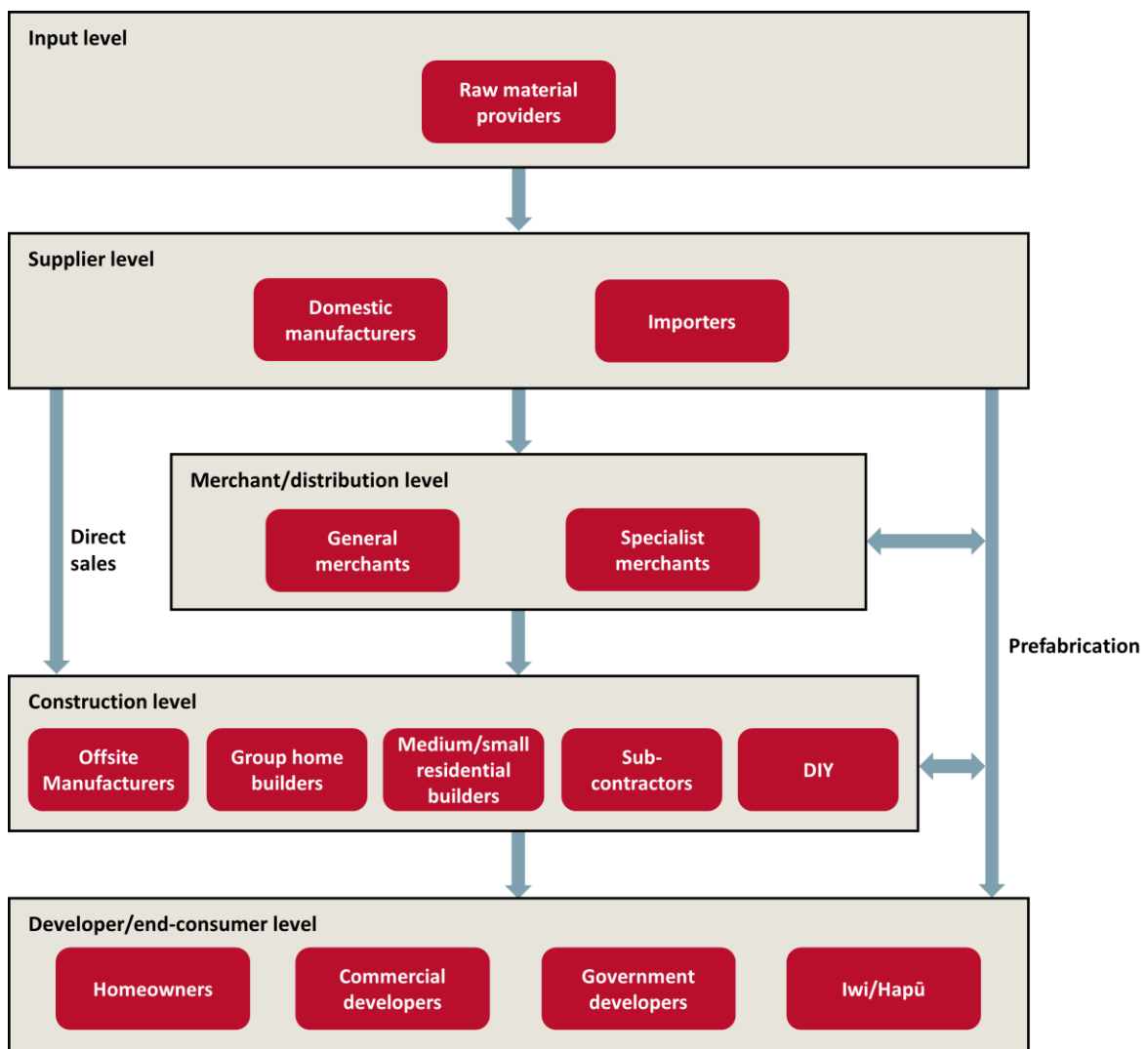
⁵⁴ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [4.2]; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 5.

2.24.2 there are specialist installers for some building supplies, such as insulation and roofing.⁵⁵

2.25 Figure 2.2 below provides a high-level summary of the supply chain for residential building supplies. Each red box represents a group of market participants, but is not intended to reflect any formally defined market.

2.26 In reality there is more complexity in the supply chain than Figure 2.2 suggests and differences depending on the particular building supplies. It does not include participants that, while not directly involved in the supply chain, can influence the choice of materials (such as designers or building consent authorities).

Figure 2.2 High-level generic supply chain for residential building materials



Source: Commerce Commission.⁵⁶

⁵⁵ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 31 and 33; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 5.

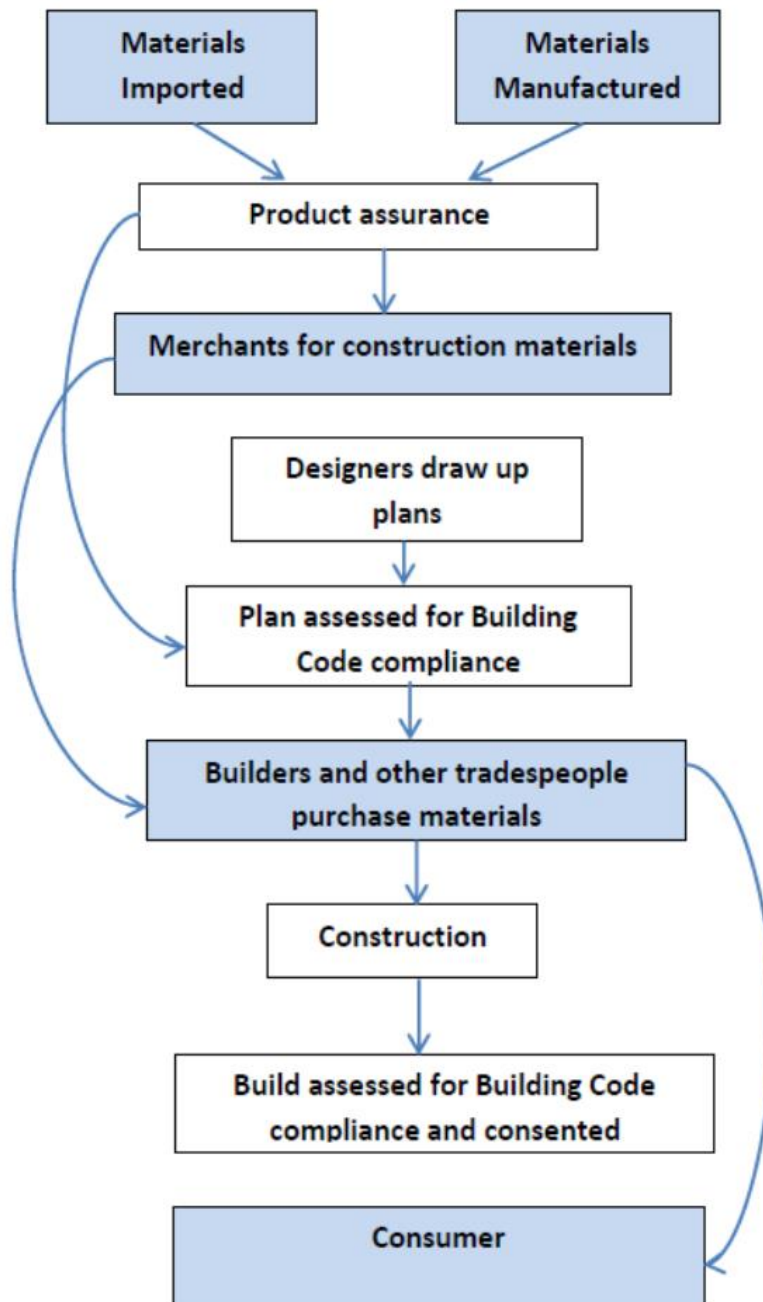
⁵⁶ [].

- 2.27 In addition to suppliers and distributors of key building supplies, builders, homeowners, and a number of other participants play significant roles in the end-to-end construction process.
- 2.28 Figure 2.3 below presents a high-level summary of the construction process and identifies industry participants with significant influence. Figure 2.3 is a stylised overview and does not seek to capture all relationships in the process.⁵⁷ In particular, it understates the number of influential relationships that designers have with various other industry participants across several different stages in the construction process.⁵⁸

⁵⁷ Offsite NZ pointed out that offsite manufacturing involves a number of quality control processes earlier in the construction process and said that, if offsite manufacturing was featured in Figure 2.3, it would highlight the benefits of this, OffsiteNZ “Submission on residential building supplies market study preliminary issues paper” (3 February 2022) at 2.

⁵⁸ [].

Figure 2.3 High-level summary of the construction process



Source: Ministry of Business, Innovation & Employment.⁵⁹

Industry participants

2.29 By category, the main participants in the industry include:

2.29.1 suppliers, who manufacture or import building supplies;

⁵⁹ Ministry of Business, Innovation & Employment "Residential Construction Sector Market Study Options Paper" (November 2013) at 8, available at: <https://www.interest.co.nz/sites/default/files/residential-construction-sector-options-paper.pdf>.

- 2.29.2 merchants, who distribute building supplies to builders;
- 2.29.3 builders, broadly categorised as small-to-medium enterprise (SME) builders and larger group home builders;
- 2.29.4 designers (eg, architects), who prepare the plans for a project including specification of the building supplies to be used;
- 2.29.5 homeowners and end consumers, who own and/or reside in residential buildings;
- 2.29.6 developers, who typically prepare the land for new housing to be built on and may also manage associated residential construction projects;
- 2.29.7 Kāinga Ora, a public sector developer and provider of social housing; and
- 2.29.8 regulatory bodies, such as building consent authorities (BCAs).

Suppliers of key building supplies

- 2.30 Some domestic manufacturers specialise in a general category of building supplies such as timber (for example, Red Stag) or ready-mix concrete (for example, Allied Concrete). Other manufacturers have ownership interests in entities supplying a range of different building supplies.
- 2.31 In addition, a number of international or domestic companies import key building supplies into New Zealand.
- 2.32 Offsite manufacturers are both purchasers of key building supplies (as inputs) and suppliers of a product which include key building supplies such as a prefabricated component or an entire modular build. Offsite manufacturers purchase materials, then process and assemble them to supply more complex key building supplies to merchants or builders (for example, frame and truss prefabrication, structural insulated panels (SIPs) and windows).
- 2.33 Chapter 8 discusses offsite manufacturing (OSM) in more detail, including its potential to positively impact competition for the supply of key building supplies.

Merchants and vertical integration

- 2.34 At the distribution level, the five major merchant chains which operate nationally are PlaceMakers, Carters, ITM, Bunnings and Mitre 10. PlaceMakers, Carters and ITM cater primarily to builders and trade customers, while Bunnings and Mitre 10 have both trade centres and retail-focused stores.

- 2.35 PlaceMakers and Carters are vertically integrated companies, with activities spanning several levels of the supply chain.
- 2.35.1 Fletcher Building manufactures products including plasterboard (Winstone Wallboards), cement (Golden Bay Cement), concrete (Firth) and insulation (Tasman Insulation). It also operates PlaceMakers and is active in residential development and construction (Fletcher Living and Clever Core).
- 2.35.2 Carter Holt Harvey (CHH) manufactures products including structural timber (CHH Woodproducts) and also operates Carters.
- 2.36 There are other vertically integrated participants in the supply chain for some key building supplies.⁶⁰
- 2.37 Outside of the major merchants, a number of smaller merchants and specialist retailers have varying presence and carry varying product ranges throughout New Zealand.

Builders

- 2.38 At the residential construction level, there is a wide range of different business models ranging from SME builders to nationwide group home builders (GHBs).
- 2.39 There is a large and diverse range of SME builders, as well as subcontractors and do-it-yourself (DIY) builders. SME builders can be sole traders with one or two staff or contractors or a group of builders that typically build a small number of homes per year (for example, up to 10 buildings per year). SME builders typically purchase building supplies from merchants for each build.
- 2.40 GHBs may operate on a national or multi-regional basis. They typically have a national office but may also operate a franchise model. GHBs build a larger number of homes per year, may offer a suite of standard plans, and maintain national accounts with merchants for purchasing building supplies. Some GHBs also operate as developers. GHBs include the likes of GJ Gardner Homes, Signature Homes, Mike Greer Homes, Golden Homes, and Classic Developments.
- 2.41 Purchasers of key building supplies also include a growing number of offsite manufacturers. Some prefabricate a component of a building (such as a wall) and assist in the construction process, while other offsite manufacturers aim to build entire buildings in a factory and complete assembly onsite.

⁶⁰ For example, Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at figures 11-15.

Designers and specifiers

- 2.42 Designers (including architects, draughtspersons, engineers and quantity surveyors) prepare plans and specifications for building work. They also provide advice on compliance of building work with the Building Code.⁶¹
- 2.43 Designers often decide what key building supplies are to be specified on the building plans and therefore used in construction. Sometimes these decisions are made in consultation with their clients and the builder.

Developers

- 2.44 A developer typically purchases land that may have the necessary infrastructure for residential housing, or the necessary infrastructure may need to be built. The developer can sell the parcels of land ready for residential construction or remain involved through the finance and management of the construction process, subsequently selling or leasing the residential buildings. To this extent, a developer may be considered a large end consumer of the residential construction process.
- 2.45 Developers may have a greater or lesser impact on the purchases of key building supplies, either through specifying and sourcing building supplies for build partners or letting build partners source their own contractors and building supplies. Some developers may also be builders by trade and, accordingly, likely to be directly involved in the construction process and sourcing building materials.
- 2.46 Developers can range in size and scale. Some focus on smaller projects of two to three terrace houses for example, while other developers focus on large apartment buildings and retirement villages.
- 2.47 We have also observed that some developers emphasise social outcomes and therefore place emphasis on affordability and quality.⁶²

⁶¹ The design process for offsite manufacturing can be different to this and is sometimes referred to as design for manufacture and assembly (DFMA), []; []; [].

⁶² [].

Kāinga Ora

- 2.48 Kāinga Ora is a public sector provider of social housing and the Government’s lead urban developer. It is involved in the building of new homes, as well as redevelopment of existing homes. It partners with the development community, Māori, local and central government, and others on urban development projects of all sizes. Through its work programme to develop and provide social housing, it is the end consumer of key building supplies in New Zealand and is responsible for approximately 7 to 8% of new homes built in New Zealand each year through its construction partners.⁶³
- 2.49 Kāinga Ora tenders for a lead contractor to manage the construction of its residential housing projects and takes a hands off approach to sourcing key building supplies. Build partners typically source their own building supplies provided they meet the requirements of the job.⁶⁴
- 2.50 Kāinga Ora operates Consentium, a standalone and independent division within Kāinga Ora that provides building consent services.⁶⁵
- 2.51 Kāinga Ora has a unique position. As well as being a large-scale social housing developer, it is also the long-term owner of the property and its mandate includes long-term social outcomes.
- 2.52 We understand that as a result of this, Kāinga Ora is focused on the economic and social benefits of higher-quality homes. For example, in June 2020 Kāinga Ora announced a commitment to build all its new homes to 6 Homestar standard, noting that this means its homes will be built to be warmer, healthier and more efficient for tenants.⁶⁶ Māori are specifically considered under the Te Aranga Design Principles which are “... founded on intrinsic Māori cultural values and aim to enhance the mana whenua presence, visibility and participation in urban design”.⁶⁷

Homeowners and end consumers

- 2.53 At the end-consumer level, there are homeowners and other end consumers who live in residential buildings. This includes owner-occupiers, landlords and tenants of rental properties.

⁶³ In FY 2020/21 it delivered 2,432 newly built state homes, and as at 31 June 2021 it had 3,500 homes under construction and 3,310 in the consenting and procurement process, Kāinga Ora “Addressing housing demand” <https://kaingaora.govt.nz/about-us/addressing-housing-demand/>;

[].

⁶⁴ [].

⁶⁵ See: <https://www.consentium.co.nz/>.

⁶⁶ Kāinga Ora “Healthier homes under Homestar” (9 June 2020) <https://kaingaora.govt.nz/news/healthier-homes-under-homestar/>. Homestar is a rating tool run by the New Zealand Green Building Council. Its requirements exceed Building Code standards, see discussion in Chapter 8.

⁶⁷ Kāinga Ora “Our approach to building” <https://kaingaora.govt.nz/developments-and-programmes/our-approach-to-building/>.

- 2.54 Preferences of homeowners and other end consumers can influence the types of structures being built and the choice of materials.
- 2.55 Kāinga Ora is a developer and long-term owner of its buildings and is a substantial driver of demand for residential construction. Hapū and iwi are also building large-scale residential developments or working in partnership with other developers.

Regulatory bodies and their roles

- 2.56 MBIE's Building Performance Branch is the building regulator and sets the performance requirements under the Building Code. The performance requirements of the Building Code influence developers' and designers' decisions for building supplies.
- 2.57 BCAs are organisations that are accredited and registered to issue building consents, carry out inspections, and issue compliance certificates. Issuing consents includes an assessment that the building supplies and systems proposed, including how they are to be used, will perform to meet the Building Code.
- 2.58 Standards NZ is an independent unit that sits within MBIE and is responsible for managing the development of standards in New Zealand. As discussed in Chapter 3, standards are agreed specifications for products, processes, services and performance.⁶⁸ Compliance with standards is generally voluntary but can be mandatory when cited in Acts, regulations or other legislative instruments. When adopted by MBIE into Acceptable Solutions or Verification Methods, standards can (among other things) specify the performance standards required of building supplies.
- 2.59 CodeMark is a product certification scheme that provides a pathway for establishing compliance with the Building Code. There are currently four bodies accredited to issue CodeMark certificates in New Zealand, with one based in New Zealand (BRANZ) and the remaining three in Australia.
- 2.60 Building Research Association of New Zealand (BRANZ) is an independent research and testing organisation involved in understanding the design and construction of the built environment in New Zealand. In addition to CodeMark certification, BRANZ has a range of functions, including independent building product testing, assurance and consultancy services, and it undertakes and commissions research (funded by the Building Research Levy).⁶⁹

Characteristics of residential building in New Zealand

- 2.61 Some characteristics of residential building in New Zealand have implications for the nature of competition.

⁶⁸ See: <https://www.standards.govt.nz/about/explaining-standards/>.

⁶⁹ See: <https://www.branz.co.nz/about/>.

- 2.62 New Zealand is a geographically distanced island nation. New Zealand’s small market can make it challenging to achieve efficient scale for domestic manufacturing.⁷⁰ The combination of a small market size and isolated geographic location (with associated transport costs) can also make it less attractive to import products manufactured overseas, relative to other countries.
- 2.63 The cyclical nature of New Zealand’s construction sector has been described as a boom-bust cycle.⁷¹ This cyclical pattern of expansion and contraction may influence domestic manufacturers’ and suppliers’ motivations to invest in capacity.⁷²
- 2.64 Notable historical events, such as ‘leaky homes’ and the Christchurch earthquakes in 2010 and 2011, have had significant influences in shaping the regulatory and standards systems as they stand today.⁷³ It seems the regulatory and industry response to leaky homes, in particular, has driven a focus on ensuring the weathertightness and durability of homes, and conservatism in design and consenting that continues today.
- 2.65 New Zealand appears to have a prevalence and preference for bespoke housing.⁷⁴ In 2012 the Productivity Commission described the industry as “a fragmented ‘cottage industry’ dominated by very small independent builders constructing bespoke homes”, and also noted low productivity growth of the industry.⁷⁵
- 2.66 Figure 2.4 shows there has been some growth in larger-scale builders but that the mix of smaller builder size has been broadly similar for the last decade, and feedback we have received indicates there has not been notable industry change since 2012. Figure 2.4 shows that approximately 50% of homes built in 2018 were by builders who constructed fewer than 10 homes per year.

⁷⁰ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [24.2].

⁷¹ Ministry of Building, Innovation & Employment “New Zealand Sectors Report 2013 – Construction” (November 2013) at 61, available at: <https://www.mbie.govt.nz/assets/77439ddc45/Construction-report-2013.pdf>; National Association of Steel Framed Housing Inc “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 2.

⁷² [].

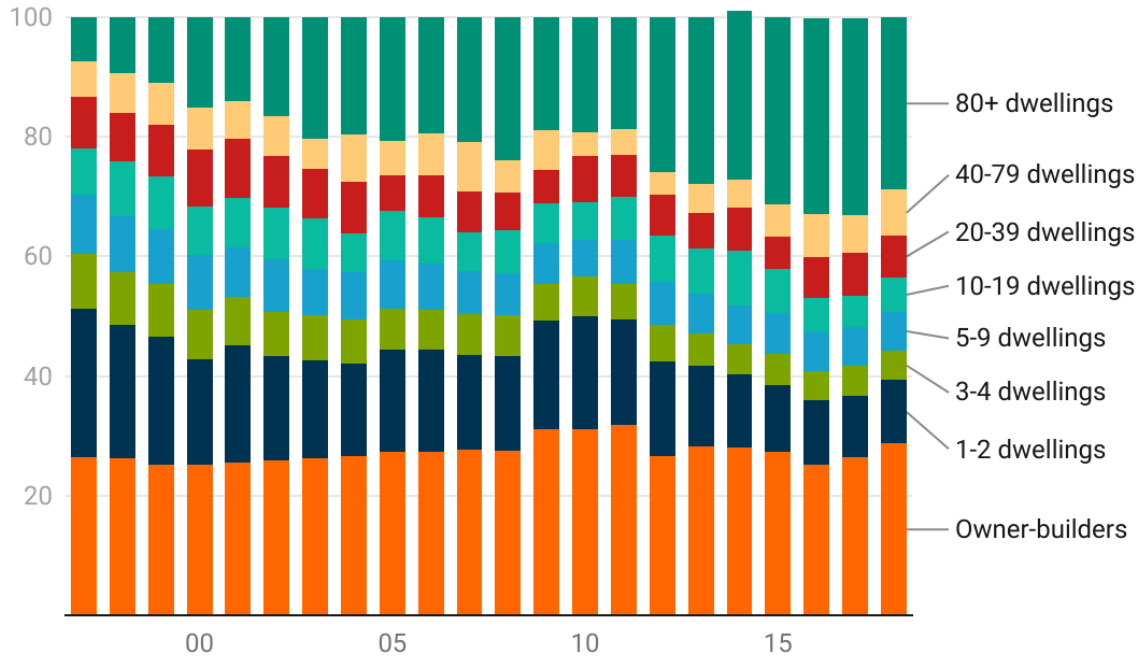
⁷³ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [10] and [13].

⁷⁴ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [12.1(a)]; HW Richardson Group Ltd “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 4.

⁷⁵ Productivity Commission “Housing Affordability” (March 2012) at 8, available at: <https://www.productivity.govt.nz/assets/Documents/9c8ef07dc3/Final-report-Housing-affordability.pdf>.

Figure 2.4 Market shares by builder size

Consents per annum, March years

Source: Infometrics analysis, BCI New Zealand dataset.⁷⁶

The acute demand and supply chain pressures the industry currently faces

- 2.67 An increase in demand for key building supplies, as well as supply chain pressures, has led to supply shortages for some key building supplies (for example, structural timber, plasterboard, and insulation).⁷⁷
- 2.68 Current demand pressures are illustrated by the significant increase in consents for new homes granted since 2020.⁷⁸ Consents for alterations increased sharply during the same period.⁷⁹
- 2.69 The COVID-19 pandemic has also placed pressures on the residential building supplies industry, among others. As well as the impact of lockdown restrictions in New Zealand, there has been major disruption to global supply chains.

⁷⁶ Gareth Kiernan/Infometrics “Larger firms increase their share of residential building activity” (October 2018), available at: <https://www.infometrics.co.nz/article/2018-10-larger-firms-increase-share-residential-building-activity>.

⁷⁷ Lawrence Gullery “Builders face ‘shortages all over the place’ thanks to ‘berserk’ housing market and Auckland’s lockdown” (5 September 2021) <https://www.stuff.co.nz/business/property/126289729/builders-face-shortages-all-over-the-place-thanks-to-berserk-housing-market-and-aucklands-lockdown>.

⁷⁸ See Figure 2.1 above.

⁷⁹ 2021 saw an 11.7% increase in consents for alterations from 2020, compared with a 2.9% constant annual growth rate for alteration consents for the period 2011-2021, [].

- 2.70 The Government-mandated lockdown periods (including the Alert Level 4 lockdown periods from 25 March 2020, and 17 August 2021) resulted in production outages and loss of production where businesses closed down for prescribed periods.
- 2.71 A survey conducted by the Construction Sector Accord identified two key issues facing the wider construction sector (including residential) in mid-2021 as being:⁸⁰
- 2.71.1 increases in the price of materials and supplies; and
 - 2.71.2 shortages of materials and supplies, particularly structural and non-structural wood products.
- 2.72 The survey also highlighted that although the COVID-19 pandemic was the main driver of these issues, a large proportion of respondents also viewed it as exacerbating existing issues. Worldwide shipping was commonly identified as being the cause of the issues, followed by delays in manufacturing.
- 2.73 Pricing and supply chain pressures have persisted over the course of this study to date and have been well publicised in the media.⁸¹
- 2.74 Supply shortages for specific key building supplies can impact the entire construction process and those working in it. For example, payments to builders for construction work are often based on hitting key milestones (for example, internal wall lining), which may cause flow-on disruptions for other industry participants.
- 2.75 This means that acute supply shortages for some key building supplies delay builders achieving key milestones and this in turn delays payment and may impact project cash flow, and in some cases, financial viability. If a milestone cannot be completed on schedule, completion of the build may be delayed, which may also cause flow-on disruptions for other industry participants. Similarly, homeowners may be affected if the project is delayed or if the builder fails financially while the project is incomplete.⁸²

Climate change and implications for the future of building supplies

- 2.76 Government policy to address climate change will make it increasingly important for residential housing (building structures and materials, and the construction process itself) to be sustainable and to limit carbon emissions, as part of reducing the emissions contribution of the construction industry as a whole.

⁸⁰ Construction Sector Accord “Construction Sector Accord supply chain research issued” (21 September 2021), available at: <https://www.constructionaccord.nz/news/news-stories/construction-sector-accord-supply-chain-research-issued/>.

⁸¹ For example, increasing costs and material shortages are impacting construction firms, Geraden Cann “Construction ‘probably entering bust cycle’ with 92 companies liquidated this year” (29 May 2022) <https://www.stuff.co.nz/business/128740312/construction-probably-entering-bust-cycle-with-92-companies-liquidated-this-year>.

⁸² [].

- 2.77 It is also becoming more important for residential housing to be resilient to withstand the effects of the changing climate. This is likely to include higher temperatures, rising sea levels, more frequent extreme weather events, and changes in rainfall patterns.⁸³
- 2.78 Building for Climate Change (BfCC) is a long-term programme run by MBIE to reduce emissions from constructing and operating buildings, and to make sure buildings are prepared for the future effects of climate change. BfCC is likely to require the introduction of new or innovative ‘green’ building supplies as a key pathway to reducing the carbon footprint of residential housing.
- 2.79 Other programmes that promote low emissions buildings include:
- 2.79.1 Homestar, an independent rating tool for assessing the health, efficiency, and sustainability of homes. Homestar is operated by the New Zealand Green Building Council; and
 - 2.79.2 Healthy Homes standards, which require specific and minimum standards for heating, insulation, ventilation, moisture and drainage, and draught stopping in rental properties.
- 2.80 Chapter 8 discusses new or innovative building materials, including green building supplies.

Legislative reform and other policy processes

- 2.81 Chapter 3 outlines the ongoing legislative reform and other policy processes that are underway during this market study.
- 2.82 The most significant of these is the Government’s Building System Legislative Reform Programme, being conducted by MBIE. At this point in time, that programme is ongoing.
- 2.83 Phase 1 is nearing completion. The Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Bill received Royal Assent on 7 June 2021. This amendment legislation is accompanied by a set of new regulations that address policy issues identified by MBIE. They are:
- 2.83.1 Regulations relating to new minimum product information requirements which will commence on 11 December 2023.
 - 2.83.2 Regulations relating to a new Modular Components scheme and CodeMark which will commence on 7 September 2022.

⁸³ Ministry of Business, Innovation & Employment “Building and Construction Sector Trends – Annual Report” (29 September 2021) at 5, available at: <https://www.mbie.govt.nz/dmsdocument/16973-building-andconstruction-sector-trends-annual-report-2021-pdf>.

- 2.84 In June 2022, MBIE implemented a range of actions to address the plasterboard shortage, including releasing guidance for:⁸⁴
- 2.84.1 designers, contractors and building owners regarding using building products different to those originally specified; and
 - 2.84.2 BCAs on how to manage product substitution.
- 2.85 On 21 June 2022, the Minister of Building and Construction announced the establishment of a Ministerial taskforce to look at what can be done to ease plasterboard shortages.⁸⁵
- 2.86 Most recently, on 21 July 2022, MBIE commenced consultation on a review of the building consent system, releasing an issues discussion document.⁸⁶
- 2.87 This policy work is intended to involve a review of all elements of the building consent system, starting from the point at which buildings are procured and designed. These elements are identified by MBIE as:
- 2.87.1 institutions – how the regulatory regime is structured;
 - 2.87.2 practice – how regulation is implemented; and
 - 2.87.3 system management – how the regulatory system is managed.
- 2.88 MBIE intends to report back on this review in 2023, enabling consideration of the findings of this study in that process.
- 2.89 There have been several other recent publications which have some relevance to our study, including Rautaki Hanganga o Aotearoa – New Zealand’s Infrastructure Strategy 2022-2052, and Aotearoa New Zealand’s First Emissions Reduction Plan.^{87, 88} We discuss the relevance of these publications in Chapter 8.

⁸⁴ Building Performance “Plasterboard substitution in Aotearoa New Zealand” <https://www.building.govt.nz/projects-and-consents/build-to-the-consent/making-changes-to-your-plans/plasterboard-substitution-in-aotearoa-new-zealand/>.

⁸⁵ Hon Dr Megan Woods “Plasterboard taskforce set up to ease shortages” (21 June 2022) <https://www.beehive.govt.nz/release/plasterboard-taskforce-set-ease-shortages>.

⁸⁶ Ministry of Business, Innovation & Employment “Issues discussion document: Review of the building consent system” (21 July 2022), available at <https://www.mbie.govt.nz/have-your-say/building-consent-system-review/>.

⁸⁷ New Zealand Infrastructure Commission, Te Waihanga “Rautaki Hanganga o Aotearoa – New Zealand Infrastructure Strategy 2022-2052” (2022), available at: <https://strategy.tewaihanga.govt.nz/strategy>

⁸⁸ <https://environment.govt.nz/what-government-is-doing/areas-of-work/climate-change/emissions-reduction-plan/>.

Chapter 3 Regulatory and standards systems

Summary of preliminary findings

- The regulatory system is making it difficult for competing suppliers of key building supplies to enter the New Zealand market and expand their businesses. Despite the flexibility that is available in the system to use and adopt new products, it is too slow, costly and uncertain to get them accepted for general use. This is due to the combined effect of:
 - the way the regulatory and standards systems (comprising the Building Act, the Building Code and related instruments, and the consenting system) are applied to building products; and
 - the decision-making behaviours designers, builders and BCAs in response to and in applying the regulatory and standards system.
- The Building Code and associated systems are complex to navigate. The Building Code uses qualitative words and phrases to set performance levels for building work and, for building products, establishing what the qualitative words and phrases mean in practice generally involves starting with the standards currently referenced in Acceptable Solutions and Verification Methods. It is those standards that are generally used to establish the required performance levels for products. These compliance pathways for building products (ie, through Acceptable Solutions and Verification Methods, and referenced Standards) are narrow and there are few 'streamlined' processes.
- These pathways have their origins in the national standards under the Building Act 1991 and, while they are not the only means of complying with the Building Code, they have become embedded as "how we build here". These compliance pathways have not been expanded to keep pace with contemporary building practices or the development of new products, limiting the potential for competition from alternative, new or innovative building supplies.
- The regulatory system does not enable timely response to changing markets and innovations in building products. It continues to incentivise designers, builders and BCAs to favour 'tried and tested' building products over new or competing products.
- The practice of designers specifying products by brand in building plans and consent applications and the perceived difficulty and cost of product substitution incentivises builders to continue to use the specified brands.
- The regulatory and standards systems are complex to navigate making it difficult for product suppliers and designers to find useful information about new or innovative products that will help them to assess whether products would be compliant with the Building Code.

Introduction

- 3.1 This chapter discusses the core elements of the regulatory and standards systems that apply to building products.⁸⁹ It considers whether features of the current regulatory and standards systems, and their application in practice, inhibit entry or expansion in the markets for key building supplies.
- 3.2 The topics covered are:
- 3.2.1 the relevant regulatory and standards systems; and
 - 3.2.2 the ways in which the regulatory and standards systems may be acting as barriers to entry and expansion in the markets for key building supplies.
- 3.3 This chapter focuses specifically on the regulation of building materials. It does not cover regulations that may impede competition for key building supplies that are outside this scope such as anti-dumping legislation, the New Zealand Emissions Trading Scheme (ETS), obtaining resource consents, and approvals from the Overseas Investment Office for certain capital investments. Where relevant these matters are discussed elsewhere in our draft report.⁹⁰
- 3.4 It also does not specifically cover impediments to the entry of ‘new or innovative’ building supplies, such as ‘green’ building supplies or novel prefabricated products although the general observations we make in this chapter would apply equally to these products. Matters specific to those building supplies are separately discussed in Chapter 8.

The relevant regulatory and standards systems

Purpose of this section

- 3.5 This section describes the different elements of the regulatory and standards systems and how they fit together.
- 3.6 The core elements of the regulatory and standards systems include:
- 3.6.1 the Building Act 2004 (Building Act) which provides the legislative framework for matters such as –
 - 3.6.1.1 the building consent processes that are run by BCAs – usually territorial authorities (TAs) which include city and district councils;
 - 3.6.1.2 relevant regulations, including the Building Code;

⁸⁹ The regulatory and standards systems discussed in this chapter apply to all building products when they are used in building work. As described in paragraphs 2.20 and 2.21 above, key building supplies are a subset of all building supplies used for residential building.

⁹⁰ For example, the ETS is discussed in paragraphs D69 to D77 below.

- 3.6.1.3 the various methods that can be used to demonstrate compliance with the Building Code;
- 3.6.1.4 the product certification system; and
- 3.6.1.5 implied warranties.
- 3.6.2 the Building Code which sets out the performance standards that all new building work must meet;⁹¹
- 3.6.3 the non-mandatory means of demonstrating compliance with the Building Code which are determined by MBIE being Acceptable Solutions and Verification Methods;⁹²
- 3.6.4 the standards (NZ, Australian and International), some of which are cited by MBIE in Acceptable Solutions and Verification Methods;
- 3.6.5 the other means of demonstrating compliance with the Building Code including product certification and Alternative Solutions; and
- 3.6.6 guidance issued by MBIE.

Overview of the regulatory and standards systems

Objectives of the regulatory and standards systems

- 3.7 The regulatory and standards systems are substantially contained in a three-part framework comprised of the Building Act, Building Regulations providing details of particular building controls made under that legislation, and most relevant for purposes of this market study, the Building Code (also a Building Regulation).⁹³
- 3.8 The Building Act provides for the regulation of buildings, building work and various occupational groups in the building industry, and the setting of requirements and standards that ensure good building performance.⁹⁴ A key focus of the Building Act is the health and safety of people using buildings.

⁹¹ Section 16 of the Building Act.

⁹² These are non-mandatory as other methods to demonstrate compliance are also available.

⁹³ The Building Code is contained in the Building Regulations 1992 which continue to apply through the Building (Forms) Regulation 2004 despite the repeal of the Building Act 1991.

⁹⁴ In the Building Act, “building work” is defined as “work for, or in connection with, the construction, alteration, demolition or removal of a building; and on an allotment that is likely to affect the extent to which an existing building on that allotment complies with the Code and includes sitework and design work that is restricted building work”.

- 3.9 Building Regulations made pursuant to the Building Act include the performance-based Building Code. The Building Code focuses on how a building must perform in its intended use rather than specifying the building method or building products that must be used. To this end, when regulating ‘building work’ the Building Act indirectly regulates the products that are used in the building work and it does not regulate the kinds of products that can be used.^{95, 96}
- 3.10 Compliance with the Building Act and with the Building Code can be demonstrated through a range of compliance pathways, which we discuss later in this chapter.
- 3.11 Published standards have a role to play in those compliance pathways. Their development in New Zealand is governed by the Standards and Accreditation Act 2015. This includes the development of standards by Standards New Zealand (Standards NZ). A key purpose of the Standards and Accreditation Act is to provide for standards that are consistent with international practice, that facilitate trade, and protect the health, safety and wellbeing of individuals.
- 3.12 The core policy objectives of the regulatory and standards systems reflected in each of these legislated components are therefore to ensure that homes and buildings are safe, healthy, and durable, while still allowing for innovation in building work (and by implication the products used in building construction).

Central Regulator (Ministry of Business, Innovation & Employment) and Building Consent Authorities

- 3.13 The key agencies with roles in the regulatory and standards systems are MBIE, including its Building Systems Performance branch (which manages the NZ building laws and regulations that protect public safety and property), its Building and Tenancy Branch, Standards NZ, and BCAs.⁹⁷
- 3.14 MBIE’s Building Systems Performance branch is the steward of New Zealand’s building and construction regulatory system with its work including the following:
- 3.14.1 overall management and monitoring of the system that regulates building work;
 - 3.14.2 setting performance requirements in the Building Code;

⁹⁵ This includes design work to the extent that the design work is restricted building work as set out in the Building (Definition of Restricted Building Work) Order 2011. The Order defines restricted building work as including design work that is related to a building’s structure, weathertightness or fire safety systems. The definition of restricted building work for design only applies to residential buildings and small-to-medium apartment buildings.

⁹⁶ As discussed later in the chapter, the Building Act specifically regulates building products via the (voluntary) product certification scheme and the (soon to be mandatory) building product information requirements.

⁹⁷ Other agencies such as the occupational registration board also have a role, but these are not relevant to our market study.

- 3.14.3 producing documents and guidance on ways to comply with the requirements in the Building Code (including Acceptable Solutions and Verification Methods); and
 - 3.14.4 monitoring the performance of BCAs in relation to building work.
- 3.15 Standards NZ is an independent unit that sits within MBIE. It is responsible for managing the development of, and providing access to, standards in New Zealand. It was established in 1932, following the Napier earthquake, to develop building standards. Today, its role includes:
- 3.15.1 standards development and standards update processes in New Zealand for the building and other sectors;
 - 3.15.2 participation in international standards developments; and
 - 3.15.3 providing access to standards, which includes both the free publication and the sale of standards.⁹⁸
- 3.16 The policy of Standards NZ is to base New Zealand standards on international standards as far as possible, although there will be times where local conditions and circumstances need to be incorporated. According to Standards NZ, this approach better enables the international exchange of goods and services as these international standards generally reflect the best practice of industry and regulators worldwide and cover conditions in a variety of countries New Zealand trades with. Standards NZ also states that it is in line with its obligations under the World Trade Organization’s Code of Practice, which requires the elimination of technical standards as barriers to international trade.⁹⁹
- 3.17 A BCA is a construct of the Building Act and is an organisation that is accredited and registered to issue building consents. Most BCAs are TAs, ie, local and district councils. However, it is possible for a non-TA to be an accredited and registered BCA. Consentium, a standalone and independent division of Kāinga Ora, is at present the only accredited and registered non-TA BCA.¹⁰⁰
- 3.18 The BCAs responsibilities include:
- 3.18.1 issuing building consents;¹⁰¹
 - 3.18.2 inspecting building work for which they granted a building consent;

⁹⁸ Standards NZ is self-funded so it charges for standards development and sells standards. It also provides free access to standards that have been sponsored, which includes a large number of Building standards sponsored by MBIE.

⁹⁹ Standards NZ “International engagement” <https://www.standards.govt.nz/develop-standards/international-engagement/>.

¹⁰⁰ Consentium “Quality Building consent and inspection Services” <https://www.consentium.co.nz/>.

¹⁰¹ A building consent is the formal approval permitting an applicant to undertake building work in accordance with the plans and specifications approved by the BCA.

- 3.18.3 issuing notices to fix;
 - 3.18.4 issuing code compliance certificates;¹⁰² and
 - 3.18.5 issuing compliance schedules and amending them where the specified systems are affected by building work.
- 3.19 There are 67 TA BCAs in New Zealand.¹⁰³ These range in size from authorities with very large populations such as Auckland Council to authorities with very small populations such as MacKenzie District Council. The Building (Accreditation of Building Consent Authorities) Regulations 2006 provide that BCAs must have a system for allocating the building control function work described in paragraph 3.18 to employees or contractors who are competent to do the work.
- 3.20 Between them BCAs currently process approximately 50,000 residential building consents for new dwellings per year, with the major metropolitan councils handling a substantial majority of all applications. For example, of the new dwellings that were consented for the year ended April 2022 approximately 21,500 of these were in Auckland, 4,700 in Christchurch, and 2,500 in Henderson-Massey. In contrast, only 12 new dwellings were consented in Wairoa, 19 in Kawerau, and 32 in Waimate over the same period.¹⁰⁴

Building control three-part framework

- 3.21 As referred to above, the regulation of all building in New Zealand sits under a framework consisting of:
- 3.21.1 The Building Act which contains the provisions for regulating building work and covers building construction, alteration, demolition and removal;
 - 3.21.2 The Building Regulations, which contain prescribed forms, list specified systems, define terms such as ‘change the use’ and ‘moderate earthquake’, and set out the rate of levy and fees for determinations; and

¹⁰² A code compliance certificate is a formal statement by a BCA that building work carried out under a building consent application complies with the building consent. It provides assurance to the owner and subsequent property owners that the approved plans and specifications have been followed.

¹⁰³ MBIE maintains a list of BCAs on its website, Building Performance “Building Consent Authorities (BCA Register”, available at: <https://www.building.govt.nz/building-officials/find-a-bca/>.

¹⁰⁴ Statistics NZ sets out the new buildings consented by TA for each year ending on April for 2017 to 2022, Statistics NZ “Building consents issued April 2022” at Table 6, available at: <https://www.stats.govt.nz/assets/Uploads/Building-consents-issued/Building-consents-issued-April-2022/Download-data/building-consents-issued-april-2022.xlsx>.

- 3.21.3 The Building Code which sets performance standards that all new building work must meet, and covers aspects such as stability, protection from fire, access, moisture, safety of users, services and facilities, and energy efficiency. The Building Code does not specify particular building methods or the performance requirements of types of building products, but rather how a building is expected to perform in its intended use. As discussed below, apart from minor variations, compliance with the Building Code can only be demonstrated by one or more of compliance with an Acceptable Solution or Verification Method published by MBIE (which, in turn, may cite a Standard), by way of product certification, or by way of an Alternative Solution.^{105, 106}

Building Act

- 3.22 The key purposes of the Building Act are to provide for the regulation of building work, the establishment of a licensing regime for building practitioners, and the setting of performance standards for buildings to ensure that:
- 3.22.1 people can use buildings safely without endangering their health, including escaping a building in case of fire;
 - 3.22.2 buildings have attributes that contribute appropriately to the health, physical independence and wellbeing of the people who use them;
 - 3.22.3 buildings are designed, constructed and able to be used in ways that promote sustainable development.
- 3.23 The Building Act also promotes the accountability of owners, designers, builders and BCAs who have responsibilities for ensuring that building work complies with the Building Code and describes their responsibilities.¹⁰⁷
- 3.24 Relevantly, the Building Act also outlines matters relating to the Building Code and building controls (such as building consents and where building consents are not required), and the requirements of building work.

¹⁰⁵ Minor variations under the Building Act are conceptually neutral as to the original design solution.

¹⁰⁶ MBIE describes an Alternative Solution as all or part of a building design that demonstrates compliance with the Building Code, but differs completely or partially from the Acceptable Solutions or Verification Methods, Building Performance “Alternative solutions for compliance with the Building Code” <https://www.building.govt.nz/building-code-compliance/how-the-building-code-works/different-ways-to-comply/alternative-solutions/>.

¹⁰⁷ Section 3 of the Building Act.

- 3.25 The responsibilities of the different participants in the building sector are primarily expressed by reference to the ways their activities contribute to the compliance of building work with the Building Code:
- 3.25.1 Suppliers are not currently obliged to provide information about their building products. However, as discussed in paragraphs 3.117 to 3.121 below, they will be required to make a minimum level of information about their products publicly available from 11 December 2023.¹⁰⁸
- 3.25.2 If they do provide information, suppliers must ensure it is accurate.¹⁰⁹ In particular, if a supplier states that the product will, if installed in accordance with the technical data, plans, specifications, and advice prescribed by the manufacturer, comply with the relevant provisions of the Building Code, they are responsible for ensuring that this is the case.¹¹⁰
- 3.25.3 Designers' plans and specifications must be sufficient to result in building work that complies with the Building Code if the building work were properly completed in accordance with those plans and specifications.^{111, 112} This includes specifying products and building methods that will comply with the Building Code.
- 3.25.4 Builders are responsible for making sure their work complies with the building consent and the related plans and specifications.¹¹³ This includes making sure they use the specified products (subject to the possibility of product substitution). Where building work is not covered by a building consent they are responsible for ensuring that the work complies with the Building Code.¹¹⁴
- 3.25.5 Building owners are responsible for obtaining the necessary consents for the building work and ensuring that any building work they carry out complies with the building consent or, if there is no building consent, with the Building Code.¹¹⁵

¹⁰⁸ 'Manufacturers and suppliers' are manufacturers, importers, distributors and retailers of products that can be used in building work.

¹⁰⁹ The Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021 introduced the power to make regulations to prescribe minimum requirements for information about building products that are available to the New Zealand market. These requirements will commence on 11 December 2023. This information will need to be provided by product manufacturers and suppliers. Distributors and/or retailers will need to check that the products they distribute or sell meet the information requirements.

¹¹⁰ Section 14G of the Building Act.

¹¹¹ A designer is someone who prepares plans and specifications for building work or who gives advice on the compliance of building work with the Building Code, including engineers and architects.

¹¹² Section 14D of the Building Act.

¹¹³ A builder is any person who carries out building work, whether in trade or not, including carpenters, plumbers and other tradespeople.

¹¹⁴ Section 14E of the Building Act.

¹¹⁵ Section 14B of the Building Act.

- 3.25.6 Building work is consented through processes run by the local BCA where the building work is taking place.¹¹⁶ The relevant BCA is responsible for checking that an application for a building consent, including the combination of products used, will result in buildings that will comply with the Building Code. It is also responsible for checking that the building work that has been done complies with the plans and specifications that were attached to the building consent through inspections during the build.¹¹⁷ Where there is product substitution it also assesses whether this change qualifies as a minor variation, or whether an amended building consent is required.^{118, 119}
- 3.26 Under the Building Act written contracts are required for any building work where the cost exceeds \$30,000. The contract must be in writing and contain prescribed information. The prescribed information includes information about the building work, timeframes, costs, payments and what to do in the event of a dispute.¹²⁰
- 3.27 The Building Act also includes implied warranties by anyone building or selling household units.¹²¹
- 3.28 The warranties, which are mandatory and cannot be contracted out of, include that:
- 3.28.1 building work will be carried out in a proper and competent manner;
 - 3.28.2 building work will be carried out in accordance with the plans and specifications set out in the contract and the relevant building consent;
 - 3.28.3 all materials to be supplied for use in the building work will be suitable for the purpose for which they will be used;
 - 3.28.4 unless otherwise stated in the contract, all materials to be supplied for use in the building work will be new;
 - 3.28.5 that the building work will be carried out in accordance with and comply with all legal requirements, including, the Building Act and the regulations (which include the Building Code).¹²²

¹¹⁶ The one exception is Consentium which operates nationally.

¹¹⁷ Section 14F of the Building Act.

¹¹⁸ Section 54A of the Building Act.

¹¹⁹ Guidance on product substitution and variations with examples is available on MBIE's website, Building Performance "Product substitutions and variations" <https://www.building.govt.nz/projects-and-consents/build-to-the-consent/making-changes-to-your-plans/product-substitution-and-variations/>.

¹²⁰ Section 362F of the Building Act and clause 6 of the Building (Residential Consumer Rights and Remedies) Regulations 2014, available at: <https://www.legislation.govt.nz/regulation/public/2014/0361/latest/DLM6322532.html>.

¹²¹ Under s 362B of the Building Act "building work" does not include design work for purposes of the implied warranties.

¹²² Section 362I of the Building Act.

- 3.29 The Building Act provides for a range of remedies against builders and on-sellers if there is a breach of the implied warranties. This includes requiring the repair of or replacement of defective materials, contract cancellation, damages for any loss or damage resulting from the breach, and compensation for any reduction in value of the product of the building work below the price paid or payable.¹²³
- 3.30 The Building Act also sets out certain principles that must be applied when performing functions or duties, or exercising powers in achieving the purpose of the Building Act. These include amongst other things:
- 3.30.1 that the building is durable for its intended use;¹²⁴
 - 3.30.2 the costs of a building (including maintenance) over the whole of its life;¹²⁵
 - 3.30.3 the importance of standards of building design and construction in achieving compliance with the Building Code;¹²⁶ and
 - 3.30.4 the importance of allowing for continuing innovation in methods of building design and construction.¹²⁷
- 3.31 Importantly, along with the implied warranties discussed above, the Building Act also provides for:
- 3.31.1 the ways in which compliance with the Building Code is established;
 - 3.31.2 the process for the issuing of Acceptable Solutions or Verification Methods by MBIE for use in establishing compliance with the Building Code, which when included in designs and plans must be accepted by BCAs;¹²⁸
 - 3.31.3 the appointment of a product certification accreditation body and the accreditation of product certification bodies;
 - 3.31.4 a process for the certification of building methods or products for use in establishing compliance with the Building Code;
 - 3.31.5 the issuing of a warning or the banning of a building product or method if it has resulted in, or is likely to result in, a building or building work failing to comply with the Building Code,¹²⁹ and

¹²³ Sections 362L, 362M and 362N of the Building Act.

¹²⁴ Section 4(2)(c) of the Building Act.

¹²⁵ Section 4(2)(e) of the Building Act.

¹²⁶ Section 4(2)(f) of the Building Act.

¹²⁷ Section 4(2)(g) of the Building Act.

¹²⁸ Section 29 of the Building Act.

¹²⁹ To date, MBIE has issued one warning (for loop bars in April 2018) and one ban (for foil insulation in July 2016).

- 3.31.6 the accreditation and registration of BCAs.
- 3.32 Under the Building Act:
- 3.32.1 all building work must comply with the Building Code (to the extent required by the Building Act), whether or not a building consent is required;¹³⁰
- 3.32.2 building work is not required to achieve performance criteria that are additional to, or more restrictive than, the performance criteria prescribed in the Building Code;¹³¹
- 3.32.3 Acceptable Solutions or Verification Methods are not the only means of complying with the Building Code (although, regulations can be made under the Building Act that require Acceptable Solutions or Verification Methods, or both, to be used to comply),^{132, 133}
- 3.32.4 a BCA must grant a building consent if it is satisfied on reasonable grounds that the provisions of the Building Code would be met if the building work was properly completed in accordance with the plans and specifications that accompanied the application;¹³⁴ and
- 3.32.5 a BCA must issue a code compliance certificate if it is satisfied, on reasonable grounds, that the building work complies with the building consent; and
- 3.32.5.1 in a case where a compliance schedule is required as a result of the building work, the specified systems in the building are capable of performing to the performance standards set out in the building consent; or
- 3.32.5.2 in a case where an amendment to an existing compliance schedule is required as a result of the building work, the specified systems that are being altered in, or added to, the building in the course of the building work are capable of performing to the performance standards set out in the building consent.¹³⁵

Building Code

- 3.33 The Building Code contains compulsory rules for all new building work.

¹³⁰ Section 17 of the Building Act.

¹³¹ Section 18 of the Building Act.

¹³² Section 23 of the Building Act.

¹³³ Section 20 of the Building Act. Although this power exists, no such regulations have been made as yet and the circumstances when such a regulation could be made would be limited in practice.

¹³⁴ Section 49(1) of the Building Act.

¹³⁵ Section 94(1) of the Building Act.

- 3.34 It sets out the performance criteria that building work must meet, but does not prescribe how work should be done and contains no prescriptive requirements stipulating that certain products, brands or designs must be used. Instead, it states how completed building work and its parts must perform. The Building Code often uses qualitative words or phrases to set performance level for building work. Examples of the words used are “adequate”, “sufficient”, “low probability” and “adequate combination”.
- 3.35 In essence, the Building Code is a performance standard for building work and not building products. A product only complies (or will contribute to compliance) when used in a particular use such as a defined scope of buildings and building work.
- 3.36 Relevantly for the purposes of our market study, the Building Code includes a wide range of technical clauses specifying the required performance in relation to matters such as stability (structure and durability), structural stability in the case of fire, moisture (surface water, external moisture and internal moisture), and hazardous building materials. Often compliance with these technical clauses is demonstrated by reference to a standard.
- 3.37 Each technical Code clause has three levels that describe the requirements:
- 3.37.1 Objective – outcomes the building must achieve;
 - 3.37.2 Functional requirement – functions the building must perform to meet the objective; and
 - 3.37.3 Performance – the performance criteria the building must achieve.
- 3.38 As an example, Clause E2 of the Building Code stipulates the following:
- 3.38.1 Objective – the objective of this provision is to safeguard people from illness or injury that could result from external moisture entering the building.
 - 3.38.2 Functional requirement – buildings must be constructed to provide adequate resistance to penetration by, and the accumulation of, moisture from the outside.
 - 3.38.3 Performance – roofs and exterior walls must prevent the penetration of water that could cause undue dampness, damage to building elements, or both.¹³⁶
- 3.39 By meeting the Performance criteria, the Objective and Functional requirements will be achieved.

¹³⁶ This is only one of seven performance requirements in this clause.

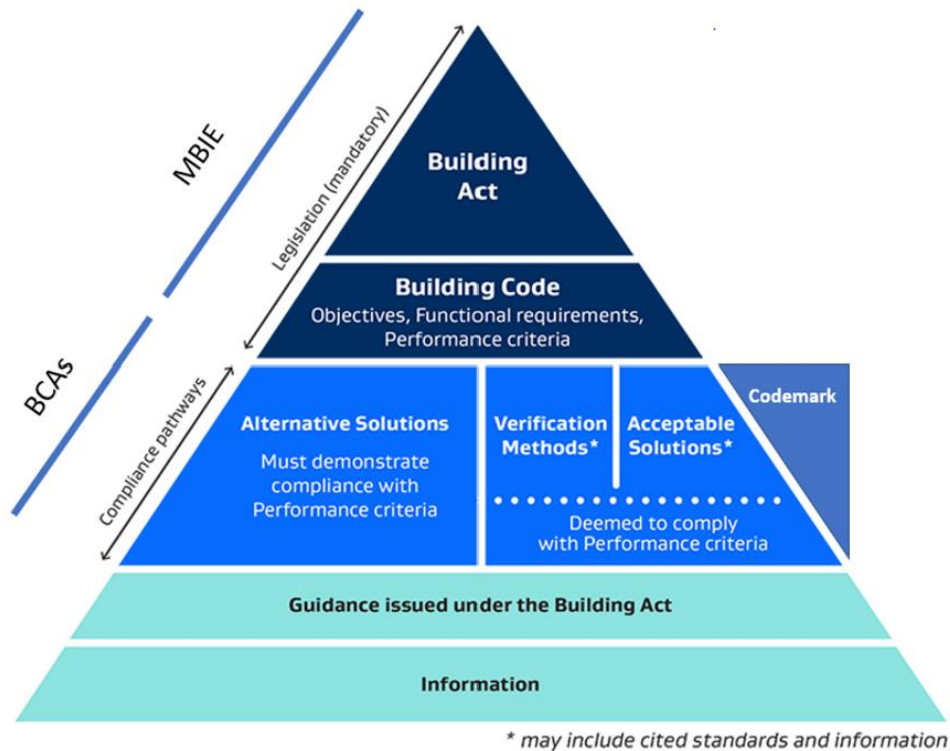
Building Regulations other than the Building Code

- 3.40 These regulations detail particular building controls that are largely unrelated to building performance such as other prescribed forms, lists of specified systems, definitions of 'change the use' and 'moderate earthquake', levies, fees and infringements.
- 3.41 They also include regulations such as those setting out the criteria for accreditation as a product certification body or as a BCA.

Demonstrating compliance with the Building Code

- 3.42 Where building work requires a building consent, the BCA assesses the plans and specifications before any building work starts, to ensure that the work will comply with the Building Code.
- 3.43 The BCA issues a building consent for the work if it is satisfied the work will meet the requirements of the Building Code.
- 3.44 Compliance with the Building Code can be demonstrated using various pathways.
- 3.45 Certain pathways must be accepted by BCAs as meeting the performance requirements of the Building Code while others must be demonstrated to the satisfaction of the BCA.
- 3.46 The diagram below sets out the key elements of the regulatory and standards systems and the different routes to compliance with the Building Code:

Figure 3.2 Regulation framework showing some ways to comply with the Building Code



Source: Ministry of Business, Innovation & Employment.¹³⁷

- 3.47 As discussed below, Acceptable Solutions and Verification Methods describe specific construction details (without referring to specific products), that if followed, will result in Code compliant building work. CodeMark typically certifies that a specific product will comply with the Building Code if used and installed in the specified way.¹³⁸

Compliance pathways that are deemed to comply with the Building Code

- 3.48 The current pathways that must be accepted by BCAs as meeting the performance requirements of the Building Code are Acceptable Solutions, Verification Methods and CodeMark. We discuss Alternative Solutions later in this chapter at paragraphs 3.98 to 3.106.

¹³⁷ Building Performance “How the Building Code Works” <https://www.building.govt.nz/building-code-compliance/how-the-building-code-works/>. We have added the product certification scheme (CodeMark) to MBIE’s diagram.

¹³⁸ While CodeMark can also extend to building systems, including methods of construction, it is more commonly used for specific products only.

- 3.49 Unless the Acceptable Solution or Verification Method needs to be declared urgently, or its effect is minor and will not adversely affect the substantial interests of any person, MBIE must publicly notify the Acceptable Solution or Verification Method proposal, invite submissions on the proposal and consider the submissions.¹³⁹
- 3.50 There is at least one Acceptable Solution or Verification Method for compliance with each of the Building Code’s clauses. For example, for clause B1 of the Building Code – Structure there are three Acceptable Solutions and two Verification Methods.¹⁴⁰
- 3.51 The Building Code handbook sets out which Acceptable Solutions and Verification Methods apply to different elements of a residential building.¹⁴¹
- 3.52 The Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021 (Amendment Act), discussed in paragraphs 3.122 to 3.126 below, will provide a further compliance pathway for manufacturers that are certified to produce modular building components that must be accepted by BCAs once the regulations come into effect on 7 September 2022.

Acceptable Solutions

- 3.53 Acceptable Solutions do not reference specific product brands (eg, a JSC weatherboard), but are designed to accommodate commonly used building materials (eg, weatherboard cladding), systems and methods and give specific construction details for compliance with the Building Code. Standards can be incorporated into Acceptable Solutions with or without modifications. When standards are incorporated into Acceptable Solutions, any products complying with the standard have a clear compliance pathway to establish compliance with the Building Code. How standards are incorporated into Acceptable Solutions is discussed in paragraphs 3.69 to 3.81 below.
- 3.54 Acceptable Solutions show step-by-step building methods (for example, what insulation is needed in the wall of a house to comply with the energy-efficiency requirements of the Building Code).

¹³⁹ Sections 29(2)(c), (d) and (e) and 29(5)(a) and (d).

¹⁴⁰ Ministry of Business, Innovation & Employment “Acceptable Solutions and Verification Methods – For New Zealand Building Code Clause – B1 Structure”, available at: <https://www.building.govt.nz/assets/Uploads/building-code-compliance/b-stability/b1-structure/asvm/b1-structure-1st-edition-amendment-20.pdf>.

¹⁴¹ Building Performance “Building Code Handbook”, available at: <https://www.building.govt.nz/building-code-compliance/building-code-and-handbooks/building-code-handbook/>.

- 3.55 Designs that comply with an Acceptable Solution must be accepted by a BCA as complying with the Building Code. In order to demonstrate compliance with an Acceptable Solution, information will need to be included with a consent application. For example, technical evidence that the product being used complies with the performance measures in a standard that has been incorporated into an Acceptable Solution. In practice, despite appearing to be a certain pathway, relying on an Acceptable Solution pathway can still involve a significant compliance burden, or delays. As described above, a BCA may require substantial evidence to be satisfied that a product meets a standard in the Acceptable Solution while residential building designs typically involves a mixture of Acceptable Solutions and Alternative Solutions.
- 3.56 For an example of an Acceptable Solution, see B1/AS1 – Structure.¹⁴²

Verification Methods

- 3.57 Verification Methods are tests or calculation methods that show a way to comply with the Building Code.
- 3.58 Verification Methods can include:
- 3.58.1 calculation methods: using recognised analytical methods and mathematical models;
 - 3.58.2 laboratory tests: using tests (sometimes to destruction) on prototype components and systems; or
 - 3.58.3 tests-in-situ: which may involve examination of plans and verification by test, where compliance with specified numbers, dimensions or locations is required (non-destructive tests, such as pipe pressure tests, are also included).
- 3.59 For an example of a Verification Method, see E2 External Moisture – Verification Method E2/VM2.¹⁴³

The role of standards in Acceptable Solutions and Verification Methods

- 3.60 Compliance with standards is not in itself a compliance pathway. However, MBIE’s Building System Performance branch can incorporate them into Acceptable Solutions and Verification Methods and they can also be part of an Alternative Solution pathway. A standard is a consensus-based technical document that sets a benchmark for how to do something that does not reference specific products.

¹⁴² Ministry of Business, Innovation & Employment “Acceptable Solutions and Verification Methods – For New Zealand Building Code Clause – B1 Structure”, available at: <https://www.building.govt.nz/assets/Uploads/building-code-compliance/b-stability/b1-structure/asvm/b1-structure-1st-edition-amendment-20.pdf>.

¹⁴³ Building Performance “E2 External Moisture – Verification Method E2/VM2”, available at: <https://www.building.govt.nz/assets/Uploads/building-code-compliance/e-moisture/e2-external-moisture/asvm/e2-external-moisture-vm2-2nd-edition-20.pdf>.

- 3.61 Standards NZ is responsible for managing the development of, and providing access to, standards in New Zealand. It charges for standards development and sells building standards. It also provides free access to building standards that MBIE has sponsored for public access using funds from the Building Levy.
- 3.62 The Building Act provides for standards to be incorporated by reference into Acceptable Solutions and Verification Methods in whole, or in part and with modifications, additions, or variations.¹⁴⁴
- 3.63 Standards are usually developed via a request from an industry or other stakeholder. Anyone within New Zealand can request the initiation of a standard update or development process if they can provide the necessary funding to Standards NZ.
- 3.64 The cost of accessing standards can range from \$5.50 to \$550 where these are not publicly available. MBIE has sponsored more than 120 New Zealand standards used in the Building Code system since 2019 to be publicly available.¹⁴⁵ These standards were selected because they were referenced in Acceptable Solutions and Verification Methods. MBIE's sponsorship involves paying for the standards to be freely available, essentially reimbursing Standards NZ for the fees they would otherwise have received from persons accessing the standards. MBIE might also separately fund the update or development of a standard, as determined by the operating protocol it released last year.¹⁴⁶
- 3.65 Standards NZ comprises a management team and a Standards Approval Board, the members of which are appointed by the relevant Minister.
- 3.66 The management team does not hold subject matter expertise and its role is to manage the various processes from a logistical perspective. The Board comprises members with specific expertise and is responsible for approving the membership of standards development committees and standards that are developed by these committees where the committees reach consensus.
- 3.67 Standards are developed through a consensus-based process involving a committee of industry stakeholders and widespread consultation with interested parties.

¹⁴⁴ Section 405 of the Building Act.

¹⁴⁵ The sponsoring related standards are listed on MBIE's website, Building Performance "Building-related standards" <https://www.standards.govt.nz/get-standards/sponsored-standards/building-related-standards>.

¹⁴⁶ Building Performance "Operating Protocol – Tier framework to support standards in the building code systems" <https://www.building.govt.nz/building-code-compliance/how-the-building-code-works/standards/operating-protocol-tier-framework-to-support-standards-in-the-building-code-system/>.

- 3.68 Standards NZ is charged with developing a committee for every standards process, and in the case of building standards this may include a member of staff from MBIE's Building System Performance branch. Standards NZ seeks to ensure the committee has a balanced representation of stakeholder interests and appropriate diversity of skills, knowledge and experience relevant to the standard being developed. This avoids individual members having excessive influence. Participation in committees is on a voluntary basis and in the case of building-related standards typically consists of up to 20 members, including nominees of a wide range of nominating organisations.¹⁴⁷ Potential members of committees are required to declare conflicts of interest.
- 3.69 When a building-related standard is published or updated, MBIE's Building Systems Performance branch reviews it to determine whether it is suitable to be incorporated in an Acceptable Solution or Verification Method.
- 3.70 This assessment considers a number of criteria that focus on alignment to the Building Code, importantly including that adherence to the standard will result in meeting the performance requirements of the part of the Building Code that the Acceptable Solution or Verification Method relates to.
- 3.71 The criteria used by MBIE apply to New Zealand and international standards, including those developed jointly by Standards NZ and other international standards bodies.
- 3.72 For building standards developed internationally, with no input from New Zealand, there is no opportunity to ensure that their content meets MBIE's criteria. However, for international standards to be referenced within Acceptable Solutions or Verification Methods MBIE considers that they should still comply with its criteria to the extent that this is practicable.¹⁴⁸
- 3.73 The primary trigger for MBIE referencing a standard is where a standard exists that meets the requirements and objectives it is seeking to achieve through the updating or creation of an Acceptable Solution or Verification Method. For example, this could be where standards have been updated to reflect new building practices or knowledge, or where MBIE identifies a need to create a new compliance pathway. It then considers from a technical perspective whether the standard is robust and workable. MBIE is then, required to consult and give notice that it intends to incorporate the standard by reference in the relevant Acceptable Solution or Verification Method.¹⁴⁹

¹⁴⁷ For example, the P3604 technical committee consisted of 19 nominating organisations and 21 individual nominees.

¹⁴⁸ Building Performance "Operating Protocol – Referencing standards in the Building Code System" <https://www.building.govt.nz/building-code-compliance/how-the-building-code-works/standards/operating-protocol-referencing-standards-in-the-building-code-system/#jumpto-criteria-to-support-decisions-on-referencing-a-standard-in-the-building-code-system>.

¹⁴⁹ Section 409 of the Building Act.

- 3.74 MBIE does not have a program of actively seeking international standards to reference in Acceptable Solutions and Verification Methods. However, its Building System Performance branch may look to incorporate international standards into Acceptable Solutions or Verification Methods if they become aware that such standards are being used to support a particular building practice outside of the existing Acceptable Solutions or Verification Methods. Similar to New Zealand standards, International standards can also be cited in Acceptable Solutions or Verification Methods with or without modifications.
- 3.75 Approximately 2,365 international standards are currently incorporated into the Building Code, Acceptable Solutions or Verification Methods. These include standards that are a primary reference (ie, those directly referenced in the instrument) and a secondary reference (those referenced in a standard that is a primary reference). Table 3.1 below sets out the standards that were primary references in the Building Code, Acceptable Solutions or Verification Methods as at December 2021.

Table 3.1 Primary standards referenced in Building Code documents

Origin	Number
Australian	55
British	60
European	6
German	2
International	36
Joint Australian/New Zealand	81
Joint British/New Zealand	6
New Zealand	88
United States	9

Source: Ministry of Business, Innovation & Employment.¹⁵⁰

- 3.76 The incorporation of these standards into the Building Code, Acceptable Solutions or Verification Methods has occurred over time. Further, as Mr Gardiner noted in his report, the raw numbers of international standards in this list does not reflect any weighting of the importance or scale of them in relation to residential building products.¹⁵¹

¹⁵⁰ Ministry of Business, Innovation & Employment “List of standards referenced in Building Code document” (December 2021), [].

¹⁵¹ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [11].

- 3.77 Where a person is relying on an Acceptable Solution or Verification Method they must make reference to the specific version of any referenced Standards, and it is only this version that can be used to demonstrate compliance with the Building Code.
- 3.78 If a standard is updated, the reference needs to be amended in the Acceptable Solution or Verification Method for the updated version to take legal effect through that Acceptable Solution or Verification Method.¹⁵² Under the Building Act this process also requires public consultation.¹⁵³
- 3.79 MBIE is informed by Standards NZ when building standards are revised. However, it usually knows that these updates are being made because respective work programmes are shared. It also receives and collects feedback from people in the industry about which standards should be revised and monitors this.
- 3.80 MBIE consults on proposals to update a selection of Acceptable Solutions or Verification Methods once a year and MBIE uses this process to check referenced Standards. If any referenced Standards within the annual selection of Acceptable Solutions or Verification Methods have been updated, MBIE will consider whether to reference the updated Standard. Interested parties provide feedback on both the need to reference particular standards and the need to reference updates to already-referenced Standards.
- 3.81 There is a lag before any updated standards can be applied, especially if MBIE has not identified the relevant Acceptable Solutions or Verification Methods as needing to go through the annual update process.
- 3.82 As discussed in paragraph 3.102 below and in Mr Gardiner’s report, standards can also be usefully referenced in Alternative Solutions when seeking to demonstrate compliance with the Building Code.¹⁵⁴

CodeMark

- 3.83 The Building Act also provides for voluntary product certification schemes as a way to show a building product or method meets the Building Code.¹⁵⁵

¹⁵² Section 406 of the Building Act.

¹⁵³ Section 409 of the Building Act.

¹⁵⁴ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [9] and [34]-[35].

¹⁵⁵ Sections 261 and 262 of the Building Act.

- 3.84 Under the Building Act a proprietor of a building method or product may apply to a product certification body for certification of that building method or product.¹⁵⁶ CodeMark is the only scheme in operation in New Zealand, although the Building Act allows for multiple product certification schemes. The Building Act also allows MBIE to specify certifications of building methods or products provided by persons outside New Zealand that are to be treated as product certifications.¹⁵⁷
- 3.85 Under CodeMark, a building product or method is evaluated to determine whether it complies with the Building Code. CodeMark certifies that a specific product will comply with the Building Code if used and installed in the specified way. In practice CodeMark has been used for a relatively small number of products since its introduction in 2008.
- 3.86 CodeMark is suitable for any building product but is considered particularly beneficial for suppliers of products that are innovative, new to the market or would have serious consequences if they failed.
- 3.87 Products or methods with a CodeMark product certificate must be accepted by BCAs as being compliant with the Building Code as long as the product is used in accordance with the use and limitations defined on the CodeMark certificate.
- 3.88 Anyone can apply for a CodeMark product certificate for a building product that is intended to be used in building work in New Zealand if they are willing to fund the application.
- 3.89 CodeMark product certificates can only be issued by an accredited product certification body. There are currently four bodies accredited for New Zealand with one based in New Zealand – BRANZ, and the remaining three in Australia (Bureau Veritas, GlobalMark Pty Ltd, and SAI Global).
- 3.90 JASANZ (the product certification accreditation body for CodeMark) is also the product certification accreditation body for CodeMark Australia. CodeMark Australia is run by the Australian Building Codes Board and assesses products against the Australian Building Code.
- 3.91 If the building product or system is found to meet CodeMark requirements, the product certification body will issue a CodeMark certificate. The certificate will state the intended use of the product and specify any installation instructions and conditions, including who should install the product.
- 3.92 The certified product must continue to be manufactured to the same standards and quality as those which were evaluated and certified. In order to keep the certificates valid, audits are carried out on an annual basis to monitor the products and their manufacturing process.¹⁵⁸

¹⁵⁶ Section 268(1) of the Building Act.

¹⁵⁷ Section 262(2) of the Building Act

¹⁵⁸ Section 270 of the Building Act.

- 3.93 When certification is granted, the product still goes through the building consent application process and the BCA will determine whether the proposed building work uses the CodeMark product according to the use and limitations of the certificate.
- 3.94 BRANZ has advised that the time to complete the certification process is dependent on the amount of work needed and availability of staff to validate the information provided by the applicant to demonstrate compliance.¹⁵⁹ However, according to Mr Gardiner, product certification processes can take anywhere between four and eight months.¹⁶⁰
- 3.95 Costs of obtaining a CodeMark certificate vary according to the product or system to which it applies, and the quality of supporting evidence provided for compliance. According to Mr Gardiner a minimum assessment fee is approximately NZD20,000. These costs do not include the costs of independent testing in order to get the material ready for presentation to BRANZ in support of an application for certification which Mr Gardiner in his report notes can be as high as \$40,000. In addition, Mr Gardiner notes that there are annual costs of a minimum of NZD\$3,000 to \$4,000 to cover ongoing audit costs as well as confirming there are no material changes to the Building Code system which impact on compliance of the product.¹⁶¹
- 3.96 BRANZ further advised that in its experience working with businesses seeking CodeMark certificates, the main challenge is obtaining the necessary information/evidence of conformity to demonstrate Building Code compliance.¹⁶²
- 3.97 There are currently around 150 CodeMark certificates.¹⁶³

Alternative Solutions for demonstrating compliance with the Building Code

- 3.98 Compliance with the performance requirements of the Building Code can also be demonstrated by way of an Alternative Solution where an Acceptable Solution or Verification Method cannot be used for the product, or where the proprietor of the product has not obtained a CodeMark. Construction of a building further typically involves a range of compliance pathways. There may be some of the design and products used in the design that have a CodeMark certificate, there may be some products which can use an Acceptable Solution, and there may be some products which are an Alternative Solution.

¹⁵⁹ [].

¹⁶⁰ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [69].

¹⁶¹ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [68].

¹⁶² [].

¹⁶³ Building Performance “Product certificate register” <https://www.building.govt.nz/building-code-compliance/product-assurance-and-certification-schemes/codemark/product-certificate-register/>.

- 3.99 Many building projects, particularly renovations or upgrades to existing buildings, and more complex projects need to use Alternative Solutions. For example, a building owner may want something that looks different or performs better, is more cost effective, or overcomes a specific site problem.
- 3.100 An Alternative Solution can include a product, system or construction method that differs completely or partially from those given in the Acceptable Solutions or Verification Methods.
- 3.101 An Alternative Solution will usually require specific design and input from suitably qualified people, such as architects or engineers.
- 3.102 To obtain a building consent from a BCA there must be sufficient evidence to show that the performance criteria of all relevant clauses in the Building Code will be met. This involves reliance on evidence such as BRANZ appraisals, expert reports, proof of in-service history, calculations, and proof of comparability to compliance achieved by Acceptable Solution or Verification Method.¹⁶⁴
- 3.103 A BRANZ appraisal is an in-depth and independent evaluation of a building product or system to assess whether it meets all relevant Building Code performance requirements and is a technical opinion of a building product or system’s fitness for purpose.
- 3.104 According to BRANZ they are commonly used by BCAs as the basis for acceptance of products for use in building and construction on the basis of BRANZ’s reputational competence and expertise.¹⁶⁵
- 3.105 BRANZ has been issuing BRANZ appraisals since 1974 and in this time has issued over 1,000 BRANZ appraisals.¹⁶⁶
- 3.106 According to BRANZ the time to complete the evaluation and related costs for an appraisal are dependent on the amount of work that is needed to validate the information provided by the applicant to demonstrate code compliance. On average BRANZ appraisals are both quicker and less costly than its CodeMark certifications.¹⁶⁷

¹⁶⁴ Guidance on how to provide sufficient evidence to show that the performance criteria of the relevant clauses in the Building Code will be met is available on MBIE’s website, Building Performance “Alternative solutions for compliance with the Building Code” <https://www.building.govt.nz/building-code-compliance/how-the-building-code-works/different-ways-to-comply/alternative-solutions>. Guidance on options for demonstrating that building products meet the requirements of the Building Code is available on MBIE’s website, Building Performance “Showing your products comply with the Building Code” <https://www.building.govt.nz/building-code-compliance/product-assurance-and-certification-schemes>.

¹⁶⁵ [].

¹⁶⁶ [].

¹⁶⁷ [].

Building system law reforms

- 3.107 Assessment of policy settings and the building systems legislative framework has been, in some form, ongoing since the Building Act 2004 reforms were fully implemented in around 2010.
- 3.108 The Law Commission reviewed the joint and several liability settings (including the operation of joint and several liability in the building and construction sector) in 2011. This was followed by MBIE’s Residential Construction Sector Market Study, which commenced in 2013.
- 3.109 The Law Commission’s Final Report (2014) and MBIE’s Market Study prompted a range of initiatives, leading to the Government launching consultation on a Building Legislative Reform Programme in April 2019.
- 3.110 In April 2019, MBIE released the Building System Legislative Reform Programme discussion paper for public consultation. The proposals in the discussion paper aimed to lift the quality of building work and deliver fairer outcomes to parties when things go wrong. MBIE received 470 submissions.
- 3.111 Cabinet policy decisions in September 2019 subsequently divided the Programme into three phases of work:
- 3.111.1 Phase One of the reforms would focus on new building laws that aim to support housing supply and affordability by supporting the use of new, innovative and efficient building methods.
 - 3.111.2 Phase Two would focus on occupational regulation to lift the performance of all building professionals and tradespeople and improve confidence and accountability in the sector.
 - 3.111.3 Phase Three would explore alternative options, including non-regulatory approaches, to address issues with risk, insurance and liability in the building system.¹⁶⁸
- 3.112 The Programme remains ongoing and, most recently, as noted below, in July 2022 MBIE announced publicly that it will be conducting a first-principles review of all elements of the building consent system.

Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021

- 3.113 As part of Phase One, on 8 May 2020, the Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Bill was introduced to Parliament. It received Royal Assent on 7 June 2021.

¹⁶⁸ Ministry of Business, Innovation & Employment “Cabinet paper – Lifting the Efficiency and Quality of the Building System: Overview” (11 October 2019), available at: <file:///C:/Users/karensn/Downloads/lifting-the-efficiency-and-quality-of-the-building-system-overview-paper-a-proactive-release.pdf>.

- 3.114 Key changes established by the Amendment Act include:
- 3.114.1 *Minimum information requirements – Part 4B of the Act*: mandating minimum information requirements for building products, to support designers and builders to choose the right products and use them in the way intended, and to support more efficient BCA decision making;
 - 3.114.2 *Modular components scheme – subpart 7A of Part 3 of the Act*: establishing a streamlined framework for consenting structures built offsite/prefabrication (Modular Component Manufacturer Scheme); and
 - 3.114.3 *Strengthening the CodeMark framework – subpart 7 of the Act*: strengthening the CodeMark framework to improve trust and confidence in the scheme – by introducing offences and giving MBIE the power of suspension/revocation where there is non-compliance. The changes also introduce registration of product certification bodies and product certificates.
- 3.115 We discuss each of these further below.
- 3.116 The regulations to support the implementation of these changes were made on 7 June 2022. The regulations relating to the Modular Component Manufacturer scheme and CodeMark will commence on 7 September 2022 and the minimum information requirements will commence on 11 December 2023.¹⁶⁹

Minimum information requirements – Part 4B of the Act

- 3.117 There is an increasing range and complexity of building products and methods available in New Zealand and this means BCAs frequently need to request additional information about products to verify compliance with the Building Code.
- 3.118 Provision of incomplete or inadequate information to a BCA can create costly delays for building owners.
- 3.119 In order to improve the efficiency of BCA decision making, the Building Act and accompanying regulations which will become operative in December 2023 specify the minimum information that must be publicly available about any building product.

¹⁶⁹ Building (Product Certification) Regulations 2022 (SL 2022/172), available at: <https://legislation.govt.nz/regulation/public/2022/0172/latest/LMS698274.html?src=qs>; Building (Modular Component Manufacturer Scheme) Regulations 2022 (SL 2022/171), available at: <https://legislation.govt.nz/regulation/public/2022/0171/latest/LMS697926.html?src=qs>; Building (Building Product Information Requirements) Regulations 2022 (SL 2022/170), available at: <https://legislation.govt.nz/regulation/public/2022/0170/latest/LMS697806.html?src=qs>; Building (Infringement Offences, Fees, and Forms) Amendment Regulations 2022 (SL 2022/173), available at: <https://legislation.govt.nz/regulation/public/2022/0173/latest/LMS697634.html?src=qs>; Building (Forms) Amendment Regulations 2022 (SL 2022/175), available at: <https://legislation.govt.nz/regulation/public/2022/0175/latest/LMS697655.html?src=qs>.

- 3.120 We understand that the regulations are intended to make it easier for designers, builders and homeowners to decide which products are right for the job, use them as intended, and make decisions about alternative products where there are product shortages.
- 3.121 We understand that they are also intended to help BCAs with more efficient consenting, as they will have the right information readily available to check that building products included in plans and specifications meet the applicable Building Code performance requirements.¹⁷⁰

Modular components scheme – subpart 7A of Part 3 of the Act

- 3.122 The Amendment Act also establishes a new voluntary manufacturer certification scheme for Modular Component Manufacturers (MCMs) enabling MCMs to be certified to produce modular building components within a defined scope of practice. Those components will be deemed to comply with the Building Code. MCMs will be able to apply for design and manufacture certification or manufacture certification only. Modular components under the scheme can range from prefabricated frames and panels to volumetric structures, to whole buildings.¹⁷¹
- 3.123 A certified manufacturer will also need to be registered by MBIE and comply with the requirements of that registration which include a fit and proper person test and adequate means test.
- 3.124 MBIE’s 2019 consultation process revealed that the existing legal framework was not fit-for-purpose for MCMs as it often resulted in consenting/approval duplication.
- 3.125 We understand that the new scheme is intended to give BCAs confidence that any construction by a certified MCM is compliant with the Building Code. It means that BCAs will be able to focus their assessment and inspections on issues not covered by the certification such as site works, foundations, plumbing, and connections to services.
- 3.126 Our understanding is that the new MCM regime will enable innovation in building methods while also offering assurance of quality construction in a controlled environment for those looking to utilise modular components in their residential building.

¹⁷⁰ Ministry of Business, Innovation & Employment “New laws will support housing supply and improve building product information” (8 June 2022), <https://www.mbie.govt.nz/about/news/new-laws-will-support-housing-supply-and-improve-building-product-information/>.

¹⁷¹ Regulations 8 to 10.

Strengthening the CodeMark framework – subpart 7 of the Act

- 3.127 As described above, CodeMark is a voluntary building product certification scheme. BCAs must accept that building products with a CodeMark certificate comply with the Building Code if they are installed correctly (ie, according to the use and limitations of the certificate).¹⁷²
- 3.128 The Amendment Act and accompanying regulations improve MBIE’s ability to oversee CodeMark certification by:
- 3.128.1 introducing registration requirements for product certification bodies and product certificates which include a fit and proper person test;
 - 3.128.2 giving MBIE the power to audit, and if necessary suspend or revoke the status of non-compliant Certificate Holders or Product Certification Bodies; and
 - 3.128.3 creating new offences for false claims about CodeMark certification.

Phase two and three of the reform program

- 3.129 The second phase of the reform program will focus on occupational regulation, including the Licensed Building Practitioners (LBP) scheme, the plumbers, gasfitters, and drainlayers scheme and the regulation of engineers.¹⁷³
- 3.129.1 A strengthened LBP scheme will aim to ensure that builders have the right skills, knowledge, experience and behaviours to do quality building work, and increase accountability when LBPs do not meet the standards expected of them.
 - 3.129.2 A statutory review of the Plumbers, Gasfitters, and Drainlayers Act 2006 was completed in March 2021. The review found that the Act is generally working well, and made 19 recommendations to improve how the regulatory regime operates.
 - 3.129.3 Strengthening the regulation of engineers will aim to ensure that engineers provide engineering services with reasonable care and skill, operate within their areas and level of competence, are held to account for substandard work or poor conduct and people have confidence in the engineering profession.
- 3.130 As set out below, Phase Three of the program has recently been updated. MBIE now intends that the third phase of reforms will aim to ensure consumer protection measures are adequately protecting homeowners.

¹⁷² All building work in New Zealand must comply with the Building Code, even if it doesn’t require a building consent.

¹⁷³ Building Performance “Background” <https://www.building.govt.nz/getting-started/building-law-reforms/background-to-the-building-law-reforms/#jumpto-phase-two>.

- 3.131 MBIE will consider whether changes need to be made to enable homeowners to make informed decisions, improve industry accountability and reduce the risk that homeowners are left exposed when things go wrong.

Ministry of Business, Innovation and Employment's 2022 review of the building consent system

- 3.132 On 21 July 2022 MBIE commenced consultation on an issues discussion document *Review of the Building Consent System*.
- 3.133 The aim of the review of the building consent system is to modernise the system to provide assurance to building owners and users that building work will be done right the first time, thereby ensuring that buildings are well-made, healthy, durable and safe.
- 3.134 The review of the building consent system is a first-principles review of all elements of the building consent system, starting from the point at which buildings are procured and designed. These elements are identified by MBIE as:
- 3.134.1 institutions – how the regulatory regime is structured;
 - 3.134.2 practice – how regulation is implemented; and
 - 3.134.3 system management – how the regulatory system is managed.
- 3.135 MBIE is consulting on the role of government in the building consent system, the desirable outcomes from the system and an initial assessment of the key issues that are barriers to achieving those outcomes. The discussion document identifies the following systemic and overlapping issues in the building consent system:
- 3.135.1 **Roles, responsibilities and accountability** – roles and responsibilities across the system are not always well understood, accepted, applied or consistently enforced. There is sometimes an over-reliance on BCAs to provide assurance of compliance with the Building Code.
 - 3.135.2 **Capability and capacity** – BCAs face capacity and capability constraints in dealing with an increased volume and complexity of building work. Sector workforce capacity and capability constraints can also undermine the performance of the system.
 - 3.135.3 **System agility** – all consents go through the same basic process, which is not always responsive to the level of risk, complexity of the building work, or type of project. The current system does not always deal well with new or innovative practices or products, or the design-and-build approach. Nor is it sufficiently responsive to the building needs and aspirations of Māori.

- 3.135.4 **Performance monitoring and system oversight** – the performance of the system is insufficiently monitored and information flows are poor. MBIE is not yet the strong central regulator that was contemplated in the original system design.
- 3.135.5 **Fragmented implementation** – the processing of building consent applications is devolved to TAs (who are BCAs), which has led to variability and unpredictability in the consent process and its outcomes. This fragmentation adds to the overall costs of the system due to variable processes, tools and functions being implemented across BCAs, and difficulties maintaining a professional workforce. Projects requiring both building and resource consents may also face inefficiencies and additional costs.
- 3.136 Of these five issues identified, there appear to be two primary areas of intersection with this study:
- 3.136.1 **System agility**, where MBIE acknowledges that the “current system does not deal well with new or innovative practices or products”.
- 3.136.2 **Fragmented implementation**, where MBIE notes that “variability and unpredictability for people navigating the consent process” adds to the “overall costs of the system through duplication of processes, tools and functions across building consent authorities”.

Liability and insurance

- 3.137 New Zealand has a joint and several liability rule that applies to both residential and commercial building construction. Unlike many other countries, New Zealand does not have a public or private building insurance scheme.
- 3.138 Under the liability rule, BCAs that provide a consent are jointly and severally liable with other parties, such as building product manufacturers in the case of defective products, builders, designers, architects and subcontractors, in the event that they were found to be negligent in carrying out their role.
- 3.139 Because liability is joint and several, if one or more of the parties found to have been negligent is not able to contribute their share of the costs, the other parties found to have been negligent have to contribute to the defaulting parties’ shares as well as bear their own share.
- 3.140 Since BCAs are often the “last person standing” because they cannot become insolvent or go out of business, they have tended to carry a significant share of the costs of settlements in the past.

- 3.141 MBIE commissioned an analysis of court cases involving building defect disputes between 2008 and 2018 to get a picture of the financial risks faced by BCAs during that period. The research found that BCAs paid out an estimated \$1 billion for the period 2008-2018. This includes court-ordered and out of court settlements. About \$332 million of the total amount paid covered the costs of defects incurred by other parties who were unavailable to pay their share of the claims (eg, insolvent).¹⁷⁴
- 3.142 BCAs generally manage their risks by requiring detailed plans and specifications, (including the specification of the systems and products that will be used in the building) for building consent applications and carrying out multiple and detailed inspections.¹⁷⁵
- 3.143 MBIE’s discussion document referred to in paragraph 3.132 above, notes that the joint and several liability rule is out of scope for the review of the building consent system. Alongside the discussion document, MBIE has released a policy position statement *Risk, Liability and Insurance in the Building Sector* which sets out the Government’s position on risk, liability and insurance matters and the case for a whole-of-system approach to risk and liability in the building and construction sector.
- 3.144 The policy position statement expressly acknowledges that the joint and several liability rule, in the building sector, means that some parties responsible for building work might bear more of the cost if others responsible are absent.
- 3.145 The policy position statement notes that the Law Commission has twice considered whether the joint and several liability rule remains appropriate in the New Zealand context and that its last review, completed in 2014, recommended that the joint and several liability rule remain.
- 3.146 MBIE notes that the Law Commission reviewed the implications of the liability rules for economic efficiency and found no sound evidence that proportionate liability can better incentivise efficient behaviour or outcomes. MBIE goes on to identify that:
- 3.146.1 “a range of other factors combine to cause risk aversion” and states that the Government is working to address these via the ongoing Building Act reform;

¹⁷⁴ Ministry of Business, Innovation & Employment “Building legislative reform – Discussion paper” (April 2019) at 130, available at: <https://www.mbie.govt.nz/dmsdocument/5009-building-system-legislative-reform-discussion-paper>; Preston Davies & Linda Tran “Liability outcomes in the building sector – glimpses from available data” (13 November 2018), available at: <https://www.mbie.govt.nz/dmsdocument/4960-liability-outcomes-in-building-sector>.

¹⁷⁵ For example, Wellington City Council “Supporting documents for a building consent application” <https://wellington.govt.nz/property-rates-and-building/building-and-resource-consents/building-consents/applying-for-a-building-consent/supporting-documents-for-a-building-consent-application>.

- 3.146.2 there is “little evidence to suggest the liability regime alone drives building consent authority behaviour”; and
- 3.146.3 joint and several liability provides the best assurance that the homeowner will be compensated.
- 3.147 The policy position statement also acknowledges that a viable insurance market for building defects in New Zealand has not developed and that this raises the policy question as to the Government’s role (if any) in developing and supporting a warranty insurance scheme.
- 3.148 Ultimately, MBIE concludes that there is currently only a “weak case” for establishing a publicly provided insurance scheme for building defects. However, the policy position statement notes it is possible that this situation could change in the future if the policy problem becomes clearer. MBIE’s discussion document further notes that an evaluation of the consumer protection measures under the Building Act is underway, and may contribute to establishing a case for a publicly provided insurance scheme.

Building for Climate Change

- 3.149 The BfCC programme is a long-term work programme run by MBIE to reduce emissions from constructing and operating buildings, and to make sure our buildings are prepared for the future effects of climate change.
- 3.150 Further details on this are set out in Chapter 8.

Extent to which the regulatory and standards systems may be impacting competition

- 3.151 This section considers the extent to which the regulatory and standards systems may be impacting on competition for key building supplies.
- 3.152 Regulations designed to improve the operation of the market can also impede its operation in other ways. For example, standards for services and building materials can enable competition that meets the needs of buyers, particularly where it would otherwise be difficult for buyers to distinguish between the quality of materials and services supplied. Appropriate quality assurance regulations may also result in lower costs of occupancy and maintenance over the lives of houses.
- 3.153 However, there is also an inherent policy tension between regulations designed to ensure building products are quality assured and the objective of making it easy for participants to supply new products so as to promote competition.
- 3.154 Regulations promoting new entry could compromise building quality if low-quality products enter the market to the detriment of New Zealand’s housing stock. Conversely, if standards are unduly restrictive, efficient market entry by new competitive products may be deterred.

- 3.155 We have relied on information gathered in a range of ways and from a range of sources to reach our preliminary findings on the extent to which the regulatory and standards systems may be acting as a barrier to entry and expansion for key building supplies.
- 3.156 The sources of information we relied on included:
- 3.156.1 A desktop review of relevant regulatory material and relevant regulations.
 - 3.156.2 Submissions we received on our preliminary issues paper.
 - 3.156.3 Submissions on possible regulatory barriers to the entry or expansion of key building supplies.
 - 3.156.4 Meetings with and information provided by bodies, including MBIE’s Building System Performance branch, Standards NZ, BCAs and BRANZ.
 - 3.156.5 Our regulatory and standards systems survey, in which we sought views on the impact of the different elements of the systems on competition in residential building supplies markets and whether any of these could be changed to enhance competition. The survey enabled us to seek views from industry participants operating across New Zealand and to identify common themes.
 - 3.156.6 The report from Mr Gardiner of Building Confidence Ltd.¹⁷⁶
- 3.157 We have summarised the submissions, survey responses and Mr Gardiner’s report, so that interested persons can readily access key themes, and to assist them when they are making submissions for us to consider when finalising our report.¹⁷⁷

Potential barriers to entry and expansion – submissions on preliminary issues paper

- 3.158 The majority of submitters on our preliminary issues paper identified a number of impediments to the entry and expansion of new building supplies.

¹⁷⁶ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022).

¹⁷⁷ We have used our own words in the summaries, partly because submitters sometimes made the same point, but described the issue slightly differently.

3.159 Themes included:¹⁷⁸

- 3.159.1 BCAs have a familiarity bias towards well-known or trusted products because this simplifies their evaluation and reduces liability risk;¹⁷⁹
- 3.159.2 Specifiers (architects, engineers, designers) and builders have familiarity bias (ie, they rely on products they know and trust). This is exacerbated by concerns that new products may not be accepted by BCAs and, in the case of builders, that they may not be able to claim against product warranties when products fail and suppliers have exited;¹⁸⁰
- 3.159.3 There is complexity and ambiguity in the Building Code, exacerbated by the fact that there are 67 BCAs each making individual decisions on a product's ability to comply with the Building Code, which together with their familiarity bias incentivises designers to specify well-known or trusted products in order to facilitate BCA approvals;¹⁸¹
- 3.159.4 Builders and architects focusing on bespoke housing and designs along with a lack of flexibility towards system rather than brand solutions;¹⁸²

¹⁷⁸ We do not include Building Confidence Ltd in this summary, as its views are included in the summary of Mr Gardiner's report.

¹⁷⁹ Fletcher Building "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 2, 5, 13, 14, 39 and 40; H W Richardson Group "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [12]; Property Council of New Zealand, "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 4. This is also consistent with what we heard from hui participants, Commerce Commission "He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes" (4 August 2022) at 4 and 6 .

¹⁸⁰ Mitre 10 "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [12], [19], [30], [49], [56] and [56a]; Registered Master Builders Association "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [30], [55] and [56a]; Fletcher Building "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 5, 39 and 40; Kiwi Infrastructure Limited "Submission on residential building supplies market study preliminary issues paper" (4 February 2022), at [33] and [55]; Bunnings "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [56a] and [57].

¹⁸¹ Registered Master Builders Association "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 4 and [16] and [54]; Fletcher Building "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 14, 13, 17, 23; H W Richardson Group "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [12]; NZ Metal Roofing Manufacturers Inc "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [49]. This is also consistent with what we heard from hui participants about BCA behaving differently in different regions, Commerce Commission "He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes" (4 August 2022) at 5 .

¹⁸² Fletcher Building "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 2, 13, 17 and 23.

- 3.159.5 There may be a perceived exaggeration of the “unique” characteristics of building in New Zealand in that New Zealand is not the only country with unique conditions, and greater international alignment on standards should be considered;¹⁸³
- 3.159.6 The time and cost involved in getting the required testing, compliance and approvals (as well as market recognition for products, where architect, builder and BCA brand specification is prevalent) means there is often a big risk for small reward for those suppliers looking to enter the market;¹⁸⁴
- 3.159.7 Incumbent suppliers have advantages in:
- 3.159.7.1 navigating the building system in terms of expertise;
 - 3.159.7.2 likely having a greater ability to express their concerns and opinions to regulatory bodies than new entrants;
 - 3.159.7.3 their products being more likely to be well-known and face less scrutiny from BCAs; and
 - 3.159.7.4 facing a lower regulatory burden when entering the market, or having been able to absorb the cost of regulatory compliance as regulatory standards were added;¹⁸⁵
- 3.159.8 There are standards that are unique to New Zealand, for example, the standard applying to the treatment of timber in New Zealand which means that imported structural timber used in other countries must be treated before being used in New Zealand, effectively precluding economic importing of structural timber from other obvious source countries;¹⁸⁶

¹⁸³ Property Council of New Zealand “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 4; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [49]; Bunnings “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [11].

¹⁸⁴ Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [49]; New Zealand Building Industry Federation “Cross-submission on residential building supplies market study preliminary issues paper” (16 March 2022) at 2; Wood Processors & Manufacturers Association “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [54]; Bunnings “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [30], [33] and [49].

¹⁸⁵ Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [51]; Kiwi Infrastructure Limited “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [51].

¹⁸⁶ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 14, 27 and 39; Frame and Truss Manufacturers Association “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [28]-[60]; Wood Processors & Manufacturers Association “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [54].

- 3.159.9 The standards which have been funded by MBIE legitimise historical methods of construction while the development of standards for alternative residential building systems, such as light steel framing, are required to be funded entirely by the relevant industry players;¹⁸⁷ and
- 3.159.10 The BRANZ CodeMark process could be improved with one submitter noting that this can be both time-consuming and expensive taking up to 12 months of testing with ongoing re-accreditation and audit fees and then extensive scrutiny and questioning by BCAs.¹⁸⁸

Potential barriers to entry and expansion – submissions on regulatory barriers

- 3.160 The submissions we received regarding regulatory barriers to the entry or expansion of key building supplies identified substantially similar issues to those in the submissions on our preliminary issues paper.¹⁸⁹
- 3.161 On the whole, the submissions:
- 3.161.1 tended to raise issues at a system level rather than pointing to particular issues in the specifics of the regulatory and standards systems for specific products;¹⁹⁰ and
- 3.161.2 all suggested that there was room for improvement in the regulatory and standards systems.
- 3.162 Relevant themes identified across the submissions include:
- 3.162.1 building product standard setting is influenced by incumbent interests;
- 3.162.2 the building consent system, and BCA decision making, is highly fragmented;
- 3.162.3 product certification and appraisals are a resource intensive undertaking, particularly for new entrants;
- 3.162.4 brand specification in consent plans generates product substitution difficulties; and

¹⁸⁷ National Association of Steel Framed Housing “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [9], [11] and [33].

¹⁸⁸ Bunnings “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [30]; H W Richardson Group “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [49]; Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 39.

¹⁸⁹ Monopoly Watch NZ “Submission on regulatory and standards systems” (18 May 2022); Castalia on behalf of Affordable Building Coalition “Submission on regulatory and standards systems” (18 May 2022); Fletcher Building “Submission on regulatory and standards systems” (13 May 2022); [].

¹⁹⁰ However, specific products are mentioned including timber cladding, plasterboard, structural timber, concrete, building wrap, sealing tape, colour coat and colour steel, and reinforcing steel.

- 3.162.5 the allocation of risk between builders, designers, manufacturers and BCAs, is not proportionate, and it encourages conservative decision making by BCAs and a preference for ‘tried and tested’ building products and methods.

Standards

- 3.163 In general, the submissions point to opportunities to more readily recognise international product standards, enabling reduced reliance on the products of domestic incumbents.¹⁹¹

Inconsistent approaches by Building Consent Authorities

- 3.164 Submitters also argued in favour of more consistent interpretation and application of the Building Code by BCAs across the country. Two submitters suggested a substantial consolidation of the BCAs to reduce the scope for difference in the treatment of products and building techniques by BCAs.¹⁹²

Product certification

- 3.165 The submissions generally pointed to the cost and burden of gaining product accreditation, and its flow-on consequences for competition in the markets.¹⁹³
- 3.166 Fletcher Building Ltd (Fletcher Building) suggested changes to the CodeMark regime, including consideration of an expedited approvals process for ‘low-risk’ products.¹⁹⁴
- 3.167 Monopoly Watch went further than the other submitters and suggested that BRANZ should be disassembled by statute and a new agency set up with new targets on productivity and cost of assembly, with the cost of construction forming a key part of its mandate.¹⁹⁵

¹⁹¹ Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [4.1]; [].

¹⁹² Monopoly Watch NZ “Submission on regulatory and standards systems” (18 May 2022) at 5; Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [6.2].

¹⁹³ Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [3.1]; [].

¹⁹⁴ Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [3.2].

¹⁹⁵ Monopoly Watch NZ “Submission on regulatory and standards systems” (18 May 2022) at 3 and 5.

Brand specification

- 3.168 All submitters acknowledged that the difficulty associated with branded product substitution, after building consent has been granted, poses difficulties for competition in the markets.¹⁹⁶ The current issues with plasterboard supply are given as an example.¹⁹⁷
- 3.169 Fletcher Building acknowledges the issue has been raised and notes that it does not object to the notion of removing unnecessary impediments to substitution.¹⁹⁸
- 3.170 For example, Castalia on behalf of Affordable Business Coalition (ABC) stated:¹⁹⁹
- Changing to alternative bracing solutions or substitute products after the consent has been issued is time-consuming, costly and subject to BCA discretion. BCA’s risk of liability for building defects also disincentivises use of alternative products.
- ...
- GIB brand plasterboard is widely used as a system to meet wall bracing requirements under NZS 3604:2011. New Zealand is unusual in permitting plasterboard as a bracing element. This creates network effects, where Fletcher/Winstone effectively control an entire building production network.

Liability of Building Consent Authorities

- 3.171 Fletcher Building and ABC made points about the consequences of the liability rule, noting that MBIE consulted on the issue in 2019, and has not appeared to progress the matter further.
- 3.172 Fletcher Building acknowledges that the current regime results in BCAs attracting a large share of the practical risk of building and product failure. Fletcher Building goes on to state that “the upshot is a very conservative approach to consenting and approving the use of new products and solutions”.²⁰⁰
- 3.173 Fletcher Building suggested that a “Guarantee and Insurance Product” may help to address the liability issues affecting the decision making in these markets (acknowledging that MBIE already considered this in 2019).²⁰¹

¹⁹⁶

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¹⁹⁷ This is consistent with what we heard from hui participants, Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 6.

¹⁹⁸ Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [7.1].

¹⁹⁹ Castalia on behalf of Affordable Building Coalition “Submission on regulatory and standards systems” (18 May 2022) at 7.

²⁰⁰ Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [5.1].

²⁰¹ Fletcher Building “Submission on regulatory and standards systems” (13 May 2022) at [5.3].

- 3.174 ABC's submission argues that liability of BCAs should be capped at a level considered appropriate by the Law Commission in 2014, being \$300,000.²⁰²
- 3.175 The themes of the submissions received on our preliminary issues paper and in the submissions we received on the regulatory and standards systems were generally aligned with the themes of responses to our survey and the key issues identified by Mr Gardiner (both of which we discuss in the sections that follow).

Potential barriers to entry and expansion – regulatory and standards systems survey

- 3.176 We received 136 responses to our survey. However, not all respondents answered all questions with the number of responses to our key questions ranging between 30 and 60.
- 3.177 The respondents included:
- 3.177.1 builders who source building supplies (including group home builders);
 - 3.177.2 architects who specify building supplies at the design stage;
 - 3.177.3 BCAs;
 - 3.177.4 merchants;
 - 3.177.5 wholesalers;
 - 3.177.6 domestic manufacturers;
 - 3.177.7 importers; and
 - 3.177.8 other interested parties.
- 3.178 The survey respondents identified impediments to the entry and expansion of new building supplies similar to those raised by submitters. Most respondents to our survey considered that the current regulatory and standards systems had a negative impact on competition in key building supplies by limiting the products that were available.
- 3.179 Some of the more common reasons given were that:
- 3.179.1 the performance requirements in the Building Code are too complex, restrictive or lacking in clarity, leading to the specification of brands or incumbents' products;
 - 3.179.2 the BCAs do not recognise alternative products that are being used overseas in similar environmental conditions, or overseas test results and standards;

²⁰² Castalia on behalf of Affordable Building Coalition "Submission on regulatory and standards systems" (18 May 2022) at 8.

- 3.179.3 the BCAs require product specification and do not allow product substitution or make this difficult, forcing certain products on builders;
 - 3.179.4 there is an absence of Acceptable Solutions for some common products or guidance on what to do if a solution does not meet specified requirements – in reality Acceptable Solutions are not used that often for compliance in residential construction, particularly more complex housing;
 - 3.179.5 Alternative Solutions are too complicated, time-consuming, or expensive;
 - 3.179.6 many of the standards are out of date and are biased in favour of incumbent suppliers and against imported products;
 - 3.179.7 some incumbents publish literature which casts doubt on alternative products and they have excessive influence over the standards setting processes;
 - 3.179.8 it is too hard to prove compliance to the satisfaction of the BCAs in the case of new products – the BCAs favour known brand products and systems and products that have been BRANZ appraised, apply their individual interpretations inconsistently, and are risk averse due to potential liability;
 - 3.179.9 the CodeMark/product certification scheme and standard setting is too costly, time-consuming and limited, and BRANZ’s prior work is not freely available but must be paid for; and
 - 3.179.10 some Code changes make little sense and result in more expensive products being needed where there are only a few suppliers.
- 3.180 A number of respondents also raised concerns relating to knowledge about the regulatory and standards systems and the guidance that is currently available:
- 3.180.1 some designers simply specify products or design solutions based on what they have always done and do not have the knowledge or competence to specify other products or design solutions;
 - 3.180.2 there is a general lack of guidance and knowledge about the Building Code and baseline measurements for compliance, with MBIE as the regulator only carrying out the policy component of its role and viewed as standing on the side-lines;
 - 3.180.3 many BCA officials lack an appropriate level of practical building knowledge, including about alternative products;²⁰³ and

²⁰³ Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 4 and 6.

3.180.4 importers of building products lack knowledge of the Building Code and expect BCAs to give them the answers.²⁰⁴

3.181 Further information on our regulatory and standards systems survey is contained in Attachment G.

Observations from our case studies

3.182 Attachments B, C and D describe our observations in the markets for plasterboard, structural timber and concrete.

3.183 Each attachment outlines in detail the Building Code clauses and cited standards applicable to the use of these three case study products in a residential building.

3.184 In the section below, we draw observations across these case study products.

3.185 We do not comment on whether the standards applicable to these products are appropriate or necessary from a technical perspective. We recognise that the compliance pathways in place are designed to ensure that residential buildings in New Zealand are safe, healthy and durable. These are plainly important policy objectives of the Building Act and our observations are not intended to detract from that.

3.186 Our observations relate to how the standards impact on competition and, in particular, how easy or difficult it may be for new competitors to enter and expand in the relevant markets.

3.187 We make three observations, relevant specifically to barriers to entry and expansion for competing products:

3.187.1 As described above, the Building Code is brand indifferent and performance based. Despite this, where a building product fits within a clear compliance pathway (ie, within an Acceptable Solution or Verification Method and cited Standard), those products appear to be used more readily, compared to competing products that do not fit within a similarly clear compliance pathway. Competing products face a longer path to establishing acceptance either through seeking CodeMark certification (at an individual cost) or as an Alternative Solution. The time and cost this entails can deter suppliers and can negatively impact competition between suppliers.

²⁰⁴ This point was supported by some BCAs in our meetings who indicated that consent applications were sometimes evidentially deficient.

- 3.187.2 Where an Acceptable Solution cites a Standard, and that Standard has features that are unique to New Zealand and/or contains highly prescriptive input requirements, this can make it more difficult for new products from overseas to enter and expand in the market, and prescription can limit opportunity for innovation. This can be contrasted with a Standard that prescribes product performance requirements and/or is aligned to at least some international standards. Such standards more easily facilitate import competition and innovation, and better promote competition between suppliers.
- 3.187.3 Where products are specified by brand due to the compliance pathway (or the way it is applied in practice) this negatively impacts competition in the markets for supply of the relevant building product. This is because once the product is specified by brand in a consent application it significantly limits the scope for the product to be substituted at a later time, after a building consent has been granted.
- 3.187.4 In the particular case of plasterboard, for example, the compliance pathway and practice, appear to result in mutually-reinforcing specifying, purchasing, and consenting behaviours that strongly favour products that are already established in the market. This is particularly the case where the product is favoured by builders. The complex interaction of the regulatory and standards system, the way it is applied in practice, and the behaviours it incentivises, can make it difficult for competing products to enter and expand in the market.²⁰⁵

Compliance pathways and ease of use

- 3.188 It is plainly of paramount importance that the products used in residential buildings are safe and durable. Acceptable Solutions and Verification Methods, which cite standards, create clear compliance pathways for the types of building supplies MBIE has determined perform according to the safety and durability requirements of the Building Code.
- 3.189 While the Building Code does not preclude new or innovative products where these products exhibit the necessary performance characteristics, the relative ease of use for existing products, with a clear compliance pathway, appears to result in established 'tried and tested' products being favoured, and new or innovative products being used less readily.
- 3.190 Some key building supplies are manufactured domestically to meet the prescriptive requirements of a cited Standard. Based on our case study analysis, this appears to be the case for structural timber.

²⁰⁵ We acknowledge the steps taken by MBIE, and the Taskforce it has established, to offer guidance around the different plasterboard products available in the New Zealand market.

- 3.191 *NZS 3640:2003 Chemical preservation of round and sawn timber* is a New Zealand standard that specifies the chemical treatments which must be applied to timber products to ensure the products will, depending on species of timber and intended use, perform with adequate durability.
- 3.192 It is not imperative that all structural timber used in residential buildings is treated according to *NZS 3640:2003*. However, we observe that products which are not:
- 3.192.1 manufactured in accordance with the precise chemical treatment specified in this Standard; or
 - 3.192.2 manufactured out of the species of timber contemplated by the standards, are not as readily specified in residential building designs.
- 3.193 Where a structural timber product has not been manufactured according to the requirements prescribed by *NZS 3640:2003*, the compliance pathway for that product will involve its assessment as an Alternative Solution. This pathway is relatively more burdensome, due to the assessment and information requirements of BCAs, to order to be persuaded that the product is safe and durable.
- 3.194 In this way a compliance pathway can make it relatively more difficult for suppliers of new products to enter and expand in the market. In the particular case of structural timber, this may be occurring where importers seek to supply a structural timber product manufactured from foreign species of timber, or chemically treated according to international standards.
- 3.195 In light of this, we observe that compliance pathways that are structured around what already exists in a market, particularly to the extent that the compliance pathway relies on a New Zealand specific standard, appear to have an impact on competition and innovation.

Level of prescription

- 3.196 The relevant regulatory requirements for cement in *NZS 3122:2009* specify performance attributes and are aligned to the standards in other countries such as Japan and Thailand.
- 3.197 Ready-mix concrete is generally viewed as a commodity and is generally not specified by brand (unless due to customer choice). Switching and substitution are easy due to the performance attributes specified in the standards.
- 3.198 The standards are also not prescriptive (for example, as to formulation or inputs). This allows suppliers to innovate with the formulation of their products, for example, by substituting cementitious materials to achieve reductions in carbon emissions.
- 3.199 What matters is whether the performance measures are met. There is a clear compliance pathway through an Acceptable Solution that facilitates import competition and innovation.

- 3.200 In contrast, the chemical treatment and timber species requirements of *NZS 3640:2003* are highly prescriptive. The New Zealand specific standard does not operate by setting performance thresholds for durability, rather it outlines the input requirements and processes that must be followed in order to ensure adequate durability of the product is achieved.
- 3.201 While we acknowledge the building safety and durability considerations at play, our preliminary observation is that where a standard operates to set performance-based thresholds, as opposed to incorporating standards that are unique to New Zealand or highly prescriptive of inputs, this has a lower impact on competition in the markets for the supply of the relevant products.

Performance requirements necessitate brand specification

- 3.202 Where specification by brand is the practical outcome of the relevant compliance pathway, the regulatory and standards systems have a more pronounced impact on competition in the markets for the relevant products.
- 3.203 Reasons for specification by brand can include:
- 3.203.1 compatibility of specified products (for example, electrical wiring must be compatible with the type of insulation);
 - 3.203.2 different products have different performance characteristics (for example, structural plasterboard).
- 3.204 For plasterboard, the relevant Acceptable Solution anticipates wall linings providing structural bracing. This is uncommon in other markets.
- 3.205 There are alternative design methods, but these do not appear to be used often.
- 3.206 Winstone Wallboards has built a successful and well-regarded product and service offering. It is trusted for Code compliance, and well established for specification. It is easily consented. Purchasers like the delivery-to-site service and product support.
- 3.207 Plasterboard is commonly specified by brand. It is not clear whether designers do this by deliberate choice or to manage their risk, or whether BCAs require brand specification where the product is to be used for a specialist application (such as for structural bracing, sound-reduction or fire resistance) or in general as a matter of interpretation of the Building Act test for consent.

- 3.208 However, once the product is specified by brand in a consent application it significantly limits the scope for the product to be substituted at a later time, after a building consent has been granted. Depending on the context, a minor variation of the building consent may be possible, and MBIE has issued both generalised guidance on product substitutions and, more recently in response to plasterboard shortages, product-specific guidance on product substitution of plasterboard.²⁰⁶
- 3.209 Precise product specification by brand does not appear to occur for concrete or structural timber. As a result, the compliance pathways for concrete and structural timber do not appear to impact the markets for supply in the same way that, for example, the plasterboard compliance pathway does.
- 3.209.1 In the case of plasterboard, we observe that the manner in which the compliance pathway has come to be applied in practice appears to be one of several elements that contribute to mutually-reinforcing specifying, purchasing, and consenting behaviours that strongly favour the product that is already well established in the market.
- 3.209.2 This mutually-reinforcing interaction of the regulatory and standards systems, the way they are applied in practice, and the behaviours they incentivise, appear to be making it difficult for competing products to enter and expand in the market.
- 3.209.3 MBIE's recent measures directed at plasterboard substitution, through raising awareness about alternative building methods through peak architectural bodies, raising awareness about product alternatives, issuing guidance to BCAs on accepting plasterboard substitutions as minor variations, and looking at ways to potentially ease the assurance pathways for overseas-certified systems to be imported, are measures that better facilitate competition from plasterboard alternatives. A Government taskforce has also now been appointed to address plasterboard shortages, with a remit that includes looking at possible legislative and/or regulatory change, and possible changes to distribution.

Summary of observations

- 3.210 Depending on the context, the combination of the regulatory and standards systems, along with how they are applied in practice and the behaviours they incentivise, can make it difficult for new or innovative products to enter and expand in the relevant market.

²⁰⁶ Ministry of Business, Innovation & Employment "Product substitution Plasterboard Guidance", available at <https://www.building.govt.nz/assets/Uploads/building-code-compliance/certifications-programmes/product-assurance/product-substitution-plasterboard-guidance.pdf>.

- 3.211 Generally speaking, where a product has a clear compliance pathway it appears that the product is likely to be more readily specified and used in residential building designs. Well-established products are much more likely to have clear compliance pathways through, or by analogy with, the standards referenced in Acceptable Solutions and Verification Methods.
- 3.212 The opposite is also true, in that where a product's compliance pathway is relatively unclear it is less likely to be used in a residential building design and more likely to be a challenger to well-established products. These challenger products face a longer path to establishing acceptance either through seeking CodeMark certification (at an individual cost) or as an Alternative Solution. The time and cost this entails can deter suppliers and can negatively impact competition between competing suppliers.
- 3.213 We acknowledge that there may well be technical reasons that necessitate the specifics of particular compliance pathways for building products, and their relative levels of prescription, from a building safety and durability perspective.
- 3.214 Our observation is that the impact of these compliance pathways, as barriers to entry and expansion for key building supplies, should nonetheless be given consideration when new compliance pathways are created or existing pathways are updated.
- 3.215 Further, where the compliance pathways either prescribe specific input treatments or requirements (as opposed to pure output or performance-based requirements), or necessitate brand specification to gain BCA consent, the compliance pathways can have a more marked impact on competition between different products in building supplies markets. In such circumstances, the compliance pathways appear to create barriers to the entry or expansion of new or innovative key building supplies.

Mr Gardiner's views on issues with the regulatory and standards systems

- 3.216 We instructed Mr Gardiner for his expertise and experience working both within the regulatory and standards systems and as a consultant to suppliers seeking to navigate these systems.
- 3.217 We asked Mr Gardiner to identify, from his expertise and experience, any features that in his view make it difficult for suppliers of building products to navigate and use the regulatory and standards systems in practice.
- 3.218 Mr Gardiner has identified a number of areas where he considers that the regulatory and standards systems cause issues for building products from a practical perspective and has suggested potential measures to improve the areas he identifies while still meeting the current performance standards.

- 3.219 In summary, Mr Gardiner’s view is that the pathways to demonstrate compliance for building products are relatively simple in theory but not in practical application. In this regard, he considers that:
- 3.219.1 There is a lack of clear pathways for product suppliers seeking to demonstrate compliance with the Building Code;
 - 3.219.2 For building products, identifying the performance requirements expected of them in a particular intended use starts with the standards referenced in Alternative Solutions and Verification Methods;
 - 3.219.3 The current Acceptable Solutions and Verification Methods are over-reliant on the use of referenced NZ Standards to set performance levels, and the development of Acceptable Solutions and Verification Methods makes insufficient use of international standards;
 - 3.219.4 There is a lack of guidance and resources to help product suppliers navigate the systems;
 - 3.219.5 BCAs apply an overly high threshold when applying the “reasonable grounds” test for considering applications for building consents, do not make risk informed decisions when considering applications for building consent, and a practice has developed of requiring products to be specified by brand in consent applications;
 - 3.219.6 There is significant variation in approach taken by BCAs and (and even within BCAs) when assessing products for compliance which leads to uncertainty;
 - 3.219.7 Aspects of the current product certification are not cost effective and the current scheme does not include recognised and competent international building product certification bodies.
- 3.220 What follows is a more detailed summary of some of the key aspects of Mr Gardiner’s views. Mr Gardiner’s report is published alongside our draft report.

Which code clauses apply and to what extent

- 3.221 Mr Gardiner explains how the relevant Building Code clauses that apply can change in different situations depending on the intended uses of a product, for example, where in a building it is proposed to be used, or the location of the building.
- 3.222 The Building Code is built around “subjects” for which the Building Code obligations apply, such as “external walls”, “thermal envelope”, “roof”, etc. Since most products only make up a part of those “subjects”, an assessment must be made of the relationship the product has in forming a “subject” and the extent to which the products contribute to compliance with the relevant Building Code clause.

- 3.223 Importantly, in most instances a product does not comply with the Building Code per se – but complies (or will contribute to compliance) when used in a particular use such as a defined scope of buildings and building work (wind zone, height, etc.). For example, a building wall underlay will contribute to compliance with Building Code clause E2.3.3 (and Building Code clause E2.3.7) and then only under defined circumstances – which comes from the scope of use.

Establishing the performance requirements of a product

- 3.224 In practice this would generally involve looking at the product standards in Acceptable Solutions and Verification Methods as they, by definition, meet the qualitative performance criteria.
- 3.225 However, there is a lack of diversity of product standards referenced in Acceptable Solutions and Verification Methods and the range of product solutions available to the building sector has grown faster than the rate of referencing standards in Acceptable Solutions. Many new or innovative products have no established performance benchmarks within the code system, even though appropriate performance benchmarks may be established in other jurisdictions.
- 3.226 Under the current regulatory framework product attributes can be given regulatory status without the use of referenced Standards by articulating them directly in Acceptable Solutions or Verification Methods or alternatively issuing Guidance under section 175 of the Building Act setting out the required attributes.

Added complexity

- 3.227 Compliance pathways are structured around individual Code clauses, not around the attributes of a product to comply with the Building Code. For example, a cladding system generally requires consideration of compliance pathways for each of external moisture, structure, fire and durability (and hazardous building materials), each of which has a different clause in the Building Code.
- 3.228 Many building products are not simply Acceptable or Alternative Solutions. There are a few products which are included in Acceptable Solutions to all relevant Code clauses (those that are, are generally commodity products and in most cases need to conform to NZ Standards to be regarded as an Acceptable Solution). In practice, most products are an Alternative Solution to at least one Code clause that is relevant to their use.
- 3.229 New Zealand does not have integrated compliance pathways for common functional products covering all relevant Code clauses. Most Acceptable Solutions are limited to buildings (and products whose performance is defined in those solutions) with a limited scope of use. Any buildings (and products) outside these are then technically 'Alternative' solutions with the need to establish performance criteria for the products in use outside this scope.

Use of standards

- 3.230 Additional system complexity is created by referencing standards in Acceptable Solutions or Verification Methods, but with modifications where the Acceptable Solution or Verification Method references a standard but makes changes to the standard to the extent it applies to that Solution or Method.
- 3.231 Where product standards for residential buildings are referenced in Acceptable Solutions or Verification Methods, they generally only relate to products that have historical New Zealand use and do not recognise contemporary building practice including international solutions designed to similar requirements.
- 3.232 The current consensus-based standard setting process also limits the ability to respond quickly to issues and there is a risk that this may allow committee members to protect a commercial position, particularly if they represent an established participant in the market.
- 3.233 Due to historical reasons, the 'environmental' zones used in the Building Code system are referenced in standards which adds to complexity, as product suppliers will need to use the standard to define an environmental condition even where their product may not be using that standard as a compliance pathway.

No systems for knowledge sharing about product compliance

- 3.234 There is no system for sharing knowledge between persons involved in product assurance or a central repository of information that can be used in support of code compliance.

Product certification

- 3.235 While product certification has the advantage that it reduces the regulatory risk (BCAs must accept a product certificate as evidence of compliance), it can be time-consuming and costly, and requires applicants to have taken good advice to establish their application and evidence base.
- 3.236 The cost structure inherent in the design of the product certification scheme may not be optimum, including parts of the scheme which may drive unnecessary costs such as overseas audit. Most well-established international products are already subject to considerable external quality assurance systems which in many cases could be relied upon to support the product certification requirements and thereby reduce costs.
- 3.237 There is scope for increasing the product certification capacity and providing some contestability through recognising product certification schemes operated by other overseas organisations.

Approvals each time a product is used in building work

- 3.238 Where product suppliers require regulatory approval on each occasion their products are used in building work they face the risks associated with the assessment of compliance of their products by the BCA that is consenting the building work using the product on that occasion. These include:
- 3.238.1 The acceptance or not of the validity of the evidence provided for compliance.
 - 3.238.2 The assessment of the risk of non-compliance and any consequence by the building official making the decision.
 - 3.238.3 A product supplier may find that the compliance of their product is accepted by one BCA but not another. There have also been instances where the evidence of compliance was accepted by one staff member or regional office but not another within the same BCA.
 - 3.238.4 The current civil liability regime for building work also makes BCAs risk averse and has arguably made them apply a higher legal standard than the 'reasonable grounds' test set out in the Building Act. This is a rational response particularly given that they have often been the 'last man standing' in a number of building defect claims – some of which relate to product failure or the inappropriate use and installation of products.
 - 3.238.5 The competency framework for building officials is based on their ability to assess building work and not building products, and the complexity in the code system is also not well understood by building officials, particularly the product related aspects.
 - 3.238.6 Where BCAs do undertake a centralised assessment of common building products to inform the assessment of building consent applications using those products these systems are opaque.

Specification of products in consents

- 3.239 Since the change in 2004 which required compliance to be demonstrated before building work is started there has been a shift to designers specifying products at the level of a specific brand.
- 3.240 Previous practice under the 1991 Building Act was that consents used phrases such as "product xx or equivalent" or "product to comply with NZS xxx". When assessing the completed building work for compliance, the building inspector would have made a decision as to whether the specific product used met the performance test as well as being installed correctly. Performance-based product specification without specifying products by specific products is also used in other jurisdictions such as most Australian states.

- 3.241 The administrative burden on any post-consent product changes makes changing products difficult. MBIE has provided some guidance on this (as well as the change to the Building Act to create the concept of minor variations). However, product substitution post-consent is problematic as it provides an advantage to the products that the designer has specified in the consent even though there may be other products on the market that would comply.
- 3.242 Mr Gardiner suggests that there are a number of potential measures to improve the processes for the introduction of new products. These fall into the following categories:
- 3.242.1 Improving the Building Code system through providing greater clarity of the performance requirements for products, including less reliance on the use of referenced NZ Standards.
 - 3.242.2 Guidance and resources to help product suppliers navigate the system.
 - 3.242.3 Guidance to assist BCAs in making more risk informed decisions about products when used in building work.
 - 3.242.4 Improving the compliance system to facilitate specification of products in consents at a performance level.
 - 3.242.5 Ensuring the product certification scheme is effective and providing for other certification schemes.
 - 3.242.6 Actively monitoring the new product disclosure regime to ensure that it does not become a barrier to consents.
- 3.243 These are set out in more detail in paragraphs 125 to 130 of his report.

Ministry of Business, Innovation & Employment's November 2013 Options Paper

- 3.244 MBIE published an options paper describing the barriers to competitive and productive outcomes in the residential construction sector in 2013.²⁰⁷ We have included reference to this paper to illustrate that the issues which we have identified in this study in relation to the regulatory and standards systems are not new, and that some of these themes are still coming through and, in our view, are having an impact on competition.

²⁰⁷ Ministry of Business, Innovation & Employment "Residential Construction Market Study – Options paper" (6 November 2013), available at: <https://www.interest.co.nz/sites/default/files/residential-construction-sector-options-paper.pdf>.

- 3.245 The five key issues relating to the regulatory and standards systems that were identified in the Options Paper included the following matters.
- 3.245.1 *Complexity and inaccessibility of Alternative Solutions* – The complexity of the product assurance system for demonstrating Code compliance may act as a barrier to new products or systems getting to market. There are also concerns that decision-making processes and risk aversion in relation to product assurance may reinforce the position of incumbents in the industry.
 - 3.245.2 *Specification of products by brand* – Specification by designers of particular brands of product in designs acts as a barrier to later substitution of equivalent products that might be cheaper or more effective. This reinforces the use of ‘tried and tested’ products.
 - 3.245.3 *Risk-averse behaviour* – Risk-averse behaviour underlies decisions about consenting. Moreover, liability risks throughout the industry incentivise conservatism and this may act as a barrier to getting products accepted for use (or selected for use in the first instance).
 - 3.245.4 *Limited availability of Acceptable Solutions* – Acceptable Solutions are ‘deemed to comply’ with the Building Code. They often rely on citation of complex technical Verification Methods, which are not always available in relation to innovative new materials or processes or new market entrants. This could act as a barrier to entry.
 - 3.245.5 *Inefficient and inconsistent consenting behaviour* – Slow and unpredictable consenting procedures across BCAs introduce delays to construction and make it difficult to plan construction projects. This particularly affects larger builders looking to realise economies of scale through improved planning and management.
- 3.246 MBIE has since initiated a process of substantial legislative and regulatory reform, which remains ongoing. Measures to respond to the issues outlined in the 2013 MBIE Options Paper have included phase 1 of the reform programme, now implemented through the Amendment Act in 2021 and the introduction of product information disclosure requirements, strengthening of the CodeMark framework, and introduce of the modular components scheme. There has also been guidance issued on minor variations and product substitutions. The programme of legislative reform continues with the review of the building consent system.

Preliminary findings

- 3.247 As described above the Building Code is performance based and brand indifferent and has a policy objective of facilitating and encouraging innovation.

- 3.248 Notwithstanding this policy intent, the regulatory system is making it difficult for competing suppliers of key building supplies to enter the New Zealand market and expand their businesses. Despite the flexibility that is available in the system to use and adopt new products, it is too slow, costly and uncertain to get them accepted for general use. This is due to the combined effect of:
- 3.248.1 the way the regulatory and standards systems (comprising the Building Act, the Building Code and related instruments, and the consenting system) are applied to building products; and
 - 3.248.2 the decision-making behaviours designers, builders and BCAs in response to and in applying the regulatory and standards system.
- 3.249 The Building Act appropriately focuses on the need to ensure safe, healthy and durable residential buildings. We therefore recognise how critical it is that, where building products are used in building work for residential buildings, they contribute to this outcome. We also recognise that there are likely to be important reasons for the specifics of the different compliance pathways, and their relative levels of prescription, from a building safety and durability perspective. However, we consider that more can be done to make it easier for suppliers of key building supplies to enter and expand their businesses in the New Zealand.
- 3.250 The Building Code and associated systems are complex to navigate. The Building Code uses qualitative words and phrases to set performance levels for building work and, for building products, establishing what the qualitative words and phrases mean in practice involves starting with the standards currently referenced in Acceptable Solutions and Verification Methods. It is those standards that are generally used to establish the required performance levels for products. These compliance pathways for building products (ie, through Acceptable Solutions and Verification Methods and referenced standards) are narrow and there are few ‘streamlined’ processes.²⁰⁸
- 3.251 These pathways have their origins in the national standards under the Building Act 1991 and, while they are not the only means of complying with the Building Code, they have become embedded as “how we build here”. These compliance pathways have not been expanded to keep pace with contemporary building practices or the development of new products, limiting the potential for competition from alternative, new or innovative building supplies.
- 3.252 The regulatory system does not enable timely response to changing markets and innovations in building products. It continues to incentivise designers, builders and BCAs to favour ‘tried and tested’ building products over new or competing products.

²⁰⁸ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022), at [8]-[9], [34] and [35].

- 3.253 Where a building product fits within an Acceptable Solution or Verification Method and cited standard, those products appear to be more readily specified and used in residential building designs compared to competing products that do not fit within a similarly clear compliance pathway. Well-established products are much more likely to have clear compliance pathways.
- 3.254 The opposite is also true, in that where a product's compliance pathway is relatively unclear it is less likely to be used in a residential building design and more likely to be a challenger to well-established products. These challenger products face a longer path to establishing acceptance, either through seeking CodeMark certification (at an individual cost) or as an Alternative Solution.
- 3.255 While anyone can fund the development of an NZ Standard and motivate for this to be included in an Acceptable Solutions or Verification Method, in practice, suppliers of new or innovative products have not sought to try this route given the time and cost.
- 3.256 While product certification is available through CodeMark this is also costly and time-consuming and the uptake remains relatively low. Since product certification relates to a particular product and use, the costs and inconvenience of having each product and associated use individually certified is often prohibitive.²⁰⁹
- 3.257 There are a number of other factors that contribute to mutually-reinforcing specifying, purchasing, and consenting behaviours that strongly favour products that are already established in the market.
- 3.258 A building consent applicant seeking to establish compliance with the Building Code by way of an Alternative Solution must persuade the BCA that the proposed building work and products will meet the performance requirements of the Building Code. This typically requires substantial evidence since BCAs favour well-known and trusted products to de-risk potential liability. There is also a lack of clarity around what information needs to be provided in order to demonstrate Code compliance. There is further some perception that BCAs apply a threshold higher than the "reasonable grounds" test set out in the Building Act for granting consents.
- 3.259 There are 67 BCAs nationally. Even if an applicant successfully persuades one BCA to consent a product, BCAs in other regions can take different interpretations and stances. While accreditation of BCAs was designed to help with BCA performance and consistency, these issues have not yet been resolved and different BCAs still often require different levels of product assurance in order to approve a particular product or process for use within a design.

²⁰⁹ See "Knauf's concerns regarding product approval processes" set out in Ministry of Business, Innovation & Employment "Residential Construction Market Study – Options paper" (6 November 2013) at 17, available at: <https://www.interest.co.nz/sites/default/files/residential-construction-sector-options-paper.pdf>.

- 3.260 The behaviours of designers, builders and BCAs appear strongly self-reinforcing. Designers and builders anticipate BCA responses to new products. They take these expected responses into account when specifying and purchasing key building supplies and generally choose the path of least resistance, given the significant time and additional costs associated with delays in the consenting process. The need to complete jobs on time and with least delay and additional cost generally prevails over any desire to use new or innovative products.
- 3.261 While this does not appear to be required by the Building Act or the Building Code, the practice has also developed of designers specifying products by brand in building plans and consent applications. Once the product is specified by brand in a consent application it significantly limits the scope for the product to be substituted at a later time, after a building consent has been granted. Depending on the context, a minor variation of the building consent may be possible, and MBIE has issued both generalised guidance on product substitutions. However, the process for seeking substitutions is likely to add time, cost and complexity to a build which incentivises builder to continue to use the specified brand.²¹⁰
- 3.262 The Building Code and associated systems are also complex for product suppliers, designers, builders and BCAs to navigate. While some information is available, such as the standards sponsored by MBIE, there is no centralised repository for product information, accessible to product supplies, designers, builders and BCAs. To the extent there is sharing of this information between BCAs this appears to be relatively ad hoc and informal. This means that it can be difficult for parties to find useful information about new or innovative products that will help them to assess whether products would be compliant with the Building Code when used in a particular way.
- 3.263 Suggested measures to address the above matters are discussed further in Chapter 9.

²¹⁰ This view is supported by the analysis and information discussed at paragraphs 4.34 to 4.38 below.

Chapter 4 How building supplies are specified and purchased

Summary of preliminary findings

- Designers often make the final decisions on specification of key building supplies to be used in residential builds, but a range of people can have input and influence. For example, engineers, builders, quantity surveyors, clients (including homeowners) and/or product suppliers may be involved when specifying building supplies.
- The most important factors designers consider when specifying building supplies are the ability for the product to be approved by Building Consent Authorities (BCAs), product durability and suitability within the design, and whether the product has been used before and is reliable ('tried and tested').
- Designers and builders generally use 'tried and tested' products because:
 - They are seen as proven to perform in residential buildings in New Zealand, not just as products but as part of the designed system. This is important because product failure can have liability implications for designers, builders and/or BCAs.
 - A clear compliance pathway to approval by BCAs provides less uncertainty around likely project timings and cost.
- Certain key building supplies are often specified by brand in building plans and consent applications. For example, plasterboard and cladding are commonly specified by brand. A number of stakeholders explained that many BCAs have adopted a strict interpretation of the consent test in the Building Act and require specification by brand. Brands can also be specified when designers favour particular brands (for example, because they are 'tried and tested').
- Designers drive builders' choices of key building supplies by what is specified in the plans. Builders do not usually use alternative supplies to those specified because of the administrative effort, uncertainty and potential delay associated with seeking a variation to the building consent.
- This preference for 'tried and tested' products from decision makers across the industry increases barriers to entry and expansion for new suppliers. Suppliers of new products need to establish compliance with multiple BCAs and report that BCA approaches and decisions are not always consistent.
- Builders of different sizes largely purchase key building supplies from major merchants. Decisions to purchase are based on relationships with the merchants, availability of the product and price. There are a range of purchasing patterns, but builders generally test the market by seeking quotes from several merchants and switch between merchants when prices, availability or terms are preferable.

Introduction

- 4.1 This chapter discusses the factors that influence which key building supplies are specified and purchased. We consider the incentives, preferences and potential biases of parties involved in selecting building supplies for residential building projects.
- 4.2 The topics covered are:
 - 4.2.1 how we gathered information on specification and purchasing behaviour;
 - 4.2.2 how building supplies are specified and selected; and
 - 4.2.3 how builders choose where to purchase building supplies.

How we gathered information on specification and purchasing behaviour

- 4.3 We have relied on information gathered in a range of ways and from a range of sources to reach the preliminary findings discussed in this chapter.
- 4.4 One source was a survey of specifiers and builders (our specifier survey). Our specifier survey sought views on the factors that influence the decisions about which key building supplies are specified and purchased for residential building work. The survey enabled us to seek the views of a range of industry participants and identify common themes.
- 4.5 We received 105 responses to our specifier survey. The respondents were:
 - 4.5.1 builders who source building supplies for the build stage and/or have some input into the products specified in plans; and
 - 4.5.2 specifiers of building supplies at the design stage.
- 4.6 Respondents to our specifier survey were of various sizes, as measured by the number of employees and time spent in the industry.
- 4.7 Described below are other key sources of information we have relied on.
 - 4.7.1 We held meetings with a number of stakeholders including specifiers, builders and trade associations. The meetings were held with those we contacted to seek views, and some who proactively contacted us. We also held meetings with some respondents to our specifier survey to seek further details regarding comments made in response to the survey.
 - 4.7.2 Information provided by merchants and suppliers regarding research into customer and specifier behaviour, in response to our information requests.
 - 4.7.3 Submissions we received in response to our preliminary issues paper.
- 4.8 Further information about our specifier survey is contained in Attachment F.

How key building supplies are specified and selected

- 4.9 This section discusses how building supplies are specified and selected for use. It notes that:
- 4.9.1 designers often make the final decisions on specification of building supplies;
 - 4.9.2 designers often favour ‘tried and tested’ products when specifying building supplies;
 - 4.9.3 designers face costs and risks when switching to new products;
 - 4.9.4 certain key building supplies are often specified by brand in building plans and consent applications;
 - 4.9.5 while information on building products is available from a range of sources, there is no central repository; and
 - 4.9.6 the extent to which designers constrain builders to use certain products varies by builder type.

Designers often make the final decisions on specification of key building supplies

- 4.10 All residential housing projects which include restricted building work require a licensed building practitioner (design) (LBP) to do or supervise the design work.²¹¹ Restricted building work is work that is critical to make a home structurally sound and weathertight.
- 4.11 Designers comprise:
- 4.11.1 architects;
 - 4.11.2 architectural designers;
 - 4.11.3 draughtspersons;
 - 4.11.4 engineers; and
 - 4.11.5 building companies with available design expertise.
- 4.12 Designers prepare plans and specifications for building work or give advice about the compliance of building work with the Building Code. They are responsible for ensuring the plans and specifications are sufficient to result in the building work complying with the Building Code if the building work was properly completed in accordance with the plans and specifications or advice.²¹²

²¹¹ Building Performance “Choosing a designer or architect” <https://www.building.govt.nz/projects-and-consents/planning-a-successful-build/scope-and-design/choosing-the-right-people-for-your-type-of-building-work/choosing-a-designer-or-architect-for-your-building-project/>.

²¹² Section 14D of the Building Act 2004.

- 4.13 Designers can be contracted for a specific purpose (eg, the design only), or for the whole project (from design through to completion of the build). Designers interact with many of the other parties involved in a project.
- 4.14 Members of the Registered Architects Board are classified automatically as LBPs but also have a duty to comply with a number of rules and regulations including the Registered Architects Rules. The Rules go to ensuring they are brand indifferent and include duties to exercise unprejudiced and unbiased professional judgement and not to accept inducements that would create a conflict of interest.²¹³ LBPs must follow a Code of Ethics.²¹⁴
- 4.15 Our survey and stakeholder meetings indicated that designers often make the final decisions on specification of key building supplies. However, a number of people can have input and influence.
- 4.16 Figure 4.1 below shows who usually makes the final decision on what key building supplies to use, based on responses to our specifier survey.

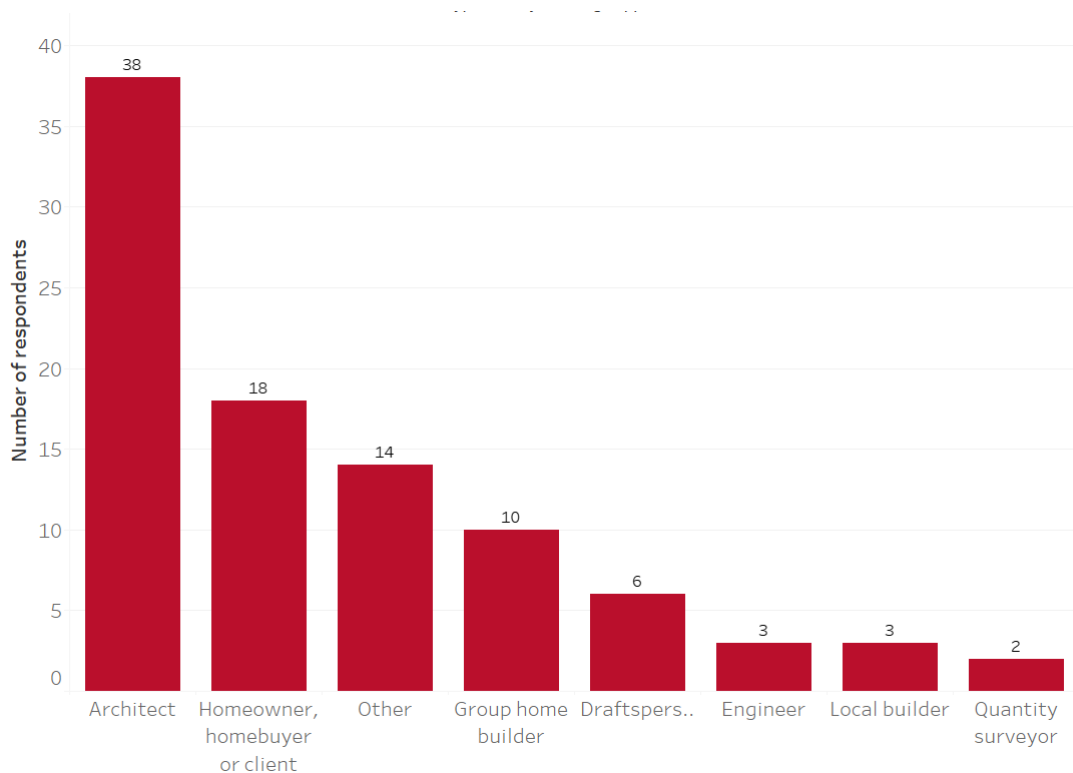
²¹³ Rules 48 and 56 of the Registered Architects Rules 2006, available at:

<https://www.legislation.govt.nz/regulation/public/2006/0161/latest/DLM388426.html>.

²¹⁴ The Code of Ethics was introduced on 26 October 2021 but is not enforceable until 25 October 2022, Building (Code of Ethics for Licensed Building Practitioners) Order 2021, available at:

<https://www.legislation.govt.nz/regulation/public/2021/0335/latest/LMS573729.html>.

Figure 4.1 Who usually makes the final decision on types of key building supplies to use



Source: Commerce Commission analysis of responses to our specifier survey, n=94.²¹⁵

- 4.17 Input can come from engineers, builders, quantity surveyors and/or clients (including homeowners) to different degrees depending on the nature of the project. For example, a homeowner may be highly involved with the building supplies specified in a bespoke, environmentally friendly development because of the requirements for the specific building supplies and their input into the overall design. On the other hand, group home builders tend to have a suite of standard designs to be built from a set of products they have chosen based on their own product and supplier criteria which are subject to periodic tender rather than project-by-project decisions.
- 4.18 Suppliers also influence decisions about which products are specified. They can provide product information, proof of past use and acceptance by BCAs and technical advice such as detailed installation information and calculations to assist with the consent process.

²¹⁵ Responses to question: For the residential projects you work on and for the key building supplies used, who usually makes the final decisions on the types of key building supplies to use? [].

- 4.19 Suppliers see designers as key to getting products specified and seek to influence specification decisions by providing information to designers and by making the process as easy as possible for them.²¹⁶

Designers often favour ‘tried and tested’ products when specifying key building supplies

- 4.20 There are a number of factors that are typically considered by designers when specifying building supplies. They include considerations such as product durability and suitability within the design.

- 4.21 However, we heard from a range of stakeholders that the most important factors to be considered at specification stage are that the product:

- 4.21.1 is likely to be accepted by BCAs;
- 4.21.2 meets the Building Code; and
- 4.21.3 has been used before and is reliable.

- 4.22 A product that has been used before and is reliable has also been described as ‘tried and tested’. These are building products that have been used before by a designer, used in existing buildings without issue, and have had rigorous testing.²¹⁷ They are also proven to perform in residential buildings in New Zealand, not just as products but as part of the system they are being designed for.²¹⁸

- 4.23 The preference for ‘tried and tested’ products appears to be an enduring theme in the industry. For example, MBIE’s 2013 study found “...a bias towards the continued use of ‘tried and true’ brands, products, methods and systems”.²¹⁹

- 4.24 As discussed in Chapter 3, this was highlighted as a theme in submissions and our survey on the regulatory and standards systems. For example, we were told that “(b)ecause councils favour familiar materials used in familiar ways, architects and engineers prefer to set plans that use familiar materials in familiar ways. It makes consenting easier”.²²⁰

- 4.25 The factors likely to influence acceptance of a product by BCAs include:

- 4.25.1 the product being BRANZ appraised;²²¹
- 4.25.2 the product meeting the performance criteria; and

²¹⁶ [].

²¹⁷ [].

²¹⁸ [].

²¹⁹ Ministry of Business, Innovation & Employment “Residential Construction Sector Market Study Options Paper (6 November 2013) at 8, available at: <https://www.interest.co.nz/sites/default/files/residential-construction-sector-options-paper.pdf>.

²²⁰ The New Zealand Initiative “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [3.10].

²²¹ [].

- 4.25.3 the supplier providing sufficient product information, including installation instructions.²²²
- 4.26 Our preliminary view is that this preference can make it harder for new or innovative products to enter or expand to compete with ‘tried and tested’ products.

Designers face costs and risks when switching to new products

- 4.27 Stakeholders described a number of costs and risks associated with designers switching to new products:
- 4.27.1 **Risk and liability.** Unfamiliarity with a product and the risk of product failure could lead to financial implications for designers later on.
- 4.27.2 **BCA preferences.** Across different BCAs, and sometimes within the same BCA, stakeholders observe differing requests for information and differing familiarity with the products involved, and a level of reluctance to approve the use of products that BCAs are not familiar with. This is colloquially referred to as “BCA risk aversion” and has led to designers sticking to ‘tried and tested’ building products and designs in order to avoid potential delay and cost to a project.
- 4.27.3 **Time and cost of researching new products.** Sufficient information is needed to consider using a new product, including but not limited to, technical and installation information, proof of performance, the likely cost to purchase the product and whether professional indemnity insurance covers its use. Acquiring and digesting the necessary level of information both before and during a project may add time and cost.
- 4.27.4 **Consenting delays.** Any potential delay in the consenting process, for example, BCA unfamiliarity with a product, can cause issues for the timing and cost of the project.
- 4.28 Our preliminary view is these switching costs can strengthen the preference for ‘tried and tested’ products. In turn, this can make it hard for new or innovative products to provide a viable competitive alternative.

Certain key building supplies are often specified by brand

- 4.29 Some key building supplies are specified generically where it can be shown they can meet the Building Code. Examples include timber and ready-mix concrete.

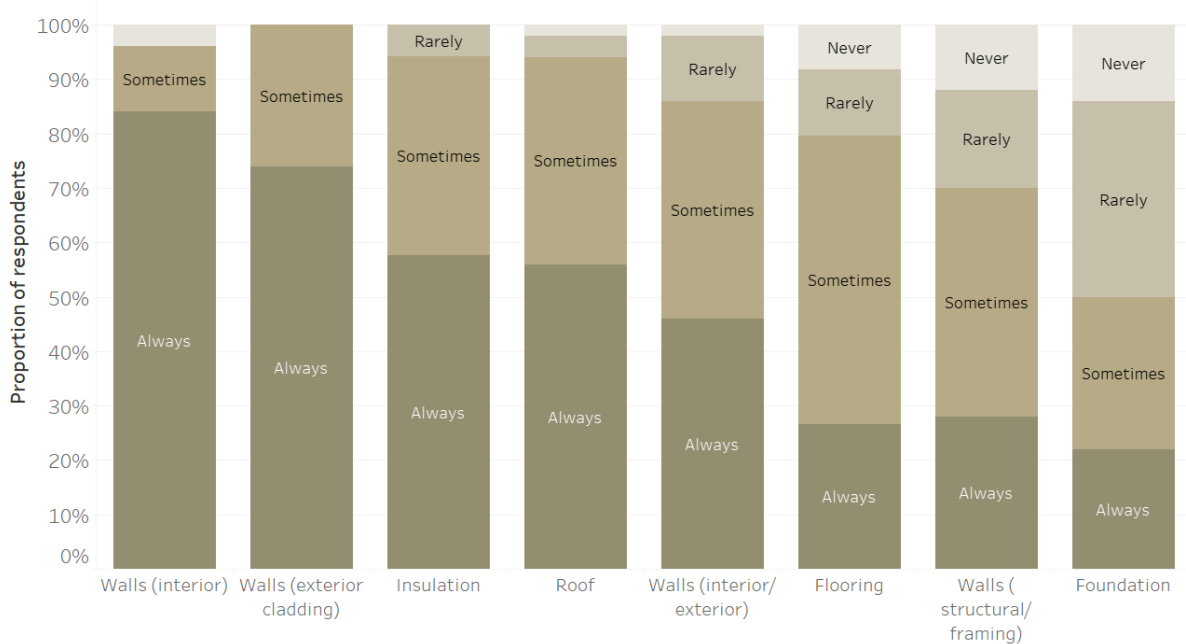
- 4.30 Other key building supplies are often specified by brand. Although views are mixed, some stakeholders have noted generic specification is not allowed by many BCAs that have adopted a strict interpretation of the consent test in the Building Act and require that certain building supplies be specified by brand.^{223, 224}
- 4.31 Specifications in plans need to be prescriptive when, for example, the product or system is a structural component of the building. BCAs will check the product information to see whether the structural component is met and how this fits alongside other components in the design. Further, “...routinely BCAs require additional information (*to be satisfied on reasonable grounds*) to support the application and how it demonstrates compliance with the Building Code clauses (for example, peer reviews, shop drawings, specific product and system details) before issuing a building consent...”.²²⁵
- 4.32 The key building supplies that are most frequently specified by brand are used in internal walls (including plasterboard), external walls (including cladding) and roofing material. Specifiers responding to our survey, and participants at our hui confirmed this.²²⁶ Figure 4.2 below shows the categories of key building supplies which are most specified by brand.

²²³ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [72].

²²⁴ [].

²²⁵ [].

²²⁶ Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 6.

Figure 4.2 Specification by brand for key building supplies

Source: Commerce Commission analysis of responses to our specifier survey, n=52.²²⁷

4.33 Other reasons given by designers for specifying by brand include:

4.33.1 previous use of a product and comfort with its use within the current design based on an assessment of the information available; and

4.33.2 not all designers are independent designers; for example, some work from specific plans created by a GHB which has pre-selected many of the building supplies.

4.34 Specification by brand can cause some issues during the build process, especially if a different product may be required for reasons such as price increases or lack of availability.

4.35 Respondents to our specifier survey indicated that altering the plans once building consent has been granted is often difficult. Stakeholders, during interviews, noted that a minor variation is often relatively uncomplicated but this depends on the product being substituted. MBIE has published guidance relating to minor variations with recommendations for builders, project managers, designers and BCAs.²²⁸

²²⁷ Responses to question: Which key building supplies are commonly specified by brand?

[].

²²⁸ Building Performance “What is a minor variation?” <https://www.building.govt.nz/projects-and-consents/build-to-the-consent/making-changes-to-your-plans/minor-variations-guidance/what-is-a-minor-variation/>.

- 4.36 For more substantive changes, if a different product is required, then designers must agree to an amendment to the plans (with amended calculations, for example, if appropriate). In either instance a BCA must then decide whether the change and an amendment to the consent is acceptable.
- 4.37 This process is uncertain because BCAs' approaches often vary when interpreting what meets the definition of a minor variation. If the substitution is not considered a minor variation it means the full consent application may need to be resubmitted.²²⁹
- 4.38 Many designers try to avoid going down this route because of the potential risks.²³⁰ These include delay to the build and addition of time, cost and complexity due to prolonged interaction with a BCA and, in some cases, potential liability for using an alternative product.
- 4.39 Our preliminary view is this tendency to specify products by brand raises the costs of switching to alternative products. In turn, this may make it harder for alternative products to compete effectively.

Information for designers about building products is available from a range of sources

- 4.40 Most designers said that information about building products is available from suppliers, certification and appraisal organisations, is contained within specification system product libraries, or available from others in the industry. However, relevant information about 'tried and tested' products tends to be most widely available and this leads them to being more frequently specified.
- 4.41 Some product specification systems overcome information difficulties to some extent by providing databases of building products and product information for selection by designers. They offer a variety of free and paid subscriptions to users, depending on how many products are to be listed by supplier and what product libraries are needed by designers.²³¹
- 4.42 Choices of product can be influenced by what is in the system, although this is not critical and information can be found elsewhere.²³²
- 4.43 Some designers indicated that technical information (both in specification systems and elsewhere) is often mixed with marketing information and compliance and product assurance information is sometimes limited.²³³

²²⁹ [].

²³⁰ [].

²³¹ There are a number of specification systems used by designers such as Productspec and Masterspec. Masterspec, for example, is "...the system over 70% of architects and designers use" and lists over 1,000 suppliers with over 8,000 products as at 8 July 2022, see: <https://miproducts.co.nz/>.

²³² [].

²³³ [].

- 4.44 It can be difficult to find information about new or innovative products and when that information is not readily available then ‘tried and tested’ products are more frequently specified.
- 4.45 There is currently no one centralised repository for product information, accessible to designers, builders and BCAs. The Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021 has introduced mandatory product information disclosure requirements, in order to improve the ease and efficiency of BCA decision making.²³⁴
- 4.46 While this will require suppliers to provide product information, there is no requirement for this information to be centrally located. This means this information may not necessarily be readily accessible. Our preliminary view is that better access to product information may help competition by reducing the costs of gaining information about new or innovative products.

The extent to which designers constrain builders to use certain products varies by builder type

- 4.47 GHBs often control their own specifications and purchases of the products for their projects, either in-house or by direction to designers. They are not constrained in their choices except to the extent that the products they have selected must be available for use in their standard designs. Products are usually selected by the application of company selection criteria, although clients can request different products.²³⁵
- 4.48 Designers of homes built by SME builders generally have the final say on which products are specified. SME builders advise that they have some input into decisions but designers make the specification and usually any later substitutions.²³⁶ Therefore, SME builders are largely constrained by the products that are specified in the building consent plans or those agreed to be substituted.²³⁷
- 4.49 However, some SME builders specialise in specific types of projects, for example, luxury or environmentally friendly developments. For these types of projects, builders, their clients and/or engineers can have more input into specification because the requirements of the project can be different.²³⁸

²³⁴ Date of Assent was 7 June 2021. Part 4B relates to building product information requirements with proposals to be made for specific regulations at a later date.

²³⁵ [].

²³⁶ Sometimes builders may substitute a product by way of minor variation without going back to the designer.

²³⁷ This is consistent with what we heard at the hui, Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 3.

²³⁸ [].

How builders choose where to purchase key building supplies

- 4.50 This section discusses how builders choose where to purchase building supplies. It notes that:
- 4.50.1 there is a range of different types of builders, reflecting the variety of building projects;
 - 4.50.2 availability and price are typically the most important factors when builders purchase building supplies;
 - 4.50.3 there is limited use of imported products which are not 'tried and tested' in New Zealand;
 - 4.50.4 many builders test the market by seeking quotes from multiple merchants;
 - 4.50.5 builders face a range of costs of switching to new products;
 - 4.50.6 builders obtain information on building supplies from a range of sources;
 - 4.50.7 builders face a number of potential costs when switching merchants;
 - 4.50.8 builders have traditionally offered fixed price contracts but this is now less common;
 - 4.50.9 Kāinga Ora has initiatives and programmes to boost the supply of new housing for New Zealanders; and
 - 4.50.10 Kāinga Ora has national supply agreements and supplier panels.

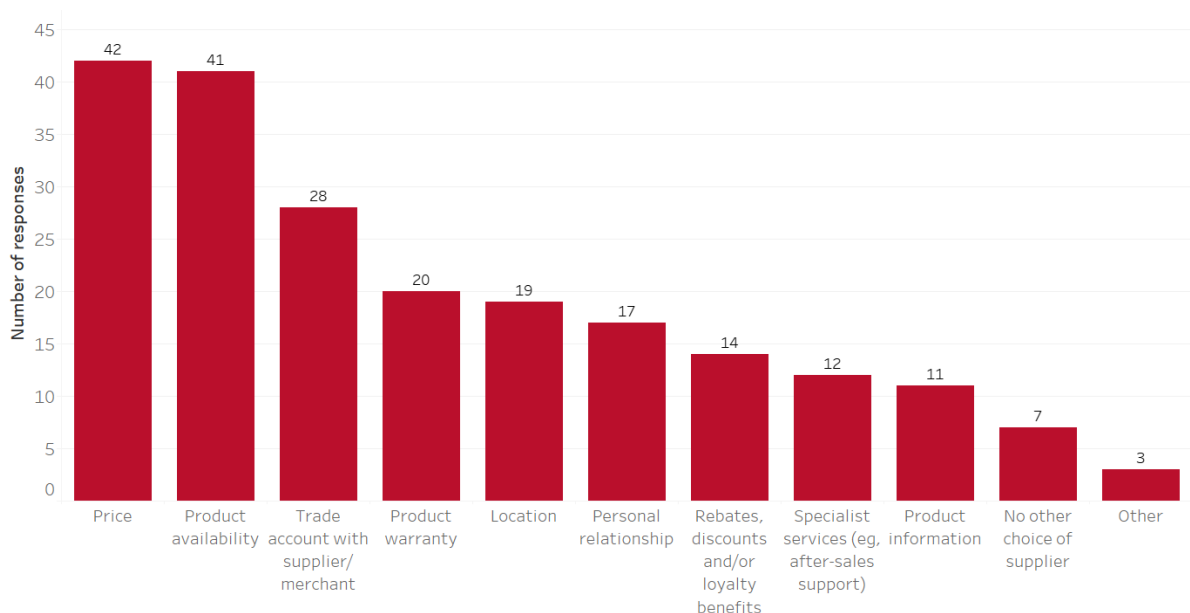
There is a range of different types of builders, reflecting the variety of building projects

- 4.51 A variety of projects are undertaken by builders. These range from homes built for large-scale developments through to bespoke projects where the focus is on environmentally friendly design for a specific site. The demands of homeowners can therefore be very different.
- 4.52 The types of builders also vary. Kāinga Ora facilitates the building and upkeep of thousands of state homes nationally, along with GHBs which also compete for business on a nationwide basis. Other GHBs compete on a more regionalised basis. SME builders generally compete at a local level in regions across the country. The way builders purchase building supplies is therefore determined by the size and needs of their business.

Availability and price are typically the most important factors when considering where to purchase building supplies

- 4.53 Our survey and interviews indicate the most important factors considered when deciding where to purchase are availability and price. Other important factors include having a good relationship with a supplier built up over time, the suitability of products on offer, the service including delivery being in full and on time and product warranties. Supply terms, including rebates and other discounts from a supplier were not one of the most important factors when choosing where to purchase building supplies.
- 4.54 Figure 4.3 below shows responses to our specifier survey question regarding factors considered when deciding where to purchase key building supplies.

Figure 4.3 Factors considered when deciding where to purchase key building supplies



Source: Commerce Commission analysis of responses to our specifier survey.²³⁹

Most supplies are purchased from merchants

- 4.55 Most builders, regardless of size, purchase supplies from one of the five major merchants. Relatively few key building supplies are widely available direct from the supplier, though concrete and windows, for example, are often supplied directly.

²³⁹ Responses to question: What is important to your business when deciding where to purchase key building supplies? [].

- 4.56 Some GHBs also have agreements with suppliers which provide for benefits such as volume-based rebates, payments for administrative support services or marketing.²⁴⁰ Where this occurs, we understand that the key building supplies are usually still source and purchased through a merchant.
- 4.57 An agreement with a supplier is often national and any benefits paid to the GHB by the supplier are separate to any benefits received through an agreement between the GHB and a merchant. We understand these agreements enable the supplier and GHB to make cost savings based on the likely volumes supplied.
- 4.58 This means competition to supply builders with key building supplies appears to largely be between the major merchants. The extent of this competition is discussed in Chapter 6.

The use of imported key building supplies varies

- 4.59 Importation of key building supplies is not currently widespread but there were a wide range of views about its feasibility, depending on the type of product. Many we spoke with during interviews have dismissed it or never considered importing building supplies.
- 4.60 The key factor limiting the import and use of key building supplies is the potential liability associated with the use of products that are not ‘tried and tested’ in New Zealand. Closely related to this is regulatory concern (ie, hesitancy because a BCA may not issue consent for use of the imported building supplies).²⁴¹ Some stakeholders indicated that the financial benefit is uncertain once all of the likely costs to bring to site are considered, while others noted logistical challenges such as certainty around delivery times.²⁴²
- 4.61 Additional challenges, as is the case for all new products, included persuading designers and merchants the supply is suitable for specification, use and stocking and that the product is better or at least equivalent to current products.
- 4.62 These challenges, and the perceived regulatory concerns, may make it harder for imported products to act as a viable competitor to domestically manufactured products. Chapter 5 further discusses how the viability of importing key building supplies can vary.

²⁴⁰ [].

²⁴¹ [].

²⁴² [].

Many builders test the market by seeking quotes from multiple merchants

- 4.63 There are a range of methods that builders use for procurement. Across the industry we have heard that builder practices vary:
- 4.63.1 Some have longstanding agreements with a single merchant and negotiate the terms from time-to-time or for a fixed period – either near to (or at) the end of the fixed term, or by the builder benchmarking against other merchants at a certain stage if there is no fixed term (eg, once a year).²⁴³ Comparisons with other merchants are made particularly around price and service. Most agreements are not exclusive;
 - 4.63.2 Some tender for business from multiple merchants to cover a fixed term and choose one as a supplier for that term;
 - 4.63.3 Some seek quotes from multiple merchants and choose multiple merchants, for example, to cover geographic locations where one merchant does not have a presence, or to cover a fixed term;
 - 4.63.4 Some tender from a range of merchants per project and choose either one or a number of merchants for the duration of the specific project; and
 - 4.63.5 Some, largely SME builders, seek supplies off-the-shelf on a project-by-project basis.
- 4.64 Many builders test the market by seeking quotes from merchants that they do not currently use. Switching does occur and the most important factors in deciding to switch supplier are product availability and price.
- 4.65 The recent issues relating to availability of some building products has had a number of effects on choice of supplier. This has stopped some builders from switching because their current merchant has guaranteed supply. However, others now use multiple merchants because some merchants cannot supply them with certain products.
- 4.66 That builders exert pressure on merchants by testing the market, and switching, is likely to incentivise merchants to compete to win this customer. This is consistent with our preliminary finding that competition between merchants appears to be working relatively well at the national level. This is discussed further in Chapter 6.

Builders face a range of costs of switching to new products

- 4.67 There are a number of potential costs involved for a builder who wishes to switch to a new product.

4.68 In the pre-consent stage:

4.68.1 **Time and cost of researching new products.** Builders will generally require sufficient information to consider using a new product, including but not limited to, technical and installation information and proof of performance to satisfy a BCA. To acquire and digest the necessary level of information both before and during a project may add time and cost, as will lengthy discussions with BCAs.

4.68.2 **Product availability.** If a builder identifies a new product to use they must first be satisfied that the product will be available to install within the project timeframes. Any difficulties relating to reliability of supply could end up delaying the build.²⁴⁴

4.69 In the post-consent stage:

4.69.1 **Financial cost of replacement product.** If a product is specified by brand a builder will have to install this product to gain consent. If a different product is installed without agreement from a designer and subsequently consent is not granted, the cost may fall to the builder to replace the product.

4.69.2 **Risk and liability.** If a different product is used with agreement from a designer and BCA the builder may still face some liability if the product later fails. This could be due to issues such as installation not being in accordance with the manufacturers' guidelines for example. We have heard that "[a]s builders are often the first point of call when a project does go wrong, builders need assurity that the products they are using will work..."²⁴⁵

4.69.3 **Product cost.** Many builders have noted that new products can cost more. Often products that are not yet supplied at a large scale in New Zealand may be more expensive, for example, those which offer greater insulation properties.

Builders obtain information about building supplies from a range of sources

4.70 Builders obtain information about products from product suppliers, doing their own research, from merchants and sometimes discussion with clients who have an interest in certain product(s).

²⁴⁴ []

²⁴⁵ Registered Master Builders Association "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 4.

- 4.71 Product information for builders about ‘tried and tested’ products is reportedly not difficult to come by, especially from suppliers. However, information about new products is more difficult to find; often relating to installation, whether the product is tested in New Zealand conditions, and whether there is any support available in New Zealand (for example, replacement product or technical support).²⁴⁶

Builders face a number of potential costs of switching merchants

- 4.72 Builders must consider a number of potential financial and relationship costs before switching merchants.
- 4.73 As noted above, one of the most important factors to consider when choosing a merchant is product availability. This is also one of the primary reasons for switching merchants, especially when, as at present, there is less availability of some products. Switching merchants without consistently available product could be costly because it could delay projects.
- 4.74 Other potential financial costs include loss of rebates or other benefits from a supplier. Builders of different sizes have expressed different opinions in this respect; some (mainly SME builders) have no costs in this regard while some (mainly GHBs) will consider this more carefully as rebates, for example, could provide financial support for the business.
- 4.75 Some builders consider that a long-term relationship of trust with the supplier is important.²⁴⁷ In their view this facilitates the supply of ‘tried and tested’, available products, delivered on site, on time and with the opportunity to rectify any issues. Some have expressed the view that switching suppliers could be risky because the relationship with a new supplier has not yet developed.

Builders have traditionally offered fixed price contracts, but this is now less common

- 4.76 Traditionally, many builders offered fixed price contracts for projects. That is, the builder and client agreed a fixed price for the work including all building supplies. Some contracts contained clauses allowing for fluctuations in materials costs, for example. However, fixed price contracts are less common now because builders are facing regular cost increases for building supplies due to issues such as materials shortages and increases in suppliers’ costs.
- 4.77 Many builders have expressed the view that materials costs are important to them and to homeowners because they have to complete a job within the necessary budget and want to compete against other builders. Other builders have expressed the view that low prices for building supplies is less important because they are seeking a specific look or performance for example. This depends upon the nature of the project.

²⁴⁶ []
²⁴⁷ []

Kāinga Ora has national supply agreements and supplier panels

- 4.78 Kāinga Ora has a number of supplier panels which are subject to regular review. They consist of businesses which carry out a range of works and services including residential building and maintenance (construction and maintenance partners) and design work (design partners).²⁴⁸
- 4.79 Currently, Kāinga Ora has 12 National Supply Agreements (NSAs) with suppliers.²⁴⁹ These Agreements cover the supply of materials and are made following a tender process. NSAs are regularly reviewed and re-tendered every four years. Maintenance partners are required to use material specified under the NSAs. Design and building partners are not obliged to specify or purchase products covered by NSAs, but all products specified and purchased must meet Kāinga Ora’s requirements.
- 4.80 Considerations for building products which are important to Kāinga Ora include:
- 4.80.1 adherence to performance-based requirements that can be applied to the design, construction and maintenance including Kāinga Housing Standard: Design M-255 for new builds;
 - 4.80.2 the product meets the requirements of the Building Code;
 - 4.80.3 considering tenants’ needs, eg, it will contribute to a healthy home and Kāinga Ora as a long-term asset owner; and
 - 4.80.4 the product meets environmental standards, eg, the 6 Homestar standard is one of the requirements additional to the Building Code and applies to all new build projects.²⁵⁰
- 4.81 Kāinga Ora often considers new or innovative products. This is done by developing designs, testing the market for availability of relevant products and conducting pilot schemes.²⁵¹ Kāinga Ora teams also collaborate with Scion, BRANZ, Callaghan Innovation and other industry leaders regarding new technologies, processes and products.²⁵² These types of products go towards meeting the Homestar standard or the goal of decarbonising homes for example. This means Kāinga Ora may be more inclined to adopt new or innovate products than other designers or builders.
- 4.82 Kāinga Ora’s experience with offsite manufacturing is discussed in Chapter 8.

²⁴⁸ Kāinga Ora “Existing Kāinga Ora Sourcing arrangements” <https://kaingaora.govt.nz/working-with-us/procurement-supplying-goods-and-services-to-us/existing-kainga-ora-sourcing-arrangements/>.

²⁴⁹ Kāinga Ora “Existing Kāinga Ora Sourcing arrangements” <https://kaingaora.govt.nz/working-with-us/procurement-supplying-goods-and-services-to-us/existing-kainga-ora-sourcing-arrangements/>.

²⁵⁰ Homestar is an independent rating tool to evaluate homes in terms of their warmth, health and sustainability, energy and water efficiency qualities. It is run by the New Zealand Green Building Council and was launched in 2010.

²⁵¹ [].

²⁵² Kāinga Ora “Innovation” <https://kaingaora.govt.nz/developments-and-programmes/innovation/>.

Chapter 5 Competition between suppliers

Summary of preliminary findings

- Overall, competition between suppliers appears to be more limited than at other stages of the supply chain – particularly for some key building supplies.
- When competition between suppliers works well, purchasers can access higher-quality key building supplies at lower prices. This can lead to better outcomes for the wider construction sector.
- Each category of key building supplies has its own set of suppliers and unique circumstances which lead to differences in conditions of entry and expansion. Distribution models vary, with some key building supplies mainly distributed through merchants, others mainly sold direct to builders while others are a combination of both.
- The supply of many key building supplies is persistently highly concentrated in New Zealand. Some categories of key building supplies (for example, plasterboard and fibre cement) have only one or two main suppliers. However, concentration in supply of some key building products may have fallen in recent years.
- Competition between suppliers is stronger if decision makers can substitute between their products more easily. While the substitutability of key building supplies is determined by a range of factors, we observe some factors that may create avoidable barriers to substitution. For example, specification of products by brand in building plans and the bundling of products into product systems.
- High structural barriers to entry and expansion appear to be protecting the market shares of incumbent suppliers. There are generally high sunk costs and scale economies associated with manufacturing key building supplies, and the viability of importing can vary between supplies. Further, New Zealand's small size and demand uncertainties make it challenging for domestic manufacturers to reach efficient scale, and less attractive for entrepreneurs to import products here.
- Some suppliers that primarily distribute their products through large merchants face a degree of countervailing power. However, merchants have limited ability to exercise countervailing power when there is only one main supplier in a category or when suppliers can supply directly to the more fragmented construction level. Supplier-to-merchant rebates may also increase the cost to merchants of switching between suppliers and weaken their incentives to use countervailing power to drive competition between suppliers. Builders do not generally have strong countervailing power when dealing directly with suppliers.
- Two of the five major merchants are vertically integrated with suppliers across several categories. There are, however, a range of independent distribution options available for non-vertically integrated suppliers. Difficulties that some suppliers face in getting stocked by merchants do not appear to be attributable to vertical integration.

Introduction

- 5.1 This chapter discusses who the different suppliers of key building supplies are, the key building supplies they provide, and what competition they face in doing so.
- 5.2 We begin the chapter with an overview of suppliers, including the categories of key building supplies within which they compete. The remaining sections discuss the following factors relevant to our assessment of factors affecting competition:
 - 5.2.1 concentration among suppliers of key building supplies;
 - 5.2.2 demand substitutability between key building supplies;
 - 5.2.3 structural conditions of entry and expansion for suppliers;
 - 5.2.4 countervailing power of merchants and builders; and
 - 5.2.5 the impact of vertical integration on competition between suppliers.
- 5.3 Other factors affecting competition between suppliers are discussed in more detail in other chapters:
 - 5.3.1 Chapter 3 explores how features of the New Zealand regulatory and standards systems can create barriers to entry and expansion for market participants, including suppliers.
 - 5.3.2 Chapter 4 explores how building supplies are specified and purchased, including how this process can favour incumbent suppliers.
 - 5.3.3 Chapter 7 explores the nature of arrangements between suppliers and merchants, including how rebates and other vertical arrangements can raise barriers to entry and expansion by suppliers in highly concentrated markets.
 - 5.3.4 Chapter 8 explores how innovation, standardisation, and building for climate change has the potential to influence competition between suppliers, including the challenges faced by suppliers trying to bring new products or approaches to market.
- 5.4 This chapter refers to findings in those other chapters where related and, in some cases, builds on them to draw out their implications for competition between suppliers.

Overview of suppliers of key building supplies

- 5.5 Suppliers, as we define them, are domestic manufacturers and importers of key building supplies. They are upstream in the supply chain from merchants and other distributors, and some are direct suppliers.²⁵³
- 5.6 In this section, we set out relevant observations about suppliers of key building supplies and our approach to assessing competition between them.

We assess competition between suppliers at a key building supply category level

- 5.7 Suppliers do not compete with each other across the whole building supply sector. They typically deal with a narrower range of key building supplies than, for example, a merchant or a builder. It would not be accurate to treat a structural timber supplier as being in competition with an insulation supplier, even if both supply to the same distributor.
- 5.8 Therefore, to assess competition between suppliers, we have defined and described 18 categories of key building supplies, which we refer to as KBS categories. These are shown in Table 5.1 below.

Table 5.1 Key building supply categories

KBS category	Description	Types/varieties included (not exhaustive)
Cement	A binder substance that is a key input into ready-mix concrete and other concrete products.	<ul style="list-style-type: none"> Bulk cement Bagged cement
Concrete	A strong composite material made from coarse and fine aggregates (eg, sand and gravel), water, cement, and additives. Commonly used in foundations and flooring.	<ul style="list-style-type: none"> Ready-mix concrete Pre-mixed bagged concrete Concrete walls (also known as tilt-slabs)
Doors and windows	Materials that comprise the doors and windows of a building.	<ul style="list-style-type: none"> Doors and door joinery Windows and window joinery
Engineered timber	A strong composite material made from wood and adhesives. It typically fulfils a structural function and includes both framing products and heavier beam products.	<ul style="list-style-type: none"> Laminated veneer lumber (LVL) Cross-laminated timber (CLT) Glued laminated timber (glulam)
Fibre cement	A durable composite material made from fibre-reinforced cement. Commonly used for exterior cladding.	<ul style="list-style-type: none"> Fibre cement weatherboard Fibre cement sheets/panels Fibre cement interior lining
Insulation	A material that traps air in still layers to achieve thermal management in homes.	<ul style="list-style-type: none"> Glass wool insulation (also known as fibreglass) Polyester insulation Polystyrene insulation

²⁵³ Direct supply occurs when suppliers bypass the distribution level and supply directly to the construction level (or to other suppliers in the case of input products like cement).

Masonry	Bricks and blocks used for cladding and/or structural purposes.	<ul style="list-style-type: none"> • Concrete bricks and blocks • Clay bricks
Other boards and panels	Board and panel products, not elsewhere specified, generally used in flooring or interior walls. Includes many engineered wood products.	<ul style="list-style-type: none"> • Particleboard • Medium-density fibreboard (MDF) • Oriented strand board (OSB)
Other cladding	Exterior cladding products not elsewhere specified.	<ul style="list-style-type: none"> • PVC cladding • Aluminium cladding • Panelised cladding systems
Other timber	Sawn timber products not elsewhere specified. Can be used in foundation, flooring, roof, and interior walls.	<ul style="list-style-type: none"> • Non-structural timber • Appearance timber • Timber mouldings
Plasterboard	An interior drywall lining consisting of two paperboards that sandwich gypsum.	<ul style="list-style-type: none"> • Standard board • Performance board • Plasterboard compounds
Plywood	An engineered wood board product made by gluing together thin layers of wood veneer.	<ul style="list-style-type: none"> • Plywood flooring • Plywood interior lining • Plywood cladding
Roofing	Materials that comprise the roof of a building.	<ul style="list-style-type: none"> • Longrun/metal roofing • Roofing tiles • Roof flashings • Roof vents
Steel framing	Steel products that can be used for structural framing in residential building.	<ul style="list-style-type: none"> • Light gauge framing • Steel studs • Steel beams
Steel reinforcing	Steel products used in conjunction with concrete foundations to supplement the tensile strength of a building.	<ul style="list-style-type: none"> • Steel reinforcing mesh • Steel reinforcing bar • Reinforcing steel rods
Structural timber	Sawn timber products that can be used for structural framing in residential building.	<ul style="list-style-type: none"> • Radiata Pine • Douglas Fir • Other species
Timber cladding	Timber products that can be used for exterior cladding in residential building.	<ul style="list-style-type: none"> • Timber weatherboard • Timber panel cladding
Wet area lining	Water-resistant interior lining products that can be used in wet areas (eg, kitchens and bathrooms).	<ul style="list-style-type: none"> • Wet area plasterboard • High-pressure laminate panels • Fibre cement wet lining

Source: Commission review of BRANZ (2020), Trends in materials used in new houses; Deloitte Access Economics (2018), Cost of residential housing development; BRANZ (2008), New house price modelling.²⁵⁴

- 5.9 These KBS categories reflect the in-scope building supplies set out in Chapter 1 (or groupings of these in-scope supplies). Each KBS category roughly resembles its own market with its own set of suppliers and competition dynamics. The rest of the section describes these and identifies some high-level differences between KBS categories.
- 5.10 We have not conducted a formal market definition analysis in defining these KBS categories. Our categorisation process involved synthesising and aggregating the product hierarchy systems of several building supply merchants, which carries some methodological limitations:
- 5.10.1 In some cases, suppliers in different KBS categories might compete, directly or indirectly, due to product substitution occurring between the categories. For example, plywood suppliers are likely to compete to some extent with suppliers of other board and panel products.
 - 5.10.2 On the other hand, some KBS categories may contain substantially different sets of products whose suppliers do not compete with each other. For example, suppliers of window glazing may not compete with suppliers of window joinery.
 - 5.10.3 Some in-scope key building supplies may not be included in a KBS category at all, especially those that are not commonly sold through merchants.
- 5.11 We also note that, although the major suppliers in most KBS categories operate nationally, in some cases it may be more appropriate to assess competition on a regional basis.
- 5.12 Our objective in defining KBS categories is not to conduct detailed competition assessments of each one, but rather to enable observations to be made about competition between suppliers of key building supplies. For more detailed assessments of industry structure and competition between suppliers at a key building supply level, see our case studies at Attachments B, C and D.

Most suppliers operate within a small selection of key building supply categories

- 5.13 There are many suppliers of key building supplies. Most supply products within a single KBS category or a small number of related KBS categories. No suppliers are active across the whole building supply sector, though some are connected more broadly by ownership.

²⁵⁴ BRANZ "Trends in materials used in new houses" (July 2020), available at: https://d39d3mj7qio96p.cloudfront.net/media/documents/BRANZ_RN_Physical_characteristics_1.pdf; Deloitte Access Economics "Cost of residential housing development: A focus on building materials" (December 2018), available at: <https://www2.deloitte.com/content/dam/Deloitte/nz/Documents/2020Economics/nz-en-DAE-Fletcher-cost-of-residential-housing-development.pdf>; BRANZ "New house price modelling" (2008), available at: https://d39d3mj7qio96p.cloudfront.net/media/documents/SR196_New_house_price_modelling.pdf.

- 5.14 The two main ownership groups active in the sector are Fletcher Building and Carter Holt Harvey (CHH) Group. Throughout this chapter, we use teal and brown colour coding respectively to indicate suppliers that are part of these groups. Table 5.5 later in the chapter provides a complete list of the relevant suppliers within these ownership groups.
- 5.15 Some suppliers are also particularly influential across the sector due to their size, their market share, and/or the relative importance of their category to residential building.
- 5.16 Table 5.2 below sets out the 25 largest suppliers according to the total value of their sales of key building supplies to the five major building supply merchants in the year ended 30 June 2021, arranged in alphabetical order.²⁵⁵ It also indicates where suppliers are part of a broader ownership group using the colour coding described above.
- 5.17 Considering only sales to merchants understates the size of suppliers that make a lot of direct sales, so these suppliers are less likely to appear in Table 5.2. Table 5.3 below has details of which KBS categories are likely to have a lot of direct sales.

Table 5.2 Top 25 suppliers by value of key building supply sales to the five major building supply merchants (year ended 30 June 2021), in alphabetical order

Supplier name	Main KBS categories ²⁵⁶	Ownership group
BBI Wood Products	Plywood	
CHH Futurebuild	Engineered timber	CHH Group
CHH Plywood	Plywood	CHH Group
CHH Woodproducts	Structural timber, other timber	CHH Group
Claymark	Other timber, timber cladding	
Firth Concrete	Concrete, masonry	Fletcher Building
Fletcher Reinforcing	Steel reinforcing	Fletcher Building
Herman Pacific	Timber cladding, other timber	
Hume Pine	Other timber, timber cladding	
I.P.L. Plywood Manufacturers	Plywood	
James Hardie	Fibre cement, other cladding, wet area lining	
Kiwi Lumber	Structural timber	
Knauf Insulation	Insulation	

²⁵⁵ The five major building supply merchants are PlaceMakers, Carters, ITM, Bunnings, and Mitre 10. Here, key building supplies includes only those that fall within KBS categories (which we expect to be the vast majority of in-scope key building supplies).

²⁵⁶ KBS categories that have a lot of direct sales (and the suppliers active in these categories) are likely to be underrepresented in this table.

Laminex	Other boards/panels, wet area lining	Fletcher Building
Max Birt Sawmills	Structural timber, other timber	
McAlpines (incl. South Pine)	Structural timber	
New Zealand Wood Products	Plywood, engineered timber	
Niagara	Timber cladding, other timber	
Prowood	Engineered timber	
Red Stag Timber	Structural timber, other timber	
Southern Pine Products	Other timber, timber cladding	
Summit Steel & Wire	Steel reinforcing	
Tasman Insulation	Insulation	Fletcher Building
United Steel	Steel reinforcing	
Winstone Wallboards	Plasterboard, wet area lining	Fletcher Building

Source: Commerce Commission analysis of data collected from major building supply merchants.²⁵⁷

The number and nature of suppliers varies between key building supply categories

- 5.18 The set of suppliers and the composition of market shares varies between KBS categories. Therefore, the overall level of concentration also differs between KBS categories.
- 5.18.1 For example, we have identified two KBS categories where a large share of supply is accounted for by only one supplier: plasterboard (Winstone Wallboards) and fibre cement (James Hardie).
- 5.18.2 On the other hand, some KBS categories (eg, insulation and timber cladding) appear to have at least five notable suppliers in New Zealand.²⁵⁸
- 5.18.3 See Table 5.4 below for a full overview of concentration in each KBS category, including the number of notable suppliers in each.
- 5.19 Suppliers can be domestic manufacturers or importers (and some are both). The prevalence of imports varies significantly between KBS categories. Some are primarily manufactured domestically (eg, structural timber, concrete), while some are mostly imported (eg, fibre cement) and some include a mix of both (eg, cement, insulation).
- 5.20 We discuss the viability of imports, and how it can vary between key building supplies, later in this chapter as part of our discussion of structural conditions of entry and expansion for suppliers.

²⁵⁷ [].

²⁵⁸ We define a notable supplier as one that accounts for at least a 5% share of supply.

- 5.21 The prevalence of direct supply also differs between KBS categories. Direct supply is more common where there is limited scope for distributors to add value to the supply chain and/or where the characteristics of a product are not suitable for being stocked by merchants and other distributors.
- 5.22 For example, our concrete case study found that ready-mix concrete is too bulky and perishable to be physically stocked by merchants. It also found that cement, due to its nature as an input product, is most suited to being supplied in bulk directly to concrete suppliers.
- 5.23 Table 5.3 below sets out the 18 KBS categories according to our understanding of their typical distribution model.

Table 5.3 Key building supply categories by typical distribution model

Primarily distributed through merchants and other retailers	Commonly supplied directly to the construction level or to other suppliers
Engineered timber	Cement
Fibre cement	Concrete
Insulation	Doors and windows
Masonry	Roofing
Other boards/panels	Steel framing
Other cladding	Steel reinforcing
Other timber	
Plasterboard	
Plywood	
Structural timber	
Timber cladding	
Wet area lining	

Source: Commerce Commission analysis of information collected from market participants.²⁵⁹

Concentration among suppliers of key building supplies

- 5.24 Concentration is often used as an indicator of the intensity of competition.²⁶⁰ An industry or market is considered to be more concentrated if relatively few suppliers control a large share of supply.
- 5.25 In this section we discuss concentration at the supplier level and how it varies for different key building supplies.

²⁵⁹ []; []; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 4-5.

²⁶⁰ See: <https://www.oecd.org/competition/market-concentration.htm>.

- 5.26 Our preliminary assessment is that:
- 5.26.1 plasterboard and fibre cement are particularly highly concentrated at the supplier level;
 - 5.26.2 supplier concentration for some KBS categories appears to be declining over time; and
 - 5.26.3 otherwise, there is a relatively high and stable level of supplier concentration among KBS categories.
- 5.27 We start with a general discussion of what we can and cannot interpret from the existence of high concentration at the supplier level. Next, we present the results of our concentration analysis, which focuses on suppliers' share of supply to merchants. The remainder of this section discusses each of the above findings in more detail.

High concentration can indicate a lack of competition between suppliers but it is not determinative on its own

- 5.28 High concentration can be the outcome of suppliers gaining market share by offering the best price or quality product and competing to maintain that position against the threat of new entry and expansion.
- 5.29 In some situations, even if concentration is persistently high, it is possible that suppliers are constrained by other factors. This generally requires the presence of another supplier or the credible threat of imminent entry.
- 5.30 However, high concentration can also indicate weak competition, particularly when high concentration persists over a long period. It can be a result of other suppliers being prevented from competing effectively due to high barriers to entry or expansion in the market, which enables them to set higher prices or to reduce the quality of goods or services without the threat of losing customers to a competitor (unilateral market power).
- 5.31 Concentration can have other consequences beyond the risk of unilateral market power. For example:
- 5.31.1 concentrated markets are more vulnerable to coordination between suppliers, all else held equal; and
 - 5.31.2 concentrated markets can be less resilient to demand shocks and uncertainty.²⁶¹

²⁶¹ Andrea Coscelli & Gavin Thompson "Competition & Markets Authority: Economics working paper – Resilience and Competition Policy", available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1064924/Resilience_and_competition_policy_-_AC.pdf.

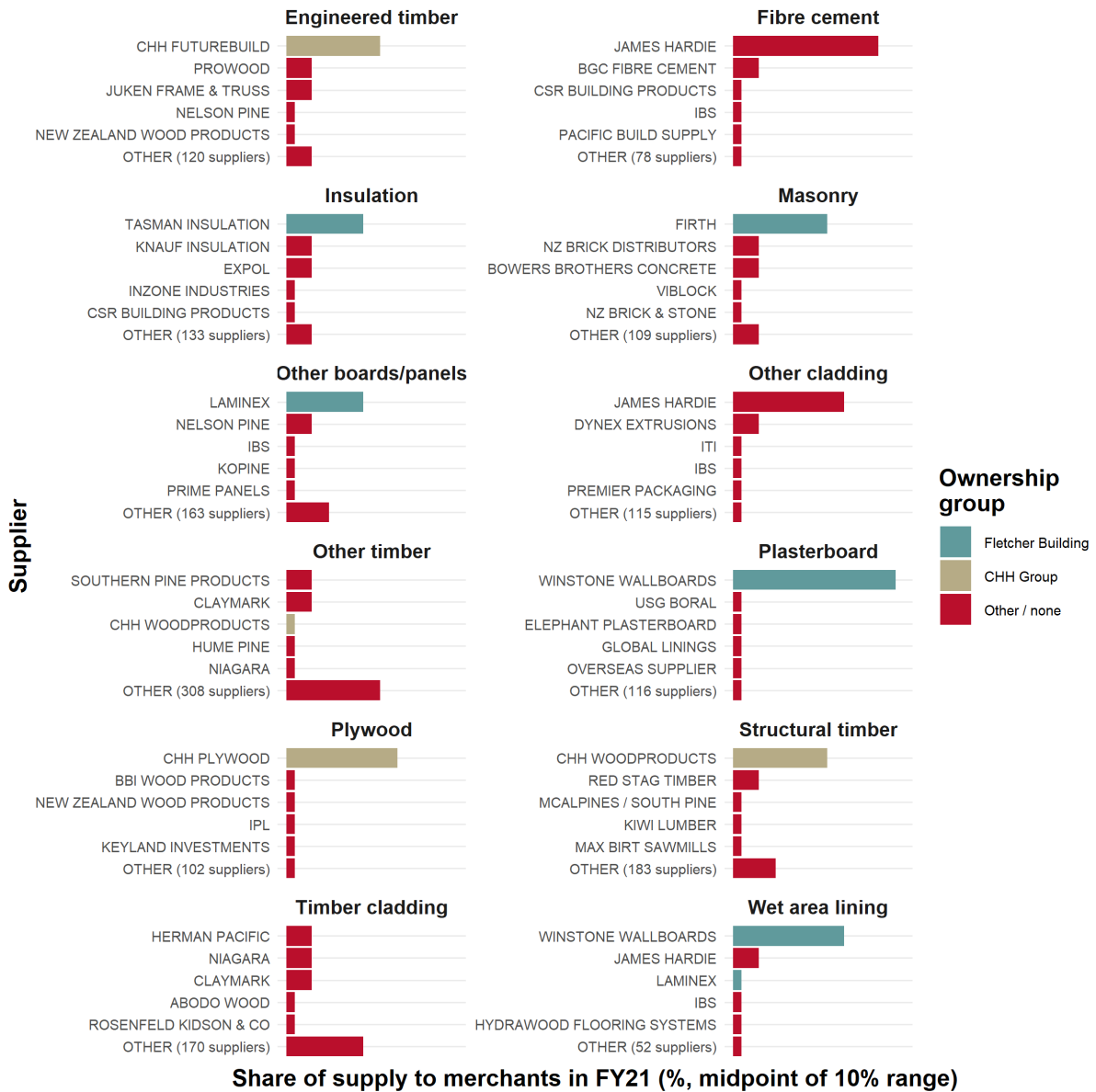
Share of supply to merchants analysis

- 5.32 The first step in our assessment of concentration is to estimate suppliers' share of supply to merchants (SSM) for each KBS category. We have done this using data on the purchases of the five major merchants – PlaceMakers, Carters, ITM, Bunnings, and Mitre 10 – over a five-year period, with a focus on the year ended 30 June 2021 (FY21).²⁶²
- 5.33 The SSM is a percentage figure that represents the proportion of merchant purchases that each supplier accounted for (per financial year and KBS category). It can be interpreted similarly to a market share percentage, but there are some data limitations:
- 5.33.1 The five major merchants are significant purchasers of key building supplies, but they are not the only purchasers. In most cases, suppliers do not solely compete to supply these merchants, and therefore our SSM measure only provides a window into the wider markets in which these suppliers compete.
 - 5.33.2 In particular, our lack of data for direct sales gives us low visibility of the six KBS categories that are typically sold directly. Therefore, we only present SSM results for the 12 KBS categories that are primarily distributed through merchants and other retailers (whose purchasing behaviour we expect can be approximated well by the five major merchants, though this may not always be the case). These are the 12 KBS categories in the left-hand column of Table 5.3.
 - 5.33.3 As noted above, the KBS categories were constructed by synthesising and aggregating the product hierarchy systems of the merchants. While consistency was prioritised, there is inevitably some imprecision and overlap which has the potential to distort supplier SSMs. Further, the KBS categories are likely to include some accessory and auxiliary products which may inflate the number of small suppliers in each KBS category and deflate the SSMs of suppliers who do not provide these products.
- 5.34 Figure 5.1 below presents supplier SSMs for each of the 12 KBS categories that, to our understanding, are primarily distributed through merchants and other retailers. We place each SSM in a 10 percent range, and present the midpoint of that range in Figure 5.1 below.

²⁶²

FY21 was the most recent complete financial year at the time we collected the data.

Figure 5.1 Suppliers' share of supply to merchants by key building supply category, year ended 30 June 2021



Source: Commerce Commission analysis of building supply merchant purchasing data.²⁶³

- 5.35 We have used our SSM estimates as proxies for market shares to calculate three indicators of concentration:
- 5.35.1 The 3-firm concentration ratio (CR3) is the sum of the three highest supplier SSMs. It indicates the proportion of total category value held by the three largest suppliers. A higher CR3 reflects a more concentrated market. We have used 70% or above as an indicator of high concentration for the purpose of our analysis (it can range from close to 0% to 100%).²⁶⁴
 - 5.35.2 The Herfindahl-Hirschman Index (HHI) is the sum of the squares of all supplier SSMs. A higher HHI reflects a more concentrated market, with 2,500 or above typically indicating high concentration (it can range from close to 0 to 10,000).²⁶⁵ Unlike CR3, HHI includes all suppliers and places greater weight on individual suppliers' sizes. It would describe a market with one large supplier and two small ones as more concentrated than a market with three equally sized suppliers, whereas this distinction would not be captured by CR3.
 - 5.35.3 Lastly, the number of suppliers with at least 5% share of supply to merchants provides a simple overview of how many notable suppliers are active in each category. We consider that three or fewer notable suppliers may indicate that the category is more likely to be highly concentrated.
- 5.36 Table 5.4 below presents these concentration indicators for each KBS category in FY21. We also include the total value of merchant purchases to give an indication of category size. The categories are ordered from most to least concentrated based on our estimate of HHI. Indicators are shaded orange if they exceed the concentration thresholds outlined above.

²⁶⁴ Commerce Commission "Mergers and acquisitions Guidelines" (May 2022), available at: https://comcom.govt.nz/_data/assets/pdf_file/0020/91019/Mergers-and-acquisitions-Guidelines-May-2022.pdf.

²⁶⁵ The United States Department of Justice "Herfindahl-Hirschman Index" <https://www.justice.gov/atr/herfindahl-hirschman-index>.

Table 5.4 Summary of concentration indicators (according to share of supply to merchants analysis), year ended 30 June 2021

KBS category	Concentration indicators (calculated using SSM)			#1 supplier ²⁶⁶
	3-firm concentration ratio (CR3, %)	Herfindahl-Hirschman Index (HHI)	# of suppliers with at least 5% share	
Plasterboard	98	9,271	1	Winstone Wallboards
Fibre cement	97	7,283	2	James Hardie
Wet area lining	93	4,926	3	Winstone Wallboards
Other cladding	87	4,667	2	James Hardie
Plywood	80	3,991	4	CHH Plywood
Engineered timber	80	3,379	3	CHH Futurebuild
Masonry	77	3,271	5	Firth Concrete
Structural timber	74	2,944	3	CHH Woodproducts
Insulation	73	2,366	5	Tasman Insulation
Other boards/panels	62	2,164	5	Laminex
Timber cladding	42.7	901	6	Herman Pacific
Other timber	34.7	653	6	Southern Pine Products

Source: Commerce Commission analysis of building supply merchant purchasing data.²⁶⁷

5.37 The remainder of this section discusses our interpretation of these concentration measures.

Plasterboard and fibre cement are particularly highly concentrated at the supplier level

5.38 Plasterboard is the most concentrated KBS category at the supplier level regardless of concentration indicator used. A sole supplier, Winstone Wallboards (WWB), has a very high SSM which drives very high concentration ratios, particularly the HHI. Moreover, we understand that sales through merchants are likely to represent a significant proportion of overall plasterboard sales in New Zealand.²⁶⁸

²⁶⁶ Business units of Fletcher Building are shaded in teal; business units of CHH Group are shaded in brown.

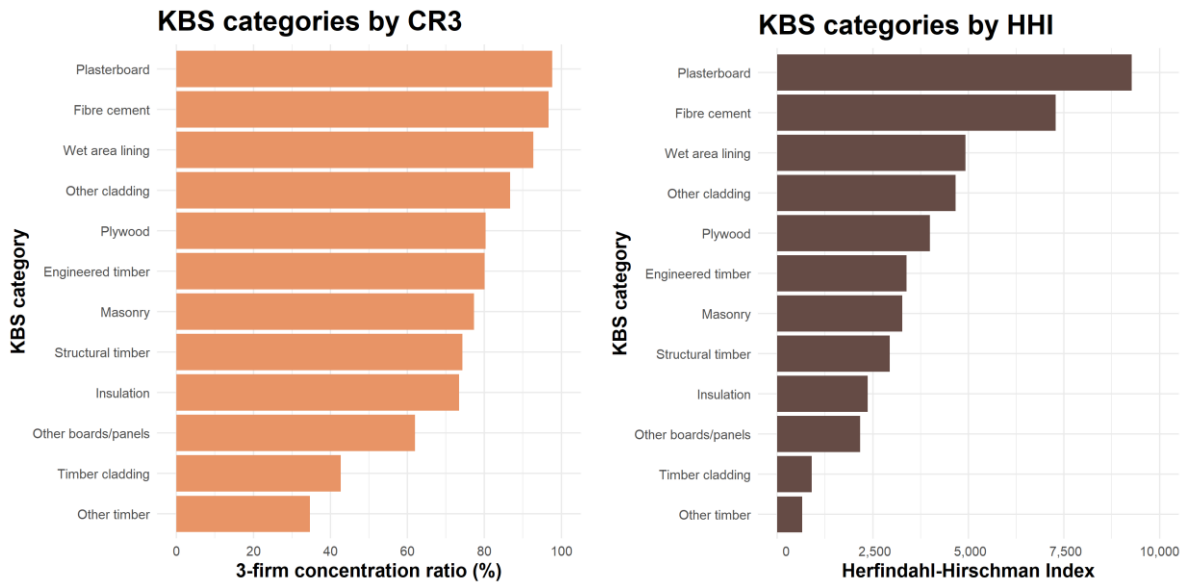
²⁶⁷ CR3 figures are rounded to the nearest whole percentage point, whilst HHI figures are rounded to the nearest whole number. We note that market shares presented here are sourced from one data source, and therefore may not be identical to market shares presented elsewhere in this report, [].

²⁶⁸ [].

- 5.39 In our view, this high concentration reflects and perpetuates a lack of effective competition between plasterboard suppliers. WWB's high share of supply provides it with a significant incumbency advantage including the scale economies it is able to achieve as a supplier. It also benefits from network effects which arise when a product or service becomes more valuable the more users it attracts. Its GIB products are embedded in the regulatory and standards systems as a preferred product and are commonly specified by brand in building plans. Currently, it does not appear to face material competitive constraint from any other supplier.²⁶⁹
- 5.40 Fibre cement is also very highly concentrated at the supplier level. One supplier, James Hardie, has a very large share of supply to merchants. The second and third largest suppliers, BGC Fibre Cement and CSR Building Products, have very much smaller shares.
- 5.41 We understand James Hardie is likely to benefit from a similar incumbency advantage to WWB in terms of achieving significant scale economies and having its products ingrained in regulatory systems and building plans. It does appear to face more competitive constraint than WWB, both from BGC Fibre Cement and from suppliers of other cladding products (eg, timber cladding). We discuss this further in the following subsection.
- 5.42 Wet area lining is the third-most concentrated KBS category at the supplier level. This is a category where WWB's wet area plasterboard products appear to compete with James Hardie's fibre cement wet lining products. Further, this is the only KBS category where we observe two Fletcher Building business units (WWB and Laminex) among the main suppliers.
- 5.43 Many other KBS categories are also highly concentrated, though to a lesser extent than plasterboard and fibre cement. This is shown most effectively by the HHI measure and illustrated in Figure 5.2 below which presents bar charts of our SSM-based concentration indicators (again for FY21).

²⁶⁹ Figure 5.1 above includes the top five suppliers of plasterboard to the major merchants. The 'overseas supplier' is likely to be ProRoc, which supplies plasterboard to Bunnings. Except for WWB, they all have very small shares of supply to merchants. We do not consider these suppliers pose a material competitive constraint on WWB, although we note that recent GIB shortages have given these suppliers (and others) opportunity to grow their market presence.

Figure 5.2 Select concentration indicators by key building supply category, year ended 30 June 2021



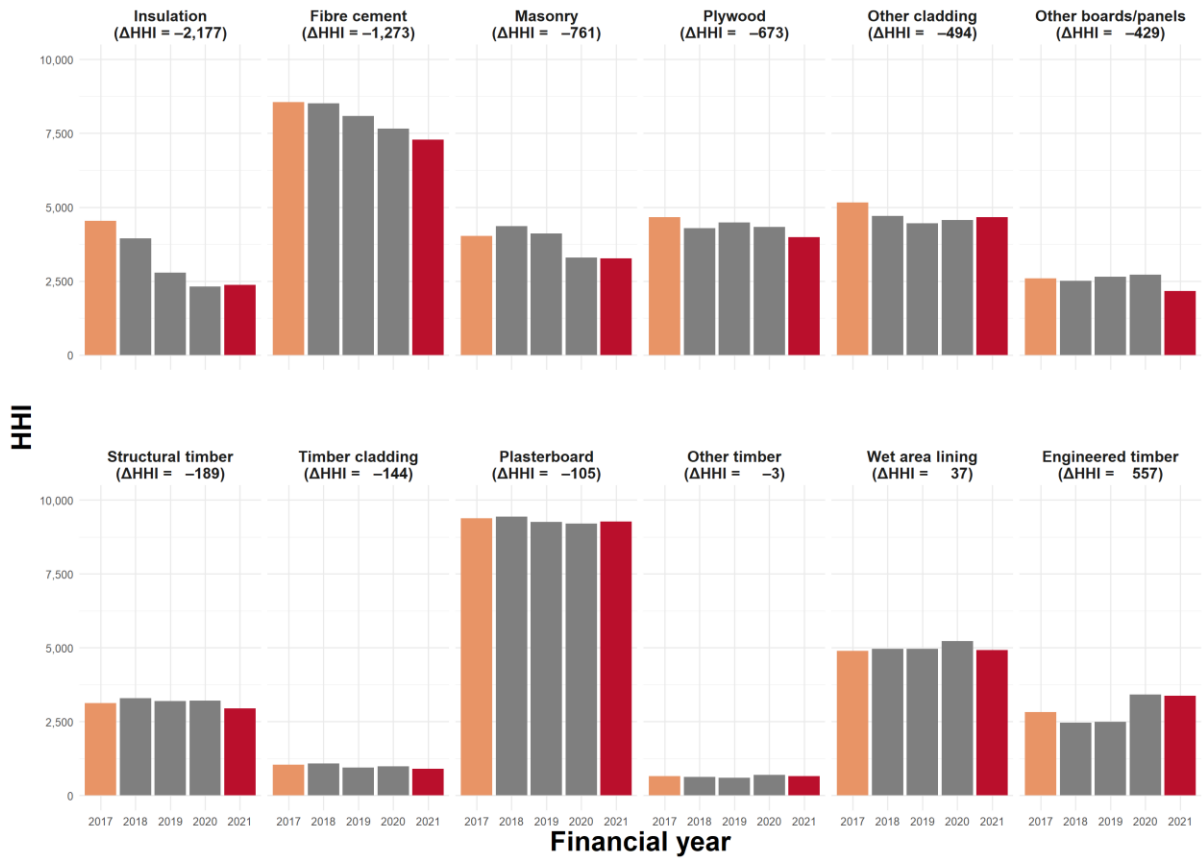
Source: Commerce Commission analysis of building supply merchant purchasing data.²⁷⁰

Supplier concentration for some key building supply categories appear to be declining over time

5.44 High concentration may be more indicative of weak competition if it persists over time. Figure 5.3 below shows the HHI of each KBS category across the five-year period FY17-FY21. It also shows the change in HHI (Δ HHI) from FY17 to FY21. A negative Δ HHI indicates a fall in concentration, whereas a positive Δ HHI indicates an increase in concentration. We used the HHI measure because it is more likely to detect small movements in market shares over time than CR3, particularly in highly concentrated markets.

270 [].

Figure 5.3 Concentration of key building supply categories over time according to HHI (ordered by Δ HHI, the total HHI decrease between FY17 and FY21)



Source: Commerce Commission analysis of building supply merchant purchasing data.²⁷¹

- 5.45 Some of the changes in HHI are small and do not suggest a material change in concentration over the period FY17-FY21.
- 5.46 However, our analysis suggests that concentration has fallen in some KBS categories. There has been a marked decrease in concentration in the Insulation KBS category between FY17 and FY21 according to HHI.²⁷²

²⁷¹ [].

²⁷² [].

- 5.47 Fibre cement also appears to have seen a marked decrease in supplier concentration between FY17 and FY21, although it remains highly concentrated. The fact that suppliers were able to expand SSM in the supply of fibre cement, but not in the supply of plasterboard, provides an interesting point of comparison between the two KBS categories.
- 5.47.1 This may be because fibre cement products can be easier to substitute than plasterboard (even when specified by brand in building plans).²⁷³
- 5.47.2 However, it has also been suggested that it continues to be very difficult to win market share off James Hardie because of its entrenchment in the regulatory system and in the preferences of decision makers.²⁷⁴
- 5.48 We also considered movements in individual suppliers' SSM over time.²⁷⁵ A gradual decline in the SSM of an incumbent with a very high share of supply can create a more pronounced HHI effect because of the category's extremely high concentration. We also observed that SSMs in other concentrated categories (aside from insulation) were relatively stable, although engineered timber stood out for its recent increase in the SSM of the main supplier.

Otherwise, there is a generally high and stable level of supplier concentration among key building supply categories

- 5.49 In addition to the very high concentration in plasterboard and fibre cement, we observe a generally high degree of supplier concentration across the 12 KBS categories that are primarily distributed through merchants. Referring back to Table 5.4:
- 5.49.1 9 out of 12 KBS categories have a 3-firm concentration ratio above 70%;
- 5.49.2 8 out of 12 KBS categories have an HHI above 2,500; and
- 5.49.3 6 out of 12 KBS categories have three or fewer suppliers with at least 5% SSM.
- 5.50 This appears to be a somewhat stable situation. Aside from the two KBS categories we identified in the previous subsection (insulation and fibre cement), we generally observed limited movement in concentration indicators and individual supplier SSM over the last five years. However, this is a relatively narrow window of time over which to make such an observation.

²⁷³ [].

²⁷⁴ Mitre 10 "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 24; [];

[].

²⁷⁵ Commerce Commission analysis [].

- 5.51 We also observe indications of high concentration in some of the categories that were not included in our merchant data analysis because they are commonly supplied directly to the construction level:
- 5.51.1 Our concrete case study found that the supply of cement is highly concentrated with two large suppliers (Golden Bay Cement and Holcim) supplying between 75 and 95% of the bulk cement market. As set out in Attachment D, Golden Bay Cement’s share has remained relatively constant over the past decade but a third supplier, HR Cement, entered the market in 2012 and now supplies between 5% and 10% of the market.
 - 5.51.2 We received submissions suggesting that steel reinforcing and steel coil (an input into steel roofing) are concentrated at the supplier level.²⁷⁶
- 5.52 The rest of this chapter discusses some potential causes of the generally high supplier concentration we have observed.

Demand substitutability between key building supplies

- 5.53 In this section we discuss the extent to which decision makers (ie, builders, specifiers, and end users) can and do substitute between key building supplies and what this tells us about competition between suppliers.
- 5.54 Our preliminary findings are that:
- 5.54.1 the substitutability of key building supplies falls along a spectrum ranging from direct to indirect;
 - 5.54.2 suppliers compete more closely if decision makers can substitute between their products more easily; and
 - 5.54.3 specification by brand can have a dampening impact on competition between suppliers.
- 5.55 The remainder of this section discusses each of the above findings in detail.

²⁷⁶ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 29.1; HW Richardson Group Ltd “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 6; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 23; New Zealand Metal Roofing Manufacturers Association “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 3.

The substitutability of key building supplies falls along a spectrum ranging from direct to indirect

- 5.56 There are different degrees to which key building supplies are substitutes for one another. At a high level, we define two key types of substitution:
- 5.56.1 two products (or groups of products) are direct substitutes if substitution is viable after building plans have been finalised;
 - 5.56.2 two products (or groups of products) are indirect substitutes if substitution is viable during the planning stage but would be expensive or time-consuming once plans have been finalised (eg, because of the need to reapply for consent and/or change other aspects of the building design).
- 5.57 An example of indirect substitutes might be timber framing and steel framing. While they both fulfil a framing functionality in residential construction, the decision to use one or the other is an important engineering decision with flow-on effects for the rest of the building design and cannot easily be modified after plans have been finalised.²⁷⁷
- 5.58 An example of direct substitutes might be two brands of ready-mix concrete. While there may be some differences in the attributes of products produced by different ready-mix suppliers, in general we would expect they can be easily substituted at any stage of the building process.²⁷⁸
- 5.59 Most instances of substitution between building supplies fall somewhere along the spectrum between direct and indirect. For example: ²⁷⁹
- 5.59.1 We have heard that different insulation products are generally substitutable after building plans have been finalised but that this can be limited by installers' preferences or capability to work between products.²⁸⁰
 - 5.59.2 We have heard that different types of engineered wood board products (eg, plywood, medium-density fibreboard, particleboard) are directly substitutable in most cases, but less so when the products are being used for structural applications such as flooring.

²⁷⁷ [].

²⁷⁸ See Attachment D.

²⁷⁹ []; [].

²⁸⁰ [].

- 5.59.3 As set out in Attachment C, we consider structural timber framing and laminated veneer lumber (LVL) framing to be direct substitutes because the regulatory system allows LVL to be used as framing when structural grade timber (eg, SG8) is specified in building plans. However, LVL cannot be assigned a structural grade itself which may create behavioural barriers to substitution.
- 5.60 One of our aims in constructing KBS categories was to group substitutable products together. Substitution *within* KBS categories is more likely to resemble direct substitution, while substitution *between* KBS categories (to the extent it occurs) is more likely to resemble indirect substitution. However, this is a broad guideline and not a strict rule.
- 5.61 Chapter 4 sets out how building supplies are specified and purchased, including the various factors that can limit substitution between products. The rest of this section discusses what the directness of substitution tells us about competition between suppliers.

Suppliers compete more closely if decision makers can substitute between their products more easily

- 5.62 Suppliers of direct substitutes are likely to compete more closely (all else held equal) because there are low costs to switching between them at all stages of the build. This means decision makers can respond quickly to changes in the price, quality, and availability of the products.
- 5.63 Suppliers of indirect substitutes may provide some competitive constraint on each other, but high switching costs for builders means the majority of switching decisions are made by designers. We consider designers are less likely to be responsive to short-term competitive conditions for the supply of a product and any substitution decisions are likely to take effect over a longer period at which point they would be direct substitutes. Moreover, built-in preferences, building styles, and features of the regulatory system may reduce the chance of indirect substitution occurring at all.
- 5.64 A supplier may be able to take steps to reduce the direct substitutability of its products and create strategic barriers for otherwise closely competing suppliers.
- 5.65 For example, suppliers may design product systems around a particular product which can have a tying effect. Product systems are groups of products that work together to achieve a particular function in the build. They are often specified and consented as a collective, and can become ingrained in the regulatory and standards systems and in the preferences of specifiers and BCAs.²⁸¹

²⁸¹ Bunnings “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 9; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 30.

- 5.66 We understand that both Winstone Wallboards and James Hardie commonly design systems around their core plasterboard and fibre cement products respectively, and that this raises barriers for suppliers who may be able to compete effectively with the core products but not with the wider systems.²⁸²
- 5.67 Product systems can offer benefits to consumers in terms of price, quality, and overall efficiency. However, in our preliminary view, product systems can reduce the ability of competing products to act as a direct substitute, especially when individual elements of the system cannot be swapped out for other suppliers' products.

Specification by brand can have a dampening impact on competition between suppliers

- 5.68 As set out in Chapter 4, specification of building products by brand (as opposed to generic functionality or performance characteristics) is a relatively common practice. This can have the effect of reducing competing products to indirect substitutes when they may otherwise be directly substitutable for the specified product.
- 5.69 In our preliminary view, specification by brand is the primary avoidable impediment to the substitutability of building supplies.²⁸³ It can significantly dampen competition between suppliers and protect incumbents from entry and expansion.
- 5.70 Our three case studies provide a useful comparison of the effects of specification by brand on competition between suppliers.
- 5.71 Winstone Wallboards' GIB plasterboard products are commonly specified by brand in building plans. This is an outcome of several factors, including:
- 5.71.1 New Zealand's structural bracing requirements which mean plasterboard is commonly used for bracing (unlike many other jurisdictions) and which mean councils often require a brand to be specified at the consenting stage;
 - 5.71.2 the integration of GIB products into plasterboard systems;
 - 5.71.3 additional services provided by WWB (eg, free technical advice and bracing calculators); and
 - 5.71.4 network effects arising from widespread familiarity with GIB.
- 5.72 We understand the specification of GIB in building plans makes it significantly more difficult for suppliers to position alternative plasterboard products as direct substitutes and is one of the key drivers of persistent high supplier concentration in the plasterboard market.

²⁸²

[].

²⁸³

By 'avoidable', we mean it is an impediment that can be overcome, as opposed to natural impediments to substitutability such as major technical differences between products.

- 5.73 On the other hand, structural timber is typically specified by structural grade (eg, SG8) in building plans. Structural grade is a generic performance-based measure, defined by New Zealand's standards system, which allows designers to specify structural timber in building plans without reference to a particular brand.²⁸⁴
- 5.74 This makes it more straightforward for decision makers to switch between different brands of structural timber, which increases the intensity of competition between structural timber suppliers.
- 5.75 In our preliminary view, this is an important reason why competition between structural timber suppliers is more effective than competition between plasterboard suppliers.
- 5.76 As noted above, we consider different brands of ready-mix concrete should be directly substitutable due to the relatively homogenous nature of the product. Our concrete case study found that ready-mix concrete is not usually specified by brand in building plans. However, we heard that RibRaft (a trademarked Firth concrete foundation system) is sometimes specified in building plans and this can make it difficult for other suppliers to compete for those particular jobs.²⁸⁵
- 5.77 See Attachments B, C and D for our full case studies into plasterboard, structural timber, and concrete respectively.

Structural conditions of entry and expansion for suppliers

- 5.78 Competition between suppliers can still work effectively in a concentrated market if barriers to entry are low. On the other hand, high barriers to entry can contribute to and reinforce supplier concentration, ultimately weakening competition between suppliers.
- 5.79 In this section we discuss the structural conditions of entry and expansion for suppliers of key building supplies. These are the conditions that are generally determined by external factors such as the size of the market and the technologies, resources or inputs a business would need to enter or expand. These include economies of scale and scope, customer switching costs, network effects and sunk costs.
- 5.80 There are other types of conditions of entry and expansion. For example, strategic conditions which arise where incumbent firms take action to discourage prospective entrants and expansion. Regulatory conditions (which we generally treat separately from structural conditions though they are technically a subset) include, for example, regulations governing standards and quality, and intellectual property rights such as patent protection. We touch on these conditions in the rest of this chapter, but they are primarily addressed in other chapters.

²⁸⁴ While structural timber is not specified by brand, the regulatory system sets durability requirements that may preclude import competition. We discuss this further in Attachment C.

²⁸⁵ See Attachment D.

- 5.81 In respect of structural conditions, our preliminary assessment is that:
- 5.81.1 there are often high sunk costs and scale economies associated with domestic manufacturing;
 - 5.81.2 the variable nature of New Zealand’s construction sector can create demand uncertainty; and
 - 5.81.3 the viability of importing can vary between key building supplies.
- 5.82 The remainder of this section discusses each of the above findings in detail.

There are often high sunk costs and scale economies associated with domestic manufacturing

- 5.83 Building, operating, and maintaining manufacturing facilities can require substantial capital investment. A large customer base is often needed to achieve the economies of scale that would justify such investment. Further, New Zealand’s small size and lack of export efficiencies can make it challenging for domestic manufacturers to reach efficient scale.
- 5.84 These structural barriers to the entry and expansion of domestic manufacturers can limit the number of large manufacturers that can sustainably operate in New Zealand. We have heard this is the case for many key building supplies, including plasterboard, structural timber, cement, insulation, and steel roll-forming (an input into steel framing and steel roofing).²⁸⁶

The variable nature of demand in New Zealand’s construction sector can create uncertainty

- 5.85 Demand for key building supplies is ultimately linked to overall residential building activity. As set out in Chapter 2, residential building activity tends to rise and fall over time. This leads to variability in demand for key building supplies over time.
- 5.86 The uncertainty arising from variable demand for key building supplies creates risk for suppliers when making decisions about entering a market and/or investing in capacity. This may act as an impediment to entry and expansion, especially when there are high sunk capital costs associated with these decisions. Further, smaller suppliers can be especially exposed to downturns in price and profitability.

²⁸⁶ See Attachments B, C and D. Also: Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 30-31; Roofing Association of New Zealand “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 3.

The viability of importing can vary between key building supplies

- 5.87 Imports can reduce supplier concentration where the New Zealand market only supports a limited number of domestic manufacturers of a key building supply. For example:
- 5.87.1 Holcim imports cement from Japan to compete with the major domestic manufacturer, Golden Bay Cement. As we discuss in Attachment D, the New Zealand market is likely to support only one domestic manufacturer (Holcim closed its domestic manufacturing facilities in 2016) but an import model can also achieve scale efficiency.
 - 5.87.2 Knauf Insulation, the second largest supplier of insulation to merchants, is an importer. It has manufacturing facilities in Europe, Asia, and North America.²⁸⁷
 - 5.87.3 We also understand that the majority of fibre cement available in New Zealand is imported, with no significant fibre cement manufacturers operating in New Zealand.
- 5.88 However, not all building supplies support import competition. The viability of importing can vary between building supplies due to product characteristics (eg, the size and weight of products making freight costs prohibitive) or market characteristics (eg, regulatory requirements preventing imported products from being approved in consents).
- 5.89 For example, structural timber is primarily a domestic commodity with very little imported from overseas. As we discuss in Attachment C, a range of factors reduce the viability of importing structural timber including limited available capacity on the global market (due to demand from other countries), volatility of international prices, and New Zealand's unique regulatory and standards system.
- 5.90 Ready-mix concrete is an example of a key building supply that cannot be imported from overseas. New Zealand standards typically require ready-mix concrete to be poured within 90 minutes of manufacture, which means manufacturers typically need to be within a 30km radius of customers. Even beyond this requirement, high freight costs lead to highly localised ready-mix concrete markets.²⁸⁸
- 5.91 New Zealand's small size, and its distance from other markets and overseas manufacturing facilities, makes the import of international products relatively less attractive in general. Even when imports are viable, there may be scale economies associated with distribution and logistics, with New Zealand's small customer base only allowing a small number of importers to reach efficient scale. This can present a structural barrier to imports.

²⁸⁷ See: <https://www.knaufinsulation.co.nz/who-we-are/about-us/our-locations>.

²⁸⁸ See Attachment D.

- 5.92 In summary, import competition can sometimes constrain domestic manufacturers of key building supplies, but it is not guaranteed to do so. It can also be unpredictable due to volatility of international prices and supply levels, as well as exchange rates and freight costs.

Countervailing power of merchants and builders

- 5.93 In this section we discuss the countervailing power of merchants and builders. Countervailing power is the ability for certain customers to exert substantial influence on negotiations. Countervailing power exists when a customer possesses special characteristics that give that customer the ability to substantially influence the price it pays. Even in somewhat concentrated markets, the ability of customers such as merchants and builders to exert countervailing power with suppliers can support competition and constrain suppliers.
- 5.94 Our preliminary assessment is that:
- 5.94.1 the countervailing power of merchants can intensify competition between suppliers unless concentration is too high;
 - 5.94.2 supplier-to-merchant rebates and other volume-based arrangements may increase switching costs and weaken merchants' incentives to use countervailing power; and
 - 5.94.3 builders are less likely to have countervailing power than merchants in their dealings with suppliers of key building supplies.
- 5.95 The remainder of this section discusses each of the above findings in detail.

The countervailing power of merchants can intensify competition between suppliers unless concentration is too high

- 5.96 Many suppliers distribute their products through merchants. These suppliers compete with suppliers of similar products to have their products stocked on shelves, including by the five major national merchants who are likely to comprise a large proportion of total purchases from these suppliers.

- 5.97 Building supply merchants appear to have sophisticated centralised procurement processes. We have been told it is common for them to renegotiate contracts and test the market regularly (including through requests for proposals) to ensure they are receiving favourable supply terms. They appear to procure from several suppliers in each category, operating ‘tier systems’ (eg, primary and secondary suppliers) and deliberately purchasing volume from small suppliers to exert competitive constraint on large ones.²⁸⁹ Overall, we consider that the size, sophistication, and purchasing volumes of the major national merchants is likely to give them a degree of countervailing power with suppliers and, all else held equal, intensify competition between suppliers.
- 5.98 For example, our structural timber case study found that structural timber distributors are generally aware of market pricing and are willing to put pressure on suppliers if their pricing is not in line with competitors, including by switching volume to other suppliers and holding requests for proposals (RFPs) to extract competitive pricing. Further, we found that their ability to do so is supported by their size and sophistication. This provides a competitive constraint in a market with relatively high supplier concentration.
- 5.99 However, there are limits to merchant countervailing power. For example, merchants have less countervailing power when there is only one major supplier to negotiate with in a category (eg, plasterboard and fibre cement). Merchants ultimately need to stock every category to provide a complete offering to their own customers, so in these cases they may have no option other than to deal with the sole supplier.²⁹⁰

Supplier-to-merchant rebates and other volume-based arrangements may increase suppliers’ switching costs and weaken incentives to use countervailing power

- 5.100 Volume-based incentives, as we define them, are contractual terms that reward purchasers for buying a certain volume of product from a supplier (or that require them to do so).
- 5.101 It is reasonably common for agreements between suppliers and merchants to include volume-based incentives. For example, tiered volume rebates, minimum order agreements, and merchant preferred supplier arrangements.
- 5.102 Volume-based incentives, including rebates, provide more surety to suppliers about sales volumes. They also allow suppliers to pass along the efficiencies achieved by supplying a significant volume to a single merchant customer.

²⁸⁹ []; [];

[].

²⁹⁰ Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 27.

- 5.103 However, volume-based incentives can increase the cost to merchants of switching between suppliers when switching would cause the merchant to miss out on a certain reward. Chapter 7 discusses agreements between suppliers and merchants in detail, including volume-based incentives and their implications for competition between suppliers.
- 5.104 In our preliminary view, volume-based rebates and other arrangements can make it less likely that merchants will switch significant volumes to alternative suppliers. All else held equal, we would expect these types of arrangements to result in each merchant using fewer suppliers thus weakening the effect that merchant's countervailing power may otherwise have in promoting competition between suppliers.
- 5.105 By reducing the total volume that merchants might be willing to shift to another supplier, volume-based rebates and other arrangements can also make it harder for other suppliers to enter and expand.
- 5.106 For some key building supplies, merchants may be able to use their countervailing power to negotiate more favourable and less restrictive contractual terms. However, as noted above, this is less likely to be the case when there is only one major supplier to negotiate with, as is the case for plasterboard and fibre cement. In our view, this is where volume-based incentives are most likely to cause competitive harm.

Builders are less likely to have significant countervailing power

- 5.107 Some suppliers sell their products directly to builders and offsite manufacturers who operate at the construction level of the supply chain as set out in Chapter 2. This is the most common distribution model for six of the 18 KBS categories we have identified.
- 5.108 As set out in Chapter 2, the construction level of the New Zealand residential building supply chain is more fragmented than the distribution level. Therefore, we would not expect any purchaser (or small group of purchasers) who buys direct from a supplier to account for a significant proportion of that suppliers' sales.
- 5.109 We consider it unlikely that any direct supplier of key building supplies is significantly constrained by the countervailing power of individual builders. For example, our case study of ready-mix concrete (which is commonly sold direct) did not find countervailing power to be a major influence on competition.
- 5.110 Moreover, we have heard that suppliers who typically distribute through merchants, but have the ability to sell directly to the construction level (or through other channels), can use this ability to constrain the buying power of merchants.²⁹¹

²⁹¹ Bunnings "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 7.

The impact of vertical integration on competition between suppliers

- 5.111 In this section we discuss the impact of vertical integration on competition between suppliers, including the extent to which non-vertically integrated suppliers might have difficulty accessing customers or distribution channels. Businesses that are vertically integrated operate at several different levels of the supply chain (for example, a supplier and a merchant). Vertical integration can generate efficiencies and lower costs. However, vertical integration can limit competition if it enables the integrated business to prevent or limit competition at any of the levels of the supply chain in which it operates. For example, an integrated business operating at the supplier and merchant level may:
- 5.111.1 refuse to supply an input to competing merchants, or supply to them on less favourable terms. This can result in what is known as input foreclosure; or
 - 5.111.2 refuse to stock products supplied by competing suppliers which can result in what is known as customer foreclosure.
- 5.112 Our preliminary findings are that:
- 5.112.1 two of the five major merchants are vertically integrated which creates a risk of foreclosure;
 - 5.112.2 however, there are a number of independent merchant and other distribution options available which reduce the risk of foreclosure;
 - 5.112.3 vertically integrated merchants often stock competitor products but may favour their own; and
 - 5.112.4 vertical integration does not appear to make it harder for suppliers to compete.
- 5.113 This section does not cover the risk of non-vertically integrated merchants finding it difficult to access the supply of some key building supplies, which is discussed in Chapter 6.
- 5.114 We start by discussing the extent of vertical integration in the building supply sector. The remainder of the section discusses each of the above findings in detail.

Two of the five major merchants are vertically integrated across several key building supply categories

- 5.115 The building supply merchants PlaceMakers and Carters are integrated with a range of suppliers through their ownership by Fletcher Building and the Carter Holt Harvey (CHH) Group respectively. Table 5.5 below sets out these ownership groups, their business units, and the KBS categories they are active in.

Table 5.5 Vertical integration between suppliers and merchants

Ownership group	Business unit	Main KBS categories/areas of activity
Fletcher Building	Altus (50% owned by Fletcher Building) ²⁹²	Doors and windows
	Dimond Roofing	Roofing
	Firth Concrete	Concrete, masonry
	Fletcher Reinforcing	Steel reinforcing
	Golden Bay Cement	Cement
	Laminex	Other boards/panels, wet area lining
	Pacific Coilcoaters	Roofing
	Tasman Insulation	Insulation
	Winstone Wallboards	Plasterboard, wet area lining
	PlaceMakers	General building supply merchant Frame and truss manufacturer
CHH Group	CHH Futurebuild	Engineered timber
	CHH Plywood	Plywood
	CHH Woodproducts	Structural timber, other timber
	Carters	General building supply merchant Frame and truss manufacturer

Source: Commerce Commission analysis of data collected from major building supply merchants.²⁹³

5.116 Vertically integrated suppliers cover almost every KBS category. Further, many of them are major suppliers in their category. For example, in eight out of 12 of the KBS categories that are typically distributed through merchants, the leading supplier is vertically integrated with either PlaceMakers or Carters (see Table 5.4).

There are independent merchants and other distribution options available

5.117 As set out earlier in this chapter, the five major national merchants, including PlaceMakers and Carters, account for a large proportion of total purchases of products in the 12 KBS categories that are typically distributed through merchants.

5.118 The ability to access merchant channels, and in particular the five major national merchants, is critical for suppliers to enter and expand in these KBS categories.

²⁹² [].

²⁹³ [].

- 5.119 Vertical integration between suppliers and merchants can impact competition between suppliers and offer a significant advantage to those that are vertically integrated, particularly during times of low demand or in regions with more limited distribution options.
- 5.120 Vertical integration could impact competition between suppliers if PlaceMakers or Carters have the ability and incentive to use their positions at the merchant level to make it difficult for competing (ie, non-vertically integrated) suppliers to access distribution channels. This is called customer foreclosure. Vertical integration could also impact competition between merchants if Fletchers or Carters had the ability and incentive to use their upstream positions to make it difficult for other (independent) merchants to obtain products (input foreclosure). We discuss the scope for input foreclosure in Chapter 6.
- 5.121 PlaceMakers and Carters are both major purchasers of key building supplies. However, there are a range of other independent distribution options available to suppliers. This reduces the risk of targeted nationwide customer foreclosure.
- 5.122 For example, any supplier that either of these merchants refused to stock would still have a range of distribution options including the other four major merchants. Further, there is no category in which both PlaceMakers and Carters are vertically integrated (and so might both be incentivised to attempt customer foreclosure).
- 5.123 Vertical integration between suppliers and merchants can still impact competition between suppliers and offer a significant advantage to those that are vertically integrated, particularly during times of low demand or in regions with more limited distribution options.

Vertically integrated merchants often stock competitor products but may favour their own

- 5.124 PlaceMakers and Carters have both told us that they prefer to use multiple suppliers in each category.²⁹⁴ As such, they often stock competitor products along with those of their vertically integrated suppliers. For example:
- 5.124.1 PlaceMakers stocks Nelson Pine’s medium-density fibreboard (MDF) panel products as well as Laminex’s, and Expol’s insulation products as well as Tasman Insulation’s.²⁹⁵
- 5.124.2 Carters stocks BBI’s plywood products as well as CHH Plywood’s, and Prowood’s engineered timber products as well as CHH Futurebuild’s.

²⁹⁴ [];

²⁹⁵ [].

- 5.125 However, there are some exceptions to this. For example, our structural timber case study found that Carters procures nearly all of its structural timber from CHH Woodproducts. This built-in demand gives CHH Woodproducts a significant advantage over other structural timber suppliers (for whom stability of demand can be a major risk and barrier to entry/expansion).

Vertical integration does not appear to make it harder for suppliers to compete

- 5.126 We have heard differing views regarding the impact of vertical integration of Fletcher Building and CHH Group on the ability of independent suppliers to compete.
- 5.127 Independent (non-vertically integrated) suppliers have raised some concerns about their ability to have their products stocked by merchants. While two of the five major merchants are vertically integrated with suppliers across several categories, a wide range of independent distribution options remain available for non-vertically integrated suppliers.
- 5.128 We carried out a supplier survey. Only 22 of the 492 suppliers we emailed provided responses to this survey. While some indicated issues with having their product stocked, the response rate was too low to produce reliable information. However, there are a range of reasons why suppliers may find it hard to get stocked. Our preliminary view is that these reasons do not appear to be attributable to vertical integration. However, we welcome further information about the issues discussed in this chapter – particularly in relation to the effect of vertical integration on suppliers' ability to compete.

Chapter 6 Competition between merchants

Summary of preliminary findings

- Competition between building supplies merchants appears to be working relatively well at the national level, but we have identified some factors that may be limiting competition.
- Five major building supplies merchants (PlaceMakers, Carters, ITM, Mitre 10 and Bunnings) compete nationwide to provide the bulk of supplies for residential building in New Zealand. There is also a fringe of other competing distributors including BuildLink, a range of specialist and online merchants, and direct supply to builders from some product manufacturers or installers.
- Merchants compete to supply trade customers at two main geographic levels.
 - Competition for national customers (eg, GHBs). PlaceMakers, Carters and ITM are the three main competitors for national customers. Mitre 10 and Bunnings may compete for some of these customers, but appear to be more focused on smaller local builders and the retail DIY market.
 - Competition for regional customers, which are primarily SME builders operating locally.
- Shares of supply for the major merchants, calculated based on sales of key building supplies to trade customers, have been changing over time. The data we have received indicates that the largest merchant (PlaceMakers) has lost national market share over the past five years. This suggests there is some competitive tension between building supplies merchants.
- However, the number of competing merchants varies between regions, and concentration has been increasing in some regions. There tend to be fewer competing merchants in less populated regions, reflecting the smaller customer bases in these areas. In some locations there are only one or two major building supplies merchants.
- We have observed some factors which may be preventing competition at the merchant level from working more effectively, including merchants lodging restrictive covenants on land and entering into exclusive leases with landlords.
 - In addition to land use restrictions under planning laws, restrictive covenants and exclusive leases can limit other merchants' ability to access suitable sites to open stores.
 - We are also aware of examples where merchants are benefitting from covenants on land zoned for residential development, which give them preferential rights to supply building materials for houses to be built.
- There is a risk of vertically integrated operators supplying key building supplies to their own merchant businesses ahead of their rivals. Outside of the current supply shortages, any challenges faced by merchants obtaining access to supplies do not appear to be attributable to the vertical integration of suppliers and competing merchants. Vertical integration does not appear to be a factor affecting competition between merchants over the longer term.

Introduction

- 6.1 This chapter discusses competition at the merchant level. It explores the extent of competition in the distribution of key building supplies.
- 6.2 The topics covered are:
 - 6.2.1 an overview of New Zealand's building supplies merchants;
 - 6.2.2 the degree of concentration at the merchant level;
 - 6.2.3 conditions of entry and expansion for merchants; and
 - 6.2.4 the impact of vertical integration on competition between merchants.
- 6.3 Rebates from merchants to builders and merchant loyalty schemes are discussed separately in Chapter 7.

Overview of New Zealand's building supplies merchants

- 6.4 This section provides an overview of New Zealand's building supplies merchants. It notes that:
 - 6.4.1 five major merchants compete to distribute key building supplies;
 - 6.4.2 other distributors also provide key building supplies;
 - 6.4.3 competition between merchants occurs at national and regional levels; and
 - 6.4.4 merchants supply the products specified in building plans, but also seek to differentiate themselves through the range they offer.

Five major merchants compete to distribute key building supplies

- 6.5 Merchants are intermediaries who purchase building supplies from suppliers and sell them to builders and retail/DIY customers.²⁹⁶ The key functions merchants provide are warehousing of a wide range of products in convenient locations and managing delivery of materials to building sites.

²⁹⁶ As discussed in Chapter 2, there is a wide range of different business models for builders, including SME builders and nationwide GHBs.

- 6.6 There are five major national building supplies merchants in New Zealand: PlaceMakers, Carters, ITM, Mitre 10 and Bunnings. The major merchants typically stock all categories of key (and other) building supplies, with the breadth of their range dependent on the size and location of each store.²⁹⁷ A brief overview of the five major merchants is included in Table 6.1 below.

Table 6.1 Overview of the five major merchants

Merchant	Description of business
PlaceMakers	PlaceMakers is the merchant business of Fletcher Building Group and is operated by Fletcher Distribution Limited. PlaceMakers supplies mainly to trade customers. It has 59 stores throughout NZ.
ITM	ITM is a co-operative of building supplies merchants. It was founded in 1991 by local timber suppliers/mills seeking alternative distribution. ITM supplies mainly to trade customers. It has 97 stores throughout NZ.
Carters	Carters is the merchant business of Carter Holt Harvey Limited, which includes CHH Woodproducts (the largest producer of structural timber in NZ). Carters supplies mainly to trade customers. It has 71 stores throughout NZ.
Bunnings	Bunnings is owned by Wesfarmers Limited. Bunnings supplies mainly to the DIY market segment and to smaller builders. It has 52 stores throughout NZ.
Mitre 10	Mitre 10 is a co-operative of building supplies merchants. Mitre 10 supplies mainly to the DIY market segment and to smaller builders. There are 82 stores operating under the Mitre 10 brand throughout NZ.

Note: This table includes the number of merchant stores which sold key building supplies during 2021.

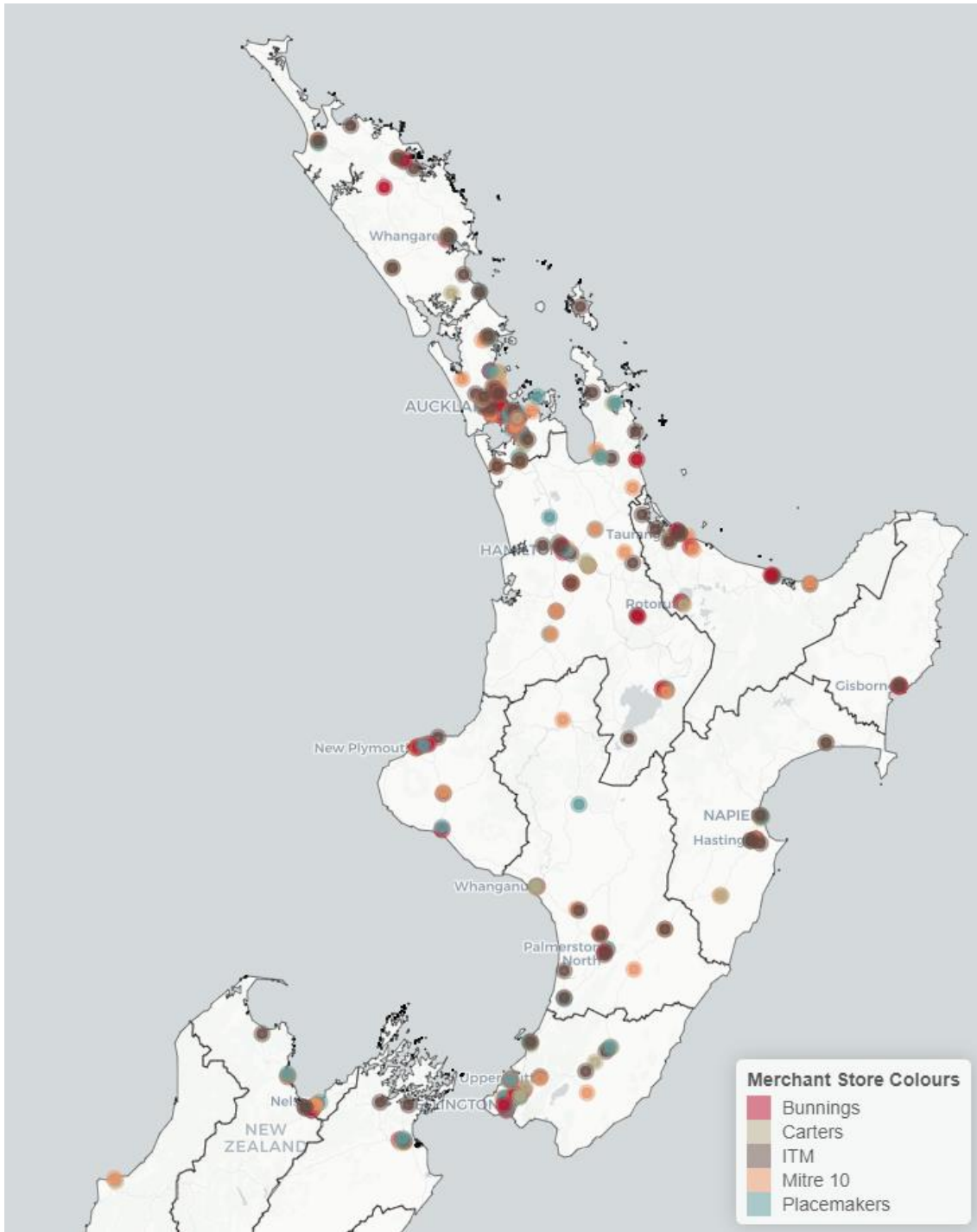
Source: Commerce Commission analysis of information provided by the major building supplies merchants.²⁹⁸

- 6.7 Each of the five major merchants has stores throughout New Zealand. Figure 6.1 and Figure 6.2 below show the location of major merchant stores which sold key building supplies during 2021, for the North Island and South Island respectively. Although merchant presence varies by region, all five major merchants typically have one or more stores in each of the main metropolitan areas.
- 6.8 Attachment H includes additional maps showing the locations of the major merchants' stores in Auckland, Wellington, Christchurch and Dunedin.

²⁹⁷ Merchants' ranges extend beyond 'key building supplies' as defined by the terms of reference for the study. They include, for example, plumbing and electrical supplies, decorative ranges, kitchen and bathroom fittings. The merchants also supply commercial (as well as residential) trade customers and retail customers.

²⁹⁸ [].

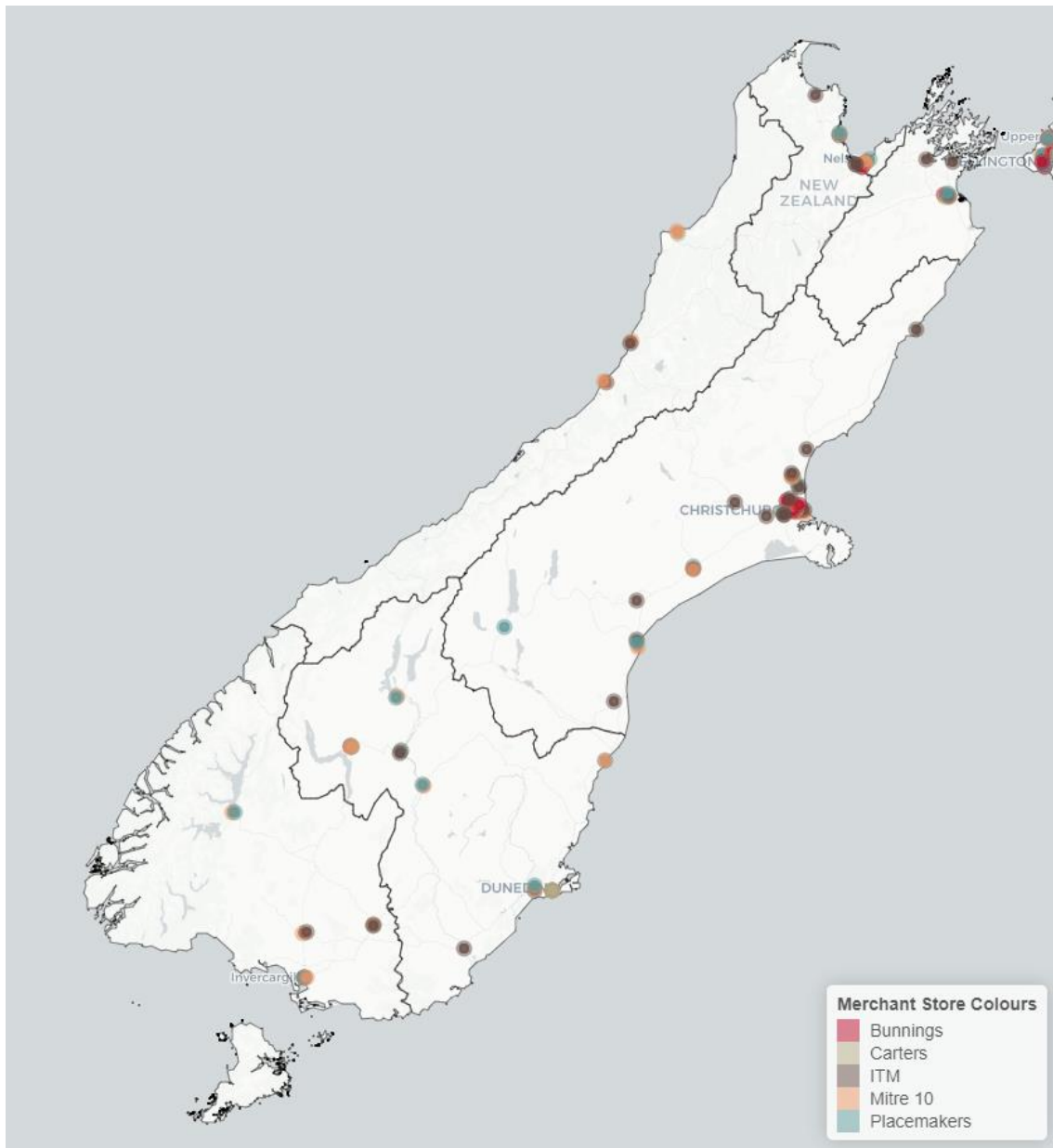
Figure 6.1 Merchant store locations – North Island (2021)



Note: In areas with multiple stores in close proximity, the markers may overlap and hide some store locations.

Source: Commerce Commission analysis of information provided by the major building supplies merchants.²⁹⁹

Figure 6.2 Merchant store locations – South Island (2021)



Note: In areas with multiple stores in close proximity, the markers may overlap and hide some store locations.

Source: Commerce Commission analysis of information provided by the major building supplies merchants.³⁰⁰

Other distributors also provide key building supplies

- 6.9 In addition to the major merchants, there are a range of other businesses that also distribute key building supplies to builders. These other distributors include:
- 6.9.1 BuildLink;
 - 6.9.2 specialist and online merchants; and
 - 6.9.3 direct supply by manufacturers and/or installers of certain products.
- 6.10 We have not focused on these other distributors in our study, given the majority of sales of most key building supplies appear to be made through the five major merchants.³⁰¹
- 6.11 BuildLink is a sixth national building supplies merchant, but is smaller than the five major merchants. BuildLink is a co-operative of building merchants which sells mainly to small-to-medium sized trade customers. It has 40 stores throughout New Zealand.³⁰²
- 6.12 Specialist merchants are smaller merchants or retailers who are either based in a certain location or supply a certain product line. For example, these specialist providers include Woodmart, Harts Fasteners, Rosenfeld Kidson, BBS Timbers, Herman Pacific, South Pacific Timber, JA Building Supplies and ITI Timspec. There are also online merchants such as Trade Direct.
- 6.13 Some manufacturers also directly supply their products to builders. This appears to be particularly focused around product categories such as ready-mix concrete, window joinery and steel.³⁰³ There are also specialist installers for some products, such as insulation and roofing.³⁰⁴

Competition between merchants occurs at national and regional levels

- 6.14 Merchants compete to supply trade customers at two main geographic levels.
- 6.14.1 Competition for national customers (eg, GHBs and Kāinga Ora). These customers typically negotiate terms of supply with merchants on a national or multi-regional basis.

³⁰¹ For example, 82% of respondents to our builder/specifier survey indicated that they purchase most of their key building supplies through the major merchants, [].

³⁰² See: <https://buildlink.co.nz/find-a-store/>.

³⁰³ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [4.2(a)]; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 4-5.

³⁰⁴ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 31 and 33; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 5.

6.14.2 Competition for regional customers (eg, SME builders). These smaller customers typically negotiate terms of supply with merchants at a local or regional level.

6.15 Competition for large national customers appears strongest between PlaceMakers, Carters and ITM, although Mitre 10 and Bunnings also compete for some of these customers. We understand that PlaceMakers, Carters and ITM have the largest shares of supply for national customers.³⁰⁵ Mitre 10 and Bunnings supply trade customers, but appear to be more focused on SME builders and the retail DIY market.³⁰⁶

6.16 It appears that many residential building jobs are quoted, and trade customers often ‘shop around’ multiple merchants for the best price and terms (at least sometimes).³⁰⁷ We understand that:

6.16.1 national customers such as GHBs tend to test the market periodically through tenders or RFPs;³⁰⁸ and

6.16.2 SME builders may have a preferred merchant, but also tend to have accounts with other merchants (which they may use where there is better pricing or product availability).³⁰⁹

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[]; [].

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Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [46.5]; Carter Holt Harvey “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 5; Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 2. In addition, 83% of respondents to our builder/specifier survey indicated that they either “sometimes” (33%), “often” (28%), or “always” (22%) seek quotes from different suppliers or merchants before deciding which one to purchase from, [].

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[]; []; []; []; [].

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[]; [].

- 6.17 The size and scale of purchasers is a material factor in securing the best prices for key building supplies. Data provided by the five major merchants shows that merchants generally achieve lower profit margins when supplying larger customers.³¹⁰ This is expected, due to the greater volume of building materials purchased by larger builders.

Merchants supply the products specified in building plans, but also seek to differentiate themselves through the range they offer

- 6.18 There is a distinction between whether a merchant stocks a product, or provides indent supply. Stocking means that the merchant holds the product at its stores, ready for sale. Indent supply means that a merchant supplies the product on request, but does not hold stock.
- 6.19 Although merchants will generally supply any product their customers want, they stock a more limited range. The products merchants stock are typically ‘tried and tested’, certified or appraised, and have a clear Building Code compliance pathway. This is because these are the products most commonly required by builders, for example, because they are specified in building plans.³¹¹
- 6.20 Factors affecting competition at the supplier level can flow through to reduced range at the merchant level. For example, merchant stocking decisions can be affected by any barriers to entry or expansion for suppliers associated with regulatory and standards systems, or the approach to specifying products in building plans.
- 6.21 We understand that merchants generally prefer to have several suppliers for each product category. This is because:³¹²
- 6.21.1 there is the potential for individual suppliers to experience supply disruptions, and having several suppliers provides some supply chain resilience; and
 - 6.21.2 having several suppliers, rather than one or two, creates competitive pressure.

³¹⁰

[].

³¹¹ See Chapter 4 for further discussion. As discussed in Chapter 7, we understand that having products stocked by merchants in sufficient quantities is important for smaller suppliers to get established in the market.

³¹² For example, [].

- 6.22 Some merchants seek to differentiate their offer by supporting new entrant suppliers. For example, Mitre 10 actively assisted Bradford Gold insulation (supplied by CSR) to maintain and expand its presence in the New Zealand market.³¹³ This may also help create competitive pressure, as noted in paragraph 6.21.2 above.
- 6.23 Competition between merchants for sales of some products appears more intense than others. This may reflect merchant stocking decisions – for example, competition for supply of a particular product may be greater if it is stocked by all merchants. A merchant referred to the potential to make greater margins on products which are not front of mind for their customers.³¹⁴
- 6.24 Data supplied by the five major merchants suggests that merchant gross profit margins for key building supplies can vary significantly between product categories, and between merchants for the same product category.³¹⁵ We have not undertaken a detailed analysis of margins and profitability.

Degree of concentration at the merchant level

- 6.25 This section discusses merchant market shares and the degree of concentration at the national and regional levels.³¹⁶ It notes that:
- 6.25.1 there have been changes in national market shares over time, with PlaceMakers (in particular) losing share over the last five years; and
 - 6.25.2 the degree of concentration varies between regions.
- 6.26 Although we have not formally defined a market as part of our study, we refer to our estimations as market shares in the analysis below. Our analysis of market shares and concentration is based on data provided by the major merchants and is subject to the following methodological limitations.
- 6.26.1 Our analysis of market shares and concentration only includes the five major merchants, so some values may be overestimated.

³¹³ Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 26.

[
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³¹⁴ [].

³¹⁵ [].

³¹⁶ An industry or market is considered to be more concentrated if relatively few suppliers control a large share of supply. The most extreme example of concentration is where a single supplier controls all the supply (ie, a monopoly).

6.26.2 We have calculated market shares based on sales of key building supplies to trade customers (ie, retail sales to DIY customers are excluded for Bunnings and Mitre 10).³¹⁷

6.26.3 Our analysis does not account for differences in customer segments (eg, national customers vs SME builders). National market shares have been calculated by aggregating store-level sales.

There have been changes in national market shares over time, with PlaceMakers losing share

6.27 PlaceMakers currently has the largest share of sales of key building supplies. In 2021, PlaceMakers had a market share between 25% and 35%. Approximate market shares for the five major merchants, presented using 10% bands, are shown in Table 6.2 below.³¹⁸

Table 6.2 Merchant market shares of sales of key building supplies (2021)

Merchant	Market share
PlaceMakers	25-35%
ITM	20-30%
Carters	20-30%
Bunnings	5-15%
Mitre 10	5-15%

Note: As discussed in paragraph 6.26 above, these market shares are based on sales of key building supplies to trade customers, for the five major merchants only.

Source: Commerce Commission analysis of data supplied by the five major merchants.³¹⁹

³¹⁷ Retail/DIY sales are included in our dataset for PlaceMakers, Carters and ITM, but we understand that these account for a small proportion of their total sales.

[]; [].

³¹⁸ [].

³¹⁹ [].

- 6.28 Concentration measures, such as the three-firm concentration ratio (CR3) and Herfindahl-Hirschman Index (HHI), can indicate levels of competition in a market. The three largest merchants hold over 80% of sales of key building supplies.³²⁰ However, the merchant channel has become slightly less concentrated over the past five years, with the HHI decreasing from approximately 2700 to 2400 between 2017 and 2021.³²¹
- 6.29 Although PlaceMakers is the largest of the five major merchants, the data we have received indicates that it lost market share for sales of key building supplies between 2017 and 2021.³²² ITM has gained market share, while market shares for Bunnings, Carters and Mitre 10 have remained relatively constant over the five-year period. Market shares changing over time can be an indication that competition is working well, with customers switching to alternative providers with better offerings.

The degree of concentration varies between regions

- 6.30 The degree of concentration varies throughout New Zealand, depending on how many merchants are operating in each local or regional market and the attractiveness of their offers. There are examples of some locations where there are only one or two building supplies merchants.³²³ Although not determinative, these differences in concentration support the view that competition varies across regions.
- 6.31 Our analysis suggests that concentration at the merchant level is generally higher in less populated and more rural regions of New Zealand. This is likely to reflect the reduced commercial viability of operating merchant stores in these areas, due to the smaller customer bases able to be served.
- 6.32 We have used the boundaries of the 16 regional councils and unitary authorities throughout New Zealand when considering regional concentration. In 2021, the largest merchant in 11 of these 16 regions had greater than 40% market share.
- 6.33 However, we have not undertaken a detailed assessment of regional concentration in this study. For example, we have not assessed the boundaries of any regional or local market, or whether a regional level is the appropriate geographic dimension, as part of a formal market definition exercise.

³²⁰ As discussed in Chapter 5, a higher CR3 reflects a more concentrated market, with 70% or above indicating high concentration.

³²¹ As discussed in Chapter 5, the HHI is the sum of squares of market shares. A higher HHI reflects a more concentrated market, with 2,500 or above indicating high concentration (it can range from 0 to 10,000).

³²²

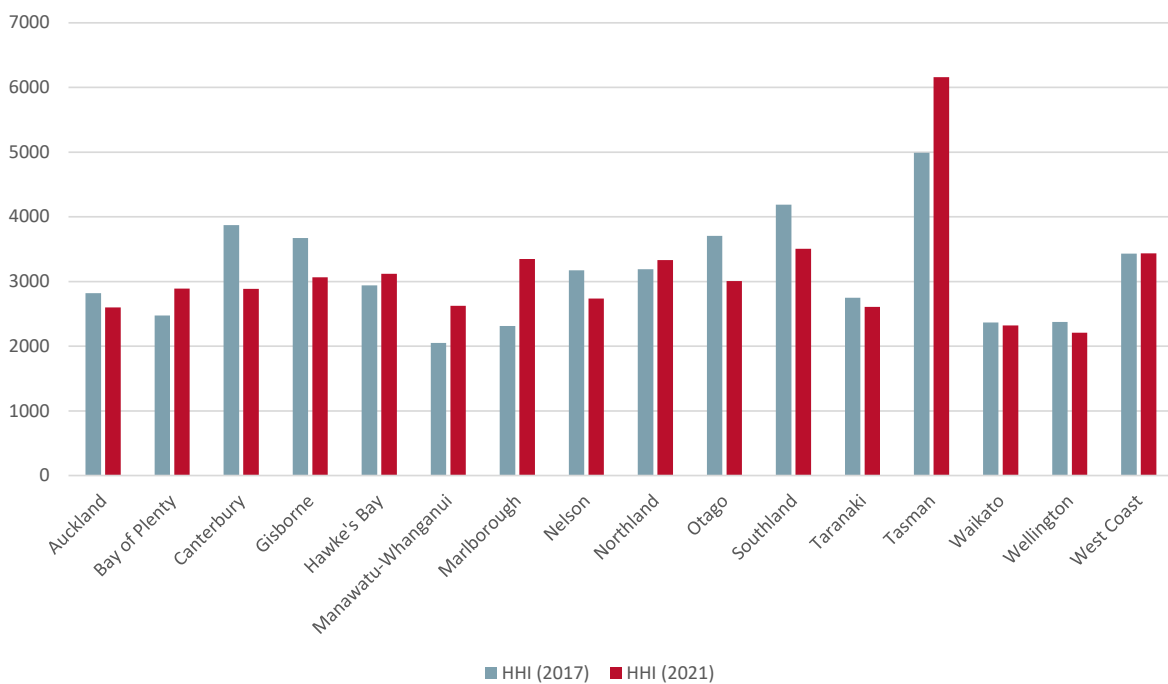
[]

³²³ For example, hui participants noted that PlaceMakers is the only merchant operating on Waiheke Island, Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 3 and 8.

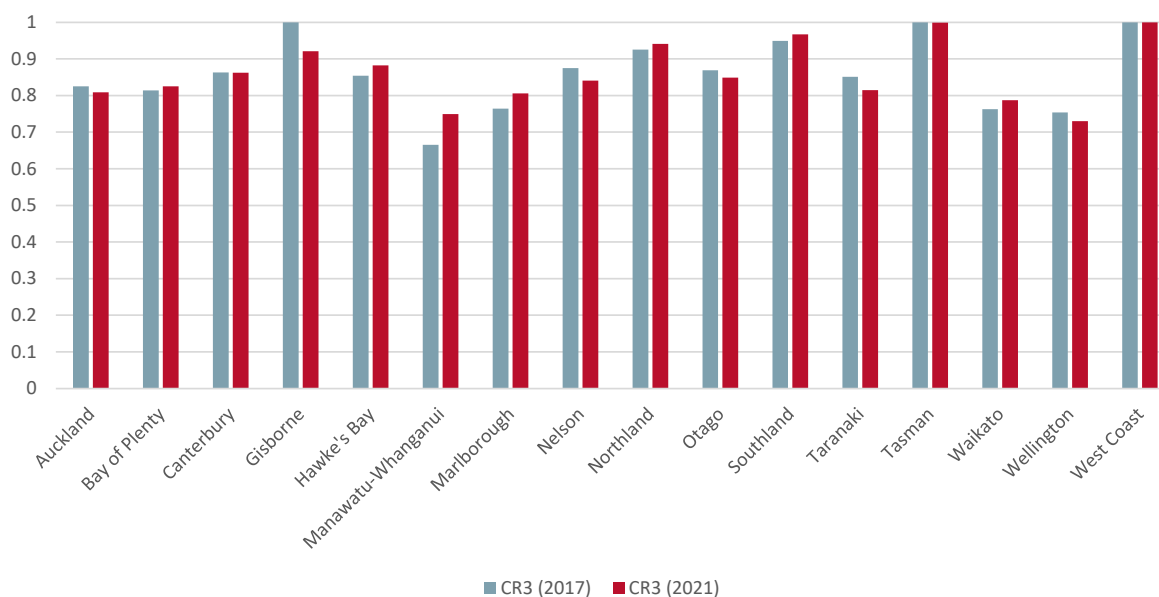
6.34 The degree of concentration in each region, as measured by the three-firm concentration ratio and HHI, is shown in Figure 6.3 and Figure 6.4 below. This suggests that the most concentrated regions are Gisborne, Northland, Southland, Tasman and the West Coast.

6.35 Concentration has changed in some regions between 2017 and 2021. Some regions have become more concentrated – for example, the HHI has increased for Bay of Plenty, Manawatū-Whanganui, Marlborough and Tasman. Others have become less concentrated – for example, the HHI has decreased for Auckland, Canterbury, Gisborne, Nelson and Otago.

Figure 6.3 HHI by region (2017 and 2021)



Source: Commerce Commission analysis of data supplied by the five major merchants.³²⁴

Figure 6.4 Three-firm concentration ratios by region (2017 and 2021)

Source: Commerce Commission analysis of data supplied by the five major merchants.³²⁵

6.36 Our analysis of data supplied by the five major merchants shows that gross profit margins are generally higher in provincial and rural areas than metropolitan areas.³²⁶ This may reflect the fact that less densely populated areas tend to be serviced by fewer competitors than more densely populated ones.

Conditions of entry and expansion for merchants

6.37 This section discusses the conditions for entry and expansion for building supplies merchants. To enter or expand, a merchant needs to:

- 6.37.1 find a location for a store (and develop the site, if it is a greenfield site);
- 6.37.2 secure supply of building products to put in the store; and
- 6.37.3 attract customers to buy from its store.

6.38 The discussion below notes that:

- 6.38.1 limited availability of suitable sites can restrict entry and expansion by merchants; and

³²⁵ [].

³²⁶ We allocated each of the five major merchants' stores into three geographic areas: metropolitan, provincial and rural. Our analysis shows that gross profit margins becomes progressively higher when moving from metropolitan centres, to provincial centres, to rural areas.

[].

- 6.38.2 restrictive covenants and exclusive leases appear to be further limiting competition between merchants.
- 6.39 Apart from the current shortages affecting products such as plasterboard and structural timber, we have not heard significant concerns regarding merchants' ability to secure supply of building products.
- 6.40 Potential barriers to builders switching between merchants, such as rebates and loyalty schemes, are discussed separately in Chapter 7. These factors could make it harder for merchants to attract customers.

Limited availability of suitable sites can restrict entry and expansion by merchants

- 6.41 Access to suitable sites may constrain entry and expansion by building supplies merchants. Merchants have told us that it can be difficult to access suitable land for stores.
- 6.42 There are several key factors in finding suitable sites. Examples are listed below.
- 6.42.1 **Location:** The land needs to be in a suitable location for customer traffic and/or to facilitate delivery of materials to building sites. The suitability of land may also be influenced by the existing networks of stores (for example, a merchant may already have an existing store nearby).³²⁷
- 6.42.2 **Size:** The land needs to be large enough for a building supplies merchant. This can be particularly challenging in urban areas, given merchants require a large amount of land (including yard areas), which may not provide the landlord with an optimal return.³²⁸
- 6.42.3 **Zoning:** The land needs to be appropriately zoned for development as a building supplies store.³²⁹
- 6.42.4 **Price:** The land needs to be priced at a level that will result in a viable long-term investment in a merchant store.³³⁰

³²⁷ [];
[].

³²⁸ [];
[].

³²⁹ [];
[];
[].

³³⁰ [];
[].

- 6.43 Sites suitable for building supplies merchants may differ from those suitable for other retailers. For example, street location and foot traffic may not be paramount considerations for a building supplies merchant who focuses on trade customers and/or operates on a delivery-based model.^{331, 332}

Restrictive covenants and exclusive leases appear to be limiting competition between merchants

- 6.44 A restrictive covenant is a promise not to do something that is registered against land, and imposes restrictions on how that land can be developed or used. Restrictive covenants are attached to (or run with) land. This means that they can bind any third parties who subsequently acquire (or lease) that land.
- 6.45 We have identified two main categories of restrictive covenants potentially affecting competition for key building supplies.
- 6.45.1 **Store covenants:** Covenants on land containing clauses or terms which prevent or restrict the site from being used for operating a business that sells key building supplies. Store covenants will tend to reduce the availability of sites for merchant stores.
- 6.45.2 **Land development covenants:** Covenants on land zoned for residential buildings, which contain clauses or terms which give a building supplies merchant preferential rights to supply key building supplies for any housing to be constructed on the land. Land development covenants will tend to limit other merchants' ability to attract customers.
- 6.46 A merchant can lodge a store covenant for its own benefit over land it owns. However, many merchants lease the land on which they operate their stores. Where this is the case, the landlord may agree to lodge a store covenant on the land (and/or adjoining land which it owns) for the benefit of the merchant.
- 6.47 We are also aware of merchants entering into commercial leases with landlords containing exclusivity clauses or terms which prevent or restrict the operation of businesses selling key building supplies nearby (exclusive leases). Exclusive leases apply in a different context to the store covenants discussed above. However, they appear to have a similar purpose and effect.

Store covenants and exclusive leases may prevent rival merchants from opening stores

- 6.48 Our preliminary view is the use of store covenants and exclusive leases is unduly restricting competition between building supplies merchants.

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³³²

Street location is likely to be more important for DIY customers, given many of these customers will drive to merchants' stores.

- 6.49 Restrictive store covenants and exclusive leases are likely to reduce a new or existing merchant’s ability to access suitable sites. In turn, this may hinder entry and expansion. The effect is likely to be greatest in developed urban areas where the cost of land is high or there is less availability of suitable sites.
- 6.50 To date, we have identified around 60 store covenants benefitting the major merchants.³³³ Of these:
 - 6.50.1 all, except three, are currently active as of July 2022; and
 - 6.50.2 all, except five, prohibit the operation of a merchant (or similar business) on the land.³³⁴
- 6.51 Four fifths of these store covenants have a fixed expiry date. As discussed below, many of them have long durations.
- 6.52 The remaining fifth of store covenants do not have a fixed expiry date. These covenants are over land adjoining, or near, land leased by a merchant, where the landlord has agreed to lodge a covenant for the merchant’s benefit. These store covenants typically expire when the merchant stops leasing the land and/or using it to sell building supplies.
- 6.53 We have also identified 80 exclusive leases held by merchants.³³⁵ These exclusive leases can prevent or restrict adjoining property held by the landlord from being used for a business which sells key building supplies.³³⁶
- 6.54 While the use of store covenants and exclusive leases is common, their use varies across merchants. Some merchants hold significantly more covenants than others, and they appear to be used more often in certain regions such as Auckland and the lower North Island.
- 6.55 Merchants told us the primary purpose of store covenants is to stop a competitor from establishing itself near a merchant’s planned or existing store.³³⁷ They consider this is justified, as it provides them with the necessary confidence that they will make a return on the investment associated with developing a new store.³³⁸

³³³ However, the number of land titles these covenants cover is more than 100. This is due to instances where land with a covenant has been subdivided, with the covenant then applying to each lot, [].

³³⁴ The remainder, for example, require that sightline of the store from nearby roads is maintained.

³³⁵ [].

³³⁶ [].

³³⁷ For example: []; [].

³³⁸ []; [].

- 6.56 Store covenants appear to have the effect of preventing, or at least slowing, the expansion of rivals. A merchant has provided a recent example where they were precluded from leasing land due to a store covenant lodged by a competing merchant.³³⁹
- 6.57 Our preliminary view is these claimed benefits for many of the store covenants and exclusive leases are unlikely to negate the competitive harm caused by the reduced availability of sites.
- 6.58 The effect of store covenants appears to be long lasting. For the two thirds of covenants which have a fixed expiry date, the median duration is 20 years. Of these, eight are due to expire within the next two years. There are also many that have terms as long as 99 or 999 years.³⁴⁰
- 6.59 Store covenants with long durations are especially concerning. Because restrictive covenants are attached to (or run with) the land, store covenants would bind any third parties who subsequently acquire or lease the site if they were still active. This may result in other merchants being precluded from operating on a site, even after the merchant who benefits from the covenant has left the area.
- 6.60 This appears inconsistent with the merchants' rationale for lodging store covenants. They told us the purpose of lodging a store covenant is generally to help ensure an adequate return on investment (ROI) for development of a new store. A store covenant appears unnecessary to achieve this purpose once the merchant stops operating on the land.
- 6.61 We have seen examples where a merchant has agreed not to enforce a store covenant on land. However, this appears limited to situations where the potential entrant is not seen as a direct competitive threat. These concessions appear to only occur where the entrant's core business is not building supplies, but provides some products also stocked by the merchant.³⁴¹
- 6.62 In summary, our preliminary view is that the use of store covenants by merchants make it harder for competitors to enter and expand. In addition, we consider that the merchants' stated rationales for using store covenants does not sufficiently justify their restrictive effect on competition.

³³⁹ For example, [] recently enquired into a site in [] but was precluded from leasing it due to a covenant lodged by a competitor, []. Incidentally, [] has an active store covenant over land in the same area, [].

³⁴⁰ [].

³⁴¹ For example, a home living retailer which also stocks paint.
[]

Restrictive covenants and exclusive leases under the Commerce Act

- 6.63 Section 27 and 28 of the Commerce Act apply to exclusivity clauses in leases and restrictive covenants. Restrictive covenants and exclusive leases may breach sections 27 and/or 28 of the Commerce Act:
- 6.63.1 section 27 prohibits entering into or giving effect to a contract, arrangement or understanding containing a provision which has the purpose, effect, or likely effect of substantially lessening competition in a market;³⁴² and
- 6.63.2 section 28 prohibits the requiring or giving of, or enforcing, a covenant that has the purpose, effect or likely effect of substantially lessening competition in a market. Such covenants are unenforceable.³⁴³
- 6.64 As noted above, we have identified around 60 restrictive covenants and 80 exclusive leases benefitting the major merchants that potentially limit competition. We identified restrictive covenants as a factor affecting competition in both our retail fuel market study and our grocery market study.³⁴⁴
- 6.65 Independent of this study, we are taking enforcement action relating to a restrictive covenant in the building supplies industry.
- 6.66 Due to the prevalence of restrictive covenants and exclusive leases, we intend to launch a compliance programme later this year to promote compliance with sections 27 and 28 of the Commerce Act. This is likely to start with the building supplies industry, but may include targeted outreach with other sectors. We encourage any merchant or supplier benefitting from restrictive covenants and exclusive leases which prevent competitors from accessing certain sites to review them for compliance with the Commerce Act.
- 6.67 As noted in Chapter 9, we are also making a draft recommendation for an economy-wide review of the use of restrictive land covenants and exclusive leases to assess whether a wider multi-sector solution is needed to address the impact of restrictive land covenants and exclusive leases on competition more generally.

Restrictive land development covenants may prevent rival merchants from attracting customers

- 6.68 Land development covenants may also be restricting competition between merchants. These covenants appear to make it more difficult for other merchants to supply building materials for new houses to be built on the land.

³⁴² Commerce Act 1986, s 27.

³⁴³ Commerce Act 1986, s 28.

³⁴⁴ Commerce Commission “Market study into the retail fuel sector: Final report” (5 December 2019) at [6.117]-[6.122]; Commerce Commission “Market study into the retail grocery sector: Final report” (8 March 2022) at [6.75]-[6.99]. We identified more than 90 restrictive covenants in the grocery market study.

- 6.69 We are aware of land development covenants in the Hawke’s Bay region. These covenants apply to residential land developments and appear to influence or dictate the merchant through which building products are purchased by trade customers wanting to build on the land. The effect of any covenants is to reduce the contestable market for new entrants (or merchants that expand), which could impact on entry or expansion.³⁴⁵
- 6.70 However, the use of land development covenants does not appear to be widespread. Preliminary evidence indicates most merchants do not have land development covenants.³⁴⁶ We are continuing to gather further information about land development covenants to help us consider their prevalence and the extent of any competitive harm in our final report.

Impact of vertical integration on competition between merchants

- 6.71 This section discusses the impact of vertical integration on competition between merchants. It notes that:

- 6.71.1 there is a risk of non-vertically integrated merchants being unable to access key building supplies from vertically integrated suppliers; and
- 6.71.2 vertical integration does not appear to be necessary for merchants to compete effectively.

- 6.72 The extent to which non-vertically integrated suppliers might have difficulty accessing customers or distribution channels is discussed separately in Chapter 5.

There is a risk of non-vertically integrated merchants being unable to access key building supplies

- 6.73 As discussed in Chapter 5, vertical integration between the supplier and merchant level is a feature of the New Zealand building supplies industry.
- 6.73.1 Fletcher Building manufactures products including plasterboard (Winstone Wallboards), cement (Golden Bay Cement), concrete (Firth) and insulation (Tasman Insulation). It also operates a merchant business (PlaceMakers).
- 6.73.2 Carter Holt Harvey manufactures products including structural timber (CHH Woodproducts), and also operates a merchant business (Carters).

³⁴⁵ Commerce Commission “Statement of Issues – Fletcher Distribution/the Tumu companies” (10 June 2022) at [84].

³⁴⁶ []; []; []; []; [].

- 6.74 Vertical integration could potentially make it harder for other non-vertically integrated merchants to compete, if they are unable to secure access to key building supplies. For example, there is a risk that Fletcher Building or Carter Holt Harvey could seek to limit competition from other merchants by restricting supply to them of key inputs such as plasterboard and structural timber (input foreclosure).
- 6.75 Allocation policies are currently in place for plasterboard and structural timber supplied by Winstone Wallboards and CHH Woodproducts respectively.³⁴⁷ This is due to current supply shortages. We understand that some non-vertically integrated suppliers have also implemented similar allocation policies for products currently subject to supply shortages.³⁴⁸
- 6.76 We understand that the policy utilised by Winstone Wallboards allocates plasterboard between merchants proportionally based on previous sales. As discussed in Attachment B, this does not appear to favour PlaceMakers over other merchants.
- 6.77 During the current shortage, we are aware that Carters has benefited from being guaranteed structural timber supply from CHH Woodproducts, and that CHH Woodproducts appears to have excluded some of Carters' main competitors from its timber allocations.³⁴⁹ Given CHH Woodproducts is a large supplier of structural timber in New Zealand, this significantly limits the pool of potential supply sources for those merchants.
- 6.78 Allocation policies under which suppliers provide preferential treatment to vertically integrated merchants can breach the Commerce Act if the supplier has a substantial degree of market power and the allocation policy has the purpose of harming, deterring, or preventing competition.
- 6.79 In 2021, we undertook enquiries with the relevant parties as to whether CHH's conduct in ceasing supply of structural timber to some third parties risked breaching the Commerce Act.

³⁴⁷ For example, Winstone Wallboards "GIB plasterboard customer allocation process overview", available at: <https://www.gib.co.nz/assets/Uploads/GIB-Flow-Chart-Allocation-Process-0422.pdf>;

[]

³⁴⁸ []; [].

³⁴⁹ For example: NZ Herald "Housing: Carter Holt Harvey cuts timber supplies to Mitre 10, Bunnings, ITM" (27 March 2021), available at: <https://www.nzherald.co.nz/business/housing-carter-holt-harvey-cuts-timber-supplies-to-mitre-10-bunnings-itm/P3T6DQ2PBT4JDZ64AAF26WIRU4>;

[]; [].

- 6.80 Based on the responses to those enquiries, we decided not to open an investigation into CHH’s conduct at that time, noting that there were legitimate reasons for the shortage of supply. However, we are continuing to engage with relevant parties to monitor the competitive effects of CHH’s conduct as market conditions evolve.
- 6.81 We retain the ability to investigate any conduct of this nature if information collected during this study, or outside of it, gives us reason to believe that it may breach the Commerce Act. We encourage any supplier deploying, or considering deploying, similar allocation models to review them for compliance with existing law, and with the revised section 36 of the Commerce Act which comes into force in April 2023. From that time, conduct by a supplier with a substantial degree of market power may also breach the Commerce Act if it has the effect or likely effect of substantially lessening competition in a market.
- 6.82 With the exception of CHH’s approach to timber allocation during recent supply shortages, we have not seen evidence of vertically integrated companies giving preferential treatment to their related merchant businesses through pricing or otherwise. Any challenges faced by merchants obtaining access to supplies do not appear to be attributable to the vertical integration of suppliers and competing merchants.

Vertical integration does not appear to be necessary for non-vertically integrated merchants to compete effectively

- 6.83 There are possible advantages and disadvantages of vertical integration.
- 6.84 Vertical integration could be generating significant efficiencies in managing the supply chain, and therefore have a positive or benign effect on competition. Fletcher Building and CHH have referred to benefits of vertical integration, including:
- 6.84.1 economies of scale, efficiencies, and lower costs for consumers;³⁵⁰
 - 6.84.2 the ability to invest in greater supply capacity, reflecting confidence in having the required customers to justify that increased capacity;³⁵¹ and
 - 6.84.3 enhanced opportunities for innovative technologies (eg, the introduction of new products or improvements to existing products) to be identified and trialled and, if successful, deployed more widely across the market.³⁵²

³⁵⁰ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [37.2].

³⁵¹ Carter Holt Harvey “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [7].

³⁵² Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [37.3].

- 6.85 Vertical integration can also lead to a risk of input foreclosure (as discussed in paragraphs 6.73 to 6.82 above), and customer foreclosure (as discussed in Chapter 5).
- 6.86 A lack of vertical integration does not appear to be preventing ITM, Mitre 10 and Bunnings from competing against PlaceMakers and Carters.³⁵³
- 6.87 Fletcher Building stated that vertical integration “does not act as a barrier to entry/expansion in New Zealand’s building supplies markets”, noting that:³⁵⁴
- The presence and ongoing success of independent players in markets of all in-scope building supplies in which Fletcher Building operates is evidence that vertical integration is not a prerequisite for success in these markets and there are no barriers.
- 6.88 We understand that PlaceMakers and Carters both operate on arms-length basis from the other business units which manufacture key building supplies.³⁵⁵ Fletcher Building and CHH also noted that:
- 6.88.1 vertical integration only applies to a subset of the products sold by PlaceMakers and Carters,³⁵⁶ and
- 6.88.2 products manufactured by Fletcher Building and CHH are not sold exclusively through PlaceMakers and Carters – they are also supplied to other merchants.³⁵⁷
- 6.89 Mitre 10 and Bunnings acknowledged that vertical integration is not necessary to compete in the sector. However, they stated that vertical integration may provide a competitive advantage in some situations.³⁵⁸

³⁵³ See paragraphs 6.27 to 6.29 above.

³⁵⁴ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [37.6].

³⁵⁵ []; [].

³⁵⁶ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [5.4]; Carter Holt Harvey “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 5.

³⁵⁷ Fletcher Building “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [37.6(b)]; Carter Holt Harvey “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [5(b)].

³⁵⁸ Mitre 10 “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 29; Bunnings “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 7.

[].

6.90 In summary, our preliminary view is that although vertical integration is affecting competition between merchants in some circumstances, this appears to be limited to current supply shortages and certain allocation policies. Outside of the current supply shortages, any challenges faced by merchants obtaining access to supplies do not appear to be attributable to the vertical integration of suppliers and competing merchants. Vertical integration does not appear to be a factor affecting competition between merchants over the longer term.

Chapter 7 Rebates, loyalty schemes and merchant preferred supplier arrangements

Summary of preliminary findings

- Arrangements between suppliers and merchants often include terms for the supplier to pay rebates to the merchants. Rebates between suppliers and merchants are widespread and can be significant in value.
- Merchant stocking is important for suppliers of many key building supplies. The structure of some of the supplier-merchant rebate arrangements, particularly tiered retroactive and share of wallet rebates, can create strong incentives for merchants to sell the products to which the arrangements relate. This can make it less likely that a merchant would be willing to dual stock or encourage sales of alternative supplies and therefore makes it harder for alternative suppliers to compete effectively.
- There is potential for supplier-merchant rebates to harm competition between suppliers, particularly in highly concentrated markets where suppliers have a significant share of supply and an assured base of sales.
- The use by suppliers of customer specific quotes to offer discounts to customers who might switch to alternative suppliers offer short-term benefits to those customers. However, they also have the potential to make it harder for smaller suppliers to compete effectively with larger incumbents and thus may limit the scope for smaller suppliers to become more effective competitors over the longer term.
- Rebates provided by suppliers to builders also occur in the case of some key building supplies. The prevalence of these rebate agreements varies by key building supply but, where paid, they are typically paid to larger customers. Based on the evidence we have received, these rebates appear less likely to harm competition than rebates from suppliers to merchants.
- Rebates are also paid by merchants to a small number of their customers, primarily GHBs. Our analysis indicates that these rebates are overall offered to customers that represent a minority of total sales of key building supplies. A wide variety of rebate structures are used and the amounts paid tend to be relatively low. It is unlikely that these rebates are adversely affecting competition between merchants.
- Many builders are part of loyalty schemes offered by merchants. There are a wide variety of rewards available. The schemes appear to be relatively low cost for merchants to operate. It is unlikely that they are adversely affecting competition between merchants.
- There is nonetheless value to the competitive process in ensuring that end consumers are well informed, including about the nature of rebates and loyalty schemes offered.

Introduction

- 7.1 This chapter discusses the arrangements between market participants at different levels of the key building supplies industry supply chain.³⁵⁹ It considers the role the arrangements may have on the effective working of competition in key building supplies, and focuses in particular on the likely effects of rebates, loyalty schemes and other vertical arrangements.
- 7.2 In this chapter, we consider the effect of rebates and other vertical arrangements between different levels of the supply chain:
- 7.2.1 arrangements between suppliers and merchants;
 - 7.2.2 arrangements between suppliers and builders; and
 - 7.2.3 arrangements between merchants and builders.

Arrangements between suppliers and merchants

- 7.3 In this section we consider the arrangements between suppliers (for example, manufacturers and importers) and merchants.
- 7.4 As described in Chapter 5, the extent to which key building supplies are distributed through merchants varies. For some supplies, most sales are through the merchant channel.
- 7.5 It is therefore important to assess whether the arrangements between suppliers and merchants are operating in a way which could harm competition.
- 7.6 Our preliminary assessment is that:
- 7.6.1 merchant stocking is important to suppliers for some key building supplies;
 - 7.6.2 merchants typically have a core product range and 'preferred' suppliers;
 - 7.6.3 merchant decisions on stocking are influenced by a range of non-price factors;
 - 7.6.4 price is also an important factor;
 - 7.6.5 merchant stocking decisions may also be influenced by the perceived risk of an adverse response from a supplier that has market power;
 - 7.6.6 some rebate structures have the potential to harm competition between suppliers; and

³⁵⁹ We refer to arrangements between market participants at different levels of the supply chain as vertical arrangements.

- 7.6.7 the use of customer specific quotes by suppliers to offer targeted price discounting to merchants may contribute to the difficulties new entrants at the supplier level have in gaining necessary scale in some markets.

Merchant stocking is important to suppliers for some key building supplies

- 7.7 We understand that all merchants supply products at the request of their customers even when they are not stocked.³⁶⁰ This is known as ‘indent’ supply. Supplying products on demand is different from choosing to purchase and stock a product line. We heard from suppliers of some key building supplies that merchant stocking was a very important driver of sales in the New Zealand market.³⁶¹
- 7.8 In relation to our case study supplies, we heard that:
- 7.8.1 in plasterboard, suppliers highlighted that not being stocked was a barrier to them reaching efficient scale, and that getting stocked was important due to the convenience it provided to builders (for example, in relation to easy returns), and the benefits it provided in brand recognition and distributing more broadly across the country.³⁶²
- 7.8.2 in structural timber, the vast majority of suppliers’ sales are to merchants and frame and truss manufacturers (most of whom are either owned by merchants or sell through merchants). Suppliers view these channels as important for ensuring sales continuity and the broad, efficient distribution of their products, with the alternatives (selling into export markets or directly to end users) being significantly less desirable.³⁶³
- 7.8.3 in ready-mix concrete, the merchant channel is less important due to the nature of the product meaning that it is delivered directly to customers. Therefore, merchant stocking is not an important feature.³⁶⁴
- 7.9 We discuss later in this chapter the effect that rebates can have on merchants’ choice of which products to stock. The importance of merchant stocking varies across key building supplies depending on how important the merchant channel is to total sales, as demonstrated by the differences in our case study products. This means that the extent to which available rebates may influence the decision to stock (or promote) products is also likely to vary across key building supplies.

³⁶⁰ [].

³⁶¹ [].

³⁶² []; []; [];

³⁶³ [].

³⁶⁴ For example: [].

Merchants typically have a core product range and preferred suppliers

- 7.10 When merchants decide on what products to stock they typically decide on a core range of products which all their stores nationally must stock or are recommended to stock.³⁶⁵ Depending on the structure of the merchant, there may be more flexibility in determining the products to be stocked at an individual store level.³⁶⁶
- 7.11 Merchants will also often choose preferred suppliers for a particular product category. The meaning of the term ‘preferred’ varies by merchant and some merchants instead refer to ‘primary’ suppliers. Typically, however, a preferred supplier is the main supplier of a particular product category across a merchant’s network. Some merchants stated that their preference was to have at least two preferred suppliers in each category, but that for some key building supplies this was not possible—for example, due to insufficient storage space or the branded or non-generic nature of a product.³⁶⁷ In other cases, such as structural timber, one merchant noted having multiple preferred suppliers was necessary as there was not any one supplier that could provide sufficient volume across its whole network.³⁶⁸ One merchant said that if there is customer demand for a product and it can pass compliance checks (ie the product meets the required industry standards) then the local store manager can decide to stock a product.³⁶⁹
- 7.12 One supplier raised concerns about the impact preferred supply agreements were having on their ability to get stocked by merchants.³⁷⁰ However, given their limited visibility of the agreements, they did not have views on which part of the agreements were likely to be problematic. A small supplier also told us that they had products which had been stocked at a local level that had been subsequently removed after pressure from head office.³⁷¹
- 7.13 Many of the supplier agreements we reviewed classify the supplier as primary/preferred or secondary but these varied in their specific provisions. None contained exclusivity clauses but many different rebate clauses were observed, including some that we have expressed concerns about elsewhere in this draft report. Our preliminary assessment is that the specific content of some preferred supply agreements may be limiting competition but the mere existence of a preferred supplier agreement is not of particular concern.

³⁶⁵ For example: []; []; [];

³⁶⁶ []; [].

³⁶⁷ For example: [].

³⁶⁸ [].

³⁶⁹ []. See also: [].

³⁷⁰ [].

³⁷¹ [].

7.14 In some cases, we saw broader agreements between suppliers and merchants which provided additional rebates and marketing support if the merchant required all their stores to stock the suppliers’ range of products.³⁷² Inducements of this nature have a greater potential to impact competition in a product market. However, they appear rare and do not appear to prevent merchants from also stocking competing products. Accordingly, they also seem unlikely to impact competition.

Merchant decisions on stocking are influenced by a range of non-price factors

7.15 Merchants’ supply agreements are typically between 1-3 years in length but often are rolled over.³⁷³ One merchant stated that they aim for multi-year enduring supplier arrangements to build and invest in relationships.³⁷⁴

7.16 Typically agreements with suppliers are reached through bilateral negotiations, although the process varies depending on the building supply.³⁷⁵ In some cases, merchants said they would conduct full tenders or RFPs to decide whether to replace their existing supply.³⁷⁶ However, we heard this was less common as doing so is a significant exercise.³⁷⁷

7.17 We understand that there are a range of non-price factors which influence whether a product is chosen to be stocked, including:³⁷⁸

7.17.1 product compliance, technical support and quality of product;

7.17.2 the ability of suppliers to deliver both in terms of meeting the required volumes and the lead times and reliability of delivery; and

7.17.3 whether there would be demand for the product.

7.18 The role of compliance and regulations is discussed further in Chapter 3. In relation to stocking being demand-led, one merchant told us that demand in the market is largely driven by what is specified in the plans.³⁷⁹

372 For example: [redacted];
 [redacted].

373 [redacted].

374 [redacted].

375 [redacted]; [redacted]; [redacted];
 [redacted]; [redacted];
 [redacted].

376 [redacted]; [redacted];
 [redacted].

377 [redacted].

378 [redacted]; [redacted].

379 [redacted].

- 7.19 Suppliers we spoke to who had struggled to get stocked in the merchant channel told us that they did not have issues with meeting the required compliance and service times.³⁸⁰ They acknowledged the role builder and designer demand had on merchant decisions but said that this argument was partly circular as until they could get access to the merchant channel it was harder to reach scale and provide a compelling offer to builders and designers to generate demand. They also noted the additional difficulties the regulatory systems and standards add to creating demand.³⁸¹
- 7.20 We also heard examples in other product areas where merchants had put in significant effort with new suppliers to meet compliance pathways and also encouraged their customers to take up a new product, working to create demand.³⁸²
- 7.21 It appears to us that, in making decisions on stocking, merchants weigh up the risks of stocking a new product, which include the risk of limited demand or more investment being needed, against the commercial benefits of doing so. Merchants can therefore have an important role in facilitating entry/expansion of suppliers and stimulating demand for a product.

Price is also an important factor

- 7.22 In addition to the non-price factors discussed above, the net price (that is the price after rebates or other discounts have been taken into account) is also an important factor when deciding which building products to stock.³⁸³
- 7.23 We understand that it is typical for key building supplies to have a standard list price and for the negotiations between suppliers and merchants to be around the level of rebates.
- 7.24 Our analysis shows that the proportion of key building supplies which are covered by rebates from suppliers to merchants is very high but varies by merchant.³⁸⁴

380 [].

381 [].

382 For example: [].

383 []; []; []; [].

384 [].

- 7.25 The value of rebates provided from suppliers to the five major merchants is substantial, with total rebates paid worth over \$200 million in 2021.³⁸⁵
- 7.26 Across all the key building supplies purchased by the five major merchants, we estimate the value of rebates received is around 10% of the total value of purchases.³⁸⁶ The average rebate level (as a proportion of purchases) for each merchant varies. Merchants with higher total sales typically receive higher rebate levels as suppliers are willing to provide additional rebates to merchants with greater scale.
- 7.27 Based on our analysis, rebate levels can vary significantly across different building supplies. There are some particularly high rebate tiers in some building supplies which are also highly concentrated.³⁸⁷

Merchant stocking decisions may also be influenced by the perceived risk of an adverse response from a supplier that has market power

- 7.28 As described in Chapter 5, markets for some key building supplies are highly concentrated and, combined with high barriers to entry, this can lead to suppliers having market power.
- 7.29 We heard that the perceived threat of action from suppliers with market power may influence merchant decision making. For example, in weighing up whether to switch some supply away from a supplier with market power, the perceived commercial risk that the supplier may respond by offering worse terms in their next agreement, or simply pursuing direct sales and disintermediating the merchant, can be a consideration.³⁸⁸
- 7.30 Similarly, we heard that the ability for suppliers to decline to provide discounts for particular jobs (to a merchant) meant that where suppliers had substantial market power, merchants may be afraid of taking action which might upset the supplier, in case they stopped offering them discounts.³⁸⁹

³⁸⁵ The exact figure we calculated has been rounded to the nearest \$50m.
[]

³⁸⁶ This figure is rounded to the nearest 10%.
[]

³⁸⁷ []

³⁸⁸ []

³⁸⁹ []

- 7.31 Our preliminary view is that the perceived threat of such an adverse response by incumbents could have an effect on competition between suppliers by dampening merchants' incentives to switch suppliers. Nevertheless, we have not seen evidence of threats of retaliatory conduct against merchants in practice. Accordingly, our preliminary view is that it is not a factor affecting competition in key building supplies.
- 7.32 We encourage any supplier or merchant with practical examples of retaliatory conduct to report them to the Commission so that we may consider what action may be appropriate using our competition compliance and enforcement functions and powers. Conduct by businesses with substantial market power that has the *purpose* of harming, deterring, or preventing competition can breach the Commerce Act. From April 2023, it will also breach the Commerce Act if the conduct has the *effect or likely effect* of substantially lessening competition in a market.³⁹⁰
- 7.33 In the next sub-sections, we consider how the structure of rebates and targeted discounts may affect competition for the upstream supply of some key building supplies in some circumstances.

Some rebate structures have the potential to harm competition between suppliers

- 7.34 Rebates can have varying effects on competition, depending on the circumstances, including the structure of rebates offered.
- 7.35 Rebates are a widely used business payment practice in many sectors that can benefit consumers. A rebate is a post-purchase discount given by a supplier to a purchaser under certain conditions. Rebate structures vary.
- 7.36 Rebates may have several purposes. For example, they may be a way for suppliers to pass through lower costs from economies of scale to customers and can allow suppliers to charge different prices to different customers with different willingness to pay (which may increase the total quantity supplied of the product). Rebates can also align the incentives of suppliers and distributors and give them confidence to make buyer-specific investments.³⁹¹

³⁹⁰ We note that from 3 April 2023 new legislation comes into force which strengthens the law to prohibit firms with market power from engaging in conduct that substantially lessens competition, regardless of whether they would have done the same thing if they did not have market power, Ministry of Business, Innovation & Employment "Review of section 36 of the Commerce Act and other matters" <https://www.mbie.govt.nz/business-and-employment/business/competition-regulation-and-policy/reviews-of-the-commerce-act-1986/review-of-section-36-of-the-commerce-act-and-other-matters/>.

³⁹¹ OECD "Executive Summary of the Roundtable on Fidelity Rebates held at the 125th meeting of the Competition Committee of the OECD" (DAF/COMP/M(2016)1/ANN4/FINAL) www.oecd.org.

- 7.37 However, rebates offered to merchants by a supplier with a large share in a market can harm competition by reducing the ability of others to compete effectively. Some rebate schemes may induce strong incentives for merchants to achieve a minimum level of sales of the firm's products, or a given market share. They may even encourage quasi or full exclusivity.³⁹² This can hinder smaller rivals from competing by raising their costs and restricting their access to sufficient distribution channels, and ultimately end consumers, to achieve necessary scale.³⁹³
- 7.38 In this subsection we describe the different types of rebate structures we have observed in relation to key building supplies and explore whether some structures may be adversely affecting competition.
- 7.39 Our preliminary views are that:
- 7.39.1 there are a range of different rebate structures used in the market;
 - 7.39.2 quantity-forcing rebate structures have the potential to harm competition between suppliers; and
 - 7.39.3 there are potential efficiency reasons for the use of quantity-forcing rebate structures but little evidence to suggest they outweigh the potential harm to competition.
- 7.40 We explain the reasons for our preliminary views below.

There are a range of different rebate structures used in agreements between suppliers and merchants

- 7.41 Our analysis in this market study revealed a range of different rebate structures are in use. We set these out in Table 7.1 below.

³⁹² David Spector "Loyalty Rebates: An Assessment of Competition concerns and a proposed rule of reason" (2005) at 94, available at: <http://www.cepremap.fr/depot/docweb/docweb0514.pdf>.

³⁹³ OECD "Executive Summary of the Roundtable on Fidelity Rebates held at the 125th meeting of the Competition Committee of the OECD" (DAF/COMP/M(2016)1/ANN4/FINAL) www.oecd.org.

Table 7.1 Overview of the different types of rebates observed in merchant-supplier agreements

Type of rebate	Description	Example
Flat percentage rebates	The supplier agrees to pay a fixed percentage of the value of purchases back to the merchant at the end of a period. These rebates are not explicitly conditional on any specific volume target.	A 7% rebate paid annually on all purchases made by a merchant from a particular supplier.
Lump sum rebates	The supplier agrees to pay a fixed value amount to the merchant as a lump sum on a periodic basis. These rebates are not explicitly conditional on any specific volume target.	An annual \$100,000 rebate paid by the supplier to the merchant as part of a supply agreement.
Tiered incremental rebates	The supplier agrees to pay different percentage levels of rebates to a merchant as a merchant reaches different volume levels. The higher tier is only payable on incremental sales above the threshold rather than the entire volume of sales.	A supplier will pay a 5% rebate to a merchant on all purchases up to \$1m within a year and a 10% rebate back on all purchases above \$1m.
Tiered retroactive rebates (also known as target, rollback or zero-rated rebates)	The supplier agrees to pay the merchant a percentage rebate based on the total volume of purchases, with the rebate level varying according to the total volume purchased in a set period.	A supplier at the end of each year will pay 5% back on all purchases if total purchases in the year are below \$10m, but 8% on all purchases if total purchases are above \$10m in the year.
Share of wallet rebates	The supplier agrees to pay the merchant a percentage rebate of purchases based on the total share of purchases the merchant made in a category from that supplier. The rebate level applies to the total volume purchased from the merchant in a set period.	A supplier will pay a rebate of 4% if a merchant makes at least 60% of its category purchases from the supplier; and a rebate of 8% if a merchant makes at least 80% of its category purchases from the supplier.

Source: Commerce Commission.

- 7.42 The two most common types of rebate arrangement we observed across our case study supplies were flat percentage rebates and tiered retroactive rebates. There were some cases where suppliers offered purely a flat percentage rebate.³⁹⁴ However, often arrangements would have a flat percentage base rate which was not dependent on sales, in combination with additional rebate tiers conditional on certain volume being achieved.³⁹⁵ In a small number of cases, rebate tiers started at zero per cent and so there was effectively no rebate given for a small number of purchases.³⁹⁶
- 7.43 Tiered rebate arrangements that are retroactive appear very common across a broad range of key building supplies. We identified these rebate arrangements in relation to the supply of many key building supplies, including our case study products of plasterboard and structural timber, as well as bagged concrete, roofing, insulation, fibre cement, timber cladding, plywood and other key building supplies.³⁹⁷
- 7.44 Among the arrangements we reviewed, lump sum rebates were not uncommon but were typically (though not always) linked to some additional benefit—for example, to support additional marketing or conferences.³⁹⁸ Tiered incremental rebates were rare. Although some of the merchant agreements appeared to include these as a potential option, the agreements we saw had not taken up this option. One merchant’s supply agreement noted that these types of rebates were ‘not preferred’.³⁹⁹
- 7.45 Share of wallet rebates do not appear to be very common.⁴⁰⁰

394

[]. For example: [];

395 [].
[];
[].

396 For example: [].

397 [].

398 For example: [].

399 For example: [].

400

[].

Quantity-forcing rebate structures have the potential to harm competition between suppliers

- 7.46 There is a large body of economic literature that discusses the potential anti-competitive effects of different rebate structures. The primary concern is that some rebate structures have the potential to exclude or limit competition from rivals by making it harder for rivals to access distribution channels. These concerns arise when rebates are structured in a way that can induce exclusivity, near exclusivity or require a minimum volume of sales.⁴⁰¹
- 7.47 In particular, rebates may be structured in a way which makes it very costly for a purchaser to switch even small amounts of volume away from the established supplier. This disincentivises switching to an alternative supplier.⁴⁰² This is sometimes referred to as ‘quantity forcing’ in the literature. In order to entice a merchant to switch, an alternative supplier attempting to win even a small share of supply would have to offer merchants a relatively greater discount to compensate for the loss of the rebate on the share of the merchant’s purchases which remain with the incumbent supplier. If the level of rebate on all units purchased is dependent on a specific volume being purchased, then any switching that reduced purchases below that threshold volume would raise the price of all units that are purchased from the incumbent supplier.
- 7.48 There is also the potential for the use of rebates by a majority of suppliers in a market that has a small number of similar sized players to harm competition by facilitating accommodating behaviour.⁴⁰³ We have not seen evidence of accommodating behaviour and do not discuss this issue further in this chapter.

⁴⁰¹ For example: OECD “Fidelity Rebates – Background Note by the Secretariat” (2016) [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP\(2016\)5&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2016)5&docLanguage=En); US FTC/DOJ “Conditional Pricing Practices: Public Workshop” (23 June 2014) <https://www.ftc.gov/news-events/events/2014/06/conditional-pricing-practices-economic-analysis-legal-policy-implications>; ICN “Report on the analysis of loyalty discounts and rebates under unilateral conduct laws” (June 2009) <https://centrocedec.files.wordpress.com/2015/07/report-on-the-analysis-of-loyalty-discounts-and-rebates-2009.pdf>; David Spector “Loyalty Rebates: An Assessment of Competition concerns and a Proposed Rule of Reason” (2005), available at: <https://www.cepremap.fr/depot/docweb/docweb0514.pdf>; Chiara Fumagalli, Massimo Motta, and Claudio Calcagno “Price Discrimination and Single-Product Rebates” in *Exclusionary Practices: The Economics of Monopolisation and Abuse of Dominance* (2018) at 126-238.

⁴⁰² For example: “Quantity ‘forcing’ refers to pricing schemes that reward a buyer for purchasing some threshold quantity from a firm. When there are significant scale economies and buyers are unable to coordinate, economic theory shows that a firm can profitably use quantity forcing to exclude rivals, reducing overall welfare and harming some buyers. Inducements to reach the quantity threshold may be provided through nonlinear pricing of the target product”, Marius Schwartz and Daniel Vincent “Quantity ‘Forcing’ and Exclusion: Bundled Discount and Nonlinear Pricing” in *Issues in Competition Law and Policy* (April 2008) at 1; “Some rebate schemes may induce strong incentives for retailers to achieve a minimum level of sales or a given market share, or even encourage quasi- or full exclusivity. This is the case in particular when they include rollback rebates (ie, rebates that apply to the entirety of a customer’s purchases conditional on reaching a given target, expressed in absolute or in market share terms)”, David Spector “Loyalty Rebates: An Assessment of Competition concerns and a Proposed Rule of Reason” (2005) at 94, available at: <https://www.cepremap.fr/depot/docweb/docweb0514.pdf>.

⁴⁰³ OECD “Policy Roundtables, Loyalty and Fidelity Discounts and Rebates” (2002) at 9, available at: <https://www.oecd.org/daf/competition/abuse/2493106.pdf>.

- 7.49 Different rebate structures are likely to affect competition to differing extents:
- 7.49.1 Attachment I sets out stylised examples which demonstrate how different rebate structures may impact merchant decisions about which suppliers to source product from, and therefore competition between suppliers.
 - 7.49.2 Flat percentage rebates or lump sum rebates appear less likely to harm competition because these types of rebates are not contingent on volume. Similarly, tiered incremental rebates may also be less likely to harm competition as the loss of any discount only applies to the volume being switched rather than to all sales.
 - 7.49.3 Quantity-forcing rebate structures (both share of wallet and tiered retroactive rebates) appear most likely to have the potential to harm competition between suppliers, particularly when used by suppliers with substantial market power that have an assured supply base. By assured supply base we mean a supply base which is ‘must have’ for the merchant and cannot be sourced from elsewhere. This may be because of the strength of the brand in the market.⁴⁰⁴ Where there is a proportion of the merchants’ customers that would otherwise be willing to switch products, suppliers may be able to use quantity-forcing rebates to make it harder for alternative suppliers to compete for this ‘contestable share’.
 - 7.49.4 As noted above, tiered retroactive rebates are the most common form of rebate that we observed in the supply agreements we reviewed.
- 7.50 Based on our analysis, supply agreements for key building supplies appear to be negotiated on a bilateral basis. We observed instances where the rebate tiers often closely matched the expected demand from each merchant. This may mean that some suppliers are able to individually tailor rebate tiers to minimise the likelihood of a particular merchant switching. This might involve setting the highest rebate tier close to the merchant’s expected purchases, thus reducing the size of the ‘headroom’ which is contestable without putting the achievement of a higher rebate at risk. Such headroom might make it more likely that a merchant would obtain sales above the highest tier from another supplier. Similarly, the tailored structures may allow suppliers to set out larger steps around the contestable share.

⁴⁰⁴ The assured base is sometimes also referred to as uncontestable demand.

7.51 Rebate agreements for key building supplies contain a range of different tiers and steps. Our analysis indicates that many agreements have steps of 1%–3%. However, some agreements have very small (for example, 0.1%) rebate steps.⁴⁰⁵ Other agreements have step ups in rebate tiers as high as 10%.⁴⁰⁶ The risk of harm to competition from quantity-forcing rebate structures likely increases with the size of the rebate step. However, even rebates with small steps could harm competition if applied retroactively across purchases of tens of millions of dollars which can result in very strong incentives to purchase from the supplier offering the rebate, particularly when close to rebate tiers.

7.52 The potential harm to competition from quantity-forcing rebate structures in agreements between suppliers and merchants may be less when suppliers have other distribution options. In both our plasterboard and structural timber case studies, the merchant channel was highlighted as being very important to suppliers. This is also the case across a range of other key building supplies. However, for other key building supplies, such as our ready-mix concrete case study, sales are made primarily on a direct basis.⁴⁰⁷

7.53 Even where the merchant channel is important, the extent of coverage across the different merchants likely also impacts the potential competitive effect of quantity-forcing rebate arrangements. For example, the risk of harm to competition may be higher if a quantity-forcing rebate is offered to all merchants and drives the exclusive or near exclusive purchases of those merchants.^{408, 409}

⁴⁰⁵ Commerce Commission analysis of rebates, [redacted].

⁴⁰⁶ For example: [redacted].

⁴⁰⁷ However, we note that sales made on a direct basis can also be covered by rebate arrangements. We discuss supplier to builder rebates from paragraph 7.70 below.

⁴⁰⁸ [redacted]; [redacted]; [redacted]; [redacted]; [redacted]; [redacted]; [redacted].

⁴⁰⁹ [redacted].

7.54 We have heard consistent evidence about the potential for quantity-forcing rebate structures to affect competition for the supply of key building supplies:

7.54.1 Although merchants typically consider a range of factors in coming to their stocking decisions, we heard from a merchant that the rebate structures they faced strongly incentivised additional purchases.⁴¹⁰

7.54.2 Merchants also appear to closely monitor how their purchase decisions are progressing and we saw multiple examples of merchants keeping tracking spreadsheets with the required purchases needed to hit the next rebate tier level. In some cases, these additional purchasing decisions were assessed against an ROI threshold to show the percentage gain from buying additional units. In the examples we saw, there were occasions when the ROI for purchasing additional units to reach a tier level was above 100%, which would indicate that making the additional purchases was beneficial even if these units could not be sold.⁴¹¹

7.54.3 Based on our analysis, it appears that merchants do consider the implications of not meeting certain volume thresholds by shifting supply arrangements, and the extent to which headroom might allow for it.⁴¹² We identified evidence of this occurring in a category review decision where a merchant indicated that it would ideally limit share growth of a new supplier to the growth of the category as if they dropped rebate tiers, they could lose a substantial amount.⁴¹³

7.54.4 Several smaller suppliers also highlighted rebates and lack of access to merchants as a factor limiting their ability to compete in the market.⁴¹⁴

410 [].

411 For example:
[].

412 [].

413 [].

414 []; [];
[];
[].

- 7.55 Our preliminary view is that the use of quantity-forcing rebate structures can make it harder for alternative suppliers to be stocked through the merchant channel and harder for existing suppliers to expand. These outcomes would tend to lessen competition and ultimately lead to worse outcomes for end consumers.
- 7.56 Of our case study products, our preliminary view is that the rebate structures applying to plasterboard are affecting competition because they impact merchant decision making and make it harder for alternative suppliers to reach scale. Although we have less information about products not included in our case studies, fibre cement also seems to be a building supply which has similar rebate structures and the conditions where quantity-forcing rebates may be harming competition.

There are potential efficiency reasons for the use of quantity-forcing rebate structures but little evidence to suggest they outweigh the potential harm to competition

- 7.57 Rebates may be pro-competitive or benign if they pass on to merchants efficiency benefits from suppliers realising economies of scale. They may also align incentives between suppliers and merchants to promote products by reducing the scope for free-riding on the supplier's promotional activity by other suppliers.
- 7.58 Tiered retroactive rebates, a form of quantity-forcing rebate, appear to have been a common feature of the industry for many years and have become standard industry practice.⁴¹⁵ We heard different explanations from suppliers of our case study products for why tiered retroactive rebates are used, including that they:
- 7.58.1 provide merchants with pricing benefits in response to volume;⁴¹⁶
 - 7.58.2 provide some degree of certainty which assists the supplier in managing sales and operations plans and therefore production levels;⁴¹⁷ and
 - 7.58.3 recognise the size and growth of a customer and the increased efficiency in ordering and logistics regarding the larger-scale operations.⁴¹⁸
- 7.59 Nevertheless, on balance our preliminary view is that potential benefits from the use of quantity-forcing rebates, particularly in highly concentrated markets, are unlikely to outweigh the possible harm to competition.
- 7.60 As noted in Chapter 1, this study does not specifically enquire into compliance with the provisions of the Commerce Act relating to anti-competitive conduct. We retain the ability to further investigate any rebate structure if information collected during this study, or outside of it, gives us reason to believe that anti-competitive conduct may be occurring.

⁴¹⁵ [].

⁴¹⁶ [].

⁴¹⁷ For example: []; [].

⁴¹⁸ [].

- 7.61 In 2014 the Commission investigated rebate structures used by Winstone Wallboards. The evidence at the time did not support a conclusion that Winstone Wallboards had breached the Commerce Act. Consistent with this draft report, the Commission observed that other factors may have been affecting competition in relevant markets at that time.
- 7.62 We are continuing to consider evidence relating to some quantity-forcing rebates that we have gathered during the course of this study to assess whether further action is warranted utilising the Commission’s compliance and enforcement functions and powers. In addition, suppliers with substantial market power, particularly those in highly concentrated markets, should review their rebate structures for compliance with the revised section 36 of the Commerce Act which comes into force in April 2023.

The use of customer specific quotes by suppliers to offer targeted price discounting to merchants may contribute to the difficulties new entrants at the supplier level have in gaining necessary scale in some markets

- 7.63 Agreements between suppliers and merchants often include provision for merchants to request customer specific quotes (CSQs) from the supplier. They appear to be a common feature across different key building supplies. Suppliers will consider requests for CSQs on a case-by-case basis.
- 7.64 CSQs appear to be used in two main ways. First, they are a mechanism for both merchants and their suppliers to enable merchants to get better pricing when the merchant is coming under competitive pressure from another supplier. Second, CSQs may be used to recognise that the volumes of the builder warrant additional price cuts.⁴¹⁹ CSQs tend to be used in larger projects, so are more common in commercial building projects than residential building projects.⁴²⁰
- 7.65 We heard that the prevalence of CSQs has declined recently as excess demand has meant customers are more focused on simply securing supply than negotiating for discounts.⁴²¹ It is unclear as to the extent this decline is a temporary trend.
- 7.66 CSQs allow suppliers to set different prices for customers who have different willingness to pay for the product. Setting different prices for different customers is common in many sectors and, provided it does not exclude rivals, often benefits consumers by increasing trade and driving firms to compete.⁴²²

⁴¹⁹ [].

⁴²⁰ []; []; [];

⁴²¹ []; [];

[].

⁴²² OECD “Fidelity Rebates – Background Note by the Secretariat” (2016) at [13]-[14], available at: [https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP\(2016\)5&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP(2016)5&docLanguage=En).

- 7.67 Competition driving sustained lower pricing is an outcome the Commission seeks to promote. However, there is a risk that short-term targeted discounts (even when above an incumbent's costs) could prevent rivals achieving and benefitting from economies of scale. This could limit their ability to provide a more effective competitive constraint over the longer term.
- 7.68 There are some markets for key building supplies where suppliers have a very high market share and there is a need for entrants to reach a certain minimum scale to cover fixed costs.⁴²³ In such markets, entry on a small scale is unlikely to significantly constrain incumbent firms in the short term. Small-scale entry may nevertheless be profitable and has the potential to become a more effective competitive constraint over time as the entrant grows to reach the necessary scale. However, a small-scale entrant may not be able to remain in the market if the incumbent responds to entry by lowering its own prices below the small entrants' costs (even when this post-entry price is above the incumbent's costs). In such cases, targeted discounts in response to small-scale entry may make it harder or impossible for the entrant to reach the scale required to compete effectively in the long term. This may ultimately lead to worse outcomes for consumers.
- 7.69 We continue to seek further information to better understand the role and impact of CSQs and targeted pricing in the industry so that we may further consider and report in our final report upon whether these arrangements may be negatively impacting competition for any key building supplies.

Arrangements between suppliers and builders

- 7.70 As well as having agreements in place with merchants, some suppliers also have arrangements with some of their end users (builders) to provide additional rebates and benefits. Suppliers that directly supply builders—that is, without going through the merchant channel—also offer end-user rebates. Both types of end-user rebates are typically offered to larger customers such as GHBs to recognise their volume.⁴²⁴
- 7.71 One supplier told us that these arrangements were conceptually similar to the rebates they provided to merchants.⁴²⁵

⁴²³ For example, paragraphs B22 and B44 in Attachment B.

⁴²⁴ For example: []; [].

⁴²⁵ [].

- 7.72 The prevalence of these rebate agreements varies by key building supply.⁴²⁶ However, we were told that they are overall a common feature.⁴²⁷
- 7.73 The structure of rebates paid varies, and a combination of structures may be used within a rebate agreement.⁴²⁸
- 7.74 However, we have not seen any evidence to suggest that builders receive share of wallet or tiered retroactive rebates.⁴²⁹
- 7.75 A merchant stated that although they do not have visibility of the details of supplier-builder rebates, its experience was that they make it more difficult for the merchant to introduce new suppliers/products to the market as they make some customers reluctant to switch to new alternatives.⁴³⁰
- 7.76 Based on the limited evidence we have considered, our preliminary view is that the provision of rebates to builders by suppliers is less likely to harm competition, than rebates from suppliers to merchants, because they are not structured in a way that may induce exclusivity, near exclusivity or require a minimum volume of sales. Additionally, the smaller volumes that builders purchase as compared to merchants means that it would more often be feasible for suppliers to compete for the whole of a builder’s supply. However, we acknowledge that the lack of transparency around builder rebates may have wider implications, both in adding uncertainty to merchants’ stocking decisions and, in some cases, leading to misaligned incentives between builders and their customers. In this way, they have the potential to inhibit competition.

⁴²⁶ [Carter Holt Harvey “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at [41]; []; []; []; []; []; []; [];

⁴²⁷ [].

⁴²⁸ [].

⁴²⁹ [].

⁴³⁰ [].

Arrangements between merchants and builders

- 7.77 In this section we consider arrangements between merchants and their customers (builders).
- 7.78 Rewards offered by merchants to builders can take the following forms:
- 7.78.1 rebates from merchants to builders;
 - 7.78.2 loyalty schemes offered by merchants to builders; and
 - 7.78.3 bundling discounts—when multiple products are offered in a package priced at a discount compared to buying each of the products individually.
- 7.79 Bundling does not appear to be common in agreements between merchants and builders (other than for warranty purposes).⁴³¹ We understand that merchants (and suppliers) rarely require builders to purchase all supplies, or specific supplies, in order to benefit from rebates or discounts.
- 7.80 For this reason, the focus of our analysis in this section is on rebates and loyalty schemes.

Rebates from merchants to builders are negotiated with a relatively small number of builders and are set at relatively low levels

- 7.81 Rebates are offered by merchants to a small number of merchants' customers. They are primarily paid to GHBs and are unusual for SME builders.⁴³²

⁴³¹ Mitre 10 "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 30; Fletcher Building "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [42.1]; []; []; []; [].

⁴³² []; []; []; [].

- 7.82 Although GHBs are some of merchants' larger customers, our analysis indicates these rebates are overall offered to customers that represent a minority of their total sales of key building supplies.⁴³³ The rebates paid appear to, for the most part, be relatively low in value.⁴³⁴
- 7.83 The structure and level of the rebates agreed is usually the result of bilateral negotiations between the parties.⁴³⁵ Some GHBs explicitly identify in RFPs the nature of rebates required to win their business, with merchants responding accordingly.⁴³⁶ Rebates may also be offered during negotiations or renegotiations to match those offered by other merchants to win or retain the business.⁴³⁷
- 7.84 We observed the range of rebate structures described in Table 7.1 above in the merchant to builder channel, with the exception of share of wallet rebates.⁴³⁸
- 7.85 Agreements may contain a package of rebates. For example, within one agreement, sales volumes might be recognised through a flat percentage or tiered retroactive rebate; marketing, event and conference support could be provided through a lump sum rebate; and show home support may be provided through discounts on products on the condition that they are used to build houses that will be used as show homes for a set period. We observed considerable variation in the packages of rebates agreed, reflecting their emergence from negotiations.

⁴³³ For example:
[];
[]].

⁴³⁴ For example: [] [];
[] [];
[]].

⁴³⁵ [];
[]].

⁴³⁶ []].

⁴³⁷ [] []].

⁴³⁸ However, since we reviewed only a selection of agreements, it is possible that share of wallet rebates are also used in this channel.

7.86 For rebates tied to sales volumes, the key figure is usually the total price paid for all products in aggregate (but may exclude amounts such as freight, pallets and GST).⁴³⁹ That is, the rebate percentage does not usually vary by product purchased. Where different rebate percentages apply, this appears to be in relation to product category rather than specific product.⁴⁴⁰

7.87 As with the rationale for other rebates, rebates to customers from merchants can recognise scale efficiencies provided by larger customers.⁴⁴¹ Prices for customers to purchase key building supplies may be the same across the board, with adjustments to price based on volume made via rebates.⁴⁴²

7.88 Administrative convenience can also influence the use of rebates rather than discounts on price to builders. Rebates are often used to fund the head office or franchisor of GHBs.⁴⁴³

7.89 Some GHBs are offered but refuse to accept rebates. These GHBs prefer to negotiate for a better upfront price.⁴⁴⁴

Loyalty schemes to builders are more widely available, with the nature of rewards varying

7.90 The major merchants all offer what could be described as loyalty schemes to some or all of their trade customers. These appear to be relatively low cost for merchants to operate.⁴⁴⁵

439 [];
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440 [].

441 []; []; [].
[]; [].

442 For example: [].
443 []; []; [].
[]; [].

444 []; [];
[].

445 For example: []; [].

- 7.91 Where these involve membership in a scheme, the level of customer spend required for eligibility varies between merchants, as do the conditions on which a customer can remain a member.⁴⁴⁶ Customers may receive additional rewards for reaching certain spend thresholds.⁴⁴⁷
- 7.92 The information that we were provided suggests that merchants do not usually offer additional rewards for purchasing specific products. Instead, the rewards are tied to overall spend (but may exclude amounts such as freight, pallets and GST) or to factors that are not solely related to the purchases made, such as a perceived need to strengthen a relationship.
- 7.93 There are both price and non-price rewards offered:
- 7.93.1 Price rewards are similar to rebates. Builders receive a discount on purchases of building supplies, sometimes based on loyalty to a particular merchant (for example, reaching a threshold for spending or making a certain number of purchases).⁴⁴⁸
- 7.93.2 Non-price rewards provide benefits that do not reduce the price of building supplies. These might be offered through points schemes or at the discretion of merchants. Rewards vary by programme and could include attendance at trade events, gift cards, consumer products or travel.⁴⁴⁹
- 7.94 Merchants identified several reasons for offering loyalty schemes, including that:
- 7.94.1 rival merchants also offer such schemes, which means that some customers have an expectation of receiving these benefits;⁴⁵⁰

⁴⁴⁶ For example, Carters may invite trade customers to the Advantage scheme if their purchases exceed \$25,000 per annum (Carters “Carters Advantage” <https://www.carters.co.nz/carters-advantage/>); PlaceMakers may invite trade customers to the PlaceMakers Plus scheme (at the “Blue” level) if their purchases exceed \$25,000 per year (PlaceMakers “Terms and Conditions” <https://plus.placemakers.co.nz/>); Bunnings’ customers can apply for a PowerPass Account by completing an online application evidencing their status as a business (Bunnings “PowerPass Accounts” <https://trade.bunnings.co.nz/powerpass/>); Mitre 10 uses Airpoints, for which some trade customers may be eligible but they need to discuss this with their Account Manager or the Trade Team at their local store (Mitre 10 “Earn Airpoints Dollars with us” <https://www.mitre10.co.nz/airpoints/>); and ITM Trade Club is dependent upon individual stores’ eligibility criteria (ITM “Trade Club Rewards” <https://www.itm.co.nz/Trade-Services/Trade-Club-Rewards/>).

⁴⁴⁷ For example,

[].

⁴⁴⁸ For example, Bunnings’ PowerPass scheme.

⁴⁴⁹ For example, Carters’ Advantage club, PlaceMakers’ PlaceMakers Plus, ITM’s Trade Club, Bunnings’ Smart Trade, Mitre 10’s Airpoints and BuildLink’s Smart Trade arrangements.

⁴⁵⁰ [];
[];

- 7.94.2 the schemes can be used to incentivise customers to pay on time;⁴⁵¹ and
- 7.94.3 events accessed through the schemes are useful for merchants to build relationships with their customers.⁴⁵²

Merchant to builder rebates and loyalty schemes do not appear to make it harder for merchants to compete for customers

- 7.95 Merchant-builder rebates and loyalty schemes have the potential to harm competition if they make it less likely that builders will purchase supplies from rival merchants.
- 7.96 If there are key customers in the market (for example, large GHBs), whose volume is critical for achieving the scale necessary for a merchant to operate effectively, then merchants could have the incentive to ‘lock in’ these customers to prevent rival merchants from achieving this scale. This would require rival merchants to compete for key customers’ entire supply volume instead of being able to supply part of their demand. However, the potential for harm is reduced if GHBs periodically tender for supplies.

Rebates

- 7.97 As rebates are typically offered to GHBs, we primarily focus on GHB behaviour in our preliminary assessment of their effect.
- 7.98 Merchants did not raise rebates as a factor locking in builders to other merchants and preventing merchants from gaining access to new customers.
- 7.99 This accords with other evidence that we received.⁴⁵³ We understand that GHBs consider several factors when choosing a merchant, including supply certainty. Price is also an important factor but the availability of rebates does not appear to be a significant component of the net price paid by GHBs.⁴⁵⁴ Those who responded to our specifier survey did not overall identify ‘rebates, discounts and/or loyalty benefits’ as one of the most important factors when choosing where to purchase building supplies.

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[];

- 7.100 We understand that, for those GHBs that enter supply agreements with merchants, GHBs typically renegotiate, put out RFPs or go out to tender approximately every one to four years.⁴⁵⁵ Regular RFPs or tenders tend to reduce customer foreclosure risk because even if the structure of a particular rebate meant that in a given period a customer might purchase all of its supply from one merchant, the customer would not be locked in for the long term. Rival merchants may be able to compete for the customer’s business when the existing agreement expires.

- 7.101 We also understand that some GHBs operate their procurement processes with a view to entering multiple preferred supplier agreements, rather than one exclusive supply agreement.⁴⁵⁶ As projects arise, they obtain quotes from each of the merchants they have entered agreements with and select the best. GHBs that are willing to trade off a possible higher rebate for the option to continually negotiate lower upfront prices do not appear to be locked in by rebate structures.

- 7.102 Other GHBs have longstanding arrangements with a particular merchant. Some of these have a preference to maintain an exclusive relationship with this chosen merchant. But, where this is the case, it seems to be in order to build a strong relationship with that merchant, rather than due to the rebate structures offered.⁴⁵⁷

- 7.103 The risk of harm to competition from rebates is also reduced if there are other customers that a merchant can supply. In this regard, we note that there are a large number of customers that are not paid rebates. The evidence we have indicates such customers are overall a majority of merchants’ sales by revenue of key building supplies.⁴⁵⁸

- 7.104 These factors suggest that merchant-builder rebates do not hinder the ability of merchants to compete among themselves, or hinder the ability of new merchants to enter. GHBs do not appear to be locked into merchants by these rebates; it seems that other merchants can (and do) compete for their business, and also have many other customers for which they can compete. Our preliminary view is that they are unlikely to be adversely affecting competition between merchants.

⁴⁵⁵ [];
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 [];
 []].

⁴⁵⁶ [];
 []].
⁴⁵⁷ [];
 []].

⁴⁵⁸ For example:
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 []].

7.105 As noted in relation to our discussion of supplier-to-merchant rebates, this study does not enquire into compliance with the provisions of the Commerce Act relating to anti-competitive conduct. While we are not currently aware of specific rebate arrangements between merchants and builders which we consider appropriate for further investigation, we retain the ability to further investigate any rebate structure if information collected during this study, or outside of it, gives us reason to believe that anti-competitive conduct may be occurring. In that context, merchants with substantial market power, particularly those in highly concentrated markets, should review their rebate structures for compliance with the revised section 36 of the Commerce Act which comes into force in April 2023.

Loyalty schemes

7.106 Loyalty schemes are more widely offered and we have considered how both GHBs and smaller customers respond to them and how they impact competition.

7.107 As above, we understand that supply certainty and price are particularly important for GHBs in their choice of merchant. For the most part, GHBs do not appear to consider loyalty schemes as one of the most important factors in their purchasing decisions.⁴⁵⁹ Some do not participate in these schemes.⁴⁶⁰ Evidence of GHBs entering multiple supplier agreements to shop between merchants referred to above suggests these GHBs do not prioritise obtaining the highest number of loyalty points (or similar) from any given merchant.

7.108 It also appears that smaller trade customers do not generally regard loyalty schemes as a significant factor.⁴⁶¹ We understand that the vast majority of smaller trade customers operate multiple trade accounts.⁴⁶² Although they may still have a preferred merchant, other accounts may be used where there is better pricing or product availability, reflecting the significant factors they identified.⁴⁶³

7.109 In our specifier survey, discussed in Chapter 4, most responders did not select the option 'rebates, discounts and/or loyalty benefits' as one of the most important factors when choosing where to purchase supplies.

⁴⁵⁹ []; [].

⁴⁶⁰ []; []; [].

⁴⁶¹ []; [].

⁴⁶² [].

⁴⁶³ []; [].

- 7.110 We understand from merchants that loyalty schemes of some form could be considered a requirement to operate in the market.⁴⁶⁴ There may be some customers for which they are particularly important.⁴⁶⁵ But, because of their overall similarity, these schemes were considered unlikely to be a key factor through which most customers differentiate between merchants.⁴⁶⁶
- 7.111 Overall, our preliminary view is that loyalty schemes are unlikely to be adversely affecting competition between merchants. Loyalty schemes do not appear to be a significant factor in the purchasing decisions of most customers. For those for which these schemes are important, there are several major merchants competing for their custom. Merchants did not suggest that they are locked out of the market through loyalty scheme offerings which they are unable to match.
- 7.112 The information we have on the costs required to operate loyalty schemes suggests that, even if they are a requirement to operate in the market, these costs are unlikely to be prohibitive for new entrants.⁴⁶⁷

There is value to the competitive process in ensuring that end consumers are well informed, including about rebates and loyalty schemes

- 7.113 Although we have reached the preliminary view above that rebates and loyalty schemes are unlikely to be adversely affecting competition between merchants, there is nevertheless value to the competitive process in ensuring that end consumers are well informed. This reduces the potential for harm from a possible misalignment of incentives.
- 7.114 In the context of rebates and loyalty schemes, there is potential for undisclosed benefits to influence a builder's capacity to objectively assess the value proposition of a product or merchant for the end consumer.⁴⁶⁸ Some industry participants also highlighted that the end consumer is ultimately paying for these benefits yet may not be aware of their prevalence. For example, the end consumer may be presented with an invoice for a project, but they may not know that the materials cost to the builder may be cheaper due to rebates, nor that the builder may be getting some loyalty rewards for purchasing with that merchant.⁴⁶⁹

⁴⁶⁴ []; [].

⁴⁶⁵ [].

⁴⁶⁶ []; [].

⁴⁶⁷ []; [].

⁴⁶⁸ For example: Master Plumbers "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 2, although this was noted as an anecdotal observation; [].

⁴⁶⁹ For example: Monopoly Watch "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 11. See also: Property Council of New Zealand "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at [10.1]; [].

- 7.115 A misalignment of incentives from these rewards is most likely to arise where end consumers are not well informed about different products, are not familiar with the building industry and rely on builders to make these decisions on their behalf, or rely on their recommendations. Such consumers may find it challenging to question the choices builders make when purchasing key building supplies. This appears to be the case for some end consumers in New Zealand.⁴⁷⁰
- 7.116 An important development is the Building (Code of Ethics for Licensed Building Practitioners) Order 2021, which will come into force on 25 October 2022. This Order introduces a Code of Ethics for Licensed Building Practitioners (LBPs). The Code of Ethics includes requirements for LBPs to inform and educate their clients and to declare and manage actual or potential conflicts of interest appropriately.⁴⁷¹
- 7.117 MBIE has also released guidelines to help users of the Code of Ethics navigate it. In relation to conflicts of interest, the guidelines note that:⁴⁷²
- Conflicts of interest exist when you or your family or company have a personal, or financial connection which may adversely affect your professional judgement or actions. For example, perhaps your professional judgement or actions could be influenced by the personal connection that you have to a particular job, product, supplier or client (e.g. rushing the job or insisting on the use of a particular product in order to get trade points from a particular manufacturer or retailer).
- 7.118 While these guidelines are not authoritative on the legal obligations created, it indicates that MBIE's expectation in developing the Code of Ethics is that LBPs' alignments with merchants through rebates and loyalty schemes will be disclosed to end consumers.
- 7.119 We consider that the Code of Ethics and guidance associated with it may assist in ensuring builders provide consumers with full information about the choices available to them and the factors influencing builders' purchasing decisions made on their behalf. LBPs will be required to share additional information, which in turn could influence wider change.

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⁴⁷¹ Clauses 14 and 22 of the Building (Code of Ethics for Licensed Building Practitioners) Order 2021, available at: <https://www.legislation.govt.nz/regulation/public/2021/0335/latest/LMS573729.html>.

⁴⁷² Ministry of Business, Innovation and Employment "Code of Ethics: Guidelines for Licensed Building Practitioners" (October 2021) at 11, available at: <https://www.lbp.govt.nz/assets/lbp/documents/guidelines/code-of-ethics-guidelines-for-lbps.pdf>.

Chapter 8 Impediments to the entry or expansion of new or innovative building supplies

Summary of preliminary findings

- Domestic initiatives, notably the MBIE-led Building for Climate Change (BfCC) programme will, over time, call for a significant innovative response from the building industry.
- BfCC will introduce new requirements for the sector to measure and eventually place caps on the embodied carbon emissions (emissions attributable to construction of buildings, including the building supplies), and operational emissions of new buildings.
- The regulatory and behavioural barriers that we discuss in Chapter 3, appear to incentivise sticking to 'tried and tested' building products and inhibit the entry or expansion of new or innovative key building supplies. If not addressed, these barriers could well inhibit the entry or expansion of the hoped-for innovation in green building supplies.
- The European Union (EU) has recently undertaken a similar programme to BfCC to reduce the emissions of its construction sector. In addition to providing direction to reduce emissions, the EU is now progressing to address whether the regulatory framework is fit-for-purpose to achieve its sustainability and climate objectives.
- It appears there is opportunity to leverage such international work to upgrade the environmental standards of building supplies, through looking to incorporate international standards for green building supplies into clear compliance pathways within the New Zealand regulatory system.
- Innovation in offsite manufacturing (OSM) can add a range of benefits for the construction process and has the potential to increase competition in the markets to supply key building supplies. Any residential build is capable of having some degree of offsite strategies employed and the process can draw on an offshore or onshore manufacturing base.
- Recently there has been significant growth in OSM activity in New Zealand, however, the sector is still small relative to the broader residential construction sector and faces a unique set of challenges.
- A consenting environment which was largely designed around inspections for onsite builds was previously an obstacle for OSM however, significant progress has been made by some BCAs and MBIE to address the concerns. The recent reforms of the Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021 aim to close the gap further through a new voluntary manufacturer certification scheme for Modular Component Manufacturers (MCM).
- For domestic offsite manufacturers, lack of certainty around pipeline and absence of large long-term contracts remains the key challenge. These businesses can be expected to defer investing in capital equipment to grow capacity to more efficient levels of production in the face of demand uncertainty.

Introduction

- 8.1 This chapter discusses impediments to the entry or expansion of new or innovative building supplies, such as 'green' building supplies or novel prefabricated products. It considers this in the context of the broader themes of building for climate change and standardisation (offsite manufacturing and prefabrication).
- 8.2 The terms of reference ask us to consider impediments to the entry or expansion of new or innovative building supplies such as 'green' building supplies or novel prefabricated products. Our [additional paper on the scope of this study](#) stated that we have placed less emphasis on the extent to which any particular current or future building supply itself may be new or innovative, as we intend to look at innovation more broadly.
- 8.3 Competition issues raised in other parts of this report also apply generally to the entry or expansion of new or innovative building supplies, such as the regulatory system appearing to incentivise sticking to 'tried and tested' building products. In this chapter we describe some specific programmes and initiatives for these innovative products and some specific barriers that have been reported to us by industry participants.
- 8.4 Innovations in building supplies can emerge in different forms, including improvements to production efficiency, process improvement, new products and/or services. New or innovative building supplies may contribute to more efficient construction processes and/or to building more energy efficient homes.
 - 8.4.1 'Green' building supplies are a subset of new or innovative building supplies that contribute to reducing emissions of the construction sector and are discussed from paragraph 8.6 below.
 - 8.4.2 Novel prefabricated products and offsite manufacturing cover a range of products and processes that utilise some form of manufacturing and standardisation that integrates with the construction process. We discuss this from paragraph 8.52 below.
- 8.5 Topics covered are:
 - 8.5.1 the implications of domestic initiatives for green building supplies; and
 - 8.5.2 factors affecting competition for new or innovative building supplies and novel prefabricated products. For the purposes of this topic we mostly use the broader industry terminology of 'offsite manufacturing' and discuss its potential impediments and impacts on competition.

Green building supplies

- 8.6 Building supplies can affect the environment through their use in construction as well as through the operational efficiency of buildings. Green building supplies contribute to reducing emissions of the construction sector.⁴⁷³ They are a subset of new or innovative building supplies that:
- 8.6.1 are more environmentally friendly to produce, supply or build with; or
 - 8.6.2 contribute to building more energy efficient homes, reducing the environmental impact of operating buildings.
- 8.7 This section finds:
- 8.7.1 domestic initiatives, notably MBIE’s BfCC programme, will, over time, call for a significant innovative response from the building industry, and are likely to encourage innovation for green building supplies;
 - 8.7.2 impediments to the entry or expansion of green building supplies that exist currently, if not addressed, could well inhibit the entry or expansion of the hoped-for innovation in green building supplies; and
 - 8.7.3 there is significant work offshore to upgrade environmental standards for building supplies, and there appears to be an opportunity to leverage this work, through looking to incorporate international standards for green building supplies into clear compliance pathways within the New Zealand regulatory system to help facilitate entry or expansion.
- 8.8 Buildings have a significant role to play in reducing emissions. In 2018, nearly 9.4 per cent of domestic emissions were building related.⁴⁷⁴ The Government’s Emissions Reduction Plan (ERP) sets a long-term vision that by 2050 building-related emissions will be near zero and buildings provide healthy places to live and work.

⁴⁷³ The terms emissions, carbon emissions and carbon are used to represent all greenhouse gas emissions, Ministry of Business, Innovation & Employment “Transforming Operational Efficiency” (August 2020) at footnote 2.

⁴⁷⁴ This includes both the construction and operations of buildings taking a “consumption” approach to measuring emissions. This figure increases to above 15% contribution when considering only long-lived domestic emissions (ie, if biogenic methane is excluded), Ministry for the Environment “Aotearoa New Zealand’s First Emissions Reduction Plan” (May 2022) at 228-229, available at: <https://environment.govt.nz/what-government-is-doing/areas-of-work/climate-change/emissions-reduction-plan/>. Other reports have found that the construction and operations of buildings are responsible for between 13 and 20% of domestic emissions (taking a consumption-orientated view). Half of this is from construction and half from operating buildings, Thinkstep “The carbon footprint of New Zealand’s built environment: hotspot or not?” (May 2018) at 4.

- 8.9 It appears that the energy efficiency of new homes built in New Zealand today is behind international comparators, as the minimum standards (that relate to energy efficiency) set in the Building Code (to which most new homes in New Zealand are built) are below international standards, and there are few incentives to build to a higher standard.⁴⁷⁵ The quality of our existing housing stock is poor.⁴⁷⁶
- 8.10 New Zealand may be starting behind our international peers as we look to our long-term vision of reducing the building-related emissions to near zero.

Domestic initiatives calling for innovation in building products

- 8.11 Several domestic initiatives are likely to require a significant innovative response from the building industry for green building supplies and promote the entry or expansion of green building supplies in the long term.
- 8.12 This is likely to include innovation in, or competing alternatives to, traditional key building supplies. The increased choice and other benefits this has the potential to bring would positively impact competition.
- 8.13 Most notably, BfCC will introduce measures to limit the emissions from the construction and operation of buildings.
- 8.14 The ERP, which is closely aligned to the objectives of BfCC, specifies how the building and construction sector will contribute to a sector-wide carbon budget through to 2035 and provides a range of actions to support reducing carbon emissions.
- 8.15 Other initiatives are:
- 8.15.1 Rautaki Hanganga o Aotearoa, New Zealand’s Infrastructure Strategy, published by Te Waihanga, the New Zealand Infrastructure Commission;⁴⁷⁷
 - 8.15.2 the Homestar programme, led by the New Zealand Building Council;⁴⁷⁸ and

⁴⁷⁵ International Energy Agency “Energy policies of IEA Countries. New Zealand 2017 Review” (2017) at 225, available at: <https://www.iea.org/reports/energy-policies-of-iea-countries-new-zealand-2017-review>; OECD “OECD Environmental Performance Reviews: New Zealand 2017” (20 March 2017) at 47, available at: https://read.oecd-ilibrary.org/environment/oecd-environmental-performance-reviews-new-zealand-2017_9789264268203-en;

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⁴⁷⁶ OECD “Better Life Index” <https://www.oecdbetterlifeindex.org/topics/housing/>; Alan Johnson, Philippa Howden-Chapman and Shamubeel Eaqub “A Stocktake of New Zealand’s Housing” (February 2018) at 42, available at: <https://www.beehive.govt.nz/sites/default/files/2018-02/A%20Stocktake%20Of%20New%20Zealand%27s%20Housing.pdf>.

⁴⁷⁷ New Zealand Infrastructure Commission, Te Waihanga “Rautaki Hanganga o Aotearoa, New Zealand Infrastructure Strategy 2022-2052” (May 2022), available at: <https://www.tewaihanga.govt.nz/strategy/>.

⁴⁷⁸ See: <https://www.nzgbc.org.nz/homestar>.

8.15.3 ongoing updates to Healthy Homes standards.⁴⁷⁹

Building for Climate Change

- 8.16 BfCC is a long-term programme run by MBIE to reduce emissions from constructing and operating buildings, and to make sure buildings are prepared for the future effects of climate change.⁴⁸⁰ It will set targets and caps for energy use and emissions, helping to change people’s behaviour and the way they think about building.
- 8.17 BfCC contributes to the development of New Zealand’s National Adaptation Plan, which will be finalised and published in August 2022, after current consultation on the impacts of climate change across a range of areas, including homes and buildings.^{481, 482} BfCC aligns closely with the ERP, which sets an emissions budget and actions across a range of sectors (including building and construction) to reduce emissions.
- 8.18 BfCC includes two emissions mitigations frameworks:
- 8.18.1 The *Whole-of-life embodied carbon framework* considers all carbon emissions attributable to the building itself. This includes emissions across the full supply chain, the construction processes (and the waste arising), repair and maintenance, and processes at the end-of-life of a building;⁴⁸³ and
- 8.18.2 The *Transforming operational efficiency framework* considers emissions directly and indirectly attributable to the operation of new buildings, including from the use of energy and water. It also defines indoor environmental quality parameters for all new buildings to comply with.⁴⁸⁴

⁴⁷⁹ See: <https://www.tenancy.govt.nz/healthy-homes/about-the-healthy-homes-standards/>.

⁴⁸⁰ Building Performance “Emissions reduction” <https://www.building.govt.nz/getting-started/building-for-climate-change/emissions-reduction/>.

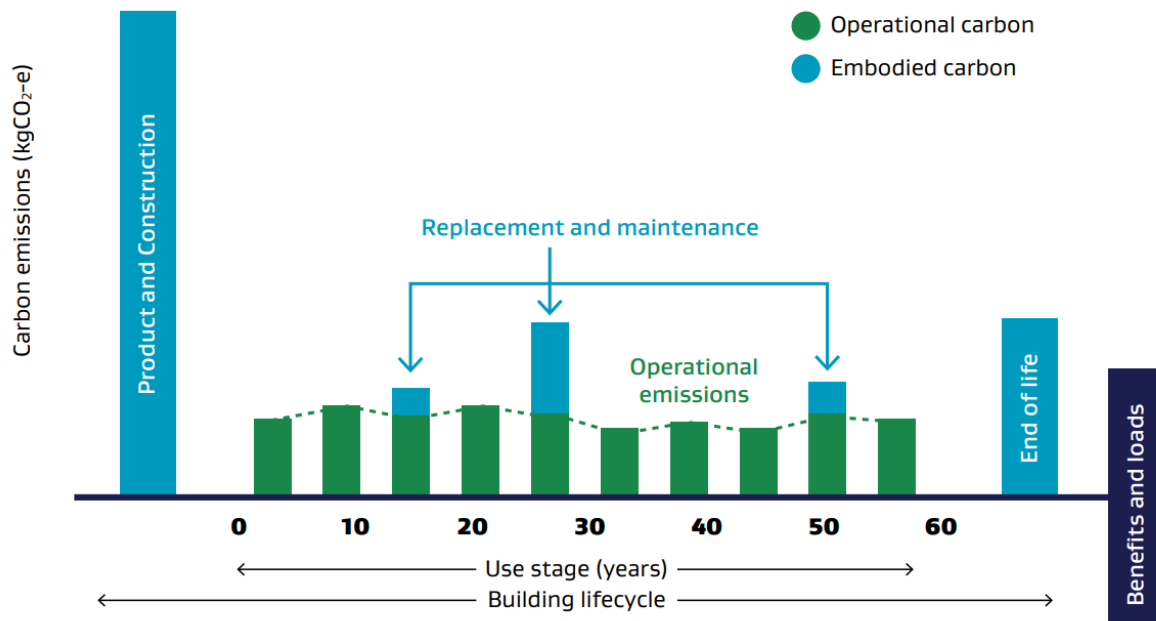
⁴⁸¹ Building Performance “Draft National Adaptation Plan for climate resilience” <https://www.building.govt.nz/about-building-performance/all-news-and-updates/draft-national-adaptation-plan-consultation/>.

⁴⁸² Ministry for the Environment “Kia urutau, kia ora: Kia āhuarangi rite a Aotearoa – Adapt and thrive: Building a climate-resilient New Zealand – Draft national adaptation plan, Managed retreat” (April 2022), available at: <https://environment.govt.nz/assets/publications/Adapt-and-Thrive-consultation-document.pdf>.

⁴⁸³ Ministry of Business Innovation & Employment “Whole-of-life embodied carbon framework” (August 2020), available at: <https://www.mbie.govt.nz/dmsdocument/11794-whole-of-life-embodied-carbon-emissions-reduction-framework>.

⁴⁸⁴ Ministry of Business Innovation & Employment “Transforming operational efficiency framework” (August 2020), available at: <https://www.mbie.govt.nz/dmsdocument/11793-transforming-operational-efficiency>.

Figure 8.1 Operational and embodied carbon emissions over the life cycle of a building



Source: Ministry of Business, Innovation & Employment.⁴⁸⁵

- 8.19 Figure 8.1 is a stylised example that shows typically the most significant embodied carbon emissions happen before the building is used, in the production of construction materials and products. However, embodied carbon emissions also occur during the building's operation due to maintenance activities, and also at the end of the life of the building due to demolition activities, and disposal or recycling of materials and products.⁴⁸⁶
- 8.20 BfCC first proposes to introduce measuring and reporting requirements of emissions for new buildings, for both whole-of-life carbon and operational efficiency. This will introduce new challenges for the sector to become familiar with measuring the emissions of new buildings.

⁴⁸⁵ Ministry of Business, Innovation & Employment "Whole-of-life embodied carbon framework" (August 2020), available at: <https://www.mbie.govt.nz/dmsdocument/11794-whole-of-life-embodied-carbon-emissions-reduction-framework>.

⁴⁸⁶ 'Benefits and loads' embodied carbon include the reuse, recovery and recycling of materials and are reported separately to other embodied carbons, Ministry of Business, Innovation & Employment "Whole-of-life embodied carbon framework" (August 2020) at 4.

- 8.21 Initial, intermediate and then final caps on emissions will then be introduced for both operational efficiency and embodied carbon. Requirements will be introduced for public sector buildings ahead of all other buildings. The level of caps will be determined closer to their introduction and be informed by the results of the reporting. Final caps are expected to reflect New Zealand’s net zero carbon emission commitment by 2050.
- 8.21.1 The requirements introduced under the operational efficiency framework may be considered an extension of existing requirements under the Building Code, with some new measures introduced (such as airtightness). However, the embodied carbon framework introduces new requirements to many sector participants as embodied carbon is not currently considered within the Building Code.
- 8.21.2 The timeframes for, and level of, the caps on emissions will impact the rate of innovation required by the sector. While the high-level approach is set out in consultation documents, the specific level of the caps and the timeframes for introducing them are yet to be determined. Cap levels will be set considering best practice and in consultation with the sector to ensure they are ambitious but achievable.
- 8.22 While there has been broad support for the need for change, we have heard concerns that implementation periods for new requirements could increase the cost of introduced measures. For example, if an implementation period is too short, builders could be required to dispose of building materials that will not meet new requirements.⁴⁸⁷
- 8.23 Increasingly significant innovations are likely to be necessary as caps are introduced and then tightened.
- 8.24 Having a series of initial, intermediate and final caps on emissions allows the programme to adjust its approach at each stage, and the impact and costs to the industry of each step-change is likely to vary. BfCC caps are an outcome requirement (a requirement of the completed building rather than any one specific component, such as the insulation performance of walls) and place less emphasis on methods to achieve an outcome. Therefore, it is difficult to determine which key building supplies will be impacted in the long term.
- 8.24.1 Incremental performance increases (such as the H1 energy-efficiency Acceptable Solution updates included in the 2021 Building Code update) may simply necessitate a 1:1 building material swap, for example, by requiring the use of window frames with a thermal break.⁴⁸⁸ This level of change would likely impact suppliers, and the design-and-build stages of the construction process.

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Building Performance “2021 Building Code update” <https://www.building.govt.nz/building-code-compliance/annual-building-code-updates/2021-building-code-update/>.

- 8.24.2 As the caps tighten, and require greater improvements to building performance, more intensive work at the design stage of the construction process may be necessary, and may impact the overall design of a building. For example, a designer may take an innovative approach to the thermal envelope rather than using traditional methods of insulating within the cavity of the structural frame, or a design using timber-pile foundations rather than a concrete slab.
- 8.24.3 Over time, it is likely that BfCC will influence decisions of building typologies being built – decisions at the developer stage of the construction process. Attached housing (such as townhouses and medium-density residential housing) can be more energy efficient and have greater opportunities to reduce the embodied carbon of the building.
- 8.24.4 Innovations in OSM are also likely to play an important role in achieving the objectives of BfCC, largely through processes that construct more energy efficient homes. Construction processes in factory conditions can allow greater accuracy, which can build more airtight and efficient homes, and we have heard there is less materials waste (and more opportunities to recycle) through OSM.⁴⁸⁹
- 8.25 As the BfCC programme develops towards its introduction (expected to be in 2025), MBIE is working to identify an appropriate pathway to introduce the BfCC emissions mitigations frameworks into the building regulatory system.⁴⁹⁰ Annual updates to the Building Code will likely be included as a process for implementing BfCC requirements.
- 8.26 Homestar will support the transition to BfCC through upskilling the sector on how to build ‘green’.⁴⁹¹ The New Zealand Green Building Council (NZGBC) has identified that sector education, skills, and understanding is critical for informing industry consultation through the development of BfCC, and to promote the use and understanding of green building supplies.

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Ministry of Business, Innovation & Employment “Building for Climate Change – Summary Report” (May 2021) at 47.

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Designing and constructing lower emissions buildings, which may include using ‘green’ building supplies or alternative construction methods.

Emissions reduction plan

- 8.27 In May 2022, the Ministry for the Environment released the ERP, which sets strategies, policies and actions for achieving New Zealand’s first emissions budget and contributes to global efforts to limit global temperature rise to 1.5°C above pre-industrial levels.⁴⁹² It is the first in a series of “stepping stone” emissions budgets and emissions reductions plans and sets the plan for the first emissions budget period (2022-2025).
- 8.28 Chapter 12 of the ERP, titled Building and Construction, introduces a range of planned actions and initiatives to reduce emissions from the building and construction sector that considers both operational and embodied carbon emissions of buildings and construction.⁴⁹³ The objectives of BfCC and the Building and Construction chapter of the ERP are closely aligned, and both are led by MBIE.
- 8.29 It indicates that, for the first emissions budget period, initiatives to reduce building and construction emissions will contribute a reduction of 0.9 to 1.7 Mt CO₂-e.⁴⁹⁴ This will be mainly through the potential impact of non-regulatory initiatives such as a behaviour change programme and providing technical infrastructure such as data and tools.
- 8.30 Many of the planned actions in the ERP will support the objectives of BfCC and promote the entry or expansion of green building supplies. Planned actions include addressing barriers in the regulatory system, supporting innovations, and proposing demand-side measures. For example:
- 8.30.1 introducing whole-of-life embodied carbon requirements into the regulatory system and addressing barriers in the current regulations to the sector considering whole-of-life embodied carbon;⁴⁹⁵
 - 8.30.2 actions to support innovation, notably an initiative to establish an Embodied Emissions Climate Innovation Platform;⁴⁹⁶ and

⁴⁹² Ministry for the Environment “Aotearoa New Zealand’s First Emissions Reduction Plan” (May 2022), available at: <https://environment.govt.nz/publications/aotearoa-new-zealands-first-emissions-reduction-plan/>.

⁴⁹³ Ministry for the Environment “Aotearoa New Zealand’s First Emissions Reduction Plan” (May 2022) at 225-244.

⁴⁹⁴ For the first budget period the total projected emissions for the sector (without initiatives in the plan) is 32.5 Mt CO₂-e.

⁴⁹⁵ Ministry for the Environment “Aotearoa New Zealand’s First Emissions Reduction Plan” (May 2022) at 231, Action 12.1.1.

⁴⁹⁶ Ministry for the Environment “Aotearoa New Zealand’s First Emissions Reduction Plan” (May 2022) at 232, Action 12.1.2.

- 8.30.3 the introduction of mandatory energy performance certificates (EPCs) for government, commercial and large residential buildings.⁴⁹⁷ EPCs provide an assessment of the energy efficiency of a building. While initially not proposed for small residential buildings, they may promote consumer interest in green building supplies that contribute to more energy efficient homes.⁴⁹⁸
- 8.31 It is difficult to assess what the impacts will be for the future supply and innovations for green building supplies, as many of the planned initiatives are not yet set out in detail. While some of the initiatives in the ERP (identified in paragraph 8.30 above) may promote the entry or expansion of green building supplies, our preliminary view is that they are unlikely to address the specific impediments that we have identified in the following section.

Other initiatives that will support new or innovative green building supplies

- 8.32 In May 2022, Te Waihanga, the New Zealand Infrastructure Commission published Rautaki Hanganga o Aotearoa, New Zealand’s Infrastructure Strategy. It includes a range of recommendations that may support the construction sector to transition to net zero carbon by 2050, including recommendations to ensure a consistent trans-Tasman approach in product and building standards and qualification requirements.⁴⁹⁹
- 8.33 The Homestar programme, led by the NZGBC, is an independent tool for assessing the health, efficiency, and sustainability of homes. It provides a rating between 6 Homestar (good standard) and 10 Homestar (world-leading) based on a home’s energy performance and environmental impact. While the Homestar rating of a building can vary, the Homestar standard is approximately 30% higher (or more) than the minimum standards required by the Building Code.⁵⁰⁰ The Homestar programme largely focuses on new builds, however existing buildings can also gain Homestar accreditation.

⁴⁹⁷ Ministry for the Environment “Aotearoa New Zealand’s First Emissions Reduction Plan” (May 2022) at 232, Action 12.1.2.

⁴⁹⁸ For example, NZ Green Building Council “Energy efficient homes – do they sell for more?” (March 2018), available at: https://www.nzgbc.org.nz/KNOWLEDGEHUB/Story?Action=View&Story_id=284;

⁴⁹⁹ New Zealand Infrastructure Commission, Te Waihanga “Rautaki Hanganga o Aotearoa, New Zealand Infrastructure Strategy 2022-2052” (May 2022) at 161, Recommendation 66, available at: <https://www.tewaihanga.govt.nz/strategy/>.

⁵⁰⁰ [].

- 8.34 Homestar facilitates demand for green building supplies by providing information about the energy efficiency of homes.⁵⁰¹ While its use has not been widespread, Kāinga Ora has recently adopted the Homestar standard for all of the homes it builds, and builders who participate in Kāinga Ora builds also benefit by upskilling in building ‘green’.^{502, 503}
- 8.35 Healthy Homes standards are requirements by the Government for rental properties and are periodically upgraded. Changes to the Healthy Homes standards will largely impact existing rental housing and may be a driver of demand for green building materials used in retrofit. Notable updates to Healthy Homes standards include requiring ceiling and underfloor insulation for all rental homes from 1 July 2019.⁵⁰⁴

Impediments to the entry or expansion of green building supplies

- 8.36 Competition issues raised in other parts of this report also apply generally to the entry or expansion of new or innovative building supplies – including green building supplies, and some issues identified below are more unique to green building supplies (such as a lack of transparency in the energy performance of new and existing homes).
- 8.37 Current impediments to the entry or expansion of green building supplies, if not addressed, could well inhibit the entry or expansion of the hoped-for innovation in green building supplies. We have found:
- 8.37.1 impediments in the regulatory system appear to incentivise sticking to ‘tried and tested’ building products;
 - 8.37.2 there may be a skills and education gap in the construction sector, with new skills being necessary to prepare for climate change; and
 - 8.37.3 a lack of transparency, and possibly limited public awareness, in the energy performance of new and existing homes in New Zealand.
- 8.38 Addressing impediments to the entry or expansion of green building supplies will be critical to the success of BfCC and the sectors’ ability to respond. Therefore, it is important to consider impediments as they stand today and their impact in the long term, should they not be addressed.

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⁵⁰² For the year ended June 2021 there were 4,871 Homestar registrations of a total of 44,299 new building consents, see: NZ Green Building Council “AGM report”, available at: https://www.nzgbc.org.nz/Attachment?Action=Download&Attachment_id=45153; Statistics NZ “Building consents issued: June 2021” <https://www.stats.govt.nz/information-releases/building-consents-issued-june-2021>; [].

⁵⁰³ Kāinga Ora “Healthier homes under Homestar” (9 June 2020)

<https://kaingaora.govt.nz/news/healthier-homes-under-homestar/>.

⁵⁰⁴ TenancyServices “Current insulation regulations” <https://www.tenancy.govt.nz/maintenance-and-inspections/insulation/compulsory-insulation/>.

Impediments in the regulatory system

- 8.39 Chapter 3 finds that regulatory and behavioural barriers appear to incentivise sticking to ‘tried and tested’ building products and inhibit the entry or expansion of new or innovative key building supplies. If not addressed, these barriers are likely to inhibit the entry or expansion of the hoped-for innovation in green building supplies.
- 8.40 We have heard examples of New Zealand builders looking to source new or innovative green building supplies from overseas, and finding considerable barriers in our regulatory system, due to a lack of alignment with international standards. For example:
- 8.40.1 a builder has had difficulty gaining consent to use imported cross-laminated timber (CLT).⁵⁰⁵ There is no clear compliance pathway for the use of CLT in New Zealand or Australia, though in Australia it appears that builders can leverage European Codes for CLT.⁵⁰⁶ CLT can be used as an alternative to steel elements in a building to reduce embodied carbon;
- 8.40.2 it can be challenging to gain consent for imported high performance windows that have been tested to international standards that are higher than the Building Code. We have heard that the challenge is proving compliance (by relying on international standards), rather than the performance of the products being an issue for consent;⁵⁰⁷ and
- 8.40.3 Mr Gardiner highlighted that the Building Code does not provide a clear compliance pathway for uPVC window frames or structural insulated panels (SIPs), which have been widely adopted overseas due to their high thermal performance and are manufactured to international standards.⁵⁰⁸

A skills and education gap in the construction sector

- 8.41 It appears there is a need to address current and future skill shortages in the construction sector, which includes new skills that may enable the sector to adapt for climate change. This includes technical design skills (eg, CAD design), OSM processes, and building with innovative materials.⁵⁰⁹

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⁵⁰⁸ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at 20-22.

⁵⁰⁹ “Some submitters also pointed out that preparing for climate change would require our future workforce to have new skills, of which many will be in high demand internationally”, New Zealand Infrastructure Commission, Te Waihanga “Rautaki Hanganga o Aotearoa, New Zealand Infrastructure Strategy 2022-2052” (May 2022) at 155.

- 8.42 As noted in paragraph 8.32 above, the New Zealand Infrastructure Commission has made recommendations to reduce barriers for international products by aligning qualification requirements to international standards. This aligns with other feedback that we have heard that there is a skills shortage in New Zealand which may inhibit the ability to adopt overseas building practices.⁵¹⁰
- 8.43 The NZGBC has identified that industry participants' experience with building green has a significant impact on perceptions of the costs and other difficulties.⁵¹¹ It has observed that builders which gain experience in building to Homestar (for example, through a Kāinga Ora build) have a more positive view on the impacts and costs, and that Kāinga Ora and other public sector funding initiatives can play a critical role to incentivise low emissions building and grow experience in the sector.⁵¹²

Lack of transparency of energy performance of existing homes

- 8.44 There appears to be a lack of transparency and possibly limited public awareness, about the energy performance of new and existing homes in New Zealand, and end consumers may not have sufficient information to make decisions that reflect the longer-term economic benefits of energy efficient homes. It is likely that if sufficient information were available, end consumers would be willing to pay more for energy efficient homes, which may provide an incentive to build to a higher standard and in turn lead to an increase in demand for green building supplies.⁵¹³
- 8.45 The ERP includes an initiative to introduce mandatory EPCs for buildings, initially for government, commercial and large residential buildings and potentially expanded to other residential buildings in future. Widespread adoption of EPCs for small residential homes may increase the demands for green building supplies (through an increased demand for more energy efficient homes).⁵¹⁴
- 8.46 EPCs were introduced in the UK and European Union from 2007. EPCs in the UK and Europe are widespread; they are mandatory for all residential homes that are built, sold, or rented. EPCs have also been used to require minimum standards for rental buildings (though New Zealand achieves similar outcomes through the Healthy Homes standards).

⁵¹⁰ For example, overseas training for builders may better support the appropriate use of untreated timber, [], and there may be a lack of skills designing with engineered timber in NZ [].

⁵¹¹ "The skills shortage is mainly thanks to a lack of industry experience...", NZ Green Building Council "A Zero Carbon Road Map for Aotearoa's Buildings" (September 2019) at 18, available at: https://www.nzgbc.org.nz/Attachment?Action=Download&Attachment_id=2528.

⁵¹² [].

⁵¹³ For example, NZ Green Building Council "Energy efficient homes – do they sell for more?" (26 March 2018) https://www.nzgbc.org.nz/KNOWLEDGEHUB/Story?Action=View&Story_id=284; Roman Jaques "Do we value homes that perform?" Build 178 (1 June 2020) <https://www.buildmagazine.org.nz/index.php/articles/show/do-we-value-homes-that-perform>.

⁵¹⁴ Similar to the UK, this could apply when a residential building is built, sold or rented.

- 8.47 Homestar can facilitate demand from homeowners that have a preference for environmentally friendly housing and demand can in turn stimulate competition. We have identified examples where Homestar ratings have been included in a Land Information Memorandum (LIM) report by a Local Council. The added validity of including the rating in a LIM may enable banks to provide more offers to those (or potentially EPC) ratings.⁵¹⁵

Significant offshore work to upgrade environment standards of building supplies

- 8.48 There may be an opportunity to leverage international work to upgrade the environmental standards of building supplies, through looking to incorporate international standards for green building supplies into clear compliance pathways within the New Zealand regulatory system. Chapter 3 discusses the compliance pathways of the regulatory system.
- 8.49 As noted in paragraph 8.9 above, it appears that the minimum standards in our Building Code are below the standard of other countries. By remaining out of step with international standards, we may not benefit from international development of standards for green building supplies.
- 8.50 We have heard that non-acceptance of European certification against ISO standards are barriers for importers, and that there are instances where overseas products have needed to be reengineered to a lower level to comply with New Zealand standards.⁵¹⁶
- 8.51 The European Union has recently undergone a similar programme to BfCC to reduce the emissions of its construction sector. In addition to providing direction to reduce emissions, it is addressing whether the regulatory framework is fit-for-purpose to achieve its sustainability and climate objectives.
- 8.51.1 Acknowledging its building sector as crucial for achieving its energy and environmental goals, the European Union amended its 'Energy Performance of Buildings Directive' in 2018 to provide direction for the building sector to reduce energy consumption and CO₂ of buildings.⁵¹⁷ It introduced energy performance measures for new and existing buildings, new standards for buildings, and facilitates more targeted financing to investments in the building sector.⁵¹⁸

⁵¹⁵ For example, ANZ offers discount home loan rates for homes that have a Homestar 6 rating or higher which may facilitate demand for environmentally friendly housing, see: ANZ "ANZ Healthy Home Loan package" <https://www.anz.co.nz/personal/home-loans-mortgages/loan-types/healthy-homes/>;

⁵¹⁶ [].

⁵¹⁷ Introduced as part of the 'Clean energy for all Europeans' package, European Commission "Clean energy for all Europeans package" https://energy.ec.europa.eu/topics/energy-strategy/clean-energy-all-europeans-package_en.

⁵¹⁸ European Commission "Energy Performance of Buildings Directive 2010/31/EU" (19 May 2010), available at: https://energy.ec.europa.eu/topics/energy-efficiency/energy-efficient-buildings/energy-performance-buildings-directive_en.

- 8.51.2 More recently in 2022, as part of a set of proposals to make sustainable products the norm and set sustainability requirements for products across the product lifecycle, the European Union is progressing a proposal that aims to boost the internal market for construction products and to ensure that the regulatory framework is fit-for-purpose for achieving its sustainability and climate objectives. This proposal includes the creation of a framework to assess and communicate the environmental and climate performance of construction products, new requirements for the design and manufacture of construction products, and make it easier for standardisation bodies to create common European standards.⁵¹⁹

Offsite manufacturing and prefabrication

- 8.52 In this section we discuss the potential for increased competition and disruption from OSM and prefabrication.
- 8.53 Topics covered are:
- 8.53.1 the range of products and processes encompassed by OSM and prefabrication;
 - 8.53.2 the potential benefits of OSM and prefabrication;
 - 8.53.3 the progress that has been made to reduce regulatory barriers to OSM and prefabrication;
 - 8.53.4 ongoing challenges and the importance of government support; and
 - 8.53.5 the potential for OSM, over time, to disrupt established industry structures.

The range of products and processes encompassed by offsite manufacturing and prefabrication

- 8.54 The term OSM is often used interchangeably with the term prefabrication (or shortened colloquially to 'prefab'), and covers the range of products and processes that utilise some form of offsite assembly and standardisation as part of the construction process. In the remainder of this chapter we refer simply to "OSM".
- 8.55 OSM includes the factory assembly of;
- 8.55.1 a basic floor, wall, roof-truss or frame;
 - 8.55.2 components such as windows;

⁵¹⁹ European Commission "Green Deal: New proposals to make sustainable products the norm and boost Europe's resource independence" (30 March 2022), available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_22_2013.

- 8.55.3 more complex panel products (such as structural insulated panels); and
- 8.55.4 full modular buildings (or hybrid ‘pod and panel’ components) ready to deliver to site.
- 8.56 There are a range of different OSM business and operational models. Some favour a more flexible customer-centric approach to design and manufacture, offering customisation by clients, whereas others emphasise greater standardisation (with less customisation) to lower cost in the design and manufacturing processes.⁵²⁰
- 8.57 Offsite NZ is a non-profit membership organisation that informs, educates, and advocates for innovation and excellence in offsite design and construction in New Zealand.⁵²¹ We have heard that any residential build could employ some degree of offsite strategies.⁵²²
- 8.58 OSM can draw on an onshore or offshore manufacturing base and can be considered as both purchasers of key building supplies (as inputs) and as suppliers of (more complex) competing key building supplies.

The potential benefits of offsite manufacturing

- 8.59 The potential benefits of OSM include:
- 8.59.1 increased speed and efficiency of onsite assembly. A number of interested parties emphasised the ability to assemble a weatherproof building envelope on site faster than a traditional build;⁵²³
- 8.59.2 increased production speed through a combination of standardisation and the use of technologies such as robotics used in the manufacturing process.⁵²⁴ In addition to production speed, site works can be carried out simultaneously and improve the build sequence timing;⁵²⁵
- 8.59.3 reduced building materials wastage when compared to a typical onsite build;⁵²⁶

⁵²⁰ [];

[].

⁵²¹ See: <https://www.offsitenz.com/about-us>.

⁵²² [].

⁵²³ [];

[].

⁵²⁴ [].

⁵²⁵ [].

⁵²⁶ [].

- 8.59.4 improved operational efficiency of buildings with the use of better performing products such as SIPs that use alternative insulations (for example, expanded foam) and the ability to build more airtight buildings.⁵²⁷ Factory-based activity is also said to be easier to monitor for quality assurance; and
- 8.59.5 the ability to work in a controlled environment may enable health and safety benefits for workers as environmental and site-specific risks can be mitigated.⁵²⁸
- 8.60 Overall, we understand that, while the potential for OSM to lower construction costs compared to a traditional onsite building is a significant driver of OSM, most interested parties we spoke to say this is not currently evident given the OSM industry is still developing capacity and there is a lack of demand certainty, which we discuss in later sections. Instead, participants cited some of the other benefits outlined above as primarily driving the appeal of OSM currently.

The progress that has been made to reduce regulatory barriers to offsite manufacturing

- 8.61 We understand that a particular challenge for OSM until recently has been a consenting system largely designed around onsite inspections for traditional onsite building, but that significant progress has been made by designers, BCAs and MBIE to address those concerns.⁵²⁹
- 8.62 An example of this progress is that we heard that technical information in relation to SIPs are better understood and that designers are including appropriate information in project documentation, which is improving BCA confidence in assessing compliance of panelised units. This was supported by the fact that BCA requests for information had, over time, reduced significantly in relation to this supplier's SIPs products.⁵³⁰
- 8.63 We understand development of digital strategies such as cloud-based monitoring software have played an important role in enabling information to be accessible to BCAs where onsite inspection may not be practical or to provide digital evidence of compliance. BCAs can access a historical record of the construction process which provides greater assurance via a desk-based review.⁵³¹

⁵²⁷ [];

⁵²⁸ [].

⁵²⁹ [].

⁵³⁰ [].

⁵³¹ [];
[].

- 8.64 Recent reforms of the Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021 (the Amendment Act) aim to further reduce remaining regulatory barriers to OSM through a new voluntary manufacturer certification scheme for MCM.⁵³²
- 8.65 The changes introduce a process relevant to design, manufacture, assembly, transportation and installation on site, to assess whether construction meets the requirements of the Building Code.
- 8.66 If manufacturers meet robust quality standards and criteria, they can apply for certification to produce modular building components in one of two ways:
- 8.66.1 Manufacture only – they can manufacture modular building components to a Building Code compliant design.
 - 8.66.2 Design and manufacture – they can manufacture modular building components to a Building Code compliant design that they have developed or adapted themselves.
- 8.67 Third-party inspections, audits and post-certification surveillance will ensure certified manufacturers are producing modular components that meet the requirements of the Building Code. BCAs can focus on onsite building work not covered by the MCM certification, such as site works, foundations, plumbing and electrical connections or connections to utilities such as sewerage and storm water.
- 8.68 The Amendment Act gives Cabinet the power to make regulations and the Chief Executive of MBIE the power to make detailed rules for the scheme. Regulations were introduced in June 2022 and the MCM scheme rules are, at the time of writing, still being consulted on.⁵³³
- 8.69 It is, as yet, too early to take any view as to what response the MCM scheme will get from OSM manufacturers in terms of uptake. We have heard that there may be some resistance to the certification requirements as manufacturers have to demonstrate they have adequate financial means to cover civil liabilities arising from manufacture or design.⁵³⁴ It is also too early to assess how this requirement will apply in practice.
- 8.70 For complete modular house builds, the MultiProof system currently offers an alternative consenting pathway for OSM that has an especially standardised approach to construction.⁵³⁵

⁵³² Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021.

⁵³³ Building (Modular Component Manufacturer Scheme) Regulations 2022.

⁵³⁴ Regulation 18 of the Building (Modular Component Manufacturer Scheme) Regulations 2022.

⁵³⁵ Building Performance “MultiProof” <https://www.building.govt.nz/building-code-compliance/product-assurance-and-certification-schemes/multiproof>.

- 8.71 Under the MultiProof system, MBIE will assess whether a set of plans and specifications for a standardise building design will comply with the Building Code. MultiProof speeds up the consenting process by requiring a BCA, where a MultiProof design has been approved by MBIE, to make a decision on a building consent application within 10 working days (instead of the usual 20 working days) and sets a narrower scope for the BCA to review.
- 8.72 The BCA must assess whether the design, with any permitted variations, is the same as the design approved by MBIE, that the proposed site meets the conditions of the MultiProof design, and that the site-specific features of the design comply with the Building Code. The BCA will then complete the inspections required.
- 8.73 To be eligible for consent under MultiProof the builder must intend and be able to build an approved design at least 10 times over two years. MultiProof therefore suits an offsite manufacturer using similar designs and a standardised construction method.
- 8.74 Some interested parties we spoke to said that adjustments to the MultiProof system to allow greater flexibility for minor variations would have been the preferred solution to reduce consenting barriers to OSM and that they were unlikely to pursue MCM certification due to an increase in compliance complexity.⁵³⁶ This perspective largely reflects an offsite business model that prioritises greater standardisation over optionality for client customisation (and involves a trade-off of offering less choice and customisation to enable greater efficiencies and design and manufacturing).

Ongoing challenges and the importance of government support

- 8.75 Currently domestic OSM manufacturers, as purchasers of key building supplies (as inputs) mostly access the same supply chain and source their materials from merchants like most builders. In that respect, their challenges as purchasers, in terms of the services, prices and/or ranges of materials stocked by the major merchants, are currently similar to other purchasers of key building supplies.
- 8.76 At larger scale, OSM manufacturers ought to be able to achieve better material prices for greater volumes. Potentially they could look to approach suppliers directly and bypass merchant intermediaries.
- 8.77 We heard consistently from interested parties that the main challenge to the OSM industry involves achieving scale while managing investment risk.

- 8.78 The OSM industry is still in the early stages of development relative to its potential. Like any large building product manufacturing facility, lack of demand certainty and an absence of larger-scale longer-term contracts to provide a pipeline of work means that investment risks remain. Businesses will be reluctant to invest in capital equipment to grow capacity to more efficient levels of production if there is a lack of visibility around pipeline.
- 8.79 Despite experiencing significant recent growth, OSM is still relatively small compared to the wider construction industry. Over the 10-year period from 2011 to 2021 the proportion of prefabrication strategies identified in residential consent data increased 300% from around 3% to around 9% of reported building consents. This equates to an underlying growth rate of approximately 12% per annum in residential projects utilising offsite strategies.⁵³⁷
- 8.80 Kāinga Ora has announced a commitment to OSM and values the benefits, in particular the speed of construction, that it provides.⁵³⁸
- 8.81 Between 2019 and 2021, Kāinga Ora doubled the number of homes delivered using offsite manufacturing solutions and is on track to complete 500 units using offsite manufacturing by the end of the 2022 financial year.⁵³⁹
- 8.82 Kāinga Ora’s target is to increase the number of offsite manufacturing builds by a minimum of 20 percent year-on-year for the duration of the public housing plan.
- 8.83 This is likely to offer significant pipeline support for the OSM industry, however, providing certainty and long-term visibility for build partners in relation to Kāinga Ora OSM demand, remains a key challenge.^{540, 541}
- 8.84 Other factors which are acting as a constraint on OSM capacity are skills and labour shortages. We understand that OSM has the potential to improve labour productivity in New Zealand and more education pathways are opening, but we have heard from some that are struggling to fill roles requiring specific skills shortages such as Computer Aided Design.⁵⁴²

⁵³⁷ Offsite NZ “Education, Skills and Attitudes Survey 2021” at 7, available at: <https://www.offsitenz.com/education-skills-attitudes-survey-2021>.

⁵³⁸ Kāinga Ora has begun discussions with iwi on Offsite Manufacturing (OSM) solutions also, for example, setting up BuildSmart with Toitū Tairāwhiti, Commerce Commission “He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes” (4 August 2022) at 3.

⁵³⁹ Kāinga Ora “Transforming construction through innovation”, available at: <https://kaingaora.govt.nz/assets/Developments-and-Programmes/Kainga-Ora-Offsite-Manufacturing-Plan-Transforming-construction-through-innovation.pdf>.

⁵⁴⁰ [].

⁵⁴¹ [].

⁵⁴² [].

8.85 Finally, in the past there have been some negative perceptions that ‘prefab’ buildings are lesser quality. Such perceptions are inconsistent with many of the benefits we have heard about OSM, such as the ability to improve airtightness and build to a greater degree of precision in a controlled factory environment. Other perceptions that may negatively impact demand for OSM include the cultural preference for bespoke housing. Some interested parties consider that these attitudes are already changing, and we have heard there are ways to differentiate designs within the OSM space, such as by the use of different colours and external cladding to offer client customisation.⁵⁴³

Offshore offsite manufacturing and importers can supplement a growing domestic offsite manufacturing sector

8.86 Offshore OSM has been identified as being able to supplement a domestic OSM sector which faces capacity constraints.⁵⁴⁴ For example, we have heard that manufacturing modular homes offshore has the advantage of being able to access less constrained labour markets and building supplies at a lower cost.⁵⁴⁵

8.87 In the vast majority of cases, however, offshore manufacture of prefabricated products such as windows or structural insulated panels, will not be set up with the New Zealand market in mind. This presents additional challenges to a potential importer wanting to access that supply because consenting pathways for certain products and systems typically reflect a particular NZ perspective. Undertaking performance assessments for compliance purposes adds time and costs and may dissuade an importer or offshore manufacturer from access to a small market.

8.88 Many overseas window manufacturers, for example, produce for much larger markets such as Europe, and could offer the same product in New Zealand but clear compliance pathways do not exist.⁵⁴⁶ Some we spoke to suggest there may a good reason for this such as the unique durability requirements for New Zealand windows.⁵⁴⁷ Others contend the products are manufactured and designed to a high international standard and ought to satisfy the requirements of the Building Code in New Zealand. We discuss alignment with international standards in Chapter 3.

8.89 International shipping costs is also a relevant consideration. These transport costs, which sometimes include inefficiencies associated with ‘shipping air’ inside the modular units, also have an associated carbon cost. We understand being closer to suppliers may also have implications for quality control. A domestic SIP manufacturer told us that they prefer sourcing supplies from a domestic supplier so they can build relationships and have confidence in the quality of product delivered.⁵⁴⁸

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- 8.90 In the longer term, it is likely that an OSM industry better suited to New Zealand might have several large domestic manufacturers with national reach and some with manufacturing bases close to sites where there are significant development opportunities.
- 8.91 It appears that while the domestic industry develops capacity, clearer consenting pathways to importing offshore prefabricated key building supplies could facilitate competition in OSM while supplementing domestic supply.

Over time offsite manufacturing has the potential to disrupt

- 8.92 While interested parties have observed that OSM should not be seen as a “silver bullet” to increasing construction costs, it appears to have significant potential to compete with more traditional ways of building.
- 8.93 In addition to the range of potential benefits that OSM offers, if the industry is able to sustain further investment in capacity, it has the potential to increase competition in key building supplies by disrupting established practices and industry structures.⁵⁴⁹
- 8.94 Greater scale and capacity of the industry may eventually enable a shift in the supply chain that is able to bypass intermediaries and source directly from suppliers, enable greater innovation in building practices, and offer homeowners and end consumers more choice.⁵⁵⁰ For OSM to achieve scale and deliver the benefits of competition, it will require investment for the long term and needs to overcome similar barriers to competition that we have identified in relation to all key building supplies.

⁵⁴⁹ [].

⁵⁵⁰ Kiwi Infrastructure “Submission on residential building supplies market study preliminary issues paper” (4 February 2022) at 1.

Chapter 9 Competition may be enhanced in a number of ways

Our approach to draft recommendations

Introduction

9.1 This chapter draws together our preliminary findings about factors affecting competition from previous chapters and identifies a suite of draft recommendations that we consider could improve competition for key building supplies for the benefit of New Zealanders.

Our study

9.2 Our study has considered the dynamics of competition within each level of the industry supply chain for key building supplies, but it has focused most strongly on conditions for the entry and expansion of new or competing products. These conditions, in our view, are critical to facilitating workable competition within the markets for key building supplies.

9.3 The operation of the building industry is subject to the building regulatory system which has, at its heart, the provision of safe, healthy, and durable homes for New Zealanders. While innovation is recognised as important to achieving those objectives, our preliminary view is that the regulatory system has a number of features which prevent competition from working well.

9.4 In particular, we have identified that the building regulatory system continues to incentivise designers, builders and BCAs to favour ‘tried and tested’ building products over new or competing products. Merchants also have incentives that reinforce this approach.

9.5 Despite flexibility to use new products being available in the building regulatory system, it is a slow, costly and uncertain process to get them accepted for general use. This is due to the combined effect of:

9.5.1 the way the regulatory and standards systems – the Building Act, the Building Code, and related instruments, and the consenting system – are applied to building products; and

9.5.2 the decision-making behaviours of designers, builders and BCAs in response to, and in applying the regulatory system.

9.6 This makes it difficult for competing products to be introduced in New Zealand markets and consequently for competing suppliers to expand their businesses. This reinforces the market position of established building supplies and methods and of existing suppliers of those products. However, we are confident that addressing regulatory barriers to entry and expansion will enhance competition for building supplies in general.

- 9.7 We have also identified two areas where we consider that strategic business conduct is affecting competition:
- 9.7.1 Quantity-forcing rebates paid by established suppliers to merchants appear, under certain conditions, to be reinforcing regulatory factors impacting entry and expansion, making it difficult for new or competing products to access distribution channels.⁵⁵¹ These rebates reward merchants for purchasing greater volumes through a single supplier, by offering higher percentage rebates that apply across all of a merchant's purchases with that supplier. These rebate structures can deter merchants from stocking competing products in their stores and make it more difficult for competing suppliers to get established in the markets; and
- 9.7.2 As in previous market studies in the fuel and groceries sectors, we have also identified the use of restrictive land covenants and exclusive leases benefitting merchants that potentially impede the entry or expansion of competitors in the supply of key building supplies.

Our recommendations

- 9.8 The factors affecting competition that we have identified relate to the building regulatory system, the way in which it is applied by industry participants such as designers, builders and BCAs, as well as the strategic business conduct of some market participants.
- 9.9 Our case studies of plasterboard, structural timber and ready-mix concrete (including cement) illustrate how the factors affecting competition apply to a greater or lesser extent in relation to different key building supplies.
- 9.10 Our draft recommendations are therefore focused in three interdependent groups:
- 9.10.1 **Enhance the regulatory system** – Ensuring the regulatory system continues to deliver quality housing to New Zealanders is critical. Technical judgements about what is required to achieve that fall to building sector expert policy agencies. However, in order to ensure the effective operation of markets delivering those objectives, we consider that competition must take a prominent position in the regulatory system and decision making within it. We make recommendations directed at creating compliance pathways for more key building supplies and providing incentives for designers and market participants to use and adopt new or competing building supplies. We also consider that better engagement with Māori is key to achieving their aspirations and ensuring that Māori perspectives are better reflected in the building regulatory system.

⁵⁵¹ Refer to the discussion of rebate structures in Chapter 7 and summary in Table 7.1.

- 9.10.2 **Support sound decision making** – In addition, we make recommendations directed at the decision-making behaviours of designers, builders and BCAs involved in the implementation and application of the regulatory system.
- 9.10.3 **Address strategic business conduct** – Other recommendations are directed at the strategic business conduct that we have identified as affecting competition in markets for key building supplies. They include recommendations relating to quantity-forcing rebates and the use of restrictive land covenants and exclusive lease arrangements.
- 9.11 Our suite of draft recommendations seeks to identify feasible options that will provide tangible improvements in competition for key building supplies without undermining the other key policy objectives of the building regulatory system. The aim is to produce better long-term outcomes for consumers – safe, healthy and durable homes, that can be built with a wider range of cost-effective key building supplies, including those that are new or innovative.
- 9.12 In our view, there is scope to place greater emphasis on competition and innovation for key building supplies, without compromising the core objectives of the building regulatory system.
- 9.13 Our draft recommendations are necessarily interdependent, and we acknowledge that changes in one part of the system can have implications for other parts of the system.
- 9.14 Cost-benefit analysis may be useful as part of a policy decision-making process. We have not undertaken cost-benefit analysis as part of developing our recommendations. Due to the interrelationships of the recommendations the effects on the functioning of the supply chain and competition need to be considered in aggregate.
- 9.15 We envisage that most draft recommendations would be implemented by the Government as they are either of a regulatory nature or involve coordination or provision of information that we consider existing government entities would be best placed to facilitate. For example, as noted in Chapter 3, there is substantive policy development planned and ongoing through the Government’s legislative programme including the review of the building consent system. We consider that if the Government accepts our final recommendations, the MBIE-led review of the building consent system may provide a pathway for further policy development in relation to several of our recommendations.

- 9.16 Other draft recommendations are directed at industry participants, particularly in areas where we suggest activity to ensure compliance with the Commerce Act regarding the use of quantity-forcing rebate structures, restrictive land covenants and exclusive leases. We also identify action that we intend to take in relation to some strategic business conduct that has come to our attention. This includes further promoting compliance with the Commerce Act in the areas described above and determining whether further action is required using our enforcement functions and powers.
- 9.17 Our suite of draft recommendations is preliminary and subject to further consultation through the submissions we are inviting, the consultation conference, and further analysis and deliberation. We may also identify areas where we (or others) could undertake further work in the future. Our recommendations may therefore change in the final report.
- 9.18 The rest of this chapter is structured around each group of draft recommendations.

Enhance the regulatory system

- 9.19 Our preliminary view is that the regulatory system is making it difficult for competing key building supplies to enter and become established in the New Zealand market and consequently for competing suppliers of key building supplies to enter and expand their businesses. Despite the flexibility that is available in the system to use and adopt new products (for example, through Alternative Solutions) it is too slow, costly and uncertain to get them accepted for general use. This is due to the combined effect of:
- 9.19.1 promoting competition not being an explicit objective in the building regulatory system;
 - 9.19.2 the way the regulatory and standards systems (comprising the Building Act, the Building Code and related instruments, and the consenting system) are applied to building products; and
 - 9.19.3 the decision-making behaviours of designers, builders and BCAs in response to and in applying the regulatory and standards systems.
- 9.20 The Building Code and associated systems are complex to navigate. The Building Code uses qualitative words and phrases to set performance levels for building work and, for building products, establishing what the qualitative words and phrases mean in practice, generally involves starting with the Standards currently referenced in Acceptable Solutions and Verification Methods. It is those Standards that are generally used to establish the required performance levels for products. These compliance pathways for building products (ie, through Acceptable Solutions and Verification Methods, and referenced Standards) are narrow and there are few 'streamlined' processes.

- 9.21 These pathways have their origins in the national standards under the Building Act 1991 and, while they are not the only means of complying with the Building Code, they have become embedded as “how we build here”. These compliance pathways have not been expanded to keep pace with contemporary building practices or the development of new products, limiting the potential for competition from alternative, new or innovative building supplies.
- 9.22 The regulatory system does not enable timely response to changing markets and innovations in building products. It continues to incentivise designers, builders and BCAs to favour ‘tried and tested’ building products over new or competing products.
- 9.23 Our preliminary findings point to the need to address the processes that underpin the regulatory framework and how it relates to the various complex compliance pathways for building supplies.
- 9.24 We make five recommendations in this group:
- 9.24.1 Introduce competition as an objective to be promoted in the building regulatory system;
 - 9.24.2 Better reflect a Māori perspective in the building regulatory system;
 - 9.24.3 Create more compliance pathways for a broader range of key building supplies;
 - 9.24.4 Explore ways to remove impediments to product substitution and variations; and
 - 9.24.5 Investigate whether the barriers to certification and appraisal can be reduced.
- 9.25 These recommendations aim to make the regulatory process more supportive of new and competing building products.

Draft Recommendation 1 – Introduce competition as an objective to be promoted in the building regulatory system

- 9.26 The building regulatory system has, at its heart, the provision of safe, healthy, and durable homes for New Zealanders. While innovation is recognised as important to achieving those objectives, our preliminary view is that the regulatory system has a number of features which prevent competition for key building supplies from working well.
- 9.27 The building regulatory system continues to incentivise designers, builders and BCAs to favour ‘tried and tested’ building products over new or competing products. Establishing Code compliance is relatively easy for well-established products but complex, time-consuming, expensive and uncertain for other products. This has resulted in barriers to entry and expansion for new or competing products which limits competition and is hindering innovation.

- 9.28 Our preliminary view is that the regulatory system has several features which prevent competition from working well because the promotion of competition is not an express objective of the regulatory system.
- 9.29 We recommend that promoting competition is included as another objective of the building regulatory system, to be evaluated alongside safety and durability without compromising those essential objectives. The benefits of this approach will depend on how the competition objective is pursued in practice. Outlined below we make some suggestions for further consideration. In general though, greater competition in key building supplies will tend to reduce prices and enhance resilience, product quality, service levels and innovation – outcomes which are consistent with the objectives of promoting safe, healthy and durable homes.
- 9.30 Other policies that influence the building sector, particularly de-carbonisation policies should also continue to promote competitive neutrality.

Draft Recommendation 2 – Better reflect a Māori perspective in the building regulatory system

- 9.31 We heard a range of views through our engagement with Māori so far in this study about the challenges with consenting, rising building costs, and supply chain disruption. We also heard that the building consent system (and other related regulatory regimes) does not adequately respond to the needs and aspirations of Māori. This mirrors the issues identified in the Government’s discussion paper relating to the review of the building consent system.⁵⁵²
- 9.32 We observe that these are aspects that need to be addressed at a much broader level than just the building consent system and are related to wider government functions (for example, relating to land, physical resources and local government).
- 9.33 We therefore support the direction of the Government’s review of the building consent system to address any barriers to Māori in determining and fulfilling their own social, cultural and economic aspirations. The broader building regulatory system also needs to be easier to navigate, and the system should have more flexibility to accommodate traditional Māori methods of construction, and actively encourage new or innovative building products and methods that support sustainable design. Better engagement with Māori is needed to achieve their aspirations in the building regulatory system.

⁵⁵² Ministry of Business, Innovation & Employment “Issues Discussion Document – Review of the Building Consent System” (July 2022) at 36, available at: <https://www.mbie.govt.nz/dmsdocument/22845-issues-discussion-document-review-of-the-building-consent-system>.

Draft Recommendation 3 – Create more compliance pathways for a broader range of key building supplies

- 9.34 The objective of a performance-based building regulatory system is to enable designers and builders to meet the requirements of the Building Code in flexible and efficient ways. However, in practice, compliance pathways for different building products can be difficult to navigate as building products may need to comply with many different clauses of the Building Code. In addition, an assessment may be required of the extent to which a product (which could be one of many product components) contributes to compliance with the Building Code. This complexity has reinforced the use of ‘tried and tested’ building products for which compliance pathways in Acceptable Solutions and Verification Methods (and referenced in Standards) already exist and are well understood.
- 9.35 There are extensive powers under the Building Act to adopt technical information and reference technical standards in regulatory tools (in part or in whole). MBIE also regularly undertakes reviews of the Building Code and associated Acceptable Solutions or Verification Methods.⁵⁵³
- 9.36 Consenting costs could be reduced, and choice, innovation and competition increased by developing more Acceptable Solutions and Verification Methods, updating those that exist to reflect international standards and, where possible, setting out performance requirements for building products. If the number of compliance pathways was expanded, competition would be enhanced without compromising the existing building regulatory system objectives of delivering safe, healthy and durable homes.
- 9.37 We describe below a range of approaches that could be explored to create more compliance pathways for a broader range of key building supplies:
- 9.37.1 Updating and developing more Acceptable Solutions and Verification Methods;
 - 9.37.2 Enabling international bodies to certify products as compliant with the NZ Building Code as well as against other Codes; and
 - 9.37.3 Developing guidance that, for key building supplies, identifies the appropriate Building Code clauses and the possible means of proving compliance with those clauses.

⁵⁵³ Ministry of Business, Innovation & Employment “Programme of work” <https://www.building.govt.nz/building-code-compliance/annual-building-code-updates/programme-of-work/>.

- 9.38 There may also be other ways to develop more compliance pathways that we have not identified that could be explored in this process.⁵⁵⁴ Ultimately, each approach would require building sector policy makers to consider how best to achieve the objectives of the building regulatory system while at the same time reducing, to the greatest extent possible, limitations on competition within the industry.
- 9.39 Compliance pathways would also need to avoid being either too specific, which could undermine the entry of new or innovative products; or too broad, which could introduce a risk of performance failure.

Updating and developing more Acceptable Solutions and Verification Methods

- 9.40 MBIE regularly reviews the Building Code and associated Acceptable Solutions or Verification Methods.⁵⁵⁵ There may be opportunity to prioritise or expand the review of Acceptable Solutions and Verification Methods to create these pathways for more key building supplies. The aim would be to make it easier for a wider range of key building supplies to be used in residential construction without the need for certification or appraisal. This would reduce the cost and time for obtaining building consents that include these products and increase choice. Barriers to imports and innovation may also be reduced.
- 9.41 There are several complementary steps to enhance and increase the availability of Acceptable Solutions or Verification Methods which could be considered, including:
- 9.41.1 systematically identifying key building supplies where compliance pathways do not exist and developing these – this could increase choice;
 - 9.41.2 developing a process for creating compliance pathways for new products identified by suppliers or specifiers – this could enhance innovation and uptake of new products;
 - 9.41.3 reviewing cross-referencing of international standards and promoting alignment of Acceptable Solutions and Verification Methods with international standards where possible – this could reduce barriers to imports and increase the availability of new products; and
 - 9.41.4 setting out product performance requirements in Acceptable Solutions and Verification Methods (or in guidance under section 175 of the Building Act), as distinct from cross-referencing NZ Standards.⁵⁵⁶

⁵⁵⁴ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022). Mr Gardiner identified several other potential improvement measures that could be considered including other guidance.

⁵⁵⁵ Ministry of Business, Innovation & Employment “Programme of work” <https://www.building.govt.nz/building-code-compliance/annual-building-code-updates/programme-of-work/>.

⁵⁵⁶ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [41] and [125.3].

- 9.42 Relatedly, we understand that when standards are updated any Acceptable Solution and Verification Method that references those standards is not automatically updated. This may mean that these Acceptable Solutions and Verification Methods cease to be useful (since products that are manufactured to the new Standards will not automatically comply). Consideration could also be given to streamlining and accelerating the process for updating associated Acceptable Solutions and Verification Methods to incorporate updated standards so as to maintain their usefulness as compliance pathways.

Enabling international bodies to certify products as compliant with the NZ Building Code as well as against other Codes

- 9.43 Certification of building products is a feature of building regulatory systems internationally. Section 262(2) of the Building Act empowers the central regulator to, by notice, specify certifications of building methods or products provided by persons outside New Zealand to be treated as product certifications for the purposes of the Building Act.
- 9.44 Currently, CodeMark is the only certification scheme recognised. If international certification schemes were accredited to also certify building product compliance against the NZ Building Code it would increase the ways for overseas suppliers to establish compliance of their products. This could reduce costs for imported products and potentially increase local innovation by enabling local manufacturers to export (if their product is internationally certified).
- 9.45 The most common international certifications for products imported into New Zealand are issued by the US-based International Code Committee Evaluation Service (ICCS ES) and the British Board of Agrément (BBA), but other overseas certification bodies may also merit consideration.⁵⁵⁷

Developing guidance for key building supplies that identifies the appropriate Building Code clauses and the possible means of proving compliance with those clauses

- 9.46 Our work, along with the report of John Gardiner, points to a current lack of guidance to assist building products suppliers to navigate the complexity of the Building Code. Two of the guidance measures Mr Gardiner identifies appear to us, in our preliminary view, as likely to assist suppliers, and so to promote competition. They are guidance:
- 9.46.1 that would act as a primary ‘one-stop-shop’ for common products. It would explain all relevant Code clauses to assist manufacturers and users of building products to understand compliance pathways more easily;⁵⁵⁸ and

⁵⁵⁷ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [74].

⁵⁵⁸ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [43.3]

- 9.46.2 on how to provide evidence on meeting the Building Code’s clause for Durability (B2). We understand that durability as an express requirement is unique to New Zealand but in effect “inferred” in other jurisdictions.⁵⁵⁹
- 9.47 Guidance of this sort should be specific enough to make understanding of compliance pathways materially easier – but broad enough to allow for its application to new or innovative products. If too specific, it may be interpreted as only relating to existing products, which could entrench the popularity of these products as ‘tried and tested’ and undermine entry of new or innovative key building supplies.

Draft Recommendation 4 – Explore ways to remove impediments to product substitution and variations

- 9.48 As discussed in Chapters 3 and 4, and in our case study on plasterboard, we observe that building supplies are often specified by brand in building plans and consent applications. Where this occurs, substitutions will either require amendment to the building consent, or may be accepted as minor variations. The process for seeking substitutions can add time, cost and complexity to a build and designers and builders tend to avoid them for this reason.
- 9.49 We recommend exploring ways to remove impediments to product substitution and the need for consent variations for minor changes to building design.
- 9.50 Making appropriate product substitution easier would prompt more consideration of competing key building supplies and switching where products, for example, are more cost effective, of a higher quality, or simply available when the specified product is not. Improving the ability of products to compete in this way would improve outcomes for consumers.
- 9.51 The key impediment to substitution is the requirement to obtain approval from the BCA for the proposed alternative product. Reducing the need to obtain approval for substitutes could be achieved by amending the way plans in consent applications are able to specify brands, or providing additional direction about what constitutes a minor variation.
- 9.52 We recommend:
- 9.52.1 exploring ways to reduce specification by brand; and
- 9.52.2 increasing flexibility of the MultiProof scheme.

⁵⁵⁹ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [57].

Explore ways to reduce specification by brand

- 9.53 Legislative approaches to reduce impediments to substitution could be achieved through regulations that would:
- 9.53.1 require product substitution options to be included when plans and specifications are lodged with building consent applications (particularly when proprietary systems or products are being specified in designs) (for example, through amendment to the Building Forms Regulations 2004); and/or
 - 9.53.2 give stronger direction about what constitutes a ‘minor variation’ to a building consent (for example, through amendment to the Building (Minor Regulations) Regulations 2009).
- 9.54 These options may avoid the drawbacks of alternative approaches. For example, the approach to specifying brands could be amended so brand specification was not allowed, or any ‘equivalent’ product would be substitutable without further consideration by the BCA. Both of these options have potential drawbacks. For example, prohibiting specification by brand could unduly restrict design choice and impact the enforceability of implied warranties provided under the Building Act. Allowing use of any equivalent product may be ineffective or unworkable as determining equivalence may be open to interpretation.
- 9.55 In November 2021, MBIE published general guidance on product substitution for designers and builders.⁵⁶⁰ This guidance includes specific examples of the process for considering substitutions for plasterboard wall lining, exterior cladding and insulation. In addition, MBIE has recently provided product-specific guidance to BCAs in relation to plasterboard substitutions, given current supply shortages for this product.⁵⁶¹ Similar guidance could be issued for other products commonly specified by brand.
- 9.56 This approach to guidance could complement the legislative approaches noted above and might facilitate a more consistent approach to ‘minor variation’ substitutions for specific products across BCAs. While it is possible, through further guidance and training, that some BCAs would be encouraged to adopt more product substitutions, their willingness to consider substitutions may be better assured through a legislative option supported by more guidance. This may provide greater certainty relating to interpretation issues for each BCA.

⁵⁶⁰ Ministry of Business, Innovation & Employment “Product Substitution Guidance” (November 2021) available at <https://www.building.govt.nz/assets/Uploads/building-code-compliance/certifications-programmes/product-assurance/product-substitution.pdf>.

⁵⁶¹ Ministry of Business, Innovation & Employment “Product Substitution – Plasterboard” (June 2022) <https://www.building.govt.nz/projects-and-consents/build-to-the-consent/making-changes-to-your-plans/plasterboard-substitution-in-aotearoa-new-zealand/>.

Increase flexibility of the MultiProof scheme

- 9.57 The Building Amendment Act 2009 introduced a framework for multiple-use approvals known as MultiProof, as discussed in Chapter 8. While a building consent is still required, MultiProof speeds up the consenting process for builders and developers that use standardised designs by providing a statement to MBIE that a set of plans and specifications for a building complies with the Building Code.
- 9.58 MultiProof can support competition for residential building products by making it easier for building products, particularly those that are less widely used, to gain approval as compliant with the Building Code across the whole country. However, its use may be impeded by the fact that if a design change is made relative to the design approved as part of the MultiProof, a BCA will need to assess the whole design for Building Code compliance. We understand that this is even the case for minor variations, although MBIE guidance encourages BCAs to take a ‘reasonable’ approach to considering Building Code compliance where there are variations.
- 9.59 There may be opportunities to amend the MultiProof scheme so that designers can make small changes to designs without ‘voiding’ the MultiProof. For example:
- 9.59.1 The legislative framework and scheme rules could be amended to provide that, if the designer certifies that changes are minor and do not affect Building Code compliance, the BCA may continue to treat the MultiProof certification as evidence of compliance with the Building Code. However, a balance is also required to be struck to avoid providing too much scope for designer self-certification.
- 9.59.2 Alternatively, the legislative framework could be amended to provide a detailed list of aspects of a design that could be changed without affecting the validity of the MultiProof.

Draft Recommendation 5 – Investigate whether barriers to certification and appraisal can be reduced

- 9.60 Product assurance pathways (for example, CodeMark certification and BRANZ appraisal) involve significant time and cost, sometimes taking up to 12 months, as we note in Chapters 3 and 4. The time and cost of these pathways can deter suppliers from introducing new products to New Zealand.
- 9.61 Along with our recommendation to create more compliance pathways for a broader range of key building supplies, reducing barriers to certification and appraisal would likely increase competition as it would increase the range of products that designers, builders and BCAs can have confidence comply with the Building Code.

- 9.62 We have identified two possible approaches that could be considered as to reduce barriers to securing certification and appraisal. They are:
- 9.62.1 Reviewing the cost structure of the CodeMark scheme, or introducing a streamlined certification process for low-risk products. This could involve, for example, allowing greater reliance on external quality assurance systems, less frequent reviews of product certificates (required under the Building Act) and/or a lower number of mandatory factors that must be considered for certification under the CodeMark scheme rules. The value of such a tiered approach would depend on which aspects of the process are most costly and whether any of these could be streamlined without introducing undue risk to the system; and
 - 9.62.2 If the benefits were sufficient, then government could also consider contributing directly to the cost of certification and/or BRANZ appraisal. By reducing the direct cost to product manufacturers and suppliers, the attractiveness of certification and appraisal would increase.⁵⁶²

Support sound decision making

- 9.63 Chapters 3 and 4 illustrate the challenges in decision making about product use and consenting reflected in information we have collected to date in our study. These challenges generally relate to access to information and perceptions of liability.
- 9.64 There is currently no centralised repository for collecting and storing product and consenting information, accessible to designers, builders and BCAs. This means it can be difficult to find information about new or innovative products, and the basis on which they have been granted consent.⁵⁶³ Further, market participants observe that decision making by BCAs can be inconsistent, both between regions and within BCAs. There are 67 BCAs throughout New Zealand, but there is no formal or authoritative system for coordinating consenting decisions between BCAs.
- 9.65 Respondents to our regulatory and standards survey commented that it is too hard to satisfy BCAs of product compliance and they consider the current regulatory and standards systems have a negative impact on competition by limiting the availability of products as a result. This is in part because BCAs are perceived too risk averse due to concerns about potential liability.⁵⁶⁴ It appears that when presented with new or unfamiliar building products, a BCA's response is often to suggest that the applicant seek CodeMark certification or BRANZ appraisal.

⁵⁶² Refer to the discussion about cost structures of the CodeMark scheme in John Gardiner "Practical issues with the building regulatory system for suppliers of building products – An assessment" (3 August 2022) at [68-71].

⁵⁶³ John Gardiner "Practical issues with the building regulatory system for suppliers of building products – An assessment" (3 August 2022) at [61]. Mr Gardiner points out that product assurance information is not public knowledge and there is no centralised repository for it currently.

⁵⁶⁴ Refer Chapter 3 at paragraph 3.179.

- 9.66 A similar view was expressed in the expert advice we received, to the effect that risk-averse behaviour underlies decisions about consenting. The current civil liability regime for building work has been said to make BCAs risk averse and apply a higher legal standard to consenting decisions than that required by the Building Act.⁵⁶⁵
- 9.67 In light of these observations, we have contemplated making recommendations regarding potential changes to the liability regime faced by BCAs and the introduction of a building warranty insurance scheme. The issue of liability is an important one if risk-averse behaviour of BCAs is being driven by liability concerns, which in turn is restricting the approval and adoption of new or innovative products and limiting competition for key building supplies.
- 9.68 However, the documents released by MBIE earlier this month, “Issues Discussion Document – Review of the Building Consent System” and the “Risk, Liability and Insurance in the Building Sector Policy Position Statement” demonstrate that these issues have been considered by MBIE. In the latter publication MBIE has expressed the views that:
- 9.68.1 its research and consultation with sector participants has produced a mixed picture on the impact of risk and liability settings on BCA behaviour. While some BCAs perceive there to be a risk of being the last party standing when there are absent defendants in building negligence cases, MBIE has been unable to find concrete evidence as to ways in which BCAs were over-investing in carrying out their consenting functions. Additionally, other BCAs and industry stakeholders do not see liability as an issue and argue that it is not a primary driver of consenting behaviour,⁵⁶⁶
 - 9.68.2 there is little evidence that capping BCAs’ liability costs or limiting BCAs duty of care would result in BCAs acting in a less risk averse way or changing their approach in delivering their consenting function (and in any event it is questionable whether this would be desirable);
 - 9.68.3 the Government is therefore not persuaded that liability and excessive risk aversion is driving BCA consenting behaviour, decision making and efficiency;⁵⁶⁷ and

⁵⁶⁵ Refer Chapter 3 at paragraphs 3.238.4 and 3.258. See also John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [82].

⁵⁶⁶ Ministry of Business, Innovation & Employment “Risk, Liability and Insurance in the Building Sector Policy Position Statement” (July 2022) at 12, available at: <https://www.mbie.govt.nz/dmsdocument/22842-risk-liability-and-insurance-in-the-building-sector-policy-position-statement>.

⁵⁶⁷ Ministry of Business, Innovation & Employment “Risk, Liability and Insurance in the Building Sector Policy Position Statement” (July 2022) at 13, available at: <https://www.mbie.govt.nz/dmsdocument/22842-risk-liability-and-insurance-in-the-building-sector-policy-position-statement>.

- 9.68.4 there is a weak case for establishing a publicly provided insurance scheme for building defects after weighing up the costs, risks and potential benefits. While the public policy case for a government provided insurance scheme is not currently justified, this could change in the future to the extent the policy problem becomes clearer and if there are material changes in the costs, risks and potential benefits of such an intervention.⁵⁶⁸
- 9.69 Given the consideration of these matters in the Government discussion paper and position statement, we are not making a draft recommendation regarding potential changes to the liability regime faced by BCAs or the introduction of a building warranty insurance scheme.
- 9.70 However, when further considering the liability regime as it applies to BCAs, designers and builders, or the possible introduction of a building warranty insurance scheme, in our view it would be appropriate for the Government to take account of competition objectives alongside the other objectives underpinning the building regulatory system as we have recommended under Recommendation 1.
- 9.71 Our preliminary view is that information sharing is a key factor underpinning sound decision making across the building system. Therefore, we recommend identifying and developing methods to improve the ease of sharing information about building products as outlined below.

Draft Recommendation 6 – Identify and develop methods to centralise information sharing about key building supplies

- 9.72 As noted above there is currently no centralised repository for product and consenting information, accessible to designers, builders, and BCAs. This means it can be difficult to find information about new or innovative products, and the basis on which they have been granted consent. Creating a more co-ordinated and centralised approach to sharing knowledge and expertise, will enhance capability and confidence to work with and assess new or innovative building products and methods.
- 9.73 We recommend two complementary initiatives that could increase confidence and trust in products, particularly as new or innovative products are developed and used in New Zealand and internationally:
- 9.73.1 Establish a national key building products register as a centralised repository for sharing information about building products; and

⁵⁶⁸ Ministry of Business, Innovation & Employment “Risk, Liability and Insurance in the Building Sector Policy Position Statement” (July 2022) at 20, available at: <https://www.mbie.govt.nz/dmsdocument/22842-risk-liability-and-insurance-in-the-building-sector-policy-position-statement>.

- 9.73.2 Establish a BCA centre of excellence to facilitate a better co-ordinated and enhanced approach by BCAs to consenting and product approval processes.

Establish a national building products register as a centralised repository for information about building products and consenting

- 9.74 The Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021 puts in place a framework to require that manufacturers provide specified information about their products, with supporting regulations. While the proposed regulations include a requirement for information to be stored in a structured data format that is accessible across the supply chain, by MBIE, and online, there is no central repository proposed for this information.⁵⁶⁹
- 9.75 Our preliminary view is that there would be benefit in introducing some form of centrally operated national products register that:
- 9.75.1 encourages, enables and incentivises the sharing of information about new or innovative building products and methods;
 - 9.75.2 includes links to Acceptable Solutions and Verification Methods; and
 - 9.75.3 enables sharing of information about new or innovative key building supplies, where BCAs have approved them for use in Alternative Solutions and any difficulties which have been encountered in the use of these building supplies in consented projects.
- 9.76 A national products register would act as the primary reference source for information about building products, including the information that will be required to be disclosed as a result of the building law reforms. This could make it easier for designers, builders and BCAs to find information about available building products, potentially reducing the barriers to use of different building products.
- 9.77 Despite the Government previously discarding the concept of a national products register, some aggregation or coordination of available building product databases should be considered, especially as the new legislative requirement is likely to stimulate the development of more information. We consider that it may be appropriate for MBIE, as the responsible policy agency, to specify the way it operates to ensure unbiased and reliable information. However, there may be scope to contract out the construction and administration functions.

⁵⁶⁹ Ministry of Business, Innovation & Employment “Discussion document: Building System Reform: Building Amendment Bill Proposals for regulations for: Building Product Information Requirements, Modular Component Manufacturer Certification Scheme, Product Certification Scheme” (April 2021), available at: <https://www.mbie.govt.nz/dmsdocument/14150-building-amendment-bill-proposals-for-regulations-discussion-document>.

Establish a Building Consent Authority centre of excellence to facilitate a better co-ordinated and enhanced approach by Building Consent Authorities to consenting and product approval processes

- 9.78 As discussed in Chapter 3, information collected during our study indicates that there can be inconsistencies between (and within) BCAs in terms of which building products and methods they accept as compliant with the Building Code. This is also a theme reflected in MBIE’s discussion paper relating to the Government’s review of the building consent system. This makes it a difficult and slow process for suppliers to get widespread acceptance for building supplies as Alternative Solutions, which may deter suppliers from looking to bring new building supplies to New Zealand.
- 9.79 BCAs already have a range of formal and informal mechanisms for sharing information between and within BCAs about the Building Code and building products. However, there may be options to expand and formalise those arrangements, with a particular focus on sharing information about new or innovative building products and methods and how these interact with the Building Code. Arrangements could potentially be facilitated by establishing a ‘centre of excellence’. This could be a new body, or based within MBIE, a large BCA, or an association such as the Building Officials Institute, Taitaurā Local Government Professionals Aotearoa.
- 9.80 The kind of initiatives that the BCA centre of excellence could pursue might include developing a risk framework for BCAs to assess non-compliance risk. The aim would be to ensure BCA staff apply an appropriate level of scrutiny to consent applications, but are also not ‘over-scrutinising’ applications as a result of misplaced understanding of their obligations.⁵⁷⁰
- 9.81 We acknowledge there are a range of training programmes and obligations on BCAs to undertake training of staff within BCA accreditation requirements which are overseen by MBIE (for example, ongoing education and training and ensuring the competence of employees and contractors). However, there may be merit in delivering some of this work through a centre of excellence.

Address strategic business conduct

- 9.82 Our preliminary view, as outlined in Chapters 6 and 7, is that:
- 9.82.1 quantity-forcing rebates paid by established suppliers to merchants appear, under certain conditions, to be reinforcing regulatory factors impacting entry and expansion, creating difficulties for new or competing products to access distribution channels; and

⁵⁷⁰ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [84].

- 9.82.2 restrictive land covenants and exclusive leases benefitting the major merchants potentially limit competition by preventing rivals from opening stores in areas where they otherwise compete directly.
- 9.83 We make two recommendations in this group:
- 9.83.1 Promote compliance with the Commerce Act prohibiting anti-competitive conduct, including by discouraging the use of quantity-forcing supplier-to-merchant rebates that may harm competition; and
- 9.83.2 Further consider the economy-wide use of restrictive land covenants and exclusive leases.
- 9.84 These recommendations aim to increase awareness of, and compliance with provisions of the Commerce Act relating to misuse of market power and other anti-competitive conduct as well as assessing the impact of restrictive land covenants and exclusive leases across this and other industries.

Draft Recommendation 7 – Promote compliance with the Commerce Act, including by discouraging the use of quantity-forcing supplier-to-merchant rebates that may harm competition

- 9.85 Our preliminary view is that quantity-forcing rebates paid by some established suppliers to merchants are, in certain circumstances, creating impediments to entry and expansion for competing suppliers of some key building supplies. Rebates between suppliers and merchants are widespread for some key building supplies and can be significant in value.
- 9.86 In particular, tiered retroactive and share of wallet rebates used by manufacturers with merchants ('quantity-forcing' rebates) appear likely to discourage merchants from stocking more than one product within a category; or if more than one product is stocked, they provide strong incentives to maintain existing market shares by deterring switching to rival products.
- 9.87 The effect of quantity-forcing rebates on competition may vary depending on the key building supply. They are more likely to be problematic in the following circumstances, where:
- 9.87.1 markets are highly concentrated;
- 9.87.2 rebate arrangements cover a larger proportion of the market;
- 9.87.3 there are reasons that alternative suppliers may only be able to compete for a partial supply of a merchant's sales;
- 9.87.4 the arrangements are tailored to each individual merchant's demand; or
- 9.87.5 the highest tier covers a large proportion of the merchant's sales and the steps between tiers are significant.

- 9.88 Our preliminary assessment is that our case study into plasterboard supply shows that competition for some key building supplies is more likely to be affected by quantity-forcing rebates given other features in those markets. There also appear to be other markets which were not case studies and which we have less detail on, such as fibre cement, where similar conditions may exist.
- 9.89 Our preliminary view is that recommending legislative change to prohibit the use of such rebate structures across the key building supplies industry is unlikely to be justified. This is because:
- 9.89.1 rebates can provide benefits;
 - 9.89.2 whether or not any given rebate structure has the effect of lessening competition is dependent on the specific circumstances; and
 - 9.89.3 rebates are used across a wide range of sectors and therefore to the extent any policy changes were called for these would make sense to apply more broadly.
- 9.90 In addition, some rebate structures may breach the Commerce Act in some circumstances. From April 2023 changes to section 36 of the Commerce Act will prohibit firms with a substantial degree of market power from engaging in conduct that substantially lessens competition, regardless of whether they would have done the same thing if they did not have market power.
- 9.91 Suppliers with substantial market, particularly those in highly concentrated markets, should review their rebate structures for compliance with the revised section 36 of the Commerce Act.
- 9.92 We intend to consult on, and issue, guidance relating to the revised prohibition against misuse of market power later this year. Our guidance will apply to all businesses but will be informed by information that we have collected during the course of this study.
- 9.93 As noted below, we are also continuing to consider evidence relating to some quantity-forcing rebates that we have identified during the course of this study to assess whether further action is warranted utilising the Commission's compliance and enforcement functions and powers.
- 9.94 We discuss below additional measures we intend to take to promote compliance with the Commerce Act relating to the use of restrictive covenants and exclusive leases. In addition, we will continue to consider whether there are other areas of compliance with the Commerce Act that require specific attention as this the study progresses.

Draft Recommendation 8 – Further consider the economy-wide use of restrictive land covenants and exclusive leases

- 9.95 In Chapter 6 we identified that restrictive land covenants and exclusive leases are used in this industry, as in others we have previously studied, and have the potential to limit competition between merchants.
- 9.96 Sections 27 and 28 of the Commerce Act apply to exclusivity clauses in leases and restrictive covenants. Restrictive covenants and exclusive leases may breach sections 27 and/or 28 of the Commerce Act:
- 9.96.1 section 27 prohibits entering into or giving effect to a contract, arrangement or understanding containing a provision which has the purpose, effect, or likely effect of substantially lessening competition in a market; and
- 9.96.2 section 28 prohibits the requiring or giving of, or enforcing, a covenant that has the purpose, effect or likely effect of substantially lessening competition in a market. Such covenants are unenforceable.
- 9.97 We have identified around 60 restrictive covenants and 80 exclusive leases benefitting the major merchants that potentially limit competition. We also identified restrictive covenants a factor affecting competition in both our retail fuel market study and our retail grocery market study.⁵⁷¹ We consider the use of these covenants may in some cases unduly restrict competition between building supplies merchants.
- 9.98 Independent of this study, we are taking enforcement action in relation to use of a restrictive land covenant in the building supplies industry.
- 9.99 Due to the prevalence of restrictive covenants and exclusive leases, we intend to launch a compliance programme later this year to promote compliance with sections 27 and 28 of the Commerce Act. This is likely to start with the building supplies industry but may include targeted outreach with other sectors. We encourage any merchant or supplier benefitting from restrictive covenants and exclusive leases which prevent competitors from accessing certain sites to review them for compliance with the Commerce Act.
- 9.100 As noted above, this is the third consecutive market study in which restrictive land covenants (in one form or another) have been identified as potentially negatively impacting on competition.

⁵⁷¹ Commerce Commission “Market study into the retail fuel sector: Final report” (5 December 2019) at [6.117]-[6.122]; Commerce Commission “Market study into the retail grocery sector: Final report” (8 March 2022) at [6.75]-[6.99]. We identified more than 90 restrictive covenants in the grocery market study.

- 9.101 For this reason, we consider it would be valuable to obtain more information about the scale of their use and their effects across the economy. We recommend an economy-wide review of the use of restrictive land covenants and exclusive leases to assess whether a wider multi-sector solution is needed to address their impacts on competition more generally.

Other matters of interest to us

- 9.102 Information we have collected during our study could also indicate conduct that merits further consideration under other parts of the Commerce Act prohibiting anti-competitive conduct.
- 9.103 Independent of the outcomes of this study, we will continue to consider the appropriate use of the full range of our compliance, investigation and enforcement functions and powers under the Commerce Act. In particular:
- 9.103.1 We are taking enforcement action in relation to a restrictive covenant in the building supplies industry. Due to the prevalence of restrictive covenants and exclusive leases we intend to launch a compliance programme later this year.
 - 9.103.2 We are continuing to consider evidence relating to some quantity-forcing rebates that we have identified during the course of this study to assess whether further action is warranted utilising our compliance and enforcement functions and powers.
 - 9.103.3 We are continuing to engage with relevant parties to monitor the competitive effects of supplier allocation policies during current supply shortages.
 - 9.103.4 We are continuing to engage with relevant parties to better understand the role of customer specific quotes and targeted pricing strategies.

Conclusion

- 9.104 The factors affecting competition that we have identified in this study relate to the building regulatory system, the way in which it is applied by industry participants such as designers, builders and BCAs, as well as the strategic business conduct of some market participants.
- 9.105 In our view, effective competition for key building supplies working in tandem with building regulation can support better prices, quality, range and innovation in respect of key building supplies, as well as ensuring safety and durability of buildings.
- 9.106 Our suite of draft recommendations is preliminary and aims to provide tangible improvements in competition for key building supplies – without undermining the other key policy objectives of the building regulatory system.

9.107 Your feedback through the next stages of the consultation process and the conference is important to us as we refine and deliberate on our analysis and form final recommendations to present to the Government.

Attachment A Next steps and how you can have your say

- A1 This attachment provides information on how stakeholders can submit on the draft report, and details about our consultation conference.
- A2 Written submissions on this draft report are due **4pm, Thursday 1 September 2022**.
- A3 We intend to hold a consultation conference in central Wellington in the week commencing **Monday 26 September 2022** and provide further details on this below.
- A4 Further submissions, including cross-submissions on matters raised at the conference and in published submissions made by others, are due **4pm, Thursday 13 October 2022**.
- A5 The remaining sections in this attachment cover:
- A5.1 making written submissions on this draft report;
 - A5.2 confidential information – disclosure of your submission;
 - A5.3 invitation to attend consultation conference; and
 - A5.4 questions on material included in this attachment.

Making written submissions on this report

- A6 Please provide your views to us by emailing us at: buildingsuppliesmarketstudy@comcom.govt.nz.
- A7 We encourage you to provide submissions that are supported by evidence. Less weight may be given to a statement or submission that cannot be supported by evidence.
- A8 Please provide submissions in both a format suitable for word processing (such as a Microsoft Word document), and a 'locked' format (such as a PDF) for publication on our website.

Confidential information – disclosure of your submission

- A9 While we intend to publish submissions on our website, we understand that it is important to parties that confidential, commercially sensitive or personal information (confidential information) is not disclosed as disclosure could cause harm to the provider of the information or a third party.
- A10 Where your submission includes confidential information, we request that you provide us with a confidential and a public version of your submission. We will publish the public versions of submissions on our website. We note that responsibility for ensuring that confidential information is not included in a public version rests on the party providing the submission.

- A11 Where confidential information is included in submissions:
- A11.1 the information should be clearly marked and highlighted in yellow; and
 - A11.2 both confidential and public versions of submissions should be provided by 4pm on the due date.
- A12 If your submission contains information which is considered confidential, a schedule must be provided which identifies each piece of information over which confidentiality is claimed and the reason why the information is confidential (preferably with reference to the Official Information Act 1982 (OIA)).
- A13 We will not disclose any confidential or commercially sensitive information in a media statement, public report, or in response to a request, unless there is a countervailing public interest in doing so in a particular case. Such cases are likely to be rare and would be discussed with you in advance of any publication.
- A14 We will consider any request from a party who wishes to keep their identity and/or the content of their submission anonymous. However, this request must be discussed with us first, before the submission is provided to us. Submitters must justify any request for anonymity by providing reasons.
- A15 We will publish on our website public versions of submissions on our draft report as soon as practicable. If, after we have published the public versions, we identify further information in submissions that may be made public, we will ask for additional public versions to be provided for publication and inform all stakeholders when they are available on our website.

Invitation to attend consultation conference

- A16 We intend to hold a consultation conference in the week commencing **Monday 26 September 2022**.
- A17 This conference is intended to inform our final report by allowing us to test our preliminary findings with stakeholders, and to clarify and test comments received on our draft report.
- A18 We intend to hold the conference at a venue in central Wellington. There will be opportunities to attend either in person, or online – further details on the conference dates, location and agenda will be provided closer to the time.

Consultation conference format

- A19 The conference is likely to include open sessions as well as some confidential sessions with stakeholders on specific topics.

- A20 During the conference, each topic will be introduced by us. Members of the Commission and Commission staff will ask specific questions of parties and experts. We may choose to direct some questions to experts without reference to the parties. Parties may only ask questions of us for the purpose of clarifying a question. No party will have the right to cross-examine us or any other party during the conference. We do not intend to update stakeholders with our views on matters addressed in our draft report prior to, or during, the conference.
- A21 Although there may not be an opportunity for participants to speak to their comments in general, we may allow for statements from participants on specific topics. Where this is the case, we will inform participants prior to the conference.

Attendance of experts at the conference

- A22 We expect that all experts that have been advising parties will be available at the conference to respond to our questions and that experts attending the conference appear as experts in their fields rather than as an advocate for any particular party. We also expect experts to follow the guidance provided in the code of conduct for expert witnesses in the High Court Rules.⁵⁷²

Confidentiality

- A23 Our expectation is that confidential material should be kept to a minimum during the conference in order to maintain as transparent a process as possible. Attendance at any closed confidential session would be limited to Commission members, Commission staff, and the party presenting the confidential information.
- A24 We understand that some information you may want to discuss with us could be commercially sensitive and highly confidential. If stakeholders wish to attend the conference but have concerns or questions regarding confidentiality, please contact us at buildingsuppliesmarketstudy@comcom.govt.nz.

Other administrative matters

- A25 The conference will be recorded, and a stenographer will also provide a transcript of the conference. A transcript of each day's discussion (excluding any closed confidential sessions) will be made available on our website as soon as practicable.
- A26 Interested media may be in attendance at public sessions.
- A27 Stakeholders are asked to register their intention to attend the conference by **4pm, Thursday 18 August 2022** by providing the following details:
- A27.1 organisation;
- A27.2 name and role of each attendee (including experts);

⁵⁷² Schedule 4 of the High Court Rules 2016:
<https://www.legislation.govt.nz/regulation/public/2016/0225/latest/DLM6953324.html>.

- A27.3 whether attending in person or online;
- A27.4 contact number; and
- A27.5 email address.
- A28 When registering, stakeholders are also requested to register their interest in speaking in public sessions should this opportunity be available. We are also interested to hear from stakeholders about topics they may consider to be important to informing the conference.
- A29 Please note that limited seating is available so the number of attendees at the conference may have to be restricted. Time constraints may also mean that we cannot accommodate all requests to speak at the conference.
- A30 We will confirm conference attendees and speakers one week prior to the conference, at the latest.
- A31 We will also confirm topics and publish an agenda for the conference prior to the conference date.

Questions on material included in this attachment

- A32 If you want to register your intention to attend the conference, or have any questions or comments regarding material covered by this attachment, please contact us at: buildingsuppliesmarketstudy@comcom.govt.nz.

Attachment B Plasterboard case study

- B1 This attachment discusses the preliminary findings in relation to our plasterboard case study. In addition to understanding how competition in the supply of plasterboard is functioning, the case study aims to illustrate the extent to which some or all of the factors affecting competition identified in our report impact the supply of plasterboard.
- B2 We acknowledge that there have been some recent and ongoing shortages of plasterboard in New Zealand. The government has established a plasterboard taskforce to examine this.⁵⁷³ The objective of our study is not to investigate short-term issues in the supply of plasterboard. However, this case study does highlight that some of the factors contributing to the recent shortages are issues which are also likely limiting effective competition in the supply of plasterboard over the long term. We note that some steps already undertaken, such as better enabling product substitution, are aligned with our own draft recommendations set out in Chapter 9.⁵⁷⁴
- B3 To inform our plasterboard case study we have:
- B3.1 interviewed six suppliers of plasterboard;⁵⁷⁵
 - B3.2 reviewed hundreds of documents provided by the major supplier of plasterboard in New Zealand and the major merchants, including supply agreements;⁵⁷⁶
 - B3.3 interviewed and surveyed builders and designers;⁵⁷⁷ and
 - B3.4 met with regulatory and standards bodies and reviewed the relevant regulations.

⁵⁷³ Hon Dr Megan Woods “Plasterboard taskforce set up to ease shortages” (21 June 2022) <https://www.beehive.govt.nz/release/plasterboard-taskforce-set-ease-shortages>.

⁵⁷⁴ Ministry of Business, Innovation & Employment “Product Substitution: Plasterboard” (June 2022), available at: <https://www.building.govt.nz/assets/Uploads/building-code-compliance/certifications-programmes/product-assurance/product-substitution-plasterboard-guidance.pdf>.

⁵⁷⁵ [].
Some suppliers did not wish comments on the market to be attributed to them, and doing so may risk the Commission being able to obtain similar evidence in future. Therefore, in most cases we do not name individual suppliers throughout this case study.

⁵⁷⁶ [].

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- B4 In this attachment we set out:
- B4.1 a summary of our preliminary findings;
 - B4.2 an overview of plasterboard as a key building supply;
 - B4.3 the industry structure and participants;
 - B4.4 the regulatory and standards system;
 - B4.5 how plasterboard is specified and purchased;
 - B4.6 pricing practices and vertical arrangements; and
 - B4.7 innovation and building for climate change.

Summary

- B5 Plasterboard represents a relatively small proportion of the total cost of building materials for a residential build. However, this understates the importance of effective competition for supply of plasterboard. This is because differences in plasterboard type and quality, as well as the accompanying service package provided by suppliers can impact the speed of installation. Delays in plasterboard installation can have consequential effects on timing and installation of other products and therefore significantly impact the overall efficiency of residential construction. These delays can have significant cash flow implications for builders and subcontractors.
- B6 Our preliminary view is that competition in the supply of plasterboard is not working well.
- B7 The market is very highly concentrated with Winstone Wallboards' GIB brand holding around 95% market share over a long period.⁵⁷⁸

⁵⁷⁸ For example: Hon Dr Megan Woods "Plasterboard taskforce set up to ease shortages" (21 June 2022) <https://www.beehive.govt.nz/release/plasterboard-taskforce-set-ease-shortages>; Radio NZ "Fletcher Building meeting: Simplicity seeking answers to GIB board shortage" (13 June 2022) <https://www.rnz.co.nz/news/national/469034/fletcher-building-meeting-simplicity-seeking-answers-to-gib-board-shortage>.

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]. Winstone Wallboards has maintained a market share of over 90% of the wholesale supply of plasterboard in New Zealand for many years, Commerce Commission "Investigation into Winstone Wallboards Limited" at [38], available at: https://comcom.govt.nz/_data/assets/pdf_file/0028/94393/Winstone-Wallboards-Limited-Investigation-closure-report-22-December-2014.pdf.

- B8 There is evidence the market position held by Winstone Wallboards is partly driven by historical strong performance and a highly regarded service and quality proposition. However, there is a range of factors which has made it harder for potential competitors to enter the market and to compete effectively or expand once they have entered. These factors limit the competition Winstone Wallboards faces. The factors include:
- B8.1 the design of the regulatory and standards systems and building practice, which have led to the use of plasterboard for structural bracing. Use of plasterboard for structural bracing is rare overseas and use in this way creates additional requirements for suppliers.⁵⁷⁹ These additional requirements make it more difficult to import plasterboard into New Zealand and lead to some products from overseas being substitutes for a more limited part of the market (eg, DIY building);
 - B8.2 designers commonly specify plasterboard by brand in building plans because the regulatory and standards systems encourage this. Once specified in a building consent, the costs associated with switching to competing products discourage builders from looking at alternative options;
 - B8.3 getting building consents approved is more challenging for products that authorities are less familiar with and so designers are more likely to specify a plasterboard product which is widely used and familiar to the industry;
 - B8.4 rebate structures disincentivise merchants from stocking alternative products, contributing to difficulties for alternative suppliers accessing the merchant channel; and
 - B8.5 the level of investment required to establish and maintain a strong distribution presence in New Zealand and the even greater level of investment required to develop a manufacturing plant mean that alternative suppliers struggle to sustain viable operations with only a small share of the market.
- B9 Due to the difficulties alternative suppliers face in entering the market and expanding their offering, consumers likely receive pricing, innovation and quality that are worse than if entry and expansion was easier. For example, when large international suppliers of plasterboard have entered the New Zealand market in the past and presented a credible competitive threat to Winstone Wallboards, it developed new products and innovations to match the competitors.

⁵⁷⁹ For example: the need for additional testing to demonstrate suitability for structural bracing; tools and systems to help designers meet compliance; and potentially different production runs as attributes of the board (such as thickness) may need to be adjusted to create a compliant system.

The role of plasterboard in residential construction

- B10 Plasterboard can also be known as gypsum board, drywall, wallboard or sheet rock, but in New Zealand is often referred to as GIB, the brand name for the product range of the largest provider, Winstone Wallboards (part of Fletcher Building).
- B11 Plasterboard consists of two paperboards that sandwich gypsum, a powdery white or grey sulfate mineral. Gypsum is non-combustible, and compared to other wall materials, like solid wood and plaster, gypsum boards are typically much lighter and cheaper.
- B12 Plasterboard is the most commonly used material for wall linings when constructing new residential buildings. At least 91% of new residential buildings use plasterboard as their primary wall lining material.^{580, 581}
- B13 Although there are other materials which can physically be used for internal wall linings such as plywood or fibre cement, there appears to be little in the way of close economic substitutes to plasterboard for interior drywall linings.⁵⁸²
- B14 The total value of plasterboard sales in New Zealand is likely to be in excess of \$250 million a year.⁵⁸³
- B15 Plasterboard comes in different thicknesses and dimensions but in New Zealand the standard boards are typically either 10mm or 13mm thick. These standard boards represent over half of all sales.⁵⁸⁴ We heard from market participants that the standard thickness in other countries is often different.⁵⁸⁵
- B16 In addition to the standard board products, there are a range of different performance boards which have additional capabilities such as additional fireproofing, soundproofing or water resistance. There is also a range of complementary products such as plaster compounds, trims and tape.

⁵⁸⁰ The other approximately 0-10% selected 'other' but did not specify the alternative and so these may have been other types of plasterboard. This excluded bathrooms and laundry rooms and where multiple wall linings were used. This figure excludes empty responses and houses with multiple lining types.

⁵⁸¹ Commerce Commission analysis of anonymised BRANZ 2020 survey data, [].

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⁵⁸³ Commerce Commission analysis of merchant sales data estimates sales of around \$250m in 2021, []. This figure is rounded to the nearest \$50m, and is likely an underestimate as there will be a small proportion of direct sales which are not counted in this data.

⁵⁸⁴ This figure has been rounded to the nearest \$50m, Commerce Commission analysis of merchant sales data, [].

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- B17 We understand from suppliers that they typically sell their products as part of wall systems. These systems are often designed to satisfy certain requirements of the regulatory and standards systems. In New Zealand plasterboard is often used to provide structural bracing which leads to additional requirements. We discuss this further below.
- B18 Some plasterboard products which have additional water-resistant properties are used to line areas of the house at higher risk of water exposure. The extent of potential substitution for wet area wall linings is likely greater due to the greater importance of water-resistant qualities which means other materials with strong water-resistant features are more likely to be used. However, the plasterboard share of supply for wet lining areas is also substantial, being estimated to be over 80% of the market.⁵⁸⁶ The plasterboard used for wet lining in New Zealand is also predominantly manufactured by Winstone Wallboards under the Aqualine product line.

Industry structure and participants

- B19 In this section we provide an overview of the industry structure in relation to plasterboard and consider both:
- B19.1 the level of concentration in the different layers of the supply chain; and
 - B19.2 whether there are any aspects of the structure of the industry which may act as an impediment to effective competition in the supply of plasterboard.
- B20 Our preliminary assessment is that:
- B20.1 the supply of plasterboard in New Zealand is very highly concentrated at the supplier level with only one domestic manufacturer and limited supply from importers;
 - B20.2 a range of factors makes it difficult for alternative suppliers to enter and expand have likely contributed to a current plasterboard shortage;
 - B20.3 there is sufficient choice of where to purchase plasterboard but ultimately, the distributors are all stocking similar products;⁵⁸⁷
 - B20.4 the scale required to efficiently service the distribution of plasterboard means that it can be difficult for smaller alternative suppliers to compete without an established presence; and

⁵⁸⁶ Commerce Commission analysis of anonymised BRANZ 2020 survey data, []. This figure excludes empty responses and houses with multiple lining types.

⁵⁸⁷ We discuss the reasons merchants all primarily stock one product in paragraphs B105 to B107 below where we discuss the vertical arrangements suppliers have with merchants.

B20.5 there is little evidence to suggest the common ownership of Winstone Wallboards and other Fletcher Building business units downstream is a significant factor driving GIB's market share or affecting competition.

B21 We describe the ways in which other factors such as regulatory and standards systems and pricing arrangements are affecting competition later in this case study.

The supply of plasterboard in New Zealand is very highly concentrated upstream

B22 The supply of plasterboard is characterised by very high concentration upstream. Winstone Wallboards has held a share of over 90% of the supply of plasterboard since the mid-1990s with their share typically fluctuating around 95%.⁵⁸⁸

⁵⁸⁸ For example: Hon Dr Megan Woods "Plasterboard taskforce set up to ease shortages" (21 June 2022) <https://www.beehive.govt.nz/release/plasterboard-taskforce-set-ease-shortages>; Radio NZ "Fletcher Building meeting: Simplicity seeking answers to GIB board shortage" (13 June 2022) <https://www.rnz.co.nz/news/national/469034/fletcher-building-meeting-simplicity-seeking-answers-to-gib-board-shortage>.

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]. Winstone Wallboards has maintained a market share of over 90% of the wholesale supply of plasterboard in New Zealand for many years, Commerce Commission "Investigation into Winstone Wallboards Limited" at [38], available at: https://comcom.govt.nz/_data/assets/pdf_file/0028/94393/Winstone-Wallboards-Limited-Investigation-closure-report-22-December-2014.pdf.

B23 We set out a brief overview of the different suppliers in Table B1 below.

Table B1 Suppliers of plasterboard in New Zealand

Supplier	Share	Overview
Winstone Wallboards	~95%	The only domestic manufacturer of plasterboard in New Zealand, producing the GIB branded plasterboard and systems which are widely used in New Zealand. Winstone Wallboards has facilities in Auckland, Wellington and Christchurch, and is part of the Building Products Division of Fletcher Building.
Elephant Plasterboard	0-5%	Elephant Plasterboard (NZ) Limited distributes the Elephant Plasterboard brand manufactured in Thailand. Elephant Plasterboard has been operating in New Zealand for over 30 years and offers its own bracing systems and calculators.
ProRoc Plasterboard	0-5%	Sold through Bunnings and is primarily targeted at DIY customers. The product is from French multinational Saint-Gobain manufactured in Thailand.
Handyboard	0-5%	Mitre 10 distributed own brand plasterboard targeted at DIY/non-structural applications.
Knauf	0-5%	Large global manufacturer of building supplies including plasterboard resulting from merger of USG Boral and Knauf. Both USG Boral and Knauf had separately tried to enter the New Zealand market. USG Boral invested in distribution in New Zealand in 2017 and gained share before pulling out of the market in 2021. During that time, it developed its own bracing systems and calculator. Knauf entered in 2013 and exited within a few years.
Youngman Supply Group	0-5%	Following Knauf/USG's withdrawal from distributing in New Zealand the Youngman Supply Group has continued to import Knauf (USG Boral) plasterboard but with a more limited distribution presence.
Baier Group	0-5%	Small independent merchant operating out of Christchurch. ⁵⁸⁹
CSR	0-5%	Large Australian manufacturer of plasterboard who have also successfully started distributing insulation in New Zealand. Currently no direct supply of plasterboard to New Zealand. Had previously tried to enter the New Zealand market in the 1990s. ⁵⁹⁰
saveBOARD	0-5%	Not technically a plasterboard but can be used in similar applications. Is made from upcycled materials and has been tested in New Zealand for NZBC structural bracing requirements.

Source: Commerce Commission analysis.⁵⁹¹

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As Winstone Wallboards has a market share of approximately 95%, all other suppliers will have market shares between 0-5%, for example: Hon Dr Megan Woods "Plasterboard taskforce set up to ease shortages" (21 June 2022) <https://www.beehive.govt.nz/release/plasterboard-taskforce-set-ease-shortages>; Radio NZ "Fletcher Building meeting: Simplicity seeking answers to GIB board shortage" (13 June 2022) <https://www.rnz.co.nz/news/national/469034/fletcher-building-meeting-simplicity-seeking-answers-to-gib-board-shortage>.

- B24 Winstone Wallboards is currently the only domestic manufacturer of plasterboard in New Zealand. Other supply comes from manufacturing plants primarily in Thailand and Australia, and we have also seen reports of some limited direct imports from China.⁵⁹²
- B25 Suppliers like Elephant Plasterboard and Knauf (USG Boral) have developed products which enable them to compete more closely with Winstone Wallboards using the product for a structural application. Other suppliers seek to supply a smaller proportion of the market where plasterboard is not used in structural applications.
- B26 There have been recent highly publicised moves to increase imports into New Zealand. For example, by Simplicity Living importing plasterboard from Thailand. Simplicity Living acknowledged the additional flexibility it had because its building used three storey concrete structures from engineered design and therefore did not rely on plasterboard bracing systems.⁵⁹³ It is too early to assess whether the increased demand to import products directly is simply a temporary response to the current supply shortage or will result in a greater expansion and use of imports in the longer term.

A range of factors makes it difficult for alternative suppliers to enter and expand have likely contributed to a current plasterboard shortage

- B27 Following a significant increase in demand, there have recently been acute shortages in the supply of plasterboard. Winstone Wallboard's has told us that demand for plasterboard is currently higher than its supply capacity, which has led to shortages and implementation of an allocation model.⁵⁹⁴ The impact of the plasterboard shortages has meant some builders have had no option other than to delay projects, driving substantial additional costs into building projects.⁵⁹⁵
- B28 Challenges with freight and high global demand, in addition to difficulties for builders switching suppliers when the product is specified by brand, have led to difficulties for importers increasing their supply in the market. We further consider the difficulties suppliers face in expanding their presence in the market later in this case study where we discuss the impact of regulatory systems and standards and the way decisions are made to choose plasterboard.

⁵⁹² For example, Jonathan Killick "Unable to source Gib here, frustrated builders import plasterboard from China" (27 May 2022) <https://www.stuff.co.nz/business/128697392/unable-to-source-gib-here-frustrated-builders-import-plasterboard-from-china>.

⁵⁹³ Jonathan Milne "Building projects grind to a halt as dominant Fletcher freezes Gib orders" (11 February 2022) <https://www.newsroom.co.nz/building-projects-grind-to-a-halt-as-dominant-fletcher-freezes-gib-orders>.

Daniel Smith "Simplicity blasts Fletcher Building for lack of Gib" (10 June 2022) <https://www.stuff.co.nz/business/128912460/simplicity-blasts-fletcher-building-for-lack-of-gib>.

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⁵⁹⁵ For example, Jonathan Milne "Builders forced to the wall as Gib shortage becomes critical" (18 May 2022) <https://www.stuff.co.nz/business/industries/300591111/builders-forced-to-the-wall-as-gib-shortage-becomes-critical>.

- B29 There is also an inherent difficulty increasing plasterboard capacity. In the short term, in response to recent increases in demand, the only domestic manufacturer Winstone Wallboards has increased production and is currently operating both its existing manufacturing plants at maximum capacity. It said it was not viable to increase the capacity of the existing Auckland facility due to site constraints.
- B30 Increasing plasterboard production capacity otherwise involves long-term investment decisions. In December 2019, Winstone Wallboards received Fletcher Building Board approval to construct a new approximately \$400 million manufacturing and distribution facility in Tauriko, Bay of Plenty to replace the Auckland facility. The facility will provide 50% more capacity than the existing Auckland plant.⁵⁹⁶
- B31 Investing in new capacity is a process which takes many years, and COVID-19 lockdowns may have delayed the process.⁵⁹⁷ The scale of investment required also affects investment decisions.
- B32 However, Winstone Wallboards' incentives to invest in a timely manner are likely weaker due to the limited constraints they face.⁵⁹⁸ Concentrated markets are also typically less resilient to demand shocks and uncertainty. In many markets, having more large suppliers in the market, motivated to invest in increased capacity, can reduce the risks of shortages.

There is a choice of where to purchase plasterboard but limited stocking of alternatives

- B33 There is a range of options for purchasers when deciding where and how to purchase plasterboard.⁵⁹⁹
- B34 The five major building supply merchants (Bunnings, Carters, ITM, Mitre 10 and PlaceMakers) account for nearly all plasterboard sales in New Zealand.⁶⁰⁰

⁵⁹⁶ Winstone Wallboards "New Tauranga Facility – It's All Go" (1 March 2022) <https://www.gib.co.nz/gib-news/new-auranga-facility/new-auranga-facility-its-all-go/>;

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⁵⁹⁷ Tina Morrison "Fletcher Building says plasterboard market will return to 'equilibrium' by October" (22 June 2022) <https://www.stuff.co.nz/business/129041772/fletcher-building-says-plasterboard-market-will-return-to-equilibrium-by-october>.

⁵⁹⁸ Concentrated markets perform particularly badly at times of significant demand uncertainty. The suppliers are less worried about losing market share to competitors if demand suddenly increases and can wait for the demand uncertainty to subside before committing to expensive investment in new production capacity, Andrea Coscelli & Gavin Thompson "Competition & Markets Authority: Economics working paper – Resilience and Competition Policy" at 12, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1064924/Resilience_and_competition_policy_-_AC.pdf.

⁵⁹⁹ For example, Registered Master Builders Association "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 11, Q29.

⁶⁰⁰ [].

- B35 There is a distinction between whether a merchant stocks plasterboard, or merely supplies it on request (indent supply). With the exceptions of Bunnings (which stocks a limited range of ProRoc plasterboard for the DIY market) and Mitre 10 (which has responded to Bunnings' offer with a rival DIY product, Handyboard), merchants have not typically stocked plasterboard other than GIB in large quantities. We understand that due to the current shortages in the market some merchants in certain stores may also have started stocking alternative products.⁶⁰¹ All major merchants supply alternatives at the request of builders.
- B36 The factors influencing merchants stocking decisions and the role of rebates is discussed further in Chapter 7 and in the discussion on rebates below.

The supply of plasterboard has scale efficiencies at two levels

- B37 The investment required to establish a manufacturing plant for plasterboard is relatively high and provides a constraint on introducing additional production capacity into the New Zealand market.⁶⁰² In order to justify such a large capital investment we heard from suppliers they would need to have gained sufficient share through an import model first to justify the risk being taken.⁶⁰³ We also understand that there can be other barriers to establishing a domestic manufacturing presence including finding suitable land which has, or for which it can obtain, suitable consents and good transport links.⁶⁰⁴
- B38 Importers manufacturing abroad may have greater scale than Winstone Wallboards, and so are likely to have similar or even lower per-unit cost production⁶⁰⁵
- B39 Set against these potential production cost advantages are the cost of freight and exchange rate risk. We understand that the freight costs have become more substantial in recent years.⁶⁰⁶ In our discussions with importers some told us they have historically been able to supply plasterboard at a level which matches or beats the incumbents' pricing in New Zealand but that freight costs have been increasing sharply.⁶⁰⁷

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606 Statistics New Zealand "Sea and air transport values rising" (2 March 2021)
<https://www.stats.govt.nz/news/sea-and-air-transport-values-rising>.

607 [].

- B40 Even prior to recent freight cost changes, in order to match the (rebate inclusive) pricing offered by the incumbent, and remain profitable, some suppliers using an import model indicated that they would need to reach certain market share thresholds to benefit from scale economies.⁶⁰⁸ This has not been achieved in recent decades.
- B41 Although almost all sales are made through the merchant channel in the supply of plasterboard, there are typically three different distribution options provided in the market for these sales:⁶⁰⁹
- B41.1 ex-warehouse, where a merchant makes their own arrangements to collect products from the supplier’s warehouse;
- B41.2 freight into store (FIS), where the supplier makes deliveries to a designated merchant store from their main warehouses; and
- B41.3 delivered to site (DTS), where product is delivered from the supplier direct to a building site.
- B42 DTS and FIS are the most common approaches, with ex-warehouse being less common. The extent of delivery-to-site varies regionally but we understand in Auckland (the largest regional market), delivery-to-site is the most common approach.⁶¹⁰ As noted in Chapter 4, availability of product (delivery in full and on time) is one of the key drivers for builders in choosing a supplier generally. The approach to distribution and reliability of service also appears to be an important component of competition in the supply of plasterboard.
- B43 This means that to establish a presence in the market, providers need to invest in their distribution capabilities within New Zealand and the competitive constraint provided by importers without this distribution network is diminished.
- B44 We have heard that building a comprehensive distribution service capable of servicing direct to site deliveries involves a not insubstantial level of fixed cost.⁶¹¹ This increases the importance of having some minimum level of scale to be a viable supplier and the inability to reach this scale appears to have been one of the key reasons past entrants have left the market.⁶¹²

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609 []; Elephant Plasterboard “Elephant Plasterboard Order & Delivery” <https://elephantplasterboard.co.nz/order-delivery/>.

610 [].

611 [].

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Vertical integration does not appear to be a significant driver of entry barriers

- B45 Winstone Wallboards is part of the Fletcher Building Group, which also includes a merchant (PlaceMakers) and a residential builder (Fletcher Living). This raises the possibility that internal trading arrangements in the vertically integrated group could be used to deter entry or weaken rivals at a different level of the supply chain.
- B46 We have not identified any evidence that Fletcher Building's position in two levels of the supply chain is being used to exclude rivals up or downstream.
- B47 Our preliminary view is that vertical integration is not having a material effect on competition in the supply of plasterboard. PlaceMakers have only a moderate share of the distribution of plasterboard.⁶¹³ It seems likely that there would be a number of other merchants which suppliers could use if PlaceMakers did not stock independent suppliers' plasterboard products. Vertical integration was not raised by other suppliers who had tried to enter the market as presenting any difficulty.
- B48 Winstone Wallboards told us that it treats PlaceMakers on an arms' length basis and consistently with its other merchant customers.⁶¹⁴ Winstone Wallboards said its general trading terms (including list prices), invoicing and payment terms apply consistently to all merchants, while rebate arrangements and other terms relating to customer support vary between merchants (as they are tailored to the merchants' specific needs).⁶¹⁵
- B49 PlaceMakers also told us they operate at arms' length and management are driven on targets for their own business unit not the broader business.⁶¹⁶
- B50 Some merchants raised concerns that Winstone Wallboards and other upstream Fletcher Building units could be incentivised to favour PlaceMakers. Merchants also raised concerns about allocation in response to stock shortages.⁶¹⁷ Winstone Wallboards have put in place a method of allocation based on previous sales. At face value this is not favouring PlaceMakers over other merchants. Our analysis of merchant competition appears to show that PlaceMakers has been losing share to other suppliers which indicates that to the extent there is any preferential treatment given to PlaceMakers its effect on merchant competition is limited. We discuss our approach to assessing allocation models in more detail in Chapter 6.

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Regulatory standards and systems

- B51 This section summarises how the regulatory and standards systems apply to plasterboard and how this could affect competition. Our survey seeking views on the regulatory and standards systems received a large volume of responses related to plasterboard and the barriers to seeking an alternative product driven by regulations.
- B52 Our preliminary assessment is that the regulatory and standards systems are creating impediments to effective competition in the supply of plasterboard. This is due to:
- B52.1 the high cost of certification and slow timeframes creating additional entry costs;
 - B52.2 the approach to consenting means that it is costly for builders to change supplier when the product has been specified by brand; and
 - B52.3 the practice in New Zealand of using plasterboard for structural bracing creates additional entry barriers.
- B53 A more detailed discussion of the regulatory and standards systems is contained in Chapter 3.

The way plasterboard is used in New Zealand requires additional certification which can be costly and slow

- B54 To use plasterboard as a structural component, in practice a branded system that complies with the Building Code will be specified in the design plans before a BCA will grant building consent.
- B55 The most recognised and widely used compliance certification is a BRANZ appraisal, which market participants have said can be difficult, lengthy, and expensive to obtain.⁶¹⁸
- B56 BRANZ appraisals are not the only way to comply with the Building Code. Some suppliers, for example, do not have a BRANZ appraisal but instead rely on appraisals from independent engineers and can still be specified in architectural plans in compliance with the Building Code.
- B57 We have heard that plasterboard that does not have an appraisal can be used for certain types of building projects, such as DIY projects, relining older houses that do not require bracing plasterboard, or other non-structural building work.

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The approach to consenting means that it is costly for builders to change supplier when the product has been specified by brand

- B58 The current regulatory system has led to products being specified by brand at the consenting stage. This means that the designer chooses the material supplier, and builders can face challenges if they want to use an alternative brand.
- B59 As discussed in Chapter 4 we understand that there are number of features of the consenting process which contribute to making it harder for alternative providers to establish a presence in New Zealand. We understand these factors as summarised below also apply to decisions in relation to plasterboard:
- B59.1 BCAs face joint/several liability and therefore require a high burden of proof when assessing consents with a preference for products which are ‘tried and tested’ in New Zealand.⁶¹⁹
- B59.2 BCAs are very familiar with the GIB products and so using those products means it is easier to get through the consenting process. This familiarity can impact how readily a builder may seek to substitute a plasterboard product after consent has been granted. One supplier stated that BCAs appear to particularly challenge consent changes for alternative plasterboard supply above and beyond other building supplies.⁶²⁰
- B59.3 There is no central consenting body and limited information sharing, so new entrants have to repeatedly prove their product across multiple BCAs (and even within BCAs).⁶²¹

The practice in New Zealand of using plasterboard for structural bracing creates additional barriers to entry and expansion

- B60 Where plasterboard is used in a non-structural capacity, the Building Code imposes no requirements. Where plasterboard is used in a structural capacity, it must comply with B1 – Structure, of the Building Code. Clause B1 includes bracing requirements.
- B61 In order to demonstrate compliance with Clause B1, a residential building can comply with Acceptable Solution B1/AS1.
- B62 B1/AS1 prescribes the design requirements for simple residential buildings. It incorporates a range of relevant standards, and one of these is *NZS 3604:2011* Timber-framed buildings. Timber-framed buildings are very common in New Zealand.

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⁶²¹ Castalia “Regulatory barriers in key building supplies – Submission to the Commerce Commission on behalf of Affordable Building Coalition” (May 2022) at [2.1.1].

- B63 *NZS 3604:2011* prescribes methods of complying with the Building Code requirements for the structure of residential buildings, including their foundations, framing layout, member sizes, bracing systems, fixings and connectors (when read along with the Acceptable Solution B1/AS1).⁶²²
- B64 Section 5 of *NZS 3604:2011* provides detailed information about how to calculate the bracing for a residential building. If a residential building is not designed to achieve B1 compliant bracing via its internal walls, external walls, roof and foundations, the building will not be within the scope of *NZS 3604:2011*.
- B65 *NZS 3604:2011* expressly refers to P21, which specifies the wall bracing test and evaluation procedure.⁶²³ P21 was developed by BRANZ. In essence, P21 describes how the bracing units (BU) of a product for use on an internal wall can be determined. Based on *NZS 3604:2011*, the relevant bracing requirements depend on the building's location.
- B66 One of the ways to comply with *NZS 3604:2011* is to use a plasterboard wall system.
- B67 In New Zealand, using plasterboard for structural bracing has become standard practice in residential buildings. In most of the rest of the world, plasterboard is primarily used as a wall lining product that must only support its own weight and be resistant to certain types of forces reasonably expected within a building.
- B68 Winstone Wallboards stated that the reason plasterboard is used for bracing in New Zealand is that the systems they have are the most effective in terms of price and usability.⁶²⁴
- B69 While some other suppliers have developed similar systems, some suppliers suggested that:⁶²⁵
- B69.1 plasterboard was not originally designed to be used as a structural component; and
- B69.2 there are other materials better suited to bracing buildings, and in other countries plasterboard is not used for bracing.⁶²⁶

⁶²² *NZS 3604:2011* <https://www.standards.govt.nz/shop/nzs-36042011/>.

⁶²³ BRANZ "Technical Paper P21, A wall bracing test and evaluation procedure" (2010).

⁶²⁴ []; BRANZ "GIB EzyBrace Systems" <https://www.branz.co.nz/appraisal-codemark-certificates/gib-ezybrace-systems/>.

⁶²⁵ Examples of similar systems include: BRANZ "USG Boral Bracing Systems" <https://www.branz.co.nz/appraisal-codemark-certificates/899-2015-usg-boral-bracing-systems/>; Elephant Plasterboard "Elephant Quickbrace Systems" <https://elephantplasterboard.co.nz/bracing-systems/>.

⁶²⁶ []; [].

- B70 One supplier suggested it was possible to change the way frame and truss was designed to take on all the bracing requirements.⁶²⁷ However, this requires getting designers to change building plans from the start and using plasterboard as structural bracing has become the default.
- B71 Our preliminary view is that the unique regulatory system in New Zealand, which permits use of plasterboard for structural bracing, in combination with the strong practice of relying on this compliance pathway, creates entry barriers. This could prevent some large international plasterboard manufacturers from entering due to additional compliance requirements they would need to meet for the New Zealand market compared with other jurisdictions (where plasterboard is only permitted for non-structural uses). It also creates additional difficulties for the suppliers who have decided to enter due to the interaction with the way plasterboard is specified and purchased, for example, increasing specification by brand which increases switching costs. We discuss such factors further in the following section.

How plasterboard is specified and purchased

- B72 In this section we consider the way in which plasterboard is specified and purchased and the different factors that influence those decisions. We consider what this tells us about how competition is functioning in the supply of plasterboard and whether the way decisions are made has any impact on the effectiveness of competition. A more detailed discussion of the way building materials are specified and purchased is set out in Chapter 4.
- B73 Our preliminary assessment is that:
- B73.1 it is very common for plasterboard to be specified by brand at the design stage meaning that designers are typically the primary decision makers;
 - B73.2 the factors which influence designers' decisions are likely to lead to indirect network effects (where different parties value a product more because other parties in the system also use the product or are more familiar with it);
 - B73.3 designers place value on BRANZ appraisals and tools to assist them in design; and
 - B73.4 builders typically purchase what is specified in the building consent, due to the potential costs and delays of attempting to substitute products.

It is very common for plasterboard to be specified by brand

- B74 The evidence from our survey of builders and designers is that the material used for interior walls (which primarily relates to plasterboard) is the building material which is most often specified by brand (see Figure 4.2 in Chapter 4).

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B75 We have also seen evidence indicating that designers are typically the primary decision-maker when it comes to selecting plasterboard.⁶²⁸

B76 We understand that this is primarily driven by the consenting process and the Acceptable Solution that includes plasterboard as a structural bracing element, meaning it is difficult to prove compliance without using a specific product.⁶²⁹

The factors which influence designers’ decisions are likely to lead to network effects

B77 We heard that because all the information for the incumbent’s products is known throughout the industry due to the prevalence of use, there are additional costs for designers in using an alternative. This reflects the time and costs involved in seeking out and understanding the relevant information for alternative plasterboard products.⁶³⁰ We also heard that this additional cost is reinforced by the responses of councils, who similarly have a lack of familiarity with other products. Therefore, specifying alternatives is viewed as creating more difficulties in getting consents.

B78 Designers also said that they often considered whether builders were comfortable using the material. We heard that due to familiarity with the incumbent’s product builders will not typically seek out an alternative to GIB if it is specified.⁶³¹

B79 We heard that certain brands are “ingrained” in the eyes of architects, designers, and councils. They gave the examples of plasterboard and fibre cement products.⁶³²

B80 Our preliminary view is that this combination of factors appears to mean that the more a product is used by others in the market, the greater value it has to other users. This is because each group of participants (for example, designers, BCAs, Builders) know that the other groups in the building supplies industry will already have familiarity with the product and are therefore unlikely to encounter problems. This creates little incentive for designers to search for alternatives, particularly as the price may be a less direct consideration for designers.⁶³³ These indirect network effects create a self-reinforcing cycle of behaviour, increasing the difficulties for alternative suppliers seeking to gain scale in the market.

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Designers also place value on BRANZ appraisals and tools to assist them in design

- B81 One designer indicated that BRANZ appraisal is one of the most important requirements for specification and that they do not recommend a product for specification if it does not have BRANZ appraisal. The designer noted that the industry expects that if BRANZ appraisal is received then the product is good to go.⁶³⁴
- B82 Designers also said that the incumbent does a good job of providing all the necessary information, including free technical advice and a free tool to architects which is used to calculate bracing solutions.⁶³⁵
- B83 If a specific bracing calculator has been used by designers to create the walls and decide how the house will be braced, it can become difficult to specify an alternative product.⁶³⁶ We understand from other suppliers that to compete in New Zealand it has become necessary to match these offerings, and we understand that USG Boral developed its own bracing calculator on entry and Elephant Plasterboard also has its own bracing calculator.
- B84 Our preliminary view is that the market expectation that suppliers' products should be BRANZ appraised and provide additional tools and systems to meet the needs of designers in structural bracing, are costs of entry for alternative suppliers which some smaller suppliers may be unable to meet.

Builders typically purchase what is specified in the plans

- B85 Builders are not the primary decision makers when it comes to selecting plasterboard. They purchase what is specified in the building plans.
- B86 We heard that the cost of switching to an alternative product once a product is specified is high, due to the additional time and expense needed to go back through the consenting process.⁶³⁷ For example, we heard that every council has consent documents relating to GIB, so it is easy and convenient to specify GIB, but when you offer an alternative, it takes a lot of time and often gets rejected.⁶³⁸ We heard that the builder can only influence the choice to use an alternative product when they are involved much earlier in the design phase, to allow more time to arrange supply and convince councils to accept different methods.

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- B87 Builders frequently commented on the lack of choice in plasterboard both in response to our survey and in interviews. One builder commented that they had never used anything but GIB, and they had no idea how you would even go about getting alternative plasterboard. Other builders suggested that the lack of alternatives was linked to merchants refusing to stock alternative products.⁶³⁹
- B88 There were also a number of positive comments made about the service and products of Winstone Wallboards relative to alternatives, including in relation to Winstone Wallboards' reliability of supply, BRANZ appraisal, long presence in the market and service proposition.⁶⁴⁰
- B89 Winstone Wallboards also told us about a double blind net promoter score (NPS) research piece where builders gave very high positive scores for Winstone Wallboards relative to alternative suppliers.⁶⁴¹
- B90 The cost of plasterboard was also highlighted as being small relative to the overall cost of a build meaning that delays to construction (eg, due to consenting problems or service issues) were viewed as outweighing any potential savings able to be secured from finding a cheaper alternative supply.⁶⁴²

Pricing practices and vertical arrangements

- B91 This section provides an overview of the pricing practices and vertical arrangements between suppliers of plasterboard. These types of arrangements are discussed more fully in Chapter 7.
- B92 Our preliminary assessment is that:
- B92.1 plasterboard prices are likely higher than they would be with more effective competition;
 - B92.2 the structure of rebates between the incumbent upstream supplier and merchants is likely to disadvantage alternative suppliers and hinder their ability to compete for more than a small share of the market;
 - B92.3 the rebates between suppliers and builders seem less likely to impact competition;

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B92.4 the approach to targeted discounts by the incumbent through customer specific quotes in response to competitors offers may also have a role in preventing alternative providers from reaching scale; and

B92.5 contracts expressly requiring exclusivity do not appear to be present between manufacturers of plasterboard and the major merchants.

Plasterboard prices are likely higher than they would be with more effective competition

B93 Pricing of plasterboard is typically based on a published list basis, but with supplier terms being negotiated with merchants on a bilateral basis (primarily on the level and tiers of rebates).⁶⁴³

B94 The agreements between plasterboard suppliers and major merchants typically last between one and three years. However, the agreements may roll over and we understand supply agreements are often longstanding, with negotiations focusing only on the rebate level.

B95 Merchants typically indicated that due to there being little choice in the supply of plasterboard, their ability to negotiate a better deal was more limited than in other product categories.⁶⁴⁴

B96 Merchants set their own prices to customers (eg, builders) with a margin to contribute to their own costs. Our analysis of merchant margins in relation to plasterboard suggest that margins for this product category appear lower than other products.⁶⁴⁵ This may partly be driven by the extent to which plasterboard is delivered directly to site by suppliers. Where plasterboard is delivered directly to site by the supplier, we understand that the merchant’s role is more limited as it is not stocking and managing the delivery of the product and so the merchant will commonly take a lower margin.⁶⁴⁶

B97 Prices of plasterboard over the last five years have been increasing. Suppliers told us that their costs have increased at a greater rate than the rate at which price increases have been implemented.⁶⁴⁷ They said that cost increases have occurred across all key inputs, with particularly significant increases occurring in the key inputs of paper, gypsum and energy.⁶⁴⁸

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644 For example: [];
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645 Commerce Commission margin analysis, [].
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- B98 There could be a range of reasons input costs may have been rising faster than plasterboard prices for a period and it is unclear whether this trend will continue. For example, this may have been the result of a temporary increase in competitive pressure in the period USG Boral expanded their competitive presence in New Zealand.
- B99 We have also seen reports that smaller players may limit their attempts to win customers as they experience fierce competition when they attempt to grow their market share or undercut Winstone Wallboards' prices.⁶⁴⁹
- B100 Our preliminary view is that prices are higher than they would be if there were more effective competition. This takes into account factors such as the fact that merchants appear to have more limited ability to negotiate because there are fewer viable alternative suppliers.⁶⁵⁰

The structure of rebates between the incumbent upstream supplier and merchants is likely to disadvantage alternative suppliers and hinder their ability to compete for more than a small share of the market

- B101 Suppliers of plasterboard have highlighted the importance of having their board stocked by merchants due to:
- B101.1 the increased awareness this provides in the market; and
- B101.2 builders often needing small additional amounts of supply (or returns), which becomes impractical to service without merchant stocking (especially outside of Auckland).⁶⁵¹
- B102 This means that the arrangements between suppliers and merchants have an important role in the market. A major feature of these arrangements are the rebates given by suppliers to merchants.

⁶⁴⁹ Elephant Plasterboard as reported in Stuff: "One thing I have learned is to keep our market share below 5%, and don't undercut Gib prices. As long as we do both of those things we are OK. But as soon as we step over that line, then we have hell to pay", Daniel Smith "How to build a plasterboard monopoly" (9 July 2022) Stuff <https://www.stuff.co.nz/business/129088441/how-to-build-a-plasterboard-monopoly>.

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B103 Most of these rebate arrangements are on tiered structures so that when a merchant’s purchases of plasterboard reach a certain threshold the rebate level steps up. This step-up in rebate applies not just to future purchases but all purchases in the period.⁶⁵² This is called a tiered retroactive rebate, which we explain in further detail in Chapter 7 and Attachment I.

B104 The level of steps and the tiers vary by merchant allowing suppliers to target each merchant’s incentives around their perceived likely volume.⁶⁵³ These structures mean that when nearing the threshold merchants can face significant incentives to purchase additional stock, including negative prices for extra stock.

B105 Merchants stated that they make their decisions on whether to stock a suppliers by considering prices net of rebates and a range of other factors. Some indicated that the rebate incentives in plasterboard strongly incentivised additional volume.⁶⁵⁴ However there are also a number of other factors which impact merchant decision making:

B105.1 Merchants typically said that a major driver in stocking decisions for plasterboard is the expected demand from builders.⁶⁵⁵ They stated that because it is so common for GIB to be specified and used by the industry they rarely get requests for alternative materials to be stocked.⁶⁵⁶

B105.2 Merchants also highlighted that material compliance with New Zealand standards is a major consideration as well as the reliability of delivery and service and ultimately the net price.

B106 Winstone Wallboards stated that the structure and operation of the New Zealand market means that a strong presence in the merchant channel will enhance a plasterboard supplier’s sales volumes. However, stocking a bulky and fragile product like plasterboard involves inventory risk for merchants. To compensate for that, a supplier’s offer to merchants will need to address not just price, but also quality, stock availability and service.⁶⁵⁷

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- B107 We heard from a number of alternative suppliers that the structure of the rebates given by suppliers to merchants is a contributing factor in the difficulties they faced entering and expanding their position in the market, as they make it harder to get stocked by the major merchants.⁶⁵⁸
- B108 As discussed in Chapter 7 our preliminary view is that quantity-forcing rebate structures, including tiered retroactive rebate structures, are likely to make it harder for alternative suppliers to be stocked through the merchant channel and contribute to less effective competition.
- B109 Our preliminary view is that the rebate structures applying to plasterboard are affecting competition because they impact merchant decision making and make it harder for alternative suppliers to reach scale.
- B110 As noted in Chapter 1, this study does not enquire into compliance with the provisions of the Commerce Act relating to anti-competitive conduct. We retain the ability to separately investigate anti-competitive conduct outside of this study.
- B111 The Commission investigated in 2014 the rebates structures used by Winstone Wallboards.⁶⁵⁹ The evidence at the time did not support a conclusion that Winstone Wallboards had breached the Commerce Act. Consistent with this draft report, the Commission observed that other factors may be affecting competition in relevant markets at that time.
- B112 We are continuing to consider evidence relating to some quantity-forcing rebates that we have gathered during the course of this study to assess whether further action is warranted utilising the Commission’s compliance and enforcement functions and powers. In addition, suppliers with substantial market power, particularly those in highly concentrated markets, should review their rebate structures for compliance with the revised section 36 of the Commerce Act which comes into force in April 2023.
- B113 As well as rebates, we also understand that suppliers such as Winstone Wallboards may give targeted Customer Service Quotes (CSQs) to merchants where the merchant is coming under competitive pressure from another supplier.⁶⁶⁰ We understand this may be less common in residential than commercial building.

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⁶⁵⁹ Commerce Commission “Investigation into Winstone Wallboards Limited” (22 December 2014) https://comcom.govt.nz/_data/assets/pdf_file/0028/94393/Winstone-Wallboards-Limited-Investigation-closure-report-22-December-2014.pdf.

⁶⁶⁰ [].

B114 Competition driving sustained lower pricing is an outcome the Commission seeks to promote. However, there is a risk that short-term targeted discounts (even when above the incumbent’s costs) could prevent rivals achieving and benefitting from economies of scale. This could limit their ability to provide a more effective competitive constraint over the longer term.⁶⁶¹

B115 We continue to seek further information to better understand the role and impact of CSQs and targeted pricing in the industry so that we may further consider and report in our final report as to whether these arrangements may be negatively impacting competition for any key building supplies.

The rebates between suppliers and builders seem less likely to impact competition

B116 We have also seen evidence of plasterboard suppliers providing additional rebates directly to some larger builders.⁶⁶²

B117 There are some factors which suggest these rebates may be harming competition:

B117.1 although these rebates are paid directly to builders by suppliers, the plasterboard is usually supplied to builders by merchants, acting as intermediaries. This could raise barriers to entry for suppliers if it makes merchants reluctant to stock new suppliers because customers are less likely to switch as they would lose the rebate;⁶⁶³

B117.2 end customer rebates involve an additional set of agreements with several builders rather than the more limited number of merchants which increase costs for new suppliers;⁶⁶⁴ and

B117.3 there is a risk the rebates may misalign incentives between builders and their customers.

B118 However, we understand that end customer rebates:

B118.1 are offered only to a limited proportion of the market;⁶⁶⁵and

B118.2 are structured in a way which an alternative supplier would be able to match, for example, on a per house basis.⁶⁶⁶

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B119 Our preliminary view is that the provision of rebates to builders by suppliers is less likely to harm competition because they are not structured in a way that may induce exclusivity, near exclusivity or require a minimum volume of sales. However, we acknowledge that the lack of transparency around end-user rebates may have wider implications, both in adding uncertainty to merchants' stocking decisions and, in some cases, leading to misaligned incentives between builders and their customers. In this way, they have the potential to inhibit competition.

Innovation and building for climate change

B120 In this section we discuss innovation in the supply of plasterboard and the evidence we have seen in relation to how the changes in the market linked to products impact on the environment and building for climate change.

B121 Our preliminary assessment is that:

B121.1 there would likely be a greater level of innovation in the market if barriers to entry were reduced;

B121.2 having products with a lower environmental impact is becoming more important for plasterboard; and

B121.3 suppliers of new or innovative products may face additional challenges to other suppliers in expanding their presence in the market.

There appears to have been a range of innovations in the market but the level of innovation in the market would likely increase if barriers to entry and expansion were reduced

B122 We heard mixed views about the level of innovation in the supply of plasterboard in New Zealand:

B122.1 We heard that there have been some innovations in the quality of plasterboard and the level of service in the plasterboard market. For instance, we understand that there have been improvements to the type of paper used and the precision of delivery systems.⁶⁶⁷

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B122.2 However, we have also heard that compared to other countries the supply of plasterboard appeared to demonstrate a number of characteristics of an uncompetitive market, including a lack of innovation.⁶⁶⁸ We heard that there were delivery techniques (for example, delivering without pallets to large sites) that new entrants introduced which had been around for years in other countries, but which were not being used in New Zealand prior to other suppliers entering the market.⁶⁶⁹

B123 Our preliminary view is that some of these innovations provide benefits for customers. These innovations may help to make the construction process more efficient. However, innovation in the supply of plasterboard is, as expected, often driven by the competitive threat of a rival supplier.⁶⁷⁰ This suggests that there would be more innovation if competition was more effective.

Having products with a lower environmental impact is becoming more important for plasterboard

B124 The industry appears to increasingly value 'green' and 'sustainable' product offerings for plasterboard.⁶⁷¹ We observed suppliers seeking to reduce the carbon footprint of manufacturing and develop their sustainability offering.⁶⁷² Suppliers are also assessing the 'green' offerings of competitors and developing products with similar credentials.⁶⁷³

B125 The potential benefits of offsite manufacturing (OSM) in relation to plasterboard were also highlighted. For example, one OSM supplier suggested that traditional building methods often lead to there being a large bin full of rubbish onsite (including offcuts of excess, plasterboard), but that there can be greater reuse and recycle of materials in a factory environment.⁶⁷⁴ For example, they said plasterboard offcuts are kept cleaner and can therefore be reused, rather than typically thrown into a wastebin.

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B126 Our preliminary view is that the increasing importance of environmental factors has the potential to disrupt industries such as plasterboard either directly or through changes in construction methods changing the customer base. However, it is not clear how quickly this may happen and the success of future innovation is likely to be assisted by the removal of barriers to entry and expansion that we have discussed in our report and in this case study.

Suppliers of new or innovative products may face additional challenges to other suppliers in expanding their presence in the market

B127 In addition to traditional plasterboard manufacturers, saveBOARD has emerged in New Zealand as an alternative product with green credentials.

B128 saveBOARD produces internal wall and ceiling lining from a structural composite panel made from upcycled materials.⁶⁷⁵ The core of the product is made from shredded and compressed composite packaging.

B129 We heard that the regulatory system is set up for historical building methods, which can make it more challenging coming in with new material like saveBOARD, as is the case for any new building product in the regulatory system.⁶⁷⁶ For example, we heard that there is a plasterboard standard, but saveBOARD is not a traditional plasterboard product so cannot be tested against plasterboard standards. We understand saveBOARD tries to demonstrate compliance by showing that the performance attributes of its product exceed those of current plasterboard products which meet the standard. We also heard the high cost of getting tested through BRANZ can be difficult for new entrants like saveBOARD to meet.⁶⁷⁷

B130 Our preliminary view is that the success of innovative products will be improved by addressing the issues we have identified as increasing the barriers to entry and expansion across key building supplies.

⁶⁷⁵ saveBOARD “Paperfaced internal lining” <https://www.saveboard.nz/paperfaced-internal>.

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Attachment C Structural timber case study

- C1 This attachment discusses the preliminary findings of our structural timber case study. In addition to understanding how competition in the supply of structural timber is functioning, the case study aims to illustrate the extent to which some or all of the factors affecting competition identified in our report impact the supply of structural timber.
- C2 For the purposes of this case study, we define structural timber as *sawn timber that can be used for structural framing in residential building*.
- C2.1 This definition does not include engineered timber, which is distinct from sawn timber in its manufacturing process among other attributes. However, we note some engineered timber products can be used for structural framing and we consider this closely throughout the case study.
- C2.2 Although we sometimes refer to a market for structural timber, it is important to note we have not conducted a formal market definition analysis for the case study. Instead, our definition above reflects our approach to defining *key building supplies* in line with the scope and objectives of this market study.
- C3 To inform our structural timber case study we have:
- C3.1 spoken with three major suppliers of structural timber;
- C3.2 reviewed hundreds of documents submitted by structural timber suppliers, engineered timber suppliers, and the major merchants (including detailed written submissions and supply agreements);
- C3.3 collected detailed product-level purchasing and sales data from the major merchants;
- C3.4 reviewed relevant survey responses and written submissions from a range of other industry participants and stakeholders; and
- C3.5 met with regulatory and standards bodies and reviewed the relevant regulations.
- C4 In this attachment we set out:
- C4.1 a summary of our preliminary findings;
- C4.2 the role of structural timber in residential construction;
- C4.3 the industry structure and participants;
- C4.4 the regulatory and standards system;
- C4.5 how structural timber is specified and purchased;

- C4.6 pricing practices and vertical arrangements;
- C4.7 innovation and building for climate change; and
- C4.8 conditions of entry and expansion.

Summary

- C5 Structural timber is by far the most common type of framing used in residential building in New Zealand. It is an important part of the overall building envelope, both on its own and as a key input into prefabricated frame and truss (F&T), which itself is a significant focus of competition between building supply merchants.
- C6 Overall, our preliminary view is that competition is working adequately in the supply of structural timber, although we have identified some areas of potential risk.
- C7 Competition appears to be working adequately because:
 - C7.1 Structural timber is seen as a commodity with limited scope for product differentiation between suppliers and brands. This is facilitated by the performance-based structural grading system. Consequently, structural timber is not commonly specified by brand in building plans, which promotes switching between suppliers. As a result, suppliers are collectively faced with variable market demand.
 - C7.2 Distributors of structural timber include major merchants and independent F&T manufacturers. These distributors appear to have a reasonable amount of countervailing power with suppliers due to their size, willingness to switch, and awareness of other suppliers' pricing. This usually makes it difficult for structural timber suppliers to price above the market level.
 - C7.3 The major suppliers of structural timber appear to face some competitive constraint from a long tail of smaller regional sawmills and from national suppliers of laminated veneer lumber (LVL) framing, which is a direct substitute (ie, LVL framing products can be used when structural timber has been specified in plans). There are also indirect framing substitutes such as panel systems and steel framing, although these substitutes are used at a relatively small scale.

- C8 The following features of the structural timber market may present risks for effective competition:
- C8.1 Two major suppliers, Carter Holt Harvey (CHH Woodproducts) and Red Stag, account for most of the supply of structural timber in New Zealand. They appear to benefit from economies of scale (and, in CHH Woodproducts' case, from vertical integration with Carters) and have strong, stable market positions. These aspects of industry structure increase the risk of unilateral market power being acquired and exercised. They may also impact the market's susceptibility to supplier coordination and/or resilience to demand pressures.
 - C8.2 New Zealand's regulatory and standards systems explicitly require structural timber to be durable for at least 50 years. Currently, it appears to be prohibitively difficult to demonstrate compliance with this requirement outside of the established standards framework, which is prescriptive regarding the species of timber that can be used structurally and the chemical treatment that must be applied. Further, the form of chemical treatment required and the express nature of the durability requirements are unique to New Zealand. These requirements are designed to improve the quality of New Zealand's housing stock and protect structural timber from damage, but may also serve to protect incumbents from innovation and import competition.
 - C8.3 Barriers to entry and expansion appear to be high for structural timber suppliers. Building and operating sawmills incur significant sunk costs and there are risks associated with the price and availability of logs (a key input sourced from third-party forest owners). Many smaller sawmills have closed in the last 15 years, and there have been few new entrants in this period.

The role of structural timber in residential construction

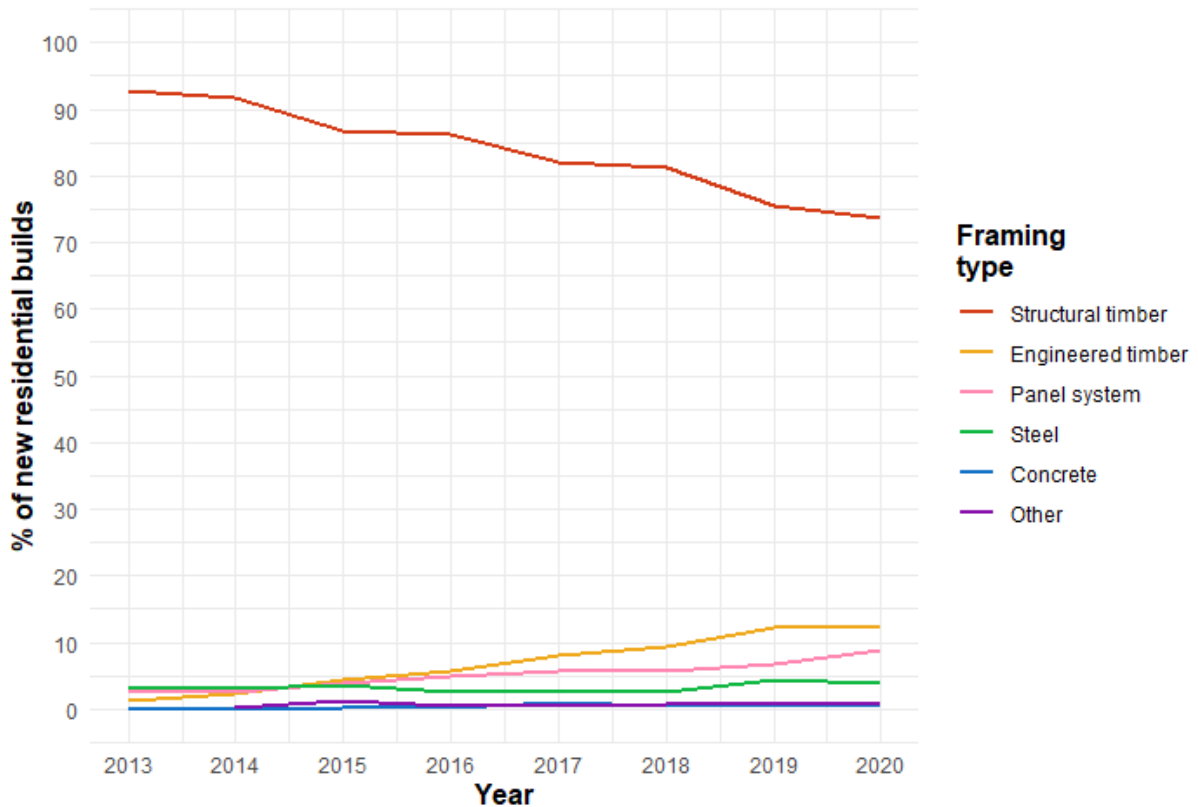
- C9 Structural timber is sawn timber that can be used for structural framing in residential building. It is often known as *framing timber* or *timber framing*. Its key structural properties are strength and stiffness; it can withstand stress without breaking or bending.
- C10 In New Zealand, most structural timber is either Radiata Pine or Douglas Fir. It is produced by sawmills, which process raw logs into sawn timber and residue.⁶⁷⁸ Not all sawn timber is suitable for structural use; around half of a log's timber will have the required structural properties, but we understand this can range from 30% to 80% depending on the 'structural yield' of the log.⁶⁷⁹ The remainder can be used in non-structural applications (eg, appearance timber).

⁶⁷⁸ Residue products can include wood chip, bark, and sawdust.

⁶⁷⁹ []; []; []; [].

- C11 Structural timber is by far the most common type of framing used in residential building in New Zealand. In 2020, it was used in 73% of new residential builds. However, as shown in Figure C1 below, this has fallen from 93% in 2013 which reflects growing usage of other framing options (especially engineered timber).⁶⁸⁰
- C11.1 As noted earlier, our definition of structural timber does not include engineered timber. Unlike sawn timber, engineered timber is a composite material made from wood and adhesives. It has different physical properties and includes a broader set of suppliers, products, and applications.
- C11.2 However, some LVL framing products are positioned as close substitutes to structural timber and are subject to similar regulations and market conditions. We consider them direct substitutes for structural timber, despite drawing a distinction in our terminology, because LVL framing products can generally be used when structural timber has been specified in building plans (see paragraphs C93 to C94 below). Usage of engineered timber as framing in new residential builds (most of which we understand to be LVL framing) has grown from 1% in 2013 to 13% in 2020.
- C11.3 Other framing types used in residential housing include panel systems and steel framing. We view these as indirect substitutes for structural timber because they have substantively different characteristics and cannot be used when structural timber has been specified in building plans. The choice to use panel systems or steel framing in place of structural timber is an important engineering decision taken by designers, who we expect to be less likely than other decision makers (eg, builders) to be responsive to short-term competitive conditions for the supply of structural timber.⁶⁸¹

⁶⁸⁰ Commerce Commission analysis of BRANZ New Dwellings Survey data, [].
⁶⁸¹ [].

Figure C1 Framing type by share of new residential builds in New Zealand

Source: Commerce Commission analysis of BRANZ New Dwellings Survey data.⁶⁸²

C12 Structural timber products can vary in terms of:

- C12.1 structural grade (all structural timber products are assigned a grade of SG6, SG8, or SG10, where a higher grade indicates stronger and stiffer timber, and SG8 is the most common);
- C12.2 species of tree (as above, usually either Radiata Pine or Douglas Fir);
- C12.3 level of chemical preservative treatment (most common is hazard class H1.2, indicating moderate risk of dampness or water);
- C12.4 whether it has been kiln dried (KD) after treatment (this is usually the case, but structural timber is sometimes purchased wet and stored until dry enough to install); and
- C12.5 the physical dimensions of the timber (ie, length, width, and height).

- C13 Structural timber is a key input into prefabricated F&T, which is produced by both merchants and independent manufacturers. Most structural timber goes through this intermediate manufacturing step before being sold to the construction level, though some is also distributed by building supply merchants as loose 'stick timber'.⁶⁸³
- C14 Overall, structural timber is an essential part of the residential construction sector. The total value of structural timber sales (including as F&T) to the major merchants alone is likely to be in excess of \$600 million a year.⁶⁸⁴
- C15 Demand for structural timber is cyclical as it is strongly linked to the overall level of residential construction. It is also generally viewed as a commodity product with limited differentiation between suppliers and brands. Therefore, suppliers are all faced with this cyclical market demand and must take it into account when making decisions around pricing and production capacity.⁶⁸⁵
- C16 There is currently a major shortage of structural timber in New Zealand due to a spike in residential construction demand that cannot be met by current sawmill capacity. The shortage has led to increased prices and rationing of supply (beginning in early 2021), which has had significant flow-on effects for the wider sector.⁶⁸⁶

Industry structure and participants

- C17 In this section we provide an overview of the industry structure in relation to structural timber and consider both:
- C17.1 the level of concentration in the different layers of the supply chain; and
 - C17.2 whether there are any aspects of the structure of the industry which may act as an impediment to effective competition in the supply of structural timber.
- C18 Our preliminary assessment is that:
- C18.1 the supply of structural timber is highly concentrated;
 - C18.2 the acute domestic capacity shortage is affecting competitive dynamics in the short term;
 - C18.3 it appears structural timber suppliers are generally price-constrained by distributors;
 - C18.4 engineered timber suppliers provide further constraint;

⁶⁸³ [].

⁶⁸⁴ Commerce Commission analysis of merchant sales data estimates sales of around \$600m in 2021. This figure is rounded to the nearest \$50m, and is likely an underestimate as there will be a small proportion of direct sales which are not counted in this data, [].

⁶⁸⁵ [].

⁶⁸⁶ []; [].

- C18.5 some features of the structural timber market could facilitate supplier coordination;
- C18.6 there are many participants competing at the distribution level; and
- C18.7 vertical integration between CHH Woodproducts and Carters has the potential to impact competition.
- C19 We start by providing an overview of the structural timber supply chain. The remainder of the section discusses each of the above findings in more detail.

Overview of the structural timber supply chain

- C20 The supplier level of the New Zealand structural timber market is mainly comprised of domestic production. Almost all structural timber used in New Zealand was produced in New Zealand; very little is imported from overseas.⁶⁸⁷
- C21 There are two major domestic suppliers of structural timber: Carter Holt Harvey (CHH Woodproducts) and Red Stag Timber (Red Stag). Combined, these two suppliers likely account for between 65-80% of structural timber volumes in New Zealand.⁶⁸⁸ The remaining volume is supplied by smaller national and regional suppliers.
- C22 Structural timber is typically sold through distributors; we are not aware of any direct sales from the supplier level to the construction level. As noted above, structural timber distribution comes in two forms:
- C22.1 loose 'stick timber' sold to the construction level by building supply merchants (including major merchants and specialist timber merchants); and
- C22.2 prefabricated F&T sold to the construction level by F&T manufacturers (directly and through merchants).
- C23 We refer to both groups (building supply merchants and F&T manufacturers) collectively as structural timber distributors. There is significant overlap between these groups; more than half of the F&T manufacturing plants in New Zealand are owned by building supply merchants.⁶⁸⁹
- C24 There is also a notable instance of vertical integration between the supplier and distribution levels. The largest structural timber supplier, CHH Woodproducts, and the building supply merchant, Carters (which operates 50 stores and nine F&T plants) are both are part of the Carter Holt Harvey Group (CHH Group).⁶⁹⁰

⁶⁸⁷ [].

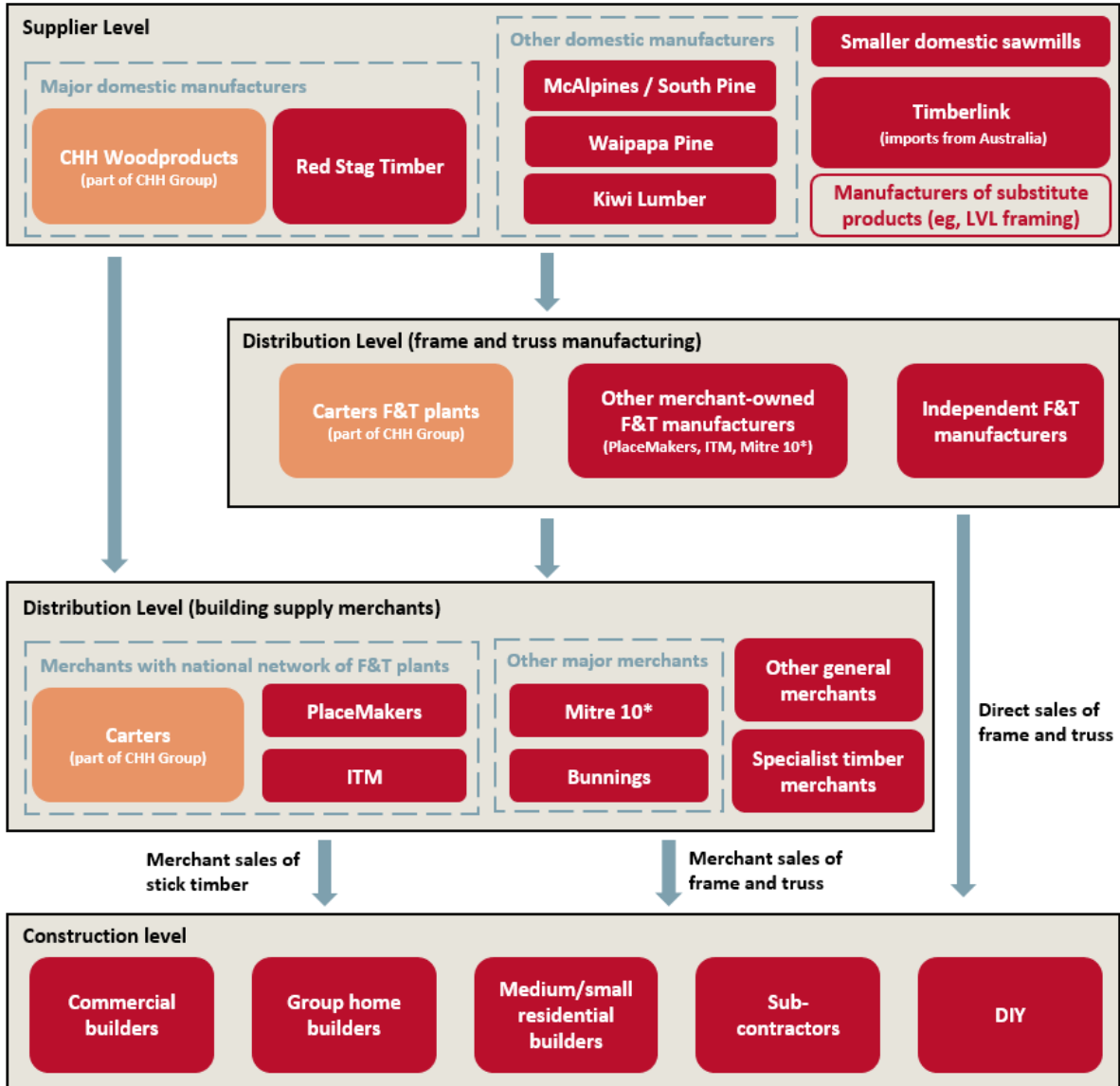
⁶⁸⁸ See Table C1 below.

⁶⁸⁹ [].

⁶⁹⁰ Ultimately owned by the parent entity, Rakau Building Supplies Holdings Limited.

C25 Figure C2 below depicts the structural timber supply chain as we understand it, including a selection of market participants at each level. The remainder of this section discusses aspects of industry structure in more detail.

Figure C2 Overview of the supply chain for structural timber



*Note: Mitre 10 has a small number of member-owned F&T plants; however, they do not have nationwide coverage so are not 'self-sufficient' (aside from those particular stores)

Source: Commerce Commission.⁶⁹¹

691 [].

The supply of structural timber is highly concentrated

- C26 In New Zealand, structural timber suppliers are mostly operators of domestic sawmills. Outside of this we are aware of one supplier, Timberlink, that does not operate a sawmill in New Zealand and instead imports structural timber from Australia.
- C27 Overall, supply of structural timber is highly concentrated at this level, ie, a small number of suppliers control a large amount of the supply. We estimate that the top two suppliers account for 65-80% of structural timber volume in New Zealand, and the top three suppliers account for 70-90%. This degree of concentration increases the risk that competition is not as effective as it could be.
- C28 Table C1 provides an overview of notable structural timber suppliers in New Zealand including our estimates of their market shares.⁶⁹²

⁶⁹² We used a range of estimates from different datasets and metrics (including on sales revenue and quantities of timber sold). The range provided is not indicative of any individual estimate but shows the range of market share estimates we have seen. Therefore, market shares will not necessarily add to 100%.

Table C1 Selection of structural timber suppliers in New Zealand

Supplier name	Estimated market share	Structural timber sawmill location(s) ⁶⁹³	Other notes
CHH Woodproducts	50-55%	Kawerau and Nelson	Historical incumbent, vertically integrated with Carters. Sells structural timber under the Laserframe brand.
Red Stag Timber	15-25%	Rotorua	Started producing structural timber in 2004.
McAlpines (incl. South Pine)	5-15%	Rotorua, Rangiora, and Nelson	For historical reasons, the Rotorua and Rangiora mills operate under the McAlpines name, while the Nelson mill operates as South Pine. ⁶⁹⁴
Waipapa Pine	0-10%	Kerikeri	Started producing structural timber in 2012.
Kiwi Lumber	0-10%	Masterton	
Max Birt Sawmills	0-10%	Pōkeno	
Pukepine Sawmills	0-10%	Te Puke	
Timberlink	0-10%	Australia	Only structural timber importer we are aware of. Used to have a mill in Blenheim that closed in Dec 2020. ⁶⁹⁵

Source: Commission review of information collected during the case study, including internal documents, RFI responses, and merchant data.⁶⁹⁶

- C29 Our analysis of merchant data suggests that CHH Woodproducts and Red Stag's shares of supply to merchants were reasonably stable between 2017 and 2020 (ie, prior to the current supply shortage).⁶⁹⁷
- C30 We have heard that CHH Woodproducts and Red Stag both benefit from substantial economies of scale, allowing them to efficiently supply distributors across the whole country and making it difficult for competitors to win market share off them.⁶⁹⁸ This suggests their strong market positions may be somewhat entrenched.

⁶⁹³ [redacted].

⁶⁹⁴ [redacted].

⁶⁹⁵ Maia Hart "Blenheim sawmill with 75 staff to close by end of the year" (Sep 8, 2020) Stuff <https://www.stuff.co.nz/business/122704945/blenheim-sawmill-with-75-staff-to-close-by-end-of-the-year>.

⁶⁹⁶ [redacted]; [redacted]; [redacted]; [redacted].

⁶⁹⁷ Commerce Commission analysis of merchant data [redacted].

⁶⁹⁸ [redacted].

- C31 However, our analysis also shows that some smaller suppliers' share of supply to merchants grew steadily over this same period. There is also a long tail of smaller sawmills that may be able to compete with the major suppliers in certain regions, if not nationally.⁶⁹⁹ This may provide some competitive constraint on CHH Woodproducts and Red Stag, especially given the limited product differentiation between different brands of structural timber.
- C32 Structural timber's declining share of the wider framing market may also be weakening the market positions of CHH Woodproducts and Red Stag over time.⁷⁰⁰ We specifically discuss the constraint provided by engineered timber suppliers below.
- C33 The acute domestic capacity shortage is affecting competitive dynamics in the short term. Following a significant increase in demand, there have recently been acute shortages in the supply of structural timber. The current nationwide capacity shortage has led to structural timber volumes being rationed by suppliers, many of whom are operating a strict allocation model. Suppliers are effectively guaranteed demand for every unit they can produce. This makes it difficult to assess the intensity of competition that would normally occur between suppliers looking to secure distribution of their product.
- C34 The shortage could be explained in part by the inherent difficulty of increasing sawmill capacity. We understand structural timber sawmills across the country are operating at full capacity (in some cases, overcapacity) to respond to heightened demand.⁷⁰¹ Further, sawmill capacity upgrades are underway, but the scale and cost of these investments inevitably result in long lead times.⁷⁰²
- C35 We have received mixed feedback on how long the acute phase of the shortage is expected to last. Some market participants consider that the market will start to return to equilibrium in the next 1-3 years as housing demand falls (due to higher interest rates and lower net migration), and the ongoing sawmill capacity upgrades are completed.⁷⁰³

⁶⁹⁹ [redacted]; [redacted].

⁷⁰⁰ See Figure C1 above.

⁷⁰¹ [redacted]; [redacted]; [redacted].

⁷⁰² [redacted].

⁷⁰³ [redacted]; [redacted].

C36 However, we note that concentrated markets are typically less resilient to demand shocks and uncertainty.⁷⁰⁴ Having more large suppliers in the market, with more motivation to invest in capacity increases, may have helped to alleviate some of the acute impacts of the shortage.

It appears structural timber suppliers are generally price-constrained by distributors

C37 Price is typically the most important factor considered by distributors when selecting a structural timber supplier. Given the commodity nature of the product, pricing is typically expected to be consistent across structural timber suppliers.⁷⁰⁵

C38 We have heard that distributors are generally aware of market pricing and are willing to put pressure on suppliers if their pricing is not in line with competitors.⁷⁰⁶

C38.1 We have seen several examples of distributors switching between suppliers, often after holding RFPs to extract competitive pricing.⁷⁰⁷

C38.2 According to one market participant, it is not common for distributors to switch structural timber suppliers because of the relationship-driven nature of supply arrangements. However, they confirmed that distributors readily provide feedback on pricing and cannot be taken for granted as customers.⁷⁰⁸

C39 This is unlikely to apply during the current supply shortage, where distributors are more likely to prioritise security of supply over price, and prices will naturally rise to reconcile supply and demand. This may also be the case somewhat during other periods of high demand, which we understand occur on a variable basis, but on balance are less common than periods of low demand.

C40 This dynamic is reinforced by the large size of many structural timber distributors. This group includes major merchants such as PlaceMakers and ITM, and large F&T manufacturers such as VIP Frames & Trusses. Due to their relative size and sophistication, these distributors are likely to have more buyer power and ability to constrain suppliers than a more fragmented customer base would.

⁷⁰⁴ Andrea Coscelli & Gavin Thompson “Competition & Markets Authority: Economics working paper – Resilience and Competition Policy”, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1064924/Resilience_and_competition_policy_-_AC.pdf.

⁷⁰⁵ []; [].

⁷⁰⁶ []; [].

⁷⁰⁷ [].

⁷⁰⁸ [].

Engineered timber suppliers provide further constraint

- C41 As noted earlier, engineered timber framing usage grew from 1% to 13% between 2013 and 2020, with structural timber usage falling from 93% to 73% over the same period. This has created an opportunity for engineered timber suppliers to expand their presence in the wider framing market and constrain the major structural timber suppliers, though we have heard that LVL can be difficult for builders to source.⁷⁰⁹
- C42 We understand the main engineered timber framing suppliers are CHH Futurebuild (also part of the CHH Group), Nelson Pine, and Juken. These suppliers all distribute nationally and produce LVL framing products that can be used in F&T.⁷¹⁰
- C43 Other relevant engineered timber suppliers include Prolam and Wood Engineering Technology; both produce glued laminated timber (glulam) products that can be used for structural framing. Ongoing innovation in the engineered timber space may continue to give rise to new suppliers and framing products.
- C44 Engineered timber framing products can carry a price premium as they are designed to be straighter and less prone to distortion than sawn timber, and are typically more expensive to manufacture.⁷¹¹
- C45 The closeness of competition between engineered timber suppliers and structural timber suppliers may depend on the level of this price premium, which we understand is usually around 10-15%.⁷¹²
- C46 Not all of the decline in structural timber usage has been captured by engineered timber. The other major beneficiary is panel systems, an indirect substitute whose usage as framing grew from 3% in 2013 to 9% in 2020. While we do not consider panel system suppliers here as a direct competitive constraint, we include them in our later discussion of potential innovative disruptors.

⁷⁰⁹ Commerce Commission "He Kohinga Kōrero – Engagement with Māori on Residential Building Supplies Market Study – Summary of key themes" (4 August 2022) at 9;

[redacted].

⁷¹⁰ [redacted].

⁷¹¹ [redacted]; [redacted];

[redacted].

⁷¹² [redacted]; [redacted];

[redacted]; [redacted]; [redacted].

Some features of the structural timber market could facilitate supplier coordination

- C47 Some aspects of industry structure make the structural timber market potentially vulnerable to coordination at the supplier level. Specifically, the high degree of concentration, homogenous product, common inputs and cost structures, and relative transparency of pricing could be exploited by suppliers to keep the market price artificially high by coordinating to restrict output.
- C48 However, other features of the structural timber market reduce the risk of coordination. For example, there do not appear to be frequent interactions between competitors and the market is characterised by variable demand.
- C49 While certain market features may create a coordination risk, we have not seen any evidence of coordination occurring.

There are many participants competing at the distribution level

- C50 Structural timber is distributed in the form of loose 'stick timber' and, more commonly, prefabricated F&T.
- C51 There are many participants at the distribution level, including major building supply merchants, specialist timber merchants, merchant-owned F&T manufacturers, and independent F&T manufacturers.
- C52 Both forms of structural timber constitute a crucial aspect of a building supply merchant's offering to customers and are generally among their highest-selling categories. The ability to supply structural timber is an important criterion for a builder when selecting a merchant, and merchants view F&T sales as a way to gain a customer's business for the 'balance of the house'.⁷¹³
- C53 We therefore observe merchants competing closely with each other for the distribution of structural timber products.⁷¹⁴
- C54 Suppliers of both structural timber and engineered timber framing told us they had not had difficulties accessing customers and having their products stocked by merchants. One supplier told us that the current distribution model is efficient and works well for its needs.⁷¹⁵

⁷¹³ [].

⁷¹⁴ []; [].

⁷¹⁵ []; []; [].

Vertical integration between CHH Woodproducts and Carters has the potential to impact competition

- C55 The main vertically integrated player in the structural timber market is CHH Group, which owns both CHH Woodproducts and the building supply merchant, Carters. This vertical integration could impact competition if:
- C55.1 CHH Woodproducts made it difficult for Carters' competitors to access structural timber (input foreclosure); or
 - C55.2 Carters made it difficult for CHH Woodproducts' competitors to access distribution channels (customer foreclosure).
- C56 Both types of foreclosure have the potential to occur and impact competition in future, particularly input foreclosure given CHH Woodproducts' relatively stronger market position. We discuss each in more detail below.

Potential for input foreclosure

- C57 We understand CHH Woodproducts supplies structural timber to a range of Carters' competitors, including other major merchants and F&T manufacturers, at similar prices to what Carters pays.⁷¹⁶ This means Carters' competitors do not appear to be limited in their ability to access structural timber.
- C58 During the current shortage, we are aware that Carters has benefited from being guaranteed structural timber supply from CHH Woodproducts, and CHH Woodproducts appears to have excluded some of Carter's main competitors from its timber allocations.⁷¹⁷ Given CHH Woodproducts is a large supplier of structural timber in New Zealand, this significantly limits the pool of potential supply for those merchants.
- C59 Allocation models under which suppliers provide preferential treatment to vertically integrated merchants can breach the Commerce Act if the supplier has market power and the allocation model has the purpose of harming, deterring or preventing competition.
- C60 In 2021, we undertook enquiries with the relevant parties as to whether CHH's conduct in ceasing supply of structural timber to some third parties risked breaching the Commerce Act.

⁷¹⁶ []; [].

⁷¹⁷ For example: NZ Herald "Housing: Carter Holt Harvey cuts timber supplies to Mitre 10, Bunnings, ITM" (27 March 2021), available at: <https://www.nzherald.co.nz/business/housing-carter-holt-harvey-cuts-timber-supplies-to-mitre-10-bunnings-itm/P3T6DQ2PBT4JDZ64AAF26WIRU4>; []; [].

- C61 Based on the responses to those enquiries, we decided not to open an investigation into CHH's conduct at that time, noting there are legitimate reasons for the shortage of supply. However, we intend to continue to engage with relevant parties to understand how the supply of structural timber is affecting competition between merchants as market conditions evolve.
- C62 We retain the ability to investigate any conduct of this nature if information collected during this study, or outside of it, gives us reason to believe that anti-competitive conduct may be occurring. We encourage any supplier deploying or considering deploying, similar allocation models to review them for compliance with existing law, and with the revised section 36 of the Commerce Act which comes into force in April 2023. From that time, conduct may also breach the Commerce Act if it has the effect or likely effect of substantially lessening competition in a market.

Regulatory and standards system

- C63 In this section we provide an overview of how the New Zealand regulatory and standards systems relate to structural timber, specifically in terms of structural grading and durability requirements.
- C64 We consider whether any aspects of the regulatory and standards systems may facilitate or impede effective competition in the supply of structural timber.
- C65 Our preliminary assessment is that:
- C65.1 there are limited pathways for satisfying the Building Code's explicit durability requirements;
 - C65.2 New Zealand's structural timber durability standards are prescriptive and unique;
 - C65.3 the structural grading system appears to be mostly performance based; and
 - C65.4 overall, the regulatory system provides some protection to incumbents from innovation and import competition.
- C66 The remainder of the section discusses each of the above findings in detail.

There are limited pathways for satisfying the Building Code's explicit durability requirements

- C67 In this subsection, we outline how Clause B2 of the Building Code and its accompanying Acceptable Solution, B2/AS1, interact to effectively require that structural timber complies with the standards *NZS 3602:2003* and *NZS 3640:2003*.
- C68 Clause B2 (Durability) of the Building Code specifies the durability requirements of building elements.

- C69 B2/AS1 is the only Acceptable Solution associated with Clause B2 of the Building Code. Clause 3.2 of B2/AS1, refers to the standard *NZS 3602:2003 Timber and Wood-based Product for use in Building*.
- C70 *NZS 3602:2003* in turn specifies a range of different treatment standards specified in further standards, depending on the intended use and species of the timber. We provide a more detailed explanation of this standard in the following subsection.
- C71 Included in B2/AS1, alongside this reference to *NZS 3602:2003*, is the following “comment” text (emphasis added):
- The use of different timbers or timber treatments to those referred to in NZS 3602 are outside the scope of this Acceptable Solution.** Where the use of a different timber or timber treatment is proposed, it shall be separately assessed for compliance with the Building Code. For example, if imported hard-wood is to be used to surface a deck, evidence that the timber was durable for a minimum of 15 years in the expected exposure conditions is required.
- C72 As such, where an unspecified species of timber is intended to be used, or the intended use of the timber is not expressly contemplated by B2/AS1, the architect will need to demonstrate compliance with the clause in the Building Code itself.
- C73 Clause 3.2 of B2/AS1 also refers to *NZS 3640:2003 Chemical preservation of round and sawn timber*. *NZS 3640:2003* prescribes the requirements for the preservative treatment and identification of timber to provide protection from decay and insect attack.
- C74 *NZS 3640:2003* specifies different treatment classes for timber according to the species and intended use of the product. The classes range from H1 to H6.
- C75 Classes H1.1 and H1.2 are applied to all species of timber and required in accordance with the specifications in *NZS 3602:2003*. Classes H2, H3.1, H3.2, H4, H5 and H6 apply only to Pinus species of timber.
- C76 At C1.12 of *NZS 3640:2003* it states (emphasis added):
- While it may be possible to treat other species using the provisions of this Standard, **such treatments are outside of the scope of this Standard** and the adequacy of the resulting treatments will need to be demonstrated.

C77 As previously outlined, the performance-based Code does not specify requirements in detail. For example, B2 provides:

PERFORMANCE B2.3.1

Building elements must, with only normal maintenance, continue to satisfy the performance requirements of this code for the lesser of the specified intended life of the building, if stated, or:

(a) The life of the building, being not less than 50 years, if:

(i) Those building elements (including floors, walls, and fixings) provide structural stability to the building, or

(ii) Those building elements are difficult to access or replace, or

(iii) Failure of those building elements to comply with the building code would go undetected during both normal use and maintenance of the building.

(b) 15 years if:

(i) Those building elements (including the building envelope, exposed plumbing in the subfloor space, and in-built chimneys and flues) are moderately difficult to access or replace, or

(ii) Failure of those building elements to comply with the building code would go undetected during normal use of the building, but would be easily detected during normal maintenance.

(c) 5 years if:

(i) The building elements (including services, linings, renewable protective coatings, and fixtures) are easy to access and replace, and

(ii) Failure of those building elements to comply with the building code would be easily detected during normal use of the building.

C78 Structural timber would naturally be subject to the 50-year durability requirement, given its structural application in buildings. While it may be possible to achieve this level of performance outside of the established standards framework, demonstrating it is likely to entail a high evidential burden and there is limited guidance on how to do so.⁷¹⁸

C79 Moreover, we understand this type of explicit durability requirement is unique to New Zealand. In other jurisdictions, similar requirements are typically implicit and do not require direct evidence to demonstrate a certain period of durability. Consequently, the required body of evidence is unlikely to exist even for types of structural timber that are commonly used overseas.

⁷¹⁸

[]; John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [56]-[59].

- C80 In our view, an importer looking to ensure their untreated or differently treated (and/or alternative species) structural timber product complies with these requirements, as determined at the discretion of an individual BCA, is unlikely to find this an easy task.
- C81 Therefore, while this alternative compliance pathway is technically possible, the remainder of this section assumes that structural timber must comply with the standard *NZS 3602:2003* in order to be used in New Zealand.

New Zealand's structural timber durability standards are prescriptive and unique

- C82 The standard *NZS 3602:2003* outlines requirements that wood-based building components (including structural framing components) must adhere to, in order to be considered durable for 50 years.
- C83 For this case study, we focus on the structural framing components. These are essentially certain uses or applications of structural timber in a framing context. For example:
- 1E.2) All midfloor framing excluding boundary joists but including associated ceiling framing
- C84 The standard includes a table that groups building components by their respective level of exposure to the elements (weather conditions, moisture, and the ground). Most structural framing components fall within two exposure categories:
- D) Members protected from the weather but with a risk of moisture penetration conducive to decay
- E) Members not exposed to weather or ground atmosphere
- C85 For each exposure category and structural framing component, the table sets out:
- C85.1 the species or type of timber that can be used;
- C85.2 the grade of timber that can be used (generally includes all structural grades);
- C85.3 the maximum moisture content of the timber (generally either 18% or 20%); and
- C85.4 the level of chemical preservative treatment required, with reference to the hazard classes defined in the standard *NZS 3640:2003 Chemical preservation of round and sawn timber* (which also details the specific chemical preservation process for each hazard class).

- C86 There is some variation in the species specified for each structural framing component in *NZS 3602:2003*:
- C86.1 Radiata Pine is specified for all structural framing components, and Douglas Fir is specified for most. For some, Larch and Cypress species are also specified.⁷¹⁹
- C86.2 LVL is specified for some components. We understand this is one of the main reasons LVL framing can be easily used in place of many structural timber components.
- C87 Significantly, the standard does not include a catch-all option, which means there are inevitably some exclusions. For example, the standard does not specify Spruce, Birch, or other Pine species (all of which we understand are used for structural framing overseas).^{720, 721} And, aside from LVL, it does not specify any other form of engineered timber (eg, glulam) for structural framing components.
- C88 Where Radiata Pine is specified in the standard for structural framing components, it is almost always required to be chemically treated to hazard class H1.2 or higher.⁷²² H1.2 indicates moderate risk of dampness or water and is usually achieved with a boron-based preservative compound, as set out in *NZS 3640:2003*.
- C88.1 Other species of timber are also generally required to be treated to at least hazard class H1.2, although there are limited exceptions in the standard for some species (including Douglas Fir) to be used untreated in certain applications due to their natural durability.⁷²³
- C89 We have heard that these treatment requirements are unique to New Zealand, in terms of both the form of treatment required and the strictness of the standard. It has been suggested that this may be due to New Zealand’s particular climate, earthquake risk, and risk of leaky homes.⁷²⁴

⁷¹⁹ Cypress species include the macrocarpa, Mexican cypress, and Lawson’s cypress. They are treated collectively throughout the standard.

⁷²⁰ [].

⁷²¹ Brooks Post and Beam “Technical info – What Species of Wood to Use in a Timber frame?” <https://www.brooksstandbeam.com/timber-frame-blog/2018/9/11/what-species-of-wood-to-use-in-a-timberframe>.

⁷²² In some cases, H1.1 is specified for Radiata Pine. However, we understand that no H1.1 treated timber is currently produced in New Zealand, so in practice H1.2 timber is always used when H1.1 is specified, Weathertight “Timber Treatment” <https://www.weathertight.org.nz/new-buildings/timber-treatment/>.

⁷²³ Weathertight “Timber Treatment” <https://www.weathertight.org.nz/new-buildings/timber-treatment/>.

⁷²⁴ []; []; []; [].

The structural grading system appears to be mostly performance based

- C90 Clause B1 (Structure) of the Building Code, and its accompanying Acceptable Solution B1/AS1, specify the structural performance requirements of building elements.
- C91 In respect of timber, B1/AS1 refers to the standards *NZS 3603:1993 Timber Structures*, *NZS 3622:2004 Verification of Timber Properties*, and the joint Australia/New Zealand standard *AS/NZS 1748.2:2011 Timber - Solid - Stress-graded for structural purposes - Qualification of grading method*.
- C92 Together, these standards interact to set out the structural grading and verification requirements for New Zealand structural timber:⁷²⁵
- C92.1 As we understand it, all structural timber must be stress-graded to determine its strength and stiffness, with statistical samples selected for further physical verification. The whole process must be independently audited.
- C92.2 Structural timber is assigned a grade of either SG6, SG8, or SG10. A higher grade indicates stronger and stiffer timber, so timber with fewer defects (eg, knots, pith, wane) is more likely to receive a higher structural grade.⁷²⁶ Different grades are suitable for different applications; we understand SG8 is the grade most often required for structural framing applications.
- C93 The standard *NZS 3604:2011 Timber-framed buildings* also outlines that engineered timber products can be directly substituted for structurally graded timber provided:
- C93.1 they are the same size and their structural properties have been verified using the same process; and
- C93.2 they are either LVL or glulam, and they were manufactured using either Radiata Pine or Douglas Fir.
- C94 To our understanding, this definition covers all engineered timber framing products currently likely to be used in New Zealand. However, it may still exclude imported products (which may be manufactured from different species), and future innovations (eg, cross-laminated timber framing).

⁷²⁵ Building Performance “Technical information inspectors should know”
<https://www.building.govt.nz/building-code-compliance/b-stability/b1-structure/non-structural-timber-issues/technical-information-builder-inspectors-should-know/>.

⁷²⁶ Andrew King “What’s behind timber strength and stiffness?” (1 February 2003)
<https://www.buildmagazine.org.nz/index.php/articles/show/whats-behind-timber-strength-and-stiffness>.

- C95 Overall, feedback from market participants suggests the performance-based nature of the structural grading system creates a level playing field for structural timber suppliers and facilitates substitution between structural timber brands.⁷²⁷
- C96 However, one structural timber distributor advised that this performance-based system still creates some avoidable barriers to entry. For example, a lack of alignment with international structural grading systems means timber that had been structurally graded overseas (even in Australia) and imported into New Zealand would need to be restamped and recertified at the importer's expense.⁷²⁸

Overall, the regulatory systems may protect incumbents from innovation and import competition

- C97 The regulatory and standards systems are restrictive in terms of the allowable characteristics of structural timber in New Zealand. We understand that it is also relatively unique in aspects such as the chemical treatment requirements and the explicit 50-year durability requirement.
- C98 We do not have a view on whether this restrictiveness and uniqueness is necessary from a technical perspective. We note it is important that New Zealanders can have confidence in the durability and structural performance of their homes and that certain attributes may differentiate New Zealand from other jurisdictions.
- C99 Our preliminary view is that these aspects of the regulatory system favour the status quo and may protect incumbent structural timber suppliers from some competition from imports.
- C100 Overseas structural timber is unlikely to comply with the species and treatment requirements set out in the durability standards. Therefore, any prospective importer of structural timber is likely to face significant regulatory compliance barriers.⁷²⁹ This is likely to come in one of two forms:
- C100.1 An importer of a specified, but untreated, species of structural timber may be able to establish standalone treatment facilities to bring the timber in line with Acceptable Solution B2/AS1. We have heard this is possible but would require a sizeable capital investment.⁷³⁰

⁷²⁷ []; John Gardiner "Practical issues with the building regulatory system for suppliers of building products – An assessment" (3 August 2022) at [97].

⁷²⁸ [].

⁷²⁹ Frame & Truss Manufacturers Association of New Zealand "Submission on residential building supplies market study preliminary issues paper" (4 February 2022) at 4.

⁷³⁰ []; [].

- C100.2 An importer of an unspecified species of structural timber would have to pursue an alternate compliance pathway to convince BCAs that the durability requirements are satisfied. This may involve CodeMark certification or BRANZ appraisal, both of which we understand are difficult, lengthy, and expensive to obtain.⁷³¹
- C101 It is unclear whether importing structural timber would be viable even in the absence of these durability standards (we discuss this further in the *Conditions of entry and expansion* section). It may also be possible to overcome the barriers discussed above. However, if prospective import competition was to materialise, we consider these regulatory barriers are likely to preclude entry in the short term.
- C102 Suppliers of innovative substitute products, for example, engineered timber framing, are also likely to face regulatory obstacles:
- C102.1 As LVL is the only type of engineered timber specified for use in structural framing components, suppliers of any other form of engineered timber framing would have to pursue a similar alternative compliance pathway to that described in C100.2.
- C102.2 We have heard that this creates barriers to market given the reliance on standards.⁷³²
- C103 The growing usage of engineered timber framing and continuing innovation in the wider engineered timber space provides an excellent opportunity for new suppliers to disrupt the structural timber market. However, we consider that these regulatory obstacles for new engineered timber products are likely to provide incumbents some protection from this disruption.
- C104 Moreover, the consensus-based nature of the standards process can provide opportunity for incumbents to frustrate the development or review of NZ Standards.⁷³³

How structural timber is specified and purchased

- C105 In this section we consider the way in which structural timber is specified and purchased and the factors that influence those decisions, including the scope for product differentiation between suppliers and brands.

⁷³¹ Fletcher Building “Submission on regulatory barriers to entry or expansion” (13 May 2022) at [3].

⁷³² [].

⁷³³ John Gardiner “Practical issues with the building regulatory system for suppliers of building products – An assessment” (3 August 2022) at [49]-[51] and [63]; []; [].

C106 Our preliminary assessment is that:

C106.1 there is little differentiation between structural timber suppliers and brands;
and

C106.2 structural timber is usually specified based on generic performance characteristics.

C107 The remainder of the section discusses each of the above findings in detail.

There is little differentiation between structural timber suppliers and brands

C108 Structural timber is generally viewed as a commodity product. It fulfils a specific functionality in construction with limited scope for additional attributes or features. It also undergoes a relatively uniform manufacturing process that is designed to produce a consistent product.

C109 Consequently, there is little difference between the structural timber products produced by different suppliers, who generally face a common market price.⁷³⁴

C109.1 As noted previously, individual structural timber products can vary in terms of structural grade, species, chemical treatment, moisture content, and sizing. However, these are all relatively generic attributes that can be produced by any structural timber supplier.

C109.2 For example, structural grade is a performance-based metric that can be achieved by any supplier that follows the grading process. As another example, we are not aware of any structural timber suppliers that market a proprietary chemical treatment process.

C110 Further, most structural timber suppliers only offer one brand. For example, CHH Woodproducts sells all of its structural timber under the Laserframe brand, which comes in SG8 and SG10 (with further variation in terms of sizing and chemical treatment).^{735, 736}

Structural timber is usually specified based on generic performance characteristics

C111 Builders, specifiers, and end users are generally indifferent between different suppliers and brands of structural timber. Due to the commodity nature of the product, it is very rare for a certain brand of structural timber to be specified in building plans.⁷³⁷

⁷³⁴ []; []; [].

⁷³⁵ Laserframe “Laserframe structural timber” <https://chhwoodproducts.co.nz/products/laserframe-structural-timber/>.

⁷³⁶ McAlpines operates under two brands (McAlpines and South Pine), but this relates to the naming of their sawmills rather than separate products produced by a single sawmill.

⁷³⁷ []; []; [].

- C112 In our survey of builders and specifiers, we asked how often materials within each of the eight major components of residential buildings were specified by brand. Materials in the *walls (structural/framing)* component (in which structural timber is by far the most common material) were ranked second-least likely to be specified by brand.
- C113 Instead, structural timber is usually specified in terms of its structural grade (as well as physical dimensions).⁷³⁸ As noted above, structural grade is a performance-based metric defined by the standards system and can be achieved by any structural timber supplier, which facilitates substitution between suppliers.
- C114 We note that the structural grading system appears to be specific to sawn timber. It seems engineered timber products cannot be assigned the structural grade SG8, which may limit the ability of engineered timber suppliers to position their products as direct substitutes.
- C115 However, as noted above, the standards system allows for LVL and glulam framing products to be treated equivalently to structurally graded timber. Therefore, if SG8 timber has been specified in plans, any reluctance to substitute it for equivalent engineered timber framing is more likely to come from behavioural bias than technical or regulatory limitations.

Pricing practices and vertical arrangements

- C116 In this section we discuss structural timber pricing, including how prices are set and the nature and prevalence of rebates.
- C117 Our preliminary assessment is that:
- C117.1 variation in the price of structural timber is driven by log prices and variable demand;
 - C117.2 rebates are commonly offered by structural timber suppliers to merchants;
 - C117.3 supplier-to-merchant rebates are not observed to cause competitive harm; and
 - C117.4 structural timber suppliers do not tend to offer exclusivity clauses or end-user rebates.
- C118 The remainder of the section discusses each of the above findings in detail.

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Variation in the price of structural timber is driven by log prices and variable demand

- C119 Logs are the main input into structural timber. Structural timber suppliers typically purchase logs from third-party forest owners, and we understand the cost of logs accounts for 40-60% of structural timber production costs (with other notable costs including labour and plant maintenance/repairs).⁷³⁹
- C120 Log prices are determined quarterly according to export parity pricing. Structural timber suppliers are price takers as export log volumes significantly exceed the volume purchased for use in structural timber sawmills, though we understand the vast majority of exported logs would not be suitable for structural timber production.⁷⁴⁰
- C121 We have heard mixed feedback about the extent to which structural timber suppliers have passed on cost increases. One supplier told us its structural timber pricing has been largely synchronous with log prices over the last decade, while others have told us they have absorbed significant increases in log costs. In any case there seems to be a consensus that both structural timber prices and log prices have trended upward during this period.⁷⁴¹
- C122 Demand for residential housing construction, which is variable, is another major driver of structural timber prices.
- C123 Times of high demand provide the main opportunity for structural timber suppliers to raise prices, as we would expect in an industry with high fixed costs. While suppliers can to some extent prioritise structural timber production and operate sawmills at increased (or full) capacity, this capacity is ultimately fixed in the short term because any upgrades are too costly and time-consuming to respond to temporary peaks in demand. Distributors (and, by extension, builders) can therefore be willing to pay significantly more to secure supply. This is currently the case, and we have heard that sawmill profitability has recently been strong as a result.⁷⁴²
- C124 When demand is low, there is surplus capacity in the market and structural timber suppliers face lower market prices. Responses can include reducing sawmill production, pivoting to other timber products, or selling into export markets. We have heard that, on balance, the market spends more time in this part of the cycle, creating risks for sawmill profitability.⁷⁴³

⁷³⁹ [redacted]; [redacted].

⁷⁴⁰ [redacted].

⁷⁴¹ [redacted]; [redacted]; [redacted].

⁷⁴² [redacted]; [redacted].

⁷⁴³ [redacted]; [redacted].

Rebates are commonly offered by structural timber suppliers to merchants

- C125 Rebates can provide more surety to suppliers about sales volumes by encouraging merchants to concentrate their purchases in a single source of supply.⁷⁴⁴ They allow suppliers to pass along the efficiencies achieved by supplying a significant volume to a single merchant customer, or otherwise reward merchants for mutually beneficial behaviour (eg, opening a new store).
- C126 However, rebates can limit merchants' incentives to promote competitive tension between multiple suppliers. They can create strategic barriers to entry and expansion of other suppliers by 'locking up' the demand of major merchant customers. Nevertheless, we have heard that some merchants may use rebates from structural timber suppliers to create competitive tension between suppliers.⁷⁴⁵
- C127 We have observed share of wallet and tiered retroactive structures in rebate arrangements between structural timber suppliers and distributors.⁷⁴⁶ However, we understand that some customers do not receive rebates from structural timber suppliers.⁷⁴⁷ Tiered retroactive rebates appear to be the most common type of rebate arrangement between structural timber suppliers and distributors. These arrangements typically include at least three volume tiers, where a higher rebate percentage is applied to purchases when the distributor reaches a higher volume tier.⁷⁴⁸
- C128 Another supplier told us that it offers a mix of tiered volume rebates and share of wallet rebates.⁷⁴⁹ Share of wallet rebates are schemes that link rebate tiers to a certain percentage of the distributor's total structural timber purchases (rather than a specific volume).
- C129 This supplier advised us that share of wallet rebates assist in providing certainty around sales volumes, and that they usually include a condition that the supplier's pricing will remain competitive with the market.⁷⁵⁰

Supplier-to-merchant rebates are not observed to cause competitive harm

- C130 It does not appear that rebates are causing merchants to purchase from a single supplier, or to only purchase from large suppliers. No suppliers advised us that they were struggling to access merchant channels because of rebates or for any other reason.

⁷⁴⁴ [].

⁷⁴⁵ [].

⁷⁴⁶ [].

⁷⁴⁷ []; [].

⁷⁴⁸ [].

⁷⁴⁹ [].

⁷⁵⁰ [].

- C131 Our analysis of merchant data shows that the major merchants tend to split their structural timber purchases between multiple suppliers. Except for Carters, no merchant purchased more than between 60-70% of their structural timber from a single supplier in any year between FY17 and FY21.⁷⁵¹
- C132 Further, we have been told by merchants that they prefer to use multiple structural timber suppliers, including smaller regional ones, to maximise efficiency and minimise the risk of supply interruptions. They also said that structural timber supply agreements are often negotiated at a store-by-store level, and different stores may choose to use different suppliers for reasons such as geographic proximity.⁷⁵²
- C133 As noted in the previous section, structural timber rebates tend to be driven by the major merchants and it appears other customers do not typically receive rebates. This means a supplier looking to enter or expand in the structural timber market should have access to a reasonably wide pool of non-rebated customers, including specialist timber merchants and independent F&T manufacturers.
- C134 One supplier also told us that, although rebates may lock in customers to an extent, the variable nature of the structural timber market creates opportunities to revise rebate agreements and gain sales to rebated customers.⁷⁵³
- C135 Overall, we have not observed supplier-to-merchant rebates causing competitive harm in the structural timber market.
- C136 Chapter 7 includes a more detailed discussion of different types of rebates and their effect on competition.

Structural timber suppliers do not tend to offer exclusivity clauses or end-user rebates

- C137 Based on our analysis, exclusivity clauses and rebate agreements do not appear to be common between suppliers and builders.⁷⁵⁴

Innovation and building for climate change

- C138 In this section we discuss how the structural timber market is impacted by innovation and the shift towards green products and building for climate change.
- C139 Our preliminary assessment is that:
- C139.1 engineered timber and panellisation are potential innovative disruptors;
- C139.2 structural timber naturally has low-embodied carbon but there are questions around its end-of-life impact; and

⁷⁵¹ Commerce Commission analysis of merchant data, [redacted].

⁷⁵² [redacted]; [redacted].

⁷⁵³ [redacted].

⁷⁵⁴ [redacted]; [redacted]; [redacted].

C139.3 building for climate change may have other indirect flow-on effects for structural timber.

C140 The remainder of the section discusses each of the above findings in detail.

Engineered timber and panellisation are potential innovative disruptors

C141 We understand structural timber suppliers continue to invest in improving the productivity and efficiency of sawmills, for instance, through automation technology.⁷⁵⁵

C142 However, it appears that innovation in the wider structural framing space is largely centred around engineered timber and panellisation.

C143 Engineered timber is generally seen as a premium product that offers quality and sustainability advantages over sawn timber. We understand it can also use logs more efficiently, including sections of the log that would not normally be used for structural timber, thereby reducing waste. It is increasingly used as framing in residential construction and we expect its emergence to exert competitive constraint on structural timber suppliers and drive further innovation.⁷⁵⁶

C144 Panellisation is a form of OSM that is becoming increasingly common in the structural framing space. Usage of panel systems as framing in residential builds has grown from 3% in 2013 to 9% in 2020.⁷⁵⁷ These systems – for example, structural insulated panels (SIPs) – can combine multiple building components including framing, insulation, and wall lining, and often offer sustainability and operational efficiency benefits (eg, by improving the airtightness of buildings).⁷⁵⁸

C145 Producers of panel systems in New Zealand include NZSIP, Formance, Bondor, Metra, and Lockwood. As we understand it, their products do not compete directly with structural timber because substitution between the products is unlikely to occur once building plans have been finalised.⁷⁵⁹ Nevertheless, we expect them to exert some level of out-of-market constraint on structural timber as any poor competitive outcomes in the structural timber market are likely to drive increased uptake of panel systems in the long term.

C146 Chapter 8 includes a more detailed discussion of OSM and its broader implications for the residential construction sector.

⁷⁵⁵ [redacted].

⁷⁵⁶ [redacted]; [redacted].

⁷⁵⁷ Commerce Commission analysis of BRANZ New Dwellings Survey data, [redacted].

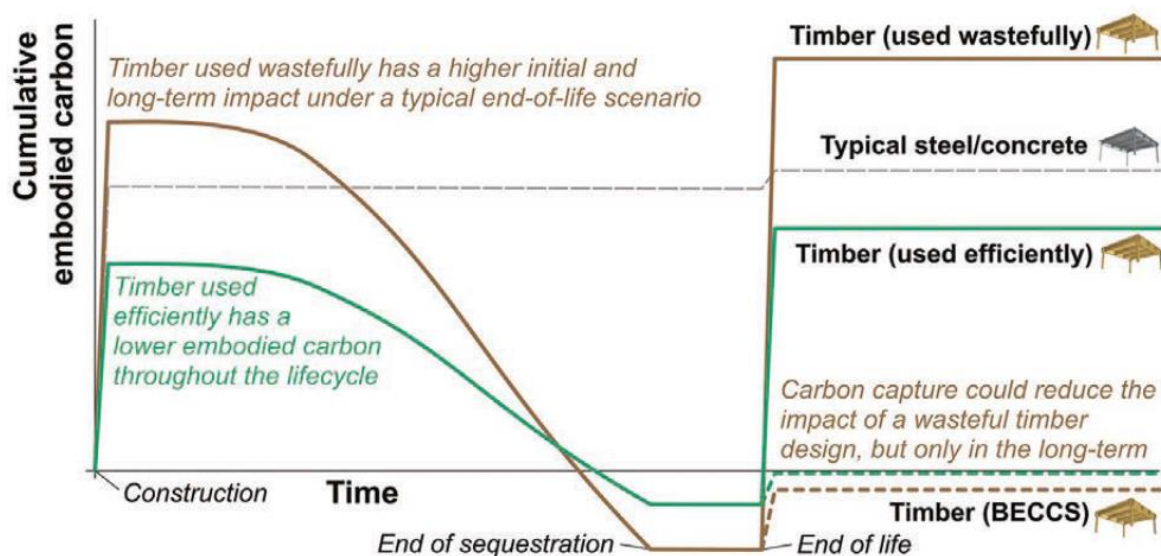
⁷⁵⁸ [redacted]; [redacted].

⁷⁵⁹ [redacted].

Structural timber naturally has low-embodied carbon but there are questions around its end-of-life impact

- C147 Timber products have naturally low-embodied carbon due to their significant level of sequestered carbon (ie, carbon absorbed by and stored within the tree), which significantly offsets emissions from the production process.
- C148 Therefore, structural timber is generally considered to be a sustainable building material, especially when compared to other structural framing options like steel or concrete framing which feature high-energy production processes and no sequestration.⁷⁶⁰
- C149 However, timber typically re-releases this sequestered carbon at the end of its life, which calls into question its sustainability benefits. There is ongoing debate about how much weight to place on end-of-life emissions when evaluating and comparing the sustainability of building supplies.⁷⁶¹
- C150 It may be possible to mitigate these end-of-life emissions by reusing timber components or recycling them into new materials, or through emissions-reducing technology such as BECCS (bioenergy with carbon capture and storage). Figure C3 below illustrates this effect.

Figure C3 Lifetime embodied carbon impact of timber vs. steel/concrete



Source: Timber and carbon sequestration (Will Hawkins, Jan 2021).⁷⁶²

⁷⁶⁰ The structural engineer “Timber and carbon sequestration” (January 2021), available at: <https://www.istructe.org/IStructE/media/Public/TSE-Archive/2021/Timber-and-carbon-sequestration.pdf>.

⁷⁶¹ [].

⁷⁶² The structural engineer “Timber and carbon sequestration” (January 2021), available at: <https://www.istructe.org/IStructE/media/Public/TSE-Archive/2021/Timber-and-carbon-sequestration.pdf>.

C151 We have heard that New Zealand’s chemical treatment requirements might make it especially difficult to use structural timber efficiently at the end of its life cycle. According to one stakeholder, treated timber is difficult to reuse, recycle, or safely burn as fuel. However, they also indicated that Golden Bay Cement has developed a system to efficiently use waste treated timber for fuel in cement manufacturing, and that others may be able to find similar applications.⁷⁶³

Building for climate change may have other indirect flow-on effects for structural timber

C152 As building techniques continue to evolve and respond to sustainability needs, structural timber is likely to be indirectly impacted in other ways due to its essential role in residential buildings.

C153 For example, one of the key aspects of MBIE’s Building for Climate Change (BfCC) programme is Transforming Operational Efficiency, which includes reducing the amount of energy required to heat and cool a house through better insulation and ventilation.⁷⁶⁴

C154 We understand that the typical sizing of structural timber framing (90mm width by 45mm height) may not always allow a sufficient cavity to house the amount of insulation required by this programme (in line with international best practice).⁷⁶⁵ Therefore, changes to the standard approach to insulating within a timber frame, or the sizing of timber frames (for example, to 140mm by 45mm) may be necessary to meet the requirements of this programme, or potentially even sooner through annual Building Code updates.

Conditions of entry and expansion

C155 In this section we discuss other potential impediments to entry and expansion in the structural timber market.

C156 Our preliminary assessment is that:

C156.1 building and operating sawmills requires significant sunk costs and there are scale economies in producing structural timber;

C156.2 log prices and availability create significant risks for the profitability of sawmills; and

C156.3 importing structural timber is unlikely to be viable.

⁷⁶³ EnviroNZ “6 simple ways to deal sustainably with construction and building waste” Stuff (15 July 2022) <https://www.stuff.co.nz/business/green-business/129234955/6-simple-ways-to-deal-sustainably-with-construction-and-building-waste>; [].

⁷⁶⁴ Ministry of Business, Innovation & Employment “Transforming Operational Efficiency – Building for climate change programme” (August 2020), available at: <https://www.mbie.govt.nz/dmsdocument/11793-transforming-operational-efficiency>.

⁷⁶⁵ [].

C157 The remainder of the section discusses each of the above findings in detail.

Building and operating sawmills requires economies of scale and significant sunk costs

C158 There are significant sunk costs associated with entering the market as a domestic sawmiller, potentially in the region of \$200-250 million or higher. Costs include building sawmilling, kiln drying/grading, and treatment facilities. We have also heard that the process of obtaining resource and council consents is costly and time-consuming.⁷⁶⁶

C159 Market participants have suggested that some of these costs could be mitigated by purchasing an existing sawmill with the required facilities and consents already in place. For example, Red Stag entered the market by purchasing a sawmill in 2003.⁷⁶⁷

C160 Economies of scale appear to play a major role in structural timber manufacturing. We understand that ongoing capital investment in sawmill capacity increases and productivity improvements are requirements to achieve and maintain economies of scale.⁷⁶⁸

C160.1 We have heard that large sawmills benefit significantly from the economies of scale that they have been able to achieve and can use their high volumes to justify continued investment in capacity, whereas smaller mills can struggle to match this.

C160.2 Other sawmills can struggle to sustain this level of investment. We have heard that some medium-sized sawmills have been able to afford incremental productivity improvements in recent years, while smaller ones are only able to keep pace with maintenance and regulatory requirements (eg, WorkSafe).

C161 Overall, the structural timber market has been trending towards consolidation at the supplier level. There have been many sawmill closures since 2008 (including the closure of CHH Woodproducts' large Whangārei mill in 2020), with very few entries in the same period.⁷⁶⁹ We understand that the importance of economies of scale and the need for ongoing capital investment is a major driver of this trend. These factors may ultimately represent barriers to entry by new sawmillers and expansion by existing small sawmillers.

⁷⁶⁶ []; []; [];

[].

⁷⁶⁷ Red Stag "Overview" <https://www.redstagtimber.co.nz/about-us/overview/>;

[];

⁷⁶⁸ [];

[];

⁷⁶⁹ [];

Log prices and availability create significant risks for the profitability of sawmills

- C162 As noted previously, logs are a critical input into structural timber. Domestic sawmills compete with a range of other timber manufacturers for log supply, including overseas purchasers who account for the majority of demand.⁷⁷⁰
- C163 For this reason, log prices are determined quarterly according to export parity pricing. Structural timber suppliers are essentially price takers and in some cases can be forced to absorb significant log price increases when structural timber demand does not support a corresponding price increase. This effect is especially pronounced for smaller sawmills that may be unable to offset input price increases with other scale efficiencies. This has a detrimental effect on the competitiveness of smaller sawmillers.
- C164 We understand that logs are treated as a commodity product despite having differentiating attributes such as structural yield (ie, the proportion of the log that is suitable for structural timber production). Therefore, even though most 'structural grade' logs are currently retained in New Zealand and used for structural timber production, they would be exported if domestic sawmills were not willing to match this parity pricing.
- C165 Moreover, sawmills can sometimes struggle to obtain log supply at all. We understand fluctuations in international log demand can create volatility in the domestic log market which has flow-on effects for ability of domestic sawmills (especially smaller ones) to secure consistent supply of structural grade logs.⁷⁷¹

Importing structural timber is unlikely to be viable

- C166 As we discussed in the *Regulatory and standards systems* section, New Zealand's unique and prescriptive regulatory and standards systems may limit or preclude the possibility of importing structural timber. However, there are other market features that may also present barriers to import competition.
- C167 We have heard that some market participants have considered importing structural timber but found it too risky due to transport costs and the volatility of international timber prices and exchange rates. We have also heard that overseas structural timber is often lower quality and can feature high levels of wane, twist, and crook that would not be accepted in the New Zealand market.⁷⁷²

Denise Piper "Coronavirus, Carter Holt Harvey Whangārei mill closure 'couldn't be worse' for industry" (Feb 10, 2020) Stuff <https://www.stuff.co.nz/business/119392473/coronavirus-carter-holt-harvey-whangarei-mill-closure-couldnt-be-worse-for-industry>.

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[].

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[]; [].

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[]; [].

- C168 We also understand that the current acute structural timber shortage is a global phenomenon, with countries like Australia and the United States facing even more significant shortages. New Zealand has relatively limited buying power and is unlikely to outcompete these countries for any surplus capacity available in the global market. This may preclude the possibility of any short-term 'top up' imports during times of shortage.⁷⁷³
- C169 One supplier also suggested that allowing "a temporary flood of cheap international timber" to resolve a domestic shortage may have adverse effects for domestic sawmills and leave New Zealand over-exposed to the international market.⁷⁷⁴
- C170 We note that at least one supplier, Timberlink, is known to import structural timber from Australia, although this may be a special case as they formerly operated a sawmill in Blenheim which closed in December 2020.^{775, 776}
- C171 Overall, it is difficult to assess the viability of importing structural timber. Our preliminary view is that importing structural timber is unlikely to be viable due to regulatory barriers. Even without these barriers, the evidence suggests that viability would remain doubtful.

⁷⁷³ [];

⁷⁷⁴ [].

⁷⁷⁵ Maia Hart "Blenheim sawmill with 75 staff to close by end of the year" (Sep 8, 2020) Stuff <https://www.stuff.co.nz/business/122704945/blenheim-sawmill-with-75-staff-to-close-by-end-of-the-year>.

⁷⁷⁶ [].

Attachment D Concrete and cement case study

- D1 This attachment discusses the preliminary findings in relation to our ready-mix concrete (RMX) and cement case study. In addition to understanding how competition in the supply of RMX and cement is functioning, the case study aims to illustrate the extent to which some or all of the factors affecting competition identified in our report impact the supply of RMX and/or cement.
- D2 In this attachment we may refer to markets for RMX and/or cement. However, we have not conducted formal market definition analysis for this case study. Instead, our definition reflects our approach to defining key building supplies in line with the scope and objectives of this market study.
- D3 We have drawn on a range of evidence and research to support the preliminary findings of this case study. For example, we have:
- D3.1 spoken with three major suppliers of RMX and/or cement;
 - D3.2 reviewed numerous written responses and internal documents provided by RMX and cement suppliers;
 - D3.3 reviewed relevant survey responses and written submissions from a range of industry participants and stakeholders, such as Concrete NZ;
 - D3.4 reviewed publicly available and firm-level data on the production and prices of cement and RMX in New Zealand; and
 - D3.5 met with regulatory and standards bodies and reviewed the relevant regulations.
- D4 This attachment sets out:
- D4.1 a summary of our preliminary findings;
 - D4.2 an overview of how cement and RMX are used in residential construction;
 - D4.3 the industry structure and participants;
 - D4.4 the relevant regulatory and standards systems;
 - D4.5 how and why customers select cement and RMX products;
 - D4.6 pricing practices and vertical arrangements;
 - D4.7 innovation in RMX and cement, and building for climate change; and
 - D4.8 the conditions for entry and expansion.

Our preliminary findings on cement and ready-mix concrete

D5 Our preliminary view is that there appears to be a reasonable level of competition occurring for both materials, particularly at the RMX level. However, there are elements of markets for both materials which may be causing competition to not work as well as it could be.

Competition for cement appears to be working reasonably well

D6 Our preliminary view is that competition to supply cement is working reasonably well. This is supported by our preliminary findings, including that:

D6.1 a new cement supplier entered the market in 2012 (HR Cement), and now supplies between 5% and 10% of the market;⁷⁷⁷

D6.2 price competition appears to be strong, driven by this new entrant, and a large player improving increasing its capacity;

D6.3 firms are responding to customer demand by innovating to introduce low-embodied carbon products to the New Zealand market; and

D6.4 customers of cement suppliers appear to be generally satisfied with the level of service and quality of product they receive.

D7 This level of competition appears to be underpinned by factors including:

D7.1 bulk cement products are somewhat homogeneous, enabling substitution;

D7.2 NZ Standards for cement have performance-based measures that are consistent with some other jurisdictions, enabling some imported cement to be used in New Zealand;

D7.3 the use of incentives such as retroactive tiered rebates being uncommon for cement, relative to other residential construction materials; and

D7.4 customers having a degree of countervailing power through price competitiveness clauses and medium-to-low barriers to switching suppliers.

However, there may be some features affecting competition for cement, or downstream at the ready-mix concrete level

D8 While there is evidence of competition between suppliers, we have observed some features which may be reducing the effectiveness of this competition or may be having downstream effects.

⁷⁷⁷ Market shares are provided as a range, due to confidentiality.

- D9 The cement market is highly concentrated. Two large players supply between 75% and 95% of the bulk cement market.⁷⁷⁸ This, along with other factors, may make the sector vulnerable to accommodating conduct. However, this concentration declined somewhat between 2012 and 2020, largely attributable to the growth of HR Cement.⁷⁷⁹
- D10 While retroactive tiered rebates are uncommon, exclusive (or minimum volume) supply agreements are prevalent. These appear to be driven by mutual benefits, such as supply chain efficiency and resilience. However, they may also have the effect of raising switching costs for customers.
- D11 Additionally, benefits from economies of scale in the cement market may act as a barrier to entry, particularly for domestic manufacturers. This is due to the capital required, but also a need to secure dependable sales to downstream RMX producers to maintain scale. These efficiencies have resulted in a high degree of vertical integration by cement manufacturers in the New Zealand sector. Vertical integration may benefit customers where these benefits are passed on. However, this may also be a barrier to cement firms seeking to enter or expand.
- D12 The New Zealand Emissions Trading Scheme (ETS) does not currently appear to be distorting competition. However, carbon-reduction policies, such as the ETS, do have the potential to do so.
- D13 Additionally, this drive to secure downstream sales has the potential to influence competition in RMX markets. For example, vertical integration may drive concentration of RMX producers, or suppliers may seek to enter exclusive contracts.

Competition for supply of ready-mix concrete also appears to be working reasonably well

- D14 Our preliminary view is that competition to supply RMX appears to be working reasonably well. Our preliminary findings include:
- D14.1 the threat of losing customers and/or market share constrains larger firms' ability to impose price increases;
 - D14.2 customers appear to have the ability to switch between suppliers, and often do;
 - D14.3 many RMX producers have entered the market in recent years;
 - D14.4 these producers appear to provide a competitive restraint at a local level; and
 - D14.5 firms are innovating to develop low-carbon products to win customers.

⁷⁷⁸ Market shares are provided as a range, due to confidentiality.

⁷⁷⁹ Commerce Commission analysis of market participant and publicly available data, [].

- D15 This level of competition between RMX suppliers appears to be underpinned by factors including:
- D15.1 performance-based New Zealand standards enable low barriers to product switching, and enable innovation;
 - D15.2 although there is some brand preference, RMX is not usually specified by brand in building plans;
 - D15.3 there are numerous competitors, particularly in densely populated regions such as Auckland, Tauranga and Hamilton;
 - D15.4 the use of exclusive supply contracts is uncommon; and
 - D15.5 the use of incentives such as retroactive tiered rebates are uncommon for RMX.
- D16 However, there are some factors which may inhibit the ability of RMX producers to enter or expand. These appear to be largely structural rather than strategic or regulatory. For example, in some regions such as Auckland, there is a perceived scarcity of suitable sites to build RMX plants.

How cement and ready-mix concrete are used in residential construction

Cement is typically used as an input material

- D17 Cement is a binder substance and is rarely used on its own. It is a key ingredient of concrete products. Cement is produced in two steps:
- D17.1 First, raw materials (eg, limestone and clay) are crushed, blended, and heated to extremely high temperatures to produce an intermediate product called clinker.
 - D17.2 Next, Clinker is cooled and ground with additives to produce cement.
- D18 Given the heat required, the process for producing clinker is extremely energy intensive. The grinding process is also energy intensive.

This case study focuses on the supply of bulk cement

- D19 Cement can be purchased in bulk, or in bagged units (eg, 20kg or 40kg). However, this case study does not specifically focus on the supply of bagged cement. Rather, it focuses on the supply of bulk cement. This is because:
- D19.1 most cement in New Zealand is supplied in bulk, rather than in bags;^{780, 781}

⁷⁸⁰

[]

⁷⁸¹

Deloitte (in a 2018 report) stated >80% of wholesale cement supply was bulk cement, Deloitte Access Economics “Cost of residential housing development: A focus on building materials” (December 2018) at 84, available at: <https://www2.deloitte.com/content/dam/Deloitte/nz/Documents/Economics/nz-en-DAE-Fletcher-cost-of-residential-housing-development.pdf>.

- D19.2 bagged cement appears to largely target DIY, or other small-scale customers, rather than the residential construction sector; and
- D19.3 bulk cement is a key input into RMX production, for which bagged cement is not a practical substitute.⁷⁸²

Most concrete is sold as ready-mix

- D20 This case study focuses primarily on ready-mix concrete (RMX), rather than other concrete products. This is because most of the concrete in New Zealand, measured by volume, is sold as RMX. RMX production is also the key driver of cement demand.⁷⁸³
- D21 Additionally, many of the key participants in the RMX market are also large suppliers of other concrete products. This means the preliminary findings set out in this attachment regarding RMX may also provide some insight into these other concrete products.
- D22 These other precast concrete products used in the building envelope include:
- D22.1 concrete walls (often referred to as tilt-slabs or tilt-up concrete); and
- D22.2 masonry products (eg, concrete bricks and blocks).

Ready-mix concrete uses and substitutability of concrete products

- D23 Foundation and flooring are the main uses for RMX in construction of the building envelope. This means precast concrete products appear unlikely to be direct substitutes for RMX, given they are typically used for walling or reinforcing.
- D24 Pre-mixed bagged concrete is also sold (eg, a 20kg dry mix of cement, aggregates and additives). Additionally, concrete can also be made by separately purchasing aggregates (often sold bagged as ‘builder mix’) and cement and mixing with water. While these products may be substitutable for RMX for some uses, the degree of substitutability appears to be low for foundation and flooring uses.
- D25 Substituting other building materials for concrete does not appear to be a material threat to concrete suppliers. For example, one RMX producer considered cross-laminated timber (CLT) to be the most likely substitute for concrete.⁷⁸⁴ However, CLT could, at most, replace a third of the concrete used in a residential building.

⁷⁸² This is consistent with the approach taken by the UK Competition Commission. In a 2014 market investigation it defined bagged cement as a separate product market due to the lack of demand-side substitutability between bulk and bagged cement, CMA “Aggregates, cement and ready-mix concrete market investigation – Final report” (14 January 2014) at [20(b)] of summary, available at: https://assets.publishing.service.gov.uk/media/552ce1d5ed915d15db000001/Aggregates_final_report.pdf.

⁷⁸³ [].

⁷⁸⁴ [].

How ready-mix concrete is made

- D26 RMX is produced by mixing coarse and fine aggregates (eg, sand and gravel), water, cement and additives (known as admixture). RMX is generally produced in purpose-built plants, typically capable of producing between 10,000m³ and 100,000m³ per year. These production plants are the key capital cost to producing cement. Energy, concrete trucks, and truck drivers are also key variable cost inputs to RMX, in addition to the raw materials noted above.
- D27 RMX is highly perishable and is typically required to be poured within 90 minutes to remain compliant with the relevant NZ Standard.⁷⁸⁵ However, additives can be used during the production process to extend the life of RMX. Given the added cost, these additives are only used when required.

Industry structure

The cement market is highly concentrated

- D28 The bulk cement market consists of three participants. Two firms, Golden Bay Cement (GBC) and Holcim, supply between 75 and 95% of the bulk cement market. Table D1 provides an overview of cement suppliers in New Zealand.

Table D1 Overview of cement participants in New Zealand

Supplier	Supply model	Approximate share of supply to RMX market in 2020-21 ⁷⁸⁶	Key products	Overview
Golden Bay Cement (GBC)	Fully integrated domestic manufacturer	45-60%	General purpose (GP) cement High early strength (HE) cement Supplementary Cementitious Materials (SCMs) (fly ash and silica fume)	GBC manufactures cement in Whangārei, and has multiple distributions points throughout the country. It is the only domestic manufacturer of cement in New Zealand. Has been operating since 1909, and owned by Fletcher Building since 1988.
Holcim (New Zealand) Limited (Holcim)	Imports cement from Japan	30-45%	GP cement HE cement SCMs (fly ash and micro-silica)	Holcim has import terminals in Auckland and Timaru. It previously manufactured cement in Westport, but switched to import model in 2016. It is part of Holcim Group, one of the world's largest cements.

⁷⁸⁵ NZS 3104:2021 at [2.10.2.2]; [].

⁷⁸⁶ Market shares are provided as ranges based on Commerce Commission analysis of data provided by market participants and publicly available data, [].

HR Cement	Imports clinker to grind domestically	5-10%	GP cement	HR Cement grinds imported clinker into cement at one site in Mount Maunganui. It entered the market in mid-2012.
Other importers		0-5%	Various	Other firms, such as Cemix and (until it went into receivership in 2020) Drymix, import cement to sell as bagged cement via merchants. However, in some cases these firms have also supplied bulk cement to RMX manufacturers. We also understand that some RMX producers have in the past self-supplied cement by importing it directly. However, we are not aware of any who currently do this.

Source: Commerce Commission analysis of market participant and public data.⁷⁸⁷

- D29 Throughout the past decade, GBC's share of supply to the RMX market has remained consistently between approximately 45% and 60%.
- D30 HR Cement's share grew between 2012 and 2018, remaining between 5-10% since then.⁷⁸⁸ However, this appears to be due to production capacity constraints; in 2019 the firm signalled its plan to expand its production facilities.⁷⁸⁹
- D31 This concentration is not inhibiting workable competition in the supply of cement. Rather, this concentration appears driven by economies of scale enabling larger firms to operate more efficiently in the cement market. For GBC, these economies of scale are gained in its manufacturing processes. For Holcim, they are gained in its import terminal infrastructure.
- D32 Our preliminary view is that this concentration is not inhibiting workable competition in the supply of cement. However, it may make the market vulnerable to accommodating behaviour. We discuss these risks at paragraph D112 below. New Zealand is a comparatively small market, which may limit the number of cement firms which can operate sustainably. However, this does not necessarily mean the sustainable market structure is limited to two or three large players, now or in the future.
- D33 Given that demand for RMX (and therefore cement) is expected to continue to grow in line with population growth, this may increase the viability of a new entrant. Additionally, we have heard HR Cement already acts as an efficient competitor in the upper North Island, indicating economies of scale can be achieved regionally.

⁷⁸⁷ [].

⁷⁸⁸ Commerce Commission analysis of market participant and public data, [].

⁷⁸⁹ Concrete NZ "HR Cement's Point of Difference" https://concretenz.org.nz/page/HR_Cement.

D34 GBC, Holcim and HR Cement all compete directly with each other to supply downstream RMX producers. However, as discussed below, HR Cement is unlikely to be a viable competitor in all regions, as it only has one distribution centre.

There are only two national suppliers of ready-mix concrete

D35 Although there are numerous RMX suppliers in New Zealand, only two operate nationally. These are Firth Concrete and Allied Concrete. Table D2 below provides an overview of the key participants operating in the New Zealand RMX market.

Table D2 Overview of ready-mix concrete participants in New Zealand

Supplier	Number of plants	Approximate share of RMX supply in 2020-21 ⁷⁹⁰	Overview
Firth Concrete (Firth)	70+	30-40%	Firth operates nationwide, and is a division of Fletcher Concrete and Infrastructure Limited. It sells a range of RMX products, including a foundation system called RibRaft. It also sells bagged concrete (under the Dricon brand) and precast masonry products.
Allied Concrete (Allied)	50+ (and eight mobile batching plants)	20-30%	Allied operates nationwide. It consists of two entities: <ol style="list-style-type: none"> Allied Concrete Limited, which operates 10 plants in the South Island, and is owned by the HW Richardson Group (HWR). AML Limited, which operates 40 plants in the North Island, and is a joint venture between Holcim and HWR.⁷⁹¹ Both entities are operated by HWR, which owns the Allied brand, under the same management structure. Given this, Allied refers to both entities together, unless otherwise noted.
Bridgeman Concrete	6	3-8%	Operates in Waikato, Bay of Plenty, Hawke's Bay and Auckland. Sister company to HR Cement.
Atlas Concrete	7	5-10%	Operates in Auckland region. Holcim has a minority stake in Atlas; however it is independently operated.
Other firms		20-30%	There are more than two dozen local and regional RMX suppliers around the country.

⁷⁹⁰ Market shares are provided as ranges based on Commerce Commission analysis of data provided by market participants and publicly available data, [].

⁷⁹¹ AML Limited also operates Ashby's Ready Mixed in Canterbury.

			<p>Each have between 1-5 plants (and/or operate under plant-share arrangements), and between 0-5% market share each.</p> <p>These include Stevenson Concrete, Christchurch Ready Mix, Tt Concrete, Ocean Concrete, Higgins.</p>
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Source: Commerce Commission analysis of market participant and public data.⁷⁹²

- D36 However, there are many regional RMX suppliers, particularly in densely populated regions. There are a particularly large number of RMX producers operating within, and between, Auckland, Hamilton, and Tauranga. This is driven by a high level of economic and residential construction activity in these regions. For example:
- D36.1 53% of national RMX production in 2021 was produced in these regions;⁷⁹³ and
- D36.2 these regions together account for a large proportion of annual building consents issued nationally.⁷⁹⁴
- D37 We have also heard of many small producers entering the market in recent years.⁷⁹⁵ For example, Concrete NZ estimated 20% of current RMX suppliers have entered in the last 10 years.⁷⁹⁶
- D38 For entry or expansion to be viable, there needs to be a customer base of sufficient size to enable a plant to earn a return which justifies the investment. Given the regional location has little impact on the cost of developing a RMX plant, areas with minimal construction activity are therefore relatively unattractive options for development.⁷⁹⁷
- D39 Given this, there are fewer competitors in less densely populated areas. Our understanding is there are typically fewer RMX competitors in provincial and sparsely populated regions. However, Allied and Firth both operate nationally and there is still typically at least one supplier in each area.

⁷⁹² [].

⁷⁹³ Commerce Commission analysis of Statistics NZ ready mixed concrete production statistics, [].

⁷⁹⁴ See, for example: Stuff ""Golden Triangle dominate property development numbers"" <https://www.stuff.co.nz/business/300412874/golden-triangle-dominates-property-development-numbers>.

⁷⁹⁵ [].

⁷⁹⁶ Concrete NZ ""Submission on preliminary issues paper"" (4 February 2022) at 4.

⁷⁹⁷ [].

D40 The minimum efficient scale of an RMX firm appears to be small. We understand many firms enter or expand in the market through plant-share or tolling arrangements. Plant-share arrangements allow firms to “rent” portions of a plant from one another. Tolling arrangements allow firms to purchase RMX in bulk from the plant to then sell to their own customers. Incumbents have told us firms operating under these arrangements price competitively and often win customers from larger players.⁷⁹⁸

Vertical integration is a common feature of the sector

D41 It is common for cement firms to have a level of ownership in RMX firms in New Zealand. However, the reverse is not necessarily true. This type of industry structure is common in cement and RMX markets globally.

D42 We consider it would be challenging to enter the New Zealand cement market without the firm also simultaneously entering, to some degree, in the RMX market.⁷⁹⁹ This is because, due to the volume required to gain economies of scale in the cement market, dependable RMX customers are a key strategic requirement for cement producers.

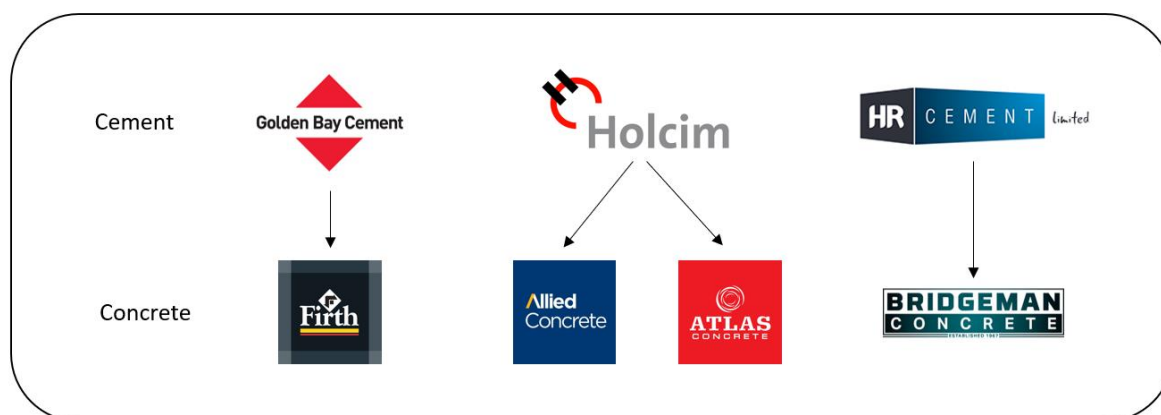
D43 Vertical integration appears to be a common way of ensuring this customer base. However, cement suppliers may also achieve this by competing to provide a consistent service and product to win customers. Additionally, exclusive supply agreements (discussed below) may also provide this surety.

D44 Figure D1 below provides an overview of the ownership relationship of the key cement and RMX suppliers in New Zealand, exemplifying the degree of vertical integration in the sector.

D45 However, this ownership structure does not necessarily determine who RMX suppliers purchase their cement from, or who cement suppliers sell their cement to. Firth, Allied Concrete and Atlas Concrete are not exclusive to their respective owner, and they purchase from their upstream competitors where economically practical. Rather, it may be that ownership in these RMX firms act as ‘backstops’ for cement firms to move volume when they need to do so.

⁷⁹⁸ [].

⁷⁹⁹ This view is supported by industry participants, such as [].

Figure D1 Overview of vertically integrated cement and ready-mix concrete suppliers

Source: Commerce Commission analysis of public data.⁸⁰⁰

- D46 As noted, cement producers achieve this secure volume, in part, by vertically integrating with RMX producers. This has the potential to affect the nature of competition in both cement and RMX markets.
- D47 In the cement market, this may have the effect of reducing the ‘contestable’ RMX market, limiting the volume any new entrant may be able to compete to supply.
- D48 In the RMX market, it may increase concentration. However, we have not observed this occurring in the past decade. Our preliminary conclusion is that vertical integration is not affecting competition in the RMX markets.

Cement and ready-mix concrete are not usually sold via merchants

- D49 Cement, given its nature as an input product, is typically sold in bulk to producers of RMX, or other concrete products (eg, masonry). Bagged cement is sold by some suppliers via merchants. However, bagged cement is typically targeted towards DIY customers, rather than residential builders.
- D50 RMX is typically sold direct-to-trade. Merchants do not physically stock RMX, given its bulky and perishable nature. Although 10% to 20% of RMX volume is sold via merchants, the customer will still often coordinate with the RMX producer directly. We understand this arrangement is to minimise administrative costs for the end customer.⁸⁰¹

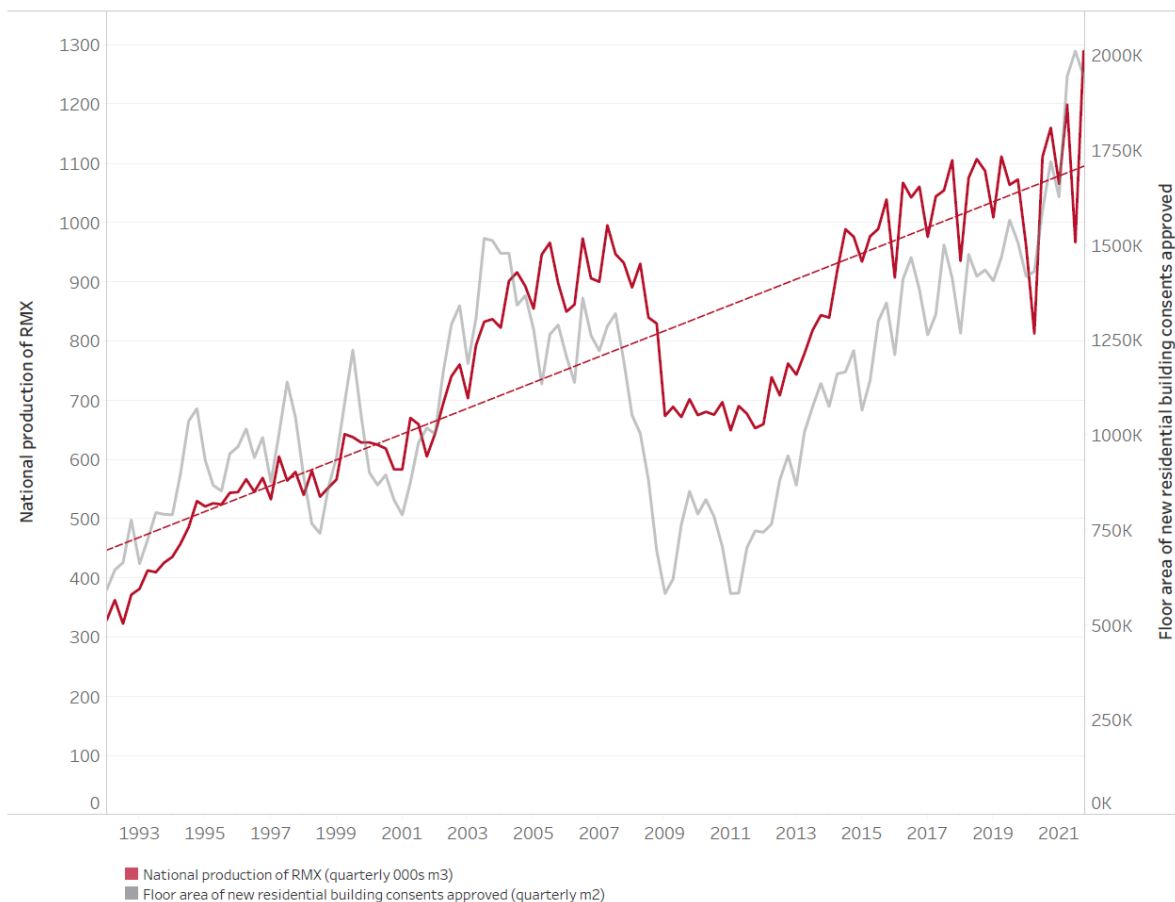
⁸⁰⁰ As noted above, Holcim’s relationship with Allied and Atlas is via a joint venture and a minority equity stake, respectively, [].

⁸⁰¹ For example, some customers prefer to be billed for all products through a merchant, rather than managing accounts with multiple suppliers.

Annual ready-mix concrete production has more than tripled in the past 30 years

- D51 Industry participants note the demand for cement and RMX is cyclical. However, in the medium term it is driven by population growth (which itself is likely to be a key driver of building consents).⁸⁰² Given this, growth of demand for cement and RMX is expected to continue.
- D52 Annual RMX production has more than tripled over the past 30 years. This growth, as shown in Figure D2 below, appears to be correlated with the level of residential construction activity.
- D53 This growth may improve the viability of firms entering or expanding in the cement and RMX markets. Both industries are process-driven and characterised by economies of scale, meaning securing volume improves firms’ cost position. This growing demand may provide more confidence to potential entrants that there are sufficient customers to compete for. This may particularly be the case where current suppliers are at capacity, and unable to quickly scale-up supply.

Figure D2 National production of ready-mix concrete and floor area of new residential building consents approved from 1992-2022



Source: Commerce Commission analysis of Statistics NZ data.⁸⁰³

802 [].
 803 [].

The effect of regulatory standards and systems on competitive dynamics

NZ Standards do not appear to be a barrier to competition or innovation

- D54 Our preliminary view is that regulatory requirements for cement and relevant standards do not materially constrain the entry or expansion of cement suppliers.
- D55 We have heard the levels of New Zealand’s cement standards are more stringent than many international standard specifications. This means, while the performance measures may be the same, New Zealand’s standard may require a higher level of performance. For example, the European Standard for cement allows a soundness measure of up to 10mm.⁸⁰⁴ The New Zealand standard allows a measure only up to 5mm.⁸⁰⁵
- D56 Nevertheless, New Zealand’s required performance measures and levels are consistent with some jurisdictions. This means there are some geographically proximate countries where cement meeting the New Zealand standards can be, and is, imported from.⁸⁰⁶ For example, Holcim currently imports cement from Japan and HR Cement imports cement and clinker from Thailand.⁸⁰⁷
- D57 This enables cement importers to act as viable competitors against domestic manufacturers. Additionally, it may also have the effect of setting a ‘price ceiling’ on domestic cement prices.⁸⁰⁸
- D58 Similarly, based on our analysis to date, the building standards requirements for concrete in residential buildings do not appear to be operating as a barrier for those seeking to enter and expand in the market.
- D59 The applicable standards for concrete depend on how the concrete is being used in a residential building. It may be used in a slab format for walls, or it may be used in foundations. The relevant requirements are prescribed by B1 – Structure, of the Building Code.
- D60 As outlined above, in order to demonstrate compliance with Clause B1, a residential building can comply with Acceptable Solution B1/AS1.

⁸⁰⁴ Soundness refers to the volume change which occurs as the cement sets and hardens, *EN 197-1:2011*, Table 3.

⁸⁰⁵ *NZS 3122:2009*, Table 1.

⁸⁰⁶ [];
[].

⁸⁰⁷ A large quantity of cement is also imported from Vietnam. World Bank “New Zealand (whether or not coloured) imports by country in 2019”, available at: <https://wits.worldbank.org/trade/comtrade/en/country/NZL/year/2019/tradeflow/Imports/partner/ALL/product/252310>.

⁸⁰⁸ For example, it may prevent cement suppliers from being able to successfully raise prices above what it would cost customers to import cement themselves.

- D61 B1/AS1 prescribes the design requirements for simple residential buildings. It incorporates a range of relevant standards, and one of these is *NZS 3604:2011 Timber-framed buildings*. Timber-framed buildings are very common in New Zealand.
- D62 *NZS 3604:2011* prescribes methods of complying with the Building Code requirements for the structure of residential buildings, including their foundations, framing layout, member sizes, bracing systems, fixings and connectors (when read along with the Acceptable Solution B1/AS1).⁸⁰⁹
- D63 *NZS 3604:2011* specifies the requirements for concrete in residential buildings. This standard, in turn, refers to the following concrete specific standards:
- D63.1 *NZS 3104:2003*, which specifies the requirements for RMX production at batching plants, as well as precast concrete. Note, *NZS 3102:2022* was published in April this year. At this point in time, both standards remain “current”;
- D63.2 *NZS 3101* parts 1 and 2:2006 (Inc A1, A2 A3), which specifies the requirements for concrete structures;
- D63.3 *NZS 3109:1997*, which specifies the requirements for concrete construction, to meet the requirements of *NZS 3101:2006*;
- D63.4 *NZS 3112.2:1986*, which specifies the methods of testing for concrete – tests relating to the determination of strength of concrete; and
- D63.5 *NZS 3101* is compatible with loading standards *AS/NZS 1170* and *NZS 1170.5*. These two standards set up the pathways for Code compliance in relation to loading due to wind actions and earthquakes (respectively).
- D64 *NZS 3122:2009* specifies the requirements and methods for testing hydraulic cement consisting of Portland cement, or mixtures of Portland cement and Supplementary Cementitious Materials (SCMs).
- D65 These standards are primarily performance based. Performance-based standards state the characteristics desired by users (eg, strength) without prescribing the specific means to be used when producing the product (eg, the type or amount of cementitious material).⁸¹⁰
- D66 For example, *NZS 3104:2021* sets out the requirements for RMX. To comply with *NZS 3104:2021*, the producer must prove its RMX achieves the minimum compressive strength requirements, among other things.⁸¹¹ However, the producer is able to choose how it formulates its RMX. This includes deciding factors such as:

⁸⁰⁹ *NZS 3604:2011*, <https://www.standards.govt.nz/shop/nzs-36042011/>.

⁸¹⁰ *NZS 3122:2009* at 12.

⁸¹¹ *NZS 3104:2021* at [2.4.1.4].

- D66.1 the proportion and amounts of aggregates used;
- D66.2 the water/cement ratio and cementitious content; and
- D66.3 the suitability and quantity of any admixture used.⁸¹²
- D67 Additionally, the standard enables producers to use a range of materials in producing the RMX. For example, a RMX producer may use SCMs such as fly ash or pozzolans, recycled aggregates and/or recycled water, if it wishes.⁸¹³
- D68 Given these standards are not prescriptive as to inputs or method, these standards may enable, or even encourage, innovation.⁸¹⁴ For example, as noted above, RMX producers can use SCMs in their mixes, which lowers the embodied carbon of the concrete. This can enable producers to compete by innovating in the formulation of their products.

The Emissions Trading Scheme has the potential to distort the competitive dynamics of cement

- D69 Our preliminary view is that the ETS does not currently appear to be distorting competition. However, carbon-reduction policies, such as the ETS, have the potential to do so, and any policy changes should have regard to competitive dynamics.
- D70 The ETS puts a price on greenhouse gas emissions. Its purpose is to incentivise businesses producing goods in New Zealand to reduce their emissions. For example, for every tonne of carbon a domestic producer emits, it must surrender an equivalent carbon credit (referred to as New Zealand Units (NZUs)). However, importers are not required to surrender NZUs for emissions from products made outside of New Zealand, and then imported.
- D71 This means, where product is imported from countries with less stringent emissions schemes than New Zealand's, importers may face lower (or no) carbon-offsetting costs than domestic manufacturers. This could result in importers of cement and clinker being able to offer customers lower prices than domestic manufacturers.
- D72 GBC considered that its requirements under the ETS make it harder for it to compete with suppliers of imported cement.⁸¹⁵ GBC told us the ETS presents domestic manufacturers with two disadvantages relative to cement importers:
- D72.1 the need to recover compliance costs (through either higher costs or lower margins); and
- D72.2 a lower return on capital employed, due to having to invest capital in emission reduction activities.

⁸¹² NZS 3104:2021 at [2.11.1].

⁸¹³ NZS 3104:2021 at [2.5].

⁸¹⁴ [].

⁸¹⁵ [].

- D73 However, Holcim considered that domestic producers can currently benefit from the ETS scheme. This is because domestic manufacturers currently receive a free allocation of NZUs as it is an Emissions Intensive Trade Exposed (EITE) businesses.⁸¹⁶ For GBC, the number of NZUs it receives is set relative to a baseline study of sector emissions conducted prior to 2016. Holcim also received a free allocation of NZUs up until it stopped domestic manufacture in 2016.⁸¹⁷
- D74 This means, if GBC’s carbon emissions are 89% or less of its baseline emissions, it currently faces no net cost under the ETS. If it emits less than this amount, it receives a net benefit as it can sell unused NZUs (or retain them for future use).
- D75 However, these dynamics will change over the medium term:
- D75.1 First, GBC’s free allocation of NZUs is set to reduce annually over the next 30 years, until it receives zero NZUs. This will slowly increase GBC’s cost of compliance with the ETS. This may reduce its competitiveness if imports do not face a commensurate change.
- D75.2 Secondly, the Ministry for the Environment is currently considering reform of the mechanism for allocating NZUs to EITE businesses. It has signalled this could include a “re-baselining” of these allocations. This would be likely to reduce the number of NZUs GBC is eligible to receive.⁸¹⁸
- D76 The Emissions Reduction Plan has identified the cement sector will be used as a test case for investigating solutions to address emissions leakage, including the possibility of a carbon border adjustment mechanism similar to the European Union.⁸¹⁹ This may see an increase in the cost of imported cement from countries with weaker climate policies.

⁸¹⁶ EITE businesses involve production processes that use significant fuel, energy and produce emissions. They usually either export product, or are exposed to competition from imports, Castalia “Emissions Intensive Trade Exposed Businesses’ Contribution to New Zealand’s Low Emissions Economy” (May 2019), available at: https://www.businessnz.org.nz/_data/assets/pdf_file/0003/169194/EITE-Report-Final.pdf.

⁸¹⁷ NZ Environmental Protection Agency “Final industrial allocation decisions since 2010” <https://www.epa.govt.nz/industry-areas/emissions-trading-scheme/industrial-allocations/decisions/>.

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⁸¹⁹ Ministry for the Environment “Aotearoa New Zealand’s first emissions reduction plan” (May 2022) at 107, available at: <https://environment.govt.nz/assets/publications/Aotearoa-New-Zealands-first-emissions-reduction-plan.pdf>. See also, Council of the EU “Council agrees on the Carbon Border Adjustment Mechanism” (March 2022), available at: <https://www.consilium.europa.eu/en/press/press-releases/2022/03/15/carbon-border-adjustment-mechanism-cbam-council-agrees-its-negotiating-mandate>.

D77 The purpose of the EITE scheme is to ensure domestic producers are not competitively disadvantaged by their obligations under the ETS.⁸²⁰ We agree with this policy intent. Our view is that Government should continue to have regard to any potential competitive effects of these reforms, minimising competitive distortions where possible.⁸²¹

How cement and ready-mix concrete are specified and purchased

Customer drivers when selecting a cement supplier

D78 Based on our analysis, product quality seems to be an important consideration for customers when selecting a cement supplier. Overall, customers appear generally satisfied with the level of quality offered by incumbents.

D79 Some customers have also expressed an unwillingness to switch cement suppliers unless they are able to offer a product with a comparable level of embodied carbon.⁸²² The final section of this attachment explains how firms are responding to this demand.

Competing cement products are substitutable

D80 While there are characteristics which mean customers prefer a certain cement brand, comparable cement products are substitutable. As discussed above, this is in part enabled by New Zealand’s cement standards.

However, ready-mix concrete producers prefer to remain with one supplier-per-plant

D81 While cement products are substitutable, RMX producers prefer not to switch frequently. This is driven by a preference to maintain consistency of their RMX ‘recipes’; cements may have slightly different properties.

Location is a driver for selecting a cement supplier

D82 The cost of obtaining cement depends where in the country the customer is located. Regions, such as Southland and the West Coast, which are far away from key distribution points tend to have higher priced cement than other areas.

⁸²⁰ For example, because they compete with overseas suppliers who do not face the same costs, see: EPA “Industrial allocations” <https://www.epa.govt.nz/industry-areas/emissions-trading-scheme/industrial-allocations/>.

⁸²¹ This is consistent with the view expressed by the Infrastructure Commission in its 2021 Infrastructure Resources Study report. This report recommended the Government’s climate change policies ensure domestically produced cement is not at a competitive disadvantage to imported cement and clinker due to the differences in the way carbon costs are accounted for, New Zealand Infrastructure Commission, Te Waihanga “Infrastructure Resources Study” (11 November 2021) at 12, available at: <https://www.tewaihanga.govt.nz/assets/Infrastructure-Resources-Study-11-Nov-21.pdf>.

⁸²² [].

- D83 This appears to be primarily driven by a higher cost-to-serve, rather than a weak competitive process: cement firms' margins also appear to be lower in these higher priced regions. This indicates that firms are facing competitive pressure to absorb some of these higher costs, rather than passing the full cost on to customers.
- D84 One RMX producer told us it does not see HR Cement as a viable option for supply, as its Mount Maunganui distribution centre is too far away from the Auckland market.⁸²³ Price (due to the higher cost-to-serve) appears to be a key factor for this view.
- D85 However, proximity to cement distribution is also important to RMX producers to ensure consistency of supply. RMX producers often require frequent deliveries of cement, sometimes even multiple deliveries in a day. Ensuring consistency in this supply is crucial, given cement's role in RMX production. We understand managing this consistency becomes significantly more challenging the greater the distance to supply.

Foundation systems are sometimes specified by brand in building consents

- D86 In some cases, foundation systems (of which, RMX is a key component) are specified by brand in building consents. This can make it harder for firms to compete for these jobs. This is because it makes switching away from the specified brand less attractive, due to the time and cost of obtaining a variation to the building consent.
- D87 For example, one RMX supplier told us that RibRaft (a trademarked Firth brand of concrete foundation) is sometimes specified in the building consent plans.⁸²⁴ Additionally, half of respondents to our specifier survey said foundation materials (concrete, timber, and steel joists) are sometimes, or always, specified by brand.
- D88 While specification of building products by brand can make product substitutions hard, this practice appears to be less common for foundations than for other categories of building materials. This issue is discussed further in Chapter 4.

Service and quality are key factor when selecting a ready-mix concrete supplier

- D89 We understand the most important factors for RMX customers are that the product arrives on site, in good condition, and that the product is of a consistently high quality.⁸²⁵ Suppliers resolving issues in an effective and timely matter was also identified as being an important factor.

⁸²³ [].

⁸²⁴ [].

⁸²⁵ []; [].

Price does not appear to be the most important factor for ready-mix concrete customers

- D90 While price is important to RMX customers, it appears to often be secondary to other factors. One RMX supplier said the primary driver for customer selection is the timing and availability of product, rather than the price.⁸²⁶ Similarly, we understand approximately one third of RMX customers do not consider competitive pricing to be extremely, or very, important.⁸²⁷
- D91 Nevertheless, this indicates a material proportion of customers consider price to be a key factor. Competition to win these price-sensitive consumers may also benefit those less price-driven unless RMX firms can offer targeted pricing or discounts. Additionally, as discussed below, there appear to be other supply-side constraints that prevent RMX suppliers from raising prices.

Ready-mix concrete markets are highly localised

- D92 Plant location, relative to the work site, is a key driver in the options available to customers selecting a RMX supplier. RMX producers typically service customers within 30km of the nearest production site.⁸²⁸
- D93 This is largely driven by the NZ Standard requirement (discussed above) which typically requires RMX to be poured within 90 minutes of manufacture. However, transport and labour costs are also a factor. Serving customers further away incurs these direct costs (some of which may be absorbed by the firm), but also an opportunity cost (ie, trucks and employees are unable to serve other customers while serving long-distance customers).

Pricing practices and vertical arrangements

Cement prices have reduced over the past 10 years

- D94 The real price of cement (ie, adjusted for general inflation) in New Zealand has reduced over the past 10 years. This trend appears to have been driven by competitive dynamics.⁸²⁹ In particular:
- D94.1 HR Cement's entry and expansion in the upper North Island; and
- D94.2 Holcim's switch to an import model, which enabled it to increase its capacity.

⁸²⁶ [].

⁸²⁷ [].

⁸²⁸ []. See also:
[].

⁸²⁹ []; []; [].

Pricing for cement varies significantly throughout regions

- D95 The price paid for cement varies depending on the region. Cement is typically cheaper in high-volume areas (eg, Auckland). Conversely, it is usually more expensive to supply customers in locations more distant from the manufacturing or distribution point, and/or lower volume areas, such as parts of the South Island.⁸³⁰
- D96 This pricing pattern may be, in part, driven by more intense competition in these high-volume areas. However, significant difference in the cost-to-serve throughout the country also appears to be a key driver of this variation.
- D97 Firms' average sales prices tend to be lower the closer they are to their respective manufacture or import sites.⁸³¹ This indicates firms face competitive pressure to pass through these lower costs to its customers.

This dynamic also has an impact on margins

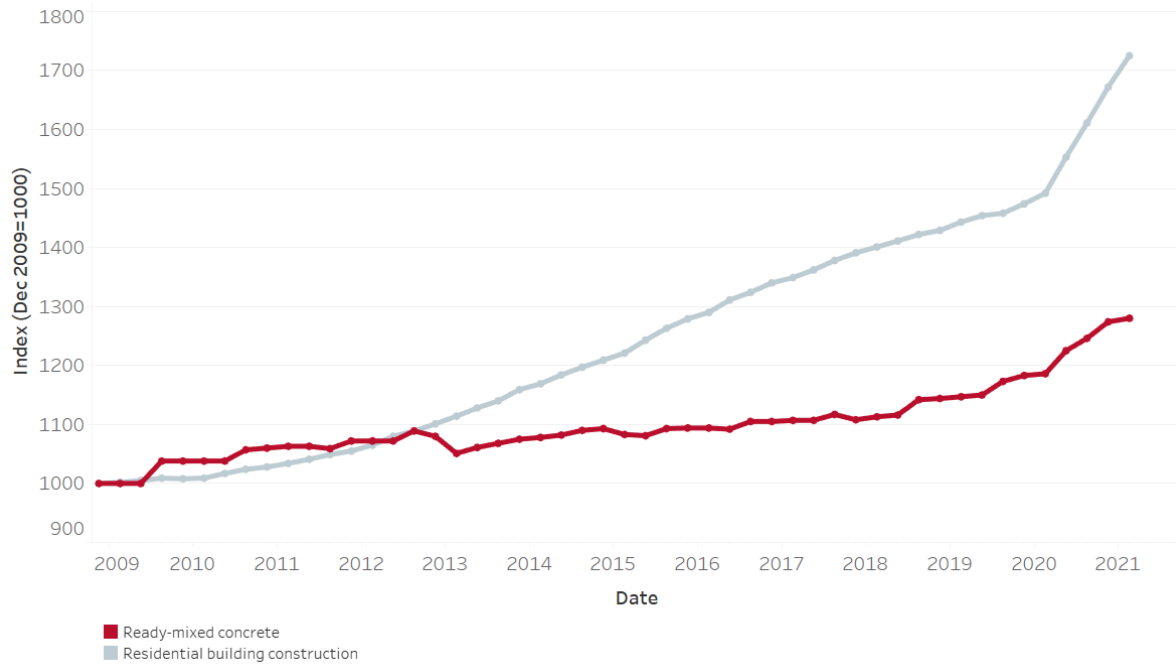
- D98 Generally, firms' margins on cement are lower the further away they are from their manufacture/distribution point. This indicates that, while some of this increased cost-to-serve is passed on to customers in the form of higher prices, firms are also absorbing some of this increased cost by lowering their margins.

The price of ready-mix concrete has increased more slowly than other residential construction costs

- D99 Figure D3 below shows the indexed price of RMX has increased significantly more slowly than residential building construction prices more generally. Price trends on their own do not provide any definitive findings about how competition is working. However, this does appear to support our qualitative evidence about the competitive constraint on price increases in the RMX markets.

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831 [].

Figure D3 Residential construction price index and ready-mix concrete price index (Q4 2009 to Q1 2022)



Source: Commerce Commission analysis of Statistics New Zealand data.⁸³²

However, concrete in New Zealand is more expensive than many other countries

D100 Concrete appears to be more expensive in New Zealand than many other jurisdictions.⁸³³ Suppliers told us this price differential could be driven by higher inputs costs (ie, cement), and higher distribution costs of RMX in New Zealand.⁸³⁴

D101 RMX firms have told us there are regulatory factors in New Zealand which limit the efficiency with which they can operate, potentially increasing the cost of RMX. For example, some firms told us:

D101.1 axle-weight requirements for trucks are more stringent in New Zealand than comparable countries. These requirements mean they are unable to transport as much product per truck as in other countries; and

D101.2 council by-laws prevent the production and/or delivery of RMX outside of certain hours, limiting the number of loads producers can deliver in each day.

⁸³² [].

⁸³³ Deloitte Access Economics “Cost of residential housing development: A focus on building materials” (2018) at 68, available at: <https://www2.deloitte.com/content/dam/Deloitte/nz/Documents/Economics/nz-en-DAE-Fletcher-cost-of-residential-housing-development.pdf>.

⁸³⁴ [].

D102 We have not verified whether New Zealand RMX producers do face more stringent operating conditions than comparable countries. However, these anecdotal examples indicate that there may be factors other than competition which influence the price of RMX in New Zealand relative to other countries.

Exclusive cement supply is common, but appear to be driven by efficiency considerations

D103 Based on our analysis of cement supply agreements, forms of exclusive supply arrangements or minimum volume requirements appear common.

D104 These might be implemented in a range of ways. For example, the agreement might:

D104.1 require the RMX firm to purchase all of its cement from the cement supplier, either for all of its plants or some specified plants;

D104.2 give the cement firm right in priority to supply a specified proportion of the RMX firm's cement requirements; or

D104.3 require the RMX firm to purchase all of its cement from the cement supplier to retain the agreed pricing.

D105 However, we have heard these clauses are often driven by mutual efficiency benefits. For example, many RMX plants have small silos, requiring multiple daily cement deliveries.⁸³⁵ This requires close coordination with its suppliers to ensure they can continue production.

D106 These arrangements often have price competitiveness clauses and provide RMX suppliers with a degree of negotiating power. Additionally, the lengths of these contracts are often 12 months, or 24 months, with the ability to renegotiate periodically. RMX producers have told us they typically do not have supply agreements with their customers. Rather, they compete on price and service to win customers.⁸³⁶

Tiered rebates are uncommon in the cement and ready-mix concrete markets except to merchants

D107 Based on the cement, RMX and other concrete product supply agreements we reviewed, tiered retroactive rebates do not appear to be a common element of cement or RMX supply arrangements.

D108 For cement customers, rebates may not be required to encourage loyalty, given the prevalence of exclusive (or minimum quantity) supply agreements, and the preference of customers to not switch suppliers too frequently. We understand the pricing in these contracts is negotiated to reflect the volume purchased. For RMX customers, supply agreements themselves appear uncommon, limiting the scope for the use of rebates.

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- D109 The supply agreements which did contain tiered retroactive rebates were almost all between suppliers and merchants (rather than end-user agreements). These agreements tended to be for dry mix concrete or cement.
- D110 The level of retroactive tiered rebates offered to the merchants in these agreements was very high (up to 30% in some cases). Although the level varied, these rebate tiers were some of the highest of all supply agreements we reviewed. As discussed in Chapter 7, we consider these types of rebates have the potential to harm competition between suppliers. However, this potential harm may be less where suppliers have other distribution options. This appears to be the case for concrete, given the small proportion of concrete products sold through merchants.

The ability to raise ready-mix concrete prices appears to be constrained by competition

- D111 Perceived competitive pressure appears to limit RMX firms' abilities to raise prices. For example, an internal survey of staff from one RMX firm showed most employees felt the company was prevented from increases in prices due to the threat of losing customers and/or market share.⁸³⁷

Structural factors and firm conduct have the potential to soften cement price competition

- D112 Some features of the cement market suggest it may be vulnerable to tacit coordination (also referred to as accommodating behaviour). Our merger guidelines explain the factors likely to make accommodating behaviour more or less likely in a particular market.⁸³⁸ In the cement market, these include:
- D112.1 a relatively concentrated market;
 - D112.2 relatively homogenous products;
 - D112.3 repeated interaction and transactions between competitors; and
 - D112.4 firms have some ability to observe each other's volumes and/or prices.⁸³⁹
- D113 We have not seen evidence of accommodating behaviour in the cement market, to date.

⁸³⁷ [].

⁸³⁸ Commerce Commission "Mergers and acquisitions guidelines" (July 2019) at [3.89], available at: https://comcom.govt.nz/_data/assets/pdf_file/0020/91019/Mergers-and-acquisitions-Guidelines-May-2022.pdf.

⁸³⁹ For example, through monthly data on cement and clinker imports published by Statistics NZ.

Upstream suppliers receive competitive information about downstream competitors

D114 Vertically integrated cement producers also supply to RMX producers which compete with their downstream RMX businesses. These trade relationships may provide competitive or strategic information about the RMX markets. For example, supply agreements indicate some cement suppliers meet with their customers quarterly to discuss demand forecasts. However, these agreements also contain clauses restricting the use of this competitively sensitive information for other purposes.

Innovation and building for climate change

D115 The embodied carbon framework of MBIE's BfCC programme looks to first measure and report, then place caps on the embodied carbon of new buildings. Concrete contributes a significant portion of a residential building's overall embodied carbon.⁸⁴⁰ Concrete is largely used in the foundations of standalone homes and is also used for structural elements of medium-density housing.

D116 Embodied carbon measurement and reporting requirements will include a mechanism that considers the quality of information sources. Where data quality is poor (for example, for cement imported from countries with weaker emissions policies), an embodied carbon penalty may apply.⁸⁴¹

D117 As caps are introduced, the building sector will be required to innovate to reduce the total embodied carbon of buildings. This will likely see innovations in cement manufacturing that reduces embodied carbon through the use of SCMs. Alternatively, builders may consider alternative foundation solutions for standalone buildings such as timber piles, or to replace structural elements of medium-density housing with engineered timbers.

D118 The timeframes of the impacts of BfCC are unclear. While reporting requirements are likely to be introduced by 2025, the timing for introducing embodied carbon caps is not yet determined, nor are the levels at which caps may be set.

Product innovation is centred around reducing embodied carbon

D119 In a workably competitive market, we would expect to see firms innovating to win customers. Where competition is not working well, innovation may languish. We understand cement suppliers are currently working to respond to market demand for low-embodied carbon products. This suggests competition is working well.

D120 The level of investment in this innovation appears high and is focused on the use of SCMs. SCMs reduce the amount of cement required (and therefore the amount of embodied carbon) per cubic metre of concrete.

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Innovation on low-embodied carbon cement appears to be lagging compared to other countries

- D121 The current level of SCM uptake in New Zealand is low, compared to other comparable countries. The substitution rate of SCMs is about 1% to 2% in New Zealand, compared to about 25% in Australia.⁸⁴²
- D122 However, it is not clear that a lack of competition is the driver of this lagging innovation. Factors such as low consumer demand, and challenges accessing SCMs, may be more important. Participants in New Zealand have told us:
- D122.1 while end users are becoming more interested in low-embodied carbon cement and RMX, sales growth is slow relative to demand;⁸⁴³ and
- D122.2 some participants have told us there is a lack of cost-effective, or accessible, SCMs in New Zealand.⁸⁴⁴

The Emissions Trading Scheme appears to have some effect on incentives to innovate

- D123 We have heard differing arguments about what effect the ETS, particularly the allocation of NZUs to GBC, has on incentives to innovate:
- D123.1 GBC argued it provides them strong incentives to innovate in carbon-reducing activities. As discussed at paragraph D74 above, if it reduces its carbon emissions below its free allocation, it can sell the unused NZUs, or retain them for future use.
- D123.2 Holcim argued the uptake of carbon-reducing products (such as SCMs) is dampened by the free allocation policy.⁸⁴⁵ This is because the domestic producers' allocation of NZUs means they do not face the full cost of their emissions.
- D124 Our preliminary view is that the ETS does incentivise GBC to invest in carbon-reducing activities. While GBC may not face the full cost of its carbon emissions, it still faces financial incentives to reduce its emissions through the ability to sell or retain unused NZUs.
- D125 GBC's incentive to innovate may, in turn, drive other firms to innovate. For example, other firms may work to reduce their embodied carbon. However, they may also respond by improving other dimensions of their offering.

⁸⁴² []; [].

⁸⁴³ [].

⁸⁴⁴ [].

⁸⁴⁵ Ministry for the Environment "Reforming industrial allocation in the New Zealand Emissions Trading Scheme: Summary of submissions" (March 2022) at 17, available at: <https://environment.govt.nz/assets/publications/Reforming-industrial-allocation-in-the-NZ-ETS-summary-of-submissions.pdf>.

Conditions of entry and expansion

D126 The markets for cement and RMX are both characterised by structural barriers. However, while regulatory and strategic barriers are present, these do not appear to be as high as we have observed in the case of other residential building supplies (eg, plasterboard).

D127 Our preliminary views are:

D127.1 high structural barriers make the entry of a second domestic cement manufacturer unlikely;

D127.2 entry into the cement market as an importer of cement is possible, although there are some barriers;

D127.3 barriers to entering the RMX market are low, due to, for example, the viability of plant-share arrangements;

D127.4 however, the challenges in finding suitable land for a RMX plant may inhibit expansion of smaller players in the market.

Entry into domestic manufacture of cement practically unviable

D128 Our preliminary view is the entry of a second domestic manufacturer of cement appears highly unlikely. This is primarily because New Zealand's market size does not appear large enough to sustain two cement producers. Incumbents told us the accepted view is that a cement manufacturer needs to produce at least 920K tonnes of cement per year to be viable; New Zealand currently consumes approximately 1,600K tonnes of cement per year.⁸⁴⁶

D129 However, the New Zealand market did previously sustain two domestic producers, before Holcim ceased operation of its Westport cement works in 2016.

D130 Potential domestic manufacturers may also face structural and regulatory barriers. These include:

D130.1 high, and rising, domestic input costs (eg, electricity, labour);

D130.2 limited ability to achieve economies of scale (as export is not economically viable); and

D130.3 compliance with the ETS.

D131 GBC's ability to compete as a commercially viable domestic producer appears largely due to historical and structural factors. For example:

D131.1 it has a highly capital-intensive manufacturing plant and distribution network;

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D131.2 it has been in the market for more than 100 years, enabling it to invest capital and grow scale slowly; and

D131.3 this time in the market also likely gave it a unique opportunity to acquire key strategic sites over time.⁸⁴⁷

D132 These are unique factors which any new entrant would be unlikely to easily replicate. We understand replacement of a cement manufacturing plant, like GBC's, is likely to exceed \$500 million dollars. Given this, GBC considered the capital required alone makes domestic entry improbable.

Structural barriers to importing cement are lower

D133 Our preliminary view is that the barriers to importing cement are low. However, any small-scale entrant is most likely to be a RMX producer (or a group of producers) initially self-supplying, before expanding to public sales. This is due to the need to ensure downstream sales to RMX suppliers.

D134 There are two main ways cement can be imported: bulk shipping, and containerised shipping.

Bulk shipping has high barriers to enter

D135 Bulk shipping cement has high fixed costs but enables low variable costs. This means the firm needs large volume for the method to be economically viable. However, if this volume is achieved, it enables the firm to secure a low per-unit cost.

D136 Bulk-shipped cement is transported in the hull of a ship. This requires specialised handling systems to load and unload the cement. For example, Holcim bulk ships its cement from Japan to two purpose-built import terminals which cost approximately \$50 million each.⁸⁴⁸

Barriers to importing containerised cement are significantly lower

D137 Conversely, containerised shipping (or "bulk bag" importing) requires minimal capital expenditure but has higher variable costs.⁸⁴⁹

D138 The method has lower barriers to entry, as it requires little supply chain infrastructure and can be shipped in smaller quantities. This means a small amount of capital is needed to establish supply, with less complexity.⁸⁵⁰

⁸⁴⁷ For example, it has a large source of limestone near its Whangārei manufacturing plant, which is a key input to cement.

⁸⁴⁸ Holcim NZ "New import terminal underway in Timaru" (15 October 2014) at 1-2, available at: https://www.holcim.co.nz/sites/newzealand/files/documents/141015_Media_Release_Timaru_0.pdf.

⁸⁴⁹ For example, one respondent to our supplier survey stated the estimated initial set up cost to operating as a cement importer is between \$100,000 and \$500,000. Similarly, []. However, we do not have evidence to verify these costs.

⁸⁵⁰ [].

- D139 However, it is typically a more expensive import method than bulk shipping. The input cost of cement is higher (eg, due to the exporter needing to package the cement). There are also higher handling costs (eg, de-bagging the cement once imported). These factors may limit the ability for firms to lower their per-unit cost by increasing volume.
- D140 Additionally, we understand the viability of this method may be limited currently due to the spike in container shipping costs during the COVID-19 pandemic.⁸⁵¹
- D141 Nevertheless, if container shipping costs return to prices similar to before 2020, it may be a viable way to obtain cost-effective cement supply.

However, there may be other barriers to effectively importing cement

- D142 One RMX producer told us that they had previously considered self-supplying cement but considered it unattractive to do so.⁸⁵² This is because:

D142.1 large capital investment would be required to develop import terminals and develop the supply chain;

D142.2 exposure to global markets (eg, shipping and production costs, exchange rates) could create unwanted uncertainty and resilience risks; and

D142.3 vertical integration would introduce unwanted complexity and costs into the business and shift its focus away from competing effectively in the RMX market.

- D143 This appears consistent with the view of the large cement firms. One told us that, while RMX producers could import cement if they chose, it usually makes more commercial sense to purchase from a supplier.⁸⁵³

There are some general structural barriers to entering the cement market, regardless of supply model

- D144 Some barriers are general to both importers and domestic manufacturers of cement. These include:

D144.1 the physical properties of cement requiring specialist transport, storage and logistical solutions; and

D144.2 large economies of scale required to achieve ROI in supply chain.

⁸⁵¹ While bulk-shipped cement is also exposed to this risk, it is likely to be mitigated somewhat as the method generally relies on longer-term and larger-scale arrangements, rather than spot prices.

⁸⁵² [].

⁸⁵³ [].

Necessary capital expenditure may be a barrier to entry and expansion of ready-mix concrete firms

- D145 One RMX producer told us the capital barriers to entering the RMX market are relatively low. The cost of a new plant can range from \$1 million to \$10 million, depending on the size.⁸⁵⁴ However, plants in New Zealand can also exceed costs of \$10 million.⁸⁵⁵
- D146 However, plant-share arrangements may ease these capital barriers. Some competitors have told us new RMX entrants operating under a plant-share model often exert competitive pressure on incumbents.

Access to and/or availability of suitable ready-mix concrete sites appears to slow entry and expansion

- D147 Identifying, and obtaining, suitable sites appears to be a key challenge for RMX producers wanting to enter or expand in the market.
- D148 In general, a site for a RMX plant would be expected to:
- D148.1 be of a suitable size;
 - D148.2 be near current and/or future construction activity;
 - D148.3 be near an arterial road (eg, a motorway);
 - D148.4 have a suitable degree of access for heavy vehicles;
 - D148.5 have a low consenting risk (ie, is likely to meet resource consent requirements); and
 - D148.6 be suitably zoned to comply with local planning regulations.⁸⁵⁶
- D149 This narrow set of requirements likely significantly limits the number of suitable sites available for RMX producers.
- D150 For example, we heard from one RMX operator in the Auckland region who had identified an area they wished to expand into, but it took them multiple years to find, and purchase, a suitable site on which to set up a plant.⁸⁵⁷ For this firm, the challenges were primarily due to:
- D150.1 the scarcity of suitable located and zoned sites; and

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⁸⁵⁶ []; [].

⁸⁵⁷ [].

D150.2 the capital-intensive nature of developing a site.

Strategic factors at the cement level

D151 Our preliminary view is that strategic factors, or conduct by incumbents, are not posing an undue barrier to entry or expansion by other firms. As discussed above, exclusive supply agreements are common, but appear to be driven by mutually beneficial efficiency gains.

Obtaining reliable ready-mix concrete customers is crucial to achieving scale as a cement supplier

D152 The ability for a cement supplier to enter or expand in the market relies on the existence of a contestable (ie, independent) RMX customer base.⁸⁵⁸

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Attachment E Supplier survey

- E1 This attachment provides further information about our supplier survey.
- E2 Our survey was aimed at suppliers (ie, domestic manufacturers and importers) of key building supplies. We conducted the survey to help to build our understanding of how well competition is working for key residential building supplies and to provide suppliers an opportunity to share their own views. We sought information on a range of topics including:
- E2.1 the nature of competition in individual key building supply markets;
 - E2.2 how suppliers make business decisions such as pricing and distribution strategies;
 - E2.3 how suppliers vary in terms of product mixes and regional presence; and
 - E2.4 any obstacles that make it difficult for suppliers to enter and compete in the markets for key building supplies.
- E3 We received 22 responses to our supplier survey. These respondents supplied a range of different key building supplies and varied significantly in size and business models.
- E4 The sections in this attachment are:
- E4.1 how we designed and conducted this survey;
 - E4.2 our approach to confidentiality of information;
 - E4.3 who responded to our supplier survey;
 - E4.4 how we have used the results of our supplier survey; and
 - E4.5 a question script for the survey.

How we designed and conducted the survey

- E5 Our supplier survey was conducted online and hosted on SurveyMonkey. The survey was available from 12 April to 9 May 2022.
- E6 It included 30 questions in total. Respondents were first given the opportunity to select up to three key building supplies that they supply. They were then asked a set of 12 questions for each building supply selected, followed by a single set of 14 general questions applying to their whole business.
- E6.1 Respondents who selected one key building supply were asked 30 questions.
 - E6.2 Respondents who selected two key building supplies were asked 42 questions (because 12 questions were repeated for their second key building supply).

- E6.3 Respondents who selected three key building supplies were asked 54 questions (because 12 questions were repeated for each of their second and third key building supplies).
- E7 After selecting their key building supplies, respondents were asked about:
- E7.1 their role in the supply chain and the locations in which they operate;
 - E7.2 access to inputs and distribution channels;
 - E7.3 the substitutability of their products;
 - E7.4 the negotiating power and preferences of their customers;
 - E7.5 the obstacles for businesses looking to enter or expand in their markets;
 - E7.6 their sales and profit made on each of their key building supplies;
 - E7.7 the factors they consider when setting prices;
 - E7.8 vertical arrangements used by themselves and their competitors; and
 - E7.9 their overall views on competition in their markets.
- E8 We sought to frame the questions using neutral language, to allow respondents to freely provide their views.
- E9 The questions were mainly multiple choice with some opportunities to input information and/or provide explanatory text.
- E10 Every question was optional, so respondents were free to skip as many questions as they wanted.
- E11 We promoted the survey to seek input from a wide range of suppliers. Strategies to promote the survey included publishing a media release, adding a link to the survey on the homepage of our website, and emailing a link to the survey to 492 suppliers of key building supplies that we had identified as potential respondents.

Our approach to confidentiality of information

- E12 We were conscious that some of the information respondents may have wanted to share with us could be confidential.
- E13 Respondents were able to either complete the survey anonymously or share their details with us. Of the 22 responses received, 9 provided their details and 13 remained anonymous.
- E14 We implemented additional information handling measures for information provided to us by respondents, including restricting the number of our staff who have access to the information.

Who responded to our supplier survey

E15 Structural timber was the most common key building supply that our respondents supplied. Table E1 below provides a full breakdown of the key building supplies provided by respondents. Note that the total adds up to more than 22, because each respondent was able to select up to three key building supplies.

Table E1 Breakdown of respondents to our supplier survey

Which key building supplies do you provide?	Number of respondents
Structural timber	8
Doors and door joinery	3
Fibre cement	3
Insulation	3
Other cladding	3
Plasterboard	3
Cement	2
Clay brick masonry	2
Concrete masonry	2
Engineered timber	2
Other timber	2
Other weatherboard	2
Timber cladding	2
Concrete	1
Frame and truss	1
Plywood	1
Roofing tiles	1
Steel roofing	1
Wet wall lining	1
Windows and window joinery	1

How we have used the results of our supplier survey

- E16 Our supplier survey enabled us to seek the views of a range of suppliers of key building supplies, and provided suppliers with an opportunity to comment on any competition issues they have observed.
- E17 Because of the relatively small number of responses, we did not produce any statistics or otherwise conduct any quantitative analysis of the results.

E18 However, we conducted a qualitative review of the written responses which informed our understanding of various topics. Some of the written responses have been referenced (anonymously) in our draft report.

Copy of questions

This survey asks questions about the building supplies your company provides and competition in each market.

It will take you around 10 to 20 minutes to complete.

Your response will be used by the Commission to inform our competition study into residential building supplies.

You are not required to provide your name or business name when completing this survey, so that your response can be anonymous.

You can skip questions that you do not want to answer.

We will not share your individual response with third parties unless required to do so by law.

We will not publish individual responses but may publish a summary of responses on our website.

The survey is open until **9 May 2022**.

Your privacy is important to us

If you wish to use another process to provide the Commission with confidential, commercially sensitive or personal information, please email us at buildingsuppliesmarketstudy@comcom.govt.nz to ask to speak with someone from the project team.

We recognise the need to ensure that you can have confidence in our use and retention of information, and we are committed to respecting any privacy, confidentiality, or commercial sensitivity attached to your information where possible.

The survey asks questions about the supply of key building supplies. The following table describes the types of building supplies within the scope of the study:

Table 1: Preliminary list of building supplies in scope

Major components of residential buildings	Building supplies in major components
Foundation	Concrete, timber, steel reinforcing
Flooring	Concrete, particleboard, strandboard
Roof	Steel roofing, other sheet metal roofing, metal and concrete tiles, shingle and membrane roofing
Walls (structural/framing)	Timber framing, laminated veneer lumber (LVL), steel framing, concrete masonry, polyblock, rammed earth framing
Walls (exterior/cladding)	Weatherboard (timber/fibre-cement/uPVC), clay and concrete bricks, metal cladding, non-weatherboard fibre-cement, plywood, stucco, sheet steel
Walls (interior)	Plasterboard, wet lining
Walls (interior/exterior)	Window/door framing (aluminium, timber, composite, uPVC, fibreglass, and steel), glazing, doors
Insulation	<u>Walls and ceiling:</u> Glass wool and polyester <u>Floor:</u> Underslab, polystyrene, glass wool, polyester, perimeter edge, under footing

This section asks questions about the specific **key building supplies** you provide.

Please use the drop down menus below to select up to three products you provide from the following list:

- Cement
- Clay brick masonry
- Concrete
- Concrete masonry
- Doors and door joinery
- Fibre cement
- Insulation
- LVL/engineered timber
- Medium-density fibreboard (MDF)
- Particleboard
- Plasterboard
- Plywood
- Roofing tiles
- Steel framing
- Steel reinforcing
- Steel roofing
- Strandboard
- Structural timber
- Timber cladding (incl. timber weatherboard)
- Wet wall lining
- Windows and window joinery
- Other weatherboard (eg, PVC)
- Other cladding
- Other key building supplies (please specify)

You will be asked a set of questions for each product.

Note:

- If you are only providing feedback on one or two products, leave the other field(s) blank.
- If you select “Other key building supply”, please specify what that is.

1. Product #1

2. Product #2

3. Product #3

4. If you supply more than three of the key building supplies above and want to answer questions on the others, please provide your email address below and we can send you a separate question list for each additional key building supply.

Email address:

Key building supply questions

Note: In the live version of the survey, questions 5-16 were repeated for each key building supply selected in questions 1-3. The placeholder [KBS] was automatically filled with the name of each key building supply.

We are now going to ask you some detailed questions about [KBS]

5. Regarding your supply of [KBS], which of the following options best describes your role in the supply chain?
- Manufacture key inputs/materials (used to make [KBS])
 - Import key inputs/materials (used to make [KBS])
 - Manufacturer of [KBS] in New Zealand
 - Offshore manufacturer and importer into New Zealand of [KBS]
 - Importer of [KBS] only
 - Seller of [KBS] (sell directly to builders, developers or other consumers)

Other (please explain)

6. Have you had any difficulty in accessing inputs/materials required to manufacture [KBS], because of the actions of a third party?

- Yes
- No
- Not applicable

If you selected 'yes', what types of inputs and materials have you had difficulty accessing and why?

7. Can any of your [KBS] products be substituted for alternative materials?

(For example, we understand builders and developers often have a choice of different cladding types.)

- Yes
- No

If yes, please describe the substitute materials and which products they are substitutes for.

8. Please provide percentage estimates of how much quantity of your supply of [KBS] is sold through each of the following channels.

Please check that the percentages you input total to 100%.

Major merchants (i.e.

Placemakers,

Carters,

Bunnings, Mitre

10, and ITM)

Installers

Specialist
merchants

Directly to
builders or
developers

Other
merchants and
distributors
(please specify
below)

9. If you provided a percentage estimate for "Other merchants and distributors" above, please specify them below.

10. If you have had any difficulty in accessing the distribution channels below, please explain the difficulties you've experienced.

Major merchants (i.e. Placemakers, Carters, Bunnings, Mitre 10, and ITM)

Installers

Specialist merchants

Directly to builders or developers

Other merchants and distributors

11. How much negotiating power do the customers (including distributors) of your [KBS] have to influence your pricing and/or supply decisions?

- Significant
- Some
- Little
- None

Please explain

12. In general, what are the most significant obstacles for new businesses looking to enter into or expand their presence in New Zealand's [KBS] market?

Please rank in order of most significant obstacle (1) to least significant obstacle (8), and tick N/A beside any that do not apply.

- Use the comment box below if you have a reason not provided.

- You can drag and drop the options to your desired position - rankings will auto-populate.

	<input type="text" value=""/>	Meeting regulatory requirements	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Obtaining product assurance	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Behaviour of consenting bodies	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Behaviour of specifiers	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Securing capital investment	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Strategic responses of competitors	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Access to inputs/raw materials	<input type="checkbox"/> N/A
	<input type="text" value=""/>	Access to distribution channels	<input type="checkbox"/> N/A

13. If you would like to add an obstacle not provided above, please state it below with your ranking number next to it.

14. Do you have any comments/explanation about your order above? If so, provide it below.

15. What is the estimated initial set up cost (in NZD) to begin operating as a [KBS] supplier?

- Less than \$100k
- \$100k-\$500k
- \$500k-\$1m
- \$1m-\$5m
- \$5m-\$10m
- \$10m-\$20m
- \$20m-\$50m
- \$50m+

16. Regarding your supply of [KBS] in the financial year ended 2021, approximately what was the total value of your sales and profit? (\$NZD)

Sales

Gross profit

General questions

17. Where in New Zealand do you supply **key building supplies** to?

Select only one.

- Whole country
- North Island only
- South Island only

18. What factors do you typically consider when setting the prices of your **key building supplies**?

Rank in order of importance with '1' being the most important, and tick N/A beside any that do not apply.

- Use the comment box below if you have a factor not provided.

- You can drag and drop the options to your desired position - rankings will auto-populate.

☰	<input type="text"/>	Available supply capacity	<input type="checkbox"/> N/A
☰	<input type="text"/>	Pricing of competitors	<input type="checkbox"/> N/A
☰	<input type="text"/>	Changes in input cost	<input type="checkbox"/> N/A
☰	<input type="text"/>	Customer demand	<input type="checkbox"/> N/A

19. If you would like to add a factor not provided above, please state it below with your ranking number next to it.

20. For the key building supplies you provide, what factors do you think your customers consider to be the most important when choosing between suppliers?

Rank in order of importance with '1' being the most important, and tick N/A beside any that do not apply.

- Use the comment box below if you have a factor not provided.

- You can drag and drop the options to your desired position - rankings will auto-populate.

- ☰ Price
- ☰ Reliability of delivery
- ☰ Quality of product
- ☰ Brand name
- ☰ Meeting of product appraisal
- ☰ Familiarity of specifiers
- ☰ Familiarity of consenting bodies

21. If you would like to add a factor not provided above, please state it below with your ranking number next to it.

22. Which of the following strategies, if any, do you use in selling your **key building supplies**?

- Volume-based rebates
- Exclusivity requirements
- Systems or product tying (i.e. specifying or requiring certain products to be purchased and/or used together)
- Minimum orders (quantity or dollar value)
- Loyalty scheme
- Training or marketing support
- None of the above
- Other strategies (please specify and describe)

23. Tell us why you use each strategy selected above.

Volume-based rebates

Exclusivity requirements

Systems or
product tying
(i.e. specifying
or requiring
certain products
to be purchased
and/or used
together)

Minimum
orders
(quantity or
dollar value)

Loyalty scheme

Training or
marketing
support

None of the
above

[Insert text from
Other]

24. Which of the following strategies, if any, do you see being used by others in your markets?

- Volume-based rebates
- Exclusivity requirements
- Systems or product tying (i.e. specifying or requiring certain products to be purchased and/or used together)
- Minimum orders (quantity or dollar value)
- Loyalty scheme
- Training or marketing support
- Other strategies (please specify and describe, including any implication for you)

25. Tell us why you think others in your markets use the strategies you selected in the previous question.

Volume-based
rebates

Exclusivity
requirements

Systems or product tying (i.e. specifying or requiring certain products to be purchased and/or used together)

Minimum orders (quantity or dollar value)

Loyalty scheme

Training or marketing support

[Insert text from Other]

26. In your view, what could be done to improve competition for the supply of **key building supplies**?

27. Do you have any other comments you'd like to make? If so, please share them with us below.

Your company information

28. What was your company's approximate annual operating revenue in New Zealand in the most recent financial year? (NZD)

- Less than \$100k
- \$100k-\$500k
- \$500k-\$1m
- \$1m-\$5m
- \$5m-\$10m
- \$10m-\$20m
- \$20m-\$50m

\$50m+

OPTIONAL

You are not required to provide your name or business name when completing this survey, so that your response can be anonymous.

29. What is your company name?

30. If you are happy for us to contact you to discuss any aspects of the survey please provide your contact details below. These contact details will only be used for the Residential Market Studies Team to contact you for follow up about this survey.

Name

Email Address

Phone Number

Thank you for taking the time to complete our survey. Your response will assist our study into whether competition is working well for the residential building supplies sector.

If you want to be kept up to date with progress on the study please [subscribe to our mailing list](#).

More information on our market study can be found on our [website](#).

Attachment F Builders/specifiers survey

- F1 This attachment provides further information about our specifier survey.
- F2 We conducted the survey to help build our understanding of how well competition is working for key residential building supplies. We sought views on the factors that influence the decisions on which key building supplies are specified in plans and are purchased for residential building work.
- F3 We received 105 responses to our specifier survey.⁸⁵⁹ The respondents were largely builders who source building supplies for the build stage and/or have some input into the products specified in plans, and specifiers of building supplies at the design stage. Respondents varied significantly in size, as measured by the number of employees and experience in the sector.
- F4 The responses we received have informed our analysis of decision-making behaviours.
- F5 The sections in this attachment are:
- F5.1 how we designed and conducted our specifier survey;
 - F5.2 our approach to confidentiality of respondents' information;
 - F5.3 who responded to our specifier survey;
 - F5.4 how we have used the results of our specifier survey; and
 - F5.5 question script for our specifier survey.

How we designed and conducted our specifier survey

- F6 Our specifier survey was conducted online and hosted on our website. The survey was available from 18 March to 9 May 2022.
- F7 It included 45 questions in total. Respondents who specify and purchase key building supplies had the opportunity to answer all questions.
- F7.1 Respondents who indicated that they only specify key building supplies were asked 24 questions.
 - F7.2 Respondents who indicated that they only purchase key building supplies were asked 36 questions.
- F8 The initial questions sought to discover who makes the final decisions on types of key building supplies to use, the brand to use and where supplies are purchased. Tick-box options were provided for these questions.

⁸⁵⁹ [].

- F9 Topics covered in questions for respondents who are specifiers included:
- F9.1 reasons for specifying key building supplies;
 - F9.2 specification by brand;
 - F9.3 use of alternative products; and
 - F9.4 sources of product information.
- F10 Tick-box options were provided with some free text boxes where reasons were requested.
- F11 Topics covered in questions for respondents who are purchasers included:
- F11.1 where and how supplies are purchased;
 - F11.2 reasons for these decisions;
 - F11.3 sources of product information;
 - F11.4 switching suppliers;
 - F11.5 using alternative products; and
 - F11.6 pricing to customers.
- F12 We sought to frame the questions using neutral language, to allow respondents to freely provide their views.
- F13 We promoted the survey to seek input from a wide range of specifiers and purchasers including publishing a media release and adding a link to the survey on the homepage of our website.
- F14 We also engaged with peak bodies, industry associations and other stakeholders to help promote the survey through their communication channels.

Our approach to confidentiality of information

- F15 We were conscious that some of the information respondents may have wanted to share with us could be confidential.
- F16 Respondents were able to either complete the survey anonymously or share their details with us. Of the 105 responses received, 20 provided their details and 85 remained anonymous.
- F17 We implemented additional information handling measures for information provided to us by respondents, including restricting the number of our staff who have access to the information.

Who responded to our specifier survey

F18 Of the respondents, 62% indicated they were builders, 19% indicated they were architects or designers, 5% engineers, 2% quantity surveyors and 12% others (such as project managers and developers). The categories of respondents are shown in Table F1 below.

Table F1 Breakdown of respondents to our specifier survey

What sector of the building industry does your business currently work in?	Number of respondents
Building and construction	40
Architectural design	12
Other	8
Engineering design	3
Quantity surveying	1
No response	41

How we have used the results of our specifier survey

F19 Our specifier survey enabled us to seek the views of a wide range of specifiers and purchasers of key building supplies. We were able to identify common themes by reviewing the responses received. These themes are described in Chapter 4 of this report, as part of our analysis of decision making for the specification and purchase of building supplies.

F20 The survey was not designed to be statistically representative. Rather, it was intended to be a simple way of gathering the views of a range of industry participants within a short period of time.

F21 Follow-up meetings were held with some respondents to our specifier survey to seek clarification or further details regarding comments they had made. We were not able to meet with all survey respondents, so we met with a sample of respondents of different sizes where they wished to engage further with us.

Copy of questions

This survey asks some questions about how key building supplies are specified in residential building plans and how they are purchased.

Your response will be used by the Commission to inform our competition study into residential building supplies.

You are not required to provide your name or business name when completing this survey, so that your response can be anonymous.

We will not share your individual response with third parties unless required to do so by law.

We will not publish individual responses but may publish a summary of responses on our website.

We expect this survey will take you around 10 to 20 minutes to complete. Feedback is open until **9 May 2022**.

Your privacy is important to us

If you wish to use another process to provide the Commission with confidential, commercially sensitive or personal information, please email us at buildingsuppliesmarketstudy@comcom.govt.nz to ask to speak with someone from the project team.

We recognise the need to ensure that you can have confidence in our use and retention of information, and we are committed to respecting any privacy, confidentiality, or commercial sensitivity attached to your information where possible.

The survey asks some questions about how key building supplies are specified in residential building plans and how they are purchased. The following table describes the types of building supplies within the scope of the study:

Table 1: Preliminary list of building supplies in scope

Major components of residential buildings	Building supplies in major components
Foundation	Concrete, timber, steel reinforcing
Flooring	Concrete, particleboard, strandboard
Roof	Steel roofing, other sheet metal roofing, metal and concrete tiles, shingle and membrane roofing
Walls (structural/framing)	Timber framing, laminated veneer lumber (LVL), steel framing, concrete masonry, polyblock, rammed earth framing
Walls (exterior/cladding)	Weatherboard (timber/fibre-cement/uPVC), clay and concrete bricks, metal cladding, non-weatherboard fibre-cement, plywood, stucco, sheet steel
Walls (interior)	Plasterboard, wet lining
Walls (interior/exterior)	Window/door framing (aluminium, timber, composite, uPVC, fibreglass, and steel), glazing, doors
Insulation	<u>Walls and ceiling:</u> Glass wool and polyester <u>Floor:</u> Underslab, polystyrene, glass wool, polyester, perimeter edge, under footing

For the residential projects you work on and for the key building supplies used, who usually makes the final decision on:

1. The **types** of key building supplies to use:

- Architect
- Engineer
- Quantity surveyor

- Draftsperson
- Local builder
- Group home builder
- Homeowner/homebuyer/client
- Other (please specify):

2. The **brand** of building supplies to use:

- Architect
- Engineer
- Quantity surveyor
- Draftsperson
- Local builder
- Group home builder
- Homeowner/homebuyer/client
- Other (please specify)

3. **Where** the key building supplies are purchased from:

- Architect
- Engineer
- Quantity surveyor
- Draftsperson
- Local builder
- Group home builder
- Homeowner/homebuyer/client
- Other (please specify)

Product specification

This section relates to the planning stage of residential projects. We are still asking only about 'key building supplies' (see previous table).

* 4. Does your business ever specify key building supplies?

- Yes
- No

5. What are the top 5 reasons for specifying particular key building supplies for the major components of residential buildings?

Please rank in order of importance.

Please note:

- You only need to rank from 1 - 5

- Use the comment box in Q6 if you have a reason not provided below.

- *Mobile users: rankings will auto-populate, you can drag and drop the options to your desired position.*

- ↑ ↓ From a list in a design package
- ↑ ↓ Product is likely to be accepted by a consenting authority
- ↑ ↓ Product meets the Building Code
- ↑ ↓ Product is certified e.g. CodeMark
- ↑ ↓ Product has been appraised e.g. by BRANZ
- ↑ ↓ Product has a warranty
- ↑ ↓ Product has been used before and is reliable
- ↑ ↓ Product will be readily available
- ↑ ↓ Product is within budget
- ↑ ↓ Based on other available product information
- ↑ ↓ At the request of the homeowner/ homebuyer/client
- ↑ ↓ Product has a desirable attribute e.g. eco-friendly or new type of product
- ↑ ↓ Product is the cheapest

6. If you would like to add a reason not provided above, please state it below with your ranking number next to it.

* 7. Are specific **brands** of key building supplies commonly specified in the design plans?

- Always
- Sometimes
- Rarely
- Never

8. Which key building supplies are commonly specified by brand?

Foundation Concrete, timber, steel joists	<p>Answer choices:</p> <input type="checkbox"/> Always <input type="checkbox"/> Sometimes <input type="checkbox"/> Rarely <input type="checkbox"/> Never <input type="checkbox"/> Don't know <input type="checkbox"/> Not applicable
Flooring Concrete, particleboard, strandboard	
Roof Steel roofing, other sheet metal roofing, metal and concrete tiles, shingle and membrane roofing	
Walls (structural/framing) Timber framing, laminated veneer lumber (LVL), steel framing, concrete masonry, polyblock, rammed earth framing)	
Walls (exterior cladding) Weatherboard (timber/fibre-cement/uPVC), clay and concrete bricks, metal cladding, non-weatherboard fibre-cement, plywood, stucco, sheet steel)	
Walls (interior) Plasterboard, wet lining	
Walls (interior/exterior) Window/door framing (aluminium, timber, composite, uPVC, fibreglass, and steel), glazing, doors)	
Insulation Walls and ceiling: Glass wool and polyester Floor: Underslab, polystyrene, glass wool, polyester, perimeter edge, under footing)	

9. How easy is it for your business to use different key building supplies to those normally used when making the plans?

- Very easy
- Somewhat easy
- Neither easy nor difficult
- Somewhat difficult
- Very difficult

Please explain why you selected this option.

10. If you answered 'somewhat difficult' or 'very difficult', what are the main difficulties?

- Potential liability risk for specifier
- Client resistance
- Consenting authority resistance
- Other (please specify)

11. What sources do you get product information from before specifying key building supplies?

Select all that apply.

- Product supplier
- Merchant(s)

- Government (eg, MBIE)
- Product certification (eg, CodeMark)
- Product certifier (eg, BRANZ)
- Trade association
- Others in the trade
- None
- Other (please specify)

12. How often does your business use alternatives to the key building supplies (products) that you normally specify?

- Always
- Often
- Sometimes
- Rarely
- Never

Please explain why you selected this option. If your answer varies by product, please explain.

13. How does your business find out about new key building supplies entering the market? *Select all that apply.*

- Product suppliers
- Own research
- Merchants
- Trade association
- Others in the trade
- Other (please specify)

Product purchasing

* 14. Does your business purchase key building supplies?

- Yes
- No

15. Where does your business purchase most of its key building supplies?

- Direct from a New Zealand supplier
- Direct from an overseas supplier
- Major merchants (Bunnings, Carters, ITM, Mitre 10, PlaceMakers)
- Specialist store(s)
- Other (please specify)

16. Thinking about where key building supplies are purchased, which of the following best describes your business:

- We use one supplier/merchant for the majority of our purchases
- We use two supplier/merchants for majority of our purchases
- We use three or more supplier/merchants for majority of our purchases
- Other (please specify)

17. What is important to your business when deciding where to purchase key building supplies? *Select all that apply.*

- Price
- Trade account with a supplier, merchant or specialist store
- Rebates, discounts and/or loyalty benefits
- Product warranty
- Availability of product
- Specialist services eg, after-sales support
- Product information
- Location
- Personal relationship with supplier
- No other choice of supplier
- Other (please specify)

18. Which is most important? *(from the previous question)*

19. Do you seek quotes from different suppliers or merchants before deciding which one to purchase from?

- Always
- Often
- Sometimes
- Rarely
- Never

20. Where does your business access the information you need to seek different quotes? *Select all that apply.*

- Information from merchant
- Information from product manufacturer
- Price comparison website(s)
- Talking to others in the trade
- Other (please specify)

21. How do you select a supplier based on different quotes. Please rank in order. *Use the comment box below if you have a reason not provided.*

Mobile users: rankings will auto-populate, you can drag and drop the options to your desired position.

- ↑ Price
- ↓ Availability
- ↓ Delivery
- ↓ After sales service
- ↑ Better product

22. If you would like to add a reason not provided above, please state it below with your ranking number next to it.

* 23. How often does your business change suppliers of key building supplies?

- Always
- Often
- Sometimes
- Rarely
- Never

Please explain why you selected this option.

24. Please rank the top 5 reasons for changing supplier for any given key building supply?

Please note:

- You only need to rank 1 - 5
- Use the comment box below if you have a reason not provided.
- *Mobile users: rankings will auto-populate, you can drag and drop the options to your desired position.*

- ↑ Better prices
- ↓ Superior product
- ↓ Product availability
- ↓ Product warranty
- ↓ Better terms eg rebates/discount/loyalty benefits
- ↓ More product information
- ↓ After sales support
- ↓ A new supplier entering the market
- ↓ A supplier leaving the market
- ↓ Product would be approved by the consenting authority
- ↓ Eco-friendly product
- ↓ Product is quality assured e.g. has CodeMark certification or appraisal from BRANZ for example

25. If you would like to add a reason not provided above, please state it below with your ranking number next to it.

26. Please select any factors which make you keep your current main supplier? *Select all that apply*

- Price
- Product quality
- Product availability
- Product warranty
- Supply terms e.g. rebates/discount/loyalty benefits
- Product information
- After sales support
- Good working relationship
- Products available as part of a bundle
- Other

Thinking now about when you receive design plans...

* 27. Are specific **brands** of key building supplies commonly specified in the design plans?

- Always
 - Sometimes
 - Rarely
 - Never
-

Product purchasing – Product

28. Which key building supplies are commonly specified by brand? Only provide answers for those which apply to your business.

Foundation Concrete, timber, steel joists	Answer choices: <input type="checkbox"/> Always <input type="checkbox"/> Sometimes <input type="checkbox"/> Rarely <input type="checkbox"/> Never <input type="checkbox"/> Don't know <input type="checkbox"/> Not applicable
Flooring Concrete, particleboard, strandboard	
Roof Steel roofing, other sheet metal roofing, metal and concrete tiles, shingle and membrane roofing	
Walls (structural/framing) Timber framing, laminated veneer lumber (LVL), steel framing, concrete masonry, polyblock, rammed earth framing)	
Walls (exterior cladding) Weatherboard (timber/fibre-cement/uPVC), clay and concrete bricks, metal cladding, non-weatherboard fibre-cement, plywood, stucco, sheet steel)	
Walls (interior) Plasterboard, wet lining	
Walls (interior/exterior) Window/door framing (aluminium, timber, composite, uPVC, fibreglass, and steel), glazing, doors)	
Insulation Walls and ceiling: Glass wool and polyester Floor: Underslab, polystyrene, glass wool, polyester, perimeter edge, under footing)	

29. Where key building supplies are specified by brand, do the design plans allow equivalent products to be selected and substituted?

- Yes
- No

If not, why not?

30. How easy does your business find suggesting alternative key building supplies to those already detailed in the plans?

- Very easy
- Somewhat easy
- Neither easy nor difficult
- Somewhat difficult
- Very difficult

Please explain why you selected this option.

31. If you answered 'somewhat difficult' or 'very difficult', what are the main difficulties? *Select all that apply.*

- Specifier resistance
- Client resistance
- Consenting authority resistance
- Other (please specify)

32. How does your business find out about key building products that are new to the market? *Select all that apply.*

- Product manufacturer
- Own research
- Merchants
- Trade association
- Architects
- Industry contacts
- Others in the trade
- Other (please specify)

33. How often do you consider or try building products that are new to the market?

- Always
- Often
- Sometimes
- Rarely
- Never

And for which building product(s) and why?

Pricing

34. Please tell us how your business usually sets the project build price for customers.

- Fixed price
- Cost plus margin
- Other (please specify)

35. How often are any discounts, rebates or loyalty benefits received from suppliers of key building supplies passed onto clients/homeowners/homebuyers as part of the project build price?

- Always
- Rarely
- Sometimes

- Never
- Not applicable

General

When competition is working effectively, businesses face pressure to deliver the right prices, quality and range to satisfy a diverse range of customer preferences.

36. Do you think competition for key building supplies is working effectively at the moment between **merchants**?

- Yes
- No

Tell us why.

37. Is competition for key building supplies working effectively at the moment between product **manufacturers**?

- Yes
- No

Tell us why.

38. What do you think would improve competition in the market for key residential building supplies? *Select all that apply.*

- Allowing for substitute like-for-like products to be readily accepted by consenting authorities
- Faster approval for certified products
- Wider product assurance options
- More product information
- More information from architects on specified products
- More suppliers of products
- Transparency in regard to loyalty and discounting programs
- Improvements to supply chain logistics
- Other (please specify)

39. Are there any other comments you would like to make on competition in the market for key residential building supplies? If so, please share your views with us below.

Demographic Information

40. What sector of the building industry does your business currently work in?

- Architectural design
- Engineering design
- Building and construction
- Quantity surveying
- Other (please specify)

41. How long have you been working in the current sector?

- Less than 1 year
- 1-2 years
- 3-5 years
- 6-10 years
- More than 10 years

42. In what region(s) does your business operate? *Select all that apply.*

- Northland
- Auckland
- Waikato
- Bay of Plenty
- Gisborne
- Hawke's Bay
- Taranaki
- Manawatu-Wanganui
- Wellington
- Tasman/Nelson
- Marlborough
- West Coast
- Canterbury
- Otago
- Southland
- Other (please specify)

43. How many employees does your business have?

- 1 (sole trader)
- 2-9
- 10-49
- 50-99
- 100+

44. What is your business' annual revenue?

- Less than \$2M
- \$2 – 9.9M

- \$10 - 49.99M
- \$50M +
- Rather not say

45. If you would like us to contact you to discuss any aspects of the survey please provide your contact details below. These contact details will only be used for the Residential Building Supplies Market Studies Team to contact you for follow up about this survey.

Note, we will not publish individual responses but may publish a summary of responses on our website.

Name

Email Address

Thank you for taking the time to complete our survey.

Your response will assist our study into whether competition is working well for the residential building supplies sector.

If you want to be kept up to date with progress on the study please subscribe to [our mailing list](#).

More information on our market study can be found on [our website](#).

Attachment G Regulatory and standards systems survey

- G1 This attachment provides further information about our regulatory and standards systems survey.
- G2 We conducted the survey to help to build our understanding of the barriers to entry and expansion in residential building supplies markets. We sought views on the different elements of the regulatory and standards systems that apply to the consent of building materials in a residential building.
- G3 The regulatory and standards systems we sought feedback on include the:
- G3.1 Building Code;
 - G3.2 Building consent system;
 - G3.3 Standards NZ system; and
 - G3.4 CodeMark product certification.
- G4 We received 136 responses to our specifier survey. These respondents were largely builders who navigate the process of obtaining building consent and a code of compliance certificate from a Building Consent Authority.
- G5 The responses we received have informed our analysis of the extent to which the regulatory and standard systems may be a barrier to entry or expansion in residential building supplies markets.
- G6 The sections in this attachment are:
- G6.1 how we designed and conducted our specifier survey;
 - G6.2 our approach to confidentiality of respondents' information;
 - G6.3 who responded to our specifier survey;
 - G6.4 how we have used the results of our specifier survey; and
 - G6.5 question script for our specifier survey.

How we designed and conducted the survey

- G7 Our regulatory and standards systems survey was conducted online and hosted on our website. The survey was available from 29 April to 23 May 2022.
- G8 It included 20 questions in total. Respondents who navigate the regulatory and standards systems for key building supplies had the opportunity to answer all questions.

- G9 The initial questions sought to discover which elements of the regulatory and standards systems may be having an impact on the markets of key building supplies. Ranking options were provided for these questions.
- G10 Topics covered in the survey included:
- G10.1 The extent to which each of the four elements of the regulatory and standards systems (see paragraphs G3.1 to G3.4 above) impact competition in the markets for key building supplies;
 - G10.2 Which aspects of each of the four elements are impacting competition, if any, including the reasons why; and
 - G10.3 How the four elements could be changed to enhance competition in residential building supplies markets, including why.
- G11 Tick-box options were provided for the initial question, with free text boxes where an explanation was requested.
- G12 We sought to frame the questions using neutral language, to allow respondents to freely provide their views.
- G13 We promoted the survey to seek input from a wide range of specifiers and purchasers including publishing a media release, sharing the survey on social media and adding a link to the survey on the homepage of our website.

Our approach to confidentiality of information

- G14 We were conscious that some of the information respondents may have wanted to share with us could be confidential.
- G15 Respondents were able to either complete the survey anonymously or share their details with us. Of the 136 responses received, 112 provided contact details and 24 remained anonymous.
- G16 We implemented additional information handling measures for information provided to us by respondents, including restricting the number of our staff who have access to the information.

Who responded to our regulatory and standards systems survey

- G17 Of the total responses (note responders were able to select more than one category, we received 153 responses), 37% indicated they were builders or group home builders, 3% indicated they are architects or designers, 7% engineers, 7% work at a BCA or Council and 16% supply product (wholesalers, domestic manufacturers and importers). The categories of responses are shown in Table G1 below.

Table G1 Breakdown of total responses to our specifier survey

What sector of the building industry does your business currently work in?	Number of respondents
Builder	50
Group home builder	7
Architect	5
Building Consent Authority/ Council	11
Engineer	10
Retailer/Merchant	9
Wholesalers	5
Domestic manufacturer	10
Importer	7
Other	39

How we have used the results of the survey

- G18 Our survey enabled us to seek the views of a wide range of those involved in the regulatory and standards systems for key building supplies. We were able to identify common themes by reviewing the responses received. These themes are described in Chapter 3 of this report, as part of our analysis of decision making for the specification and purchase of building supplies.
- G19 The survey was not designed to be statistically representative. Rather, it was intended to be a simple way of gathering the views of a range of industry participants within a short period of time.

Copy of questions

This survey asks questions about the role of the regulatory and standards system in the residential building sector and its impact on competition in the markets for residential building supplies.

If you are able to do so, please provide real world examples with reference to specific building supplies.

It will take you around 10 minutes to complete.

We acknowledge the important role the regulatory and standards system plays in ensuring New Zealand residential buildings are safe and well built. The questions we are asking are intended to understand how, given this important role, the regulatory and standards system works for competition in the supply of building materials in New Zealand.

Your response will be used by the Commission to inform our competition study into residential building supplies.

You are not required to provide your name or business name when completing this survey, so that your response can be anonymous.

Only the first two questions require answers. Thereafter, if there's a question you don't want to answer, you can skip it.

We will not share your individual response with third parties unless required to do so by law.

We will not publish individual responses but may publish a summary of responses on our website.

The survey is open until **23 May 2022**.

Confidential information

If you wish to use another process to provide the Commission with confidential, commercially sensitive or personal information, please email us at buildingsuppliesmarketstudy@comcom.govt.nz to ask to speak with someone from the project team.

We recognise the need to ensure that you can have confidence in our use and retention of information, and we are committed to respecting any privacy, confidentiality, or commercial sensitivity attached to your information where possible.

This survey covers four parts of the regulatory and standards system relevant to residential building supplies in New Zealand:

1. Building Code;
2. Building Consent System;
3. Standards NZ;
4. Codemark product certification.

When we refer to 'competition', please consider:

What effective competition looks like

When competition is working effectively, businesses face pressure to deliver the right prices, quality and range to satisfy a diverse range of customer preferences.

This section asks you to identify where you fit into the residential building sector and where you are located.

* 1. What is your role within the residential building supplies sector in NZ?

(Select all that apply)

- Builder
- Group home builder
- Architect
- Building Consent Authority/Council
- Engineer
- Retailer/Merchant
- Wholesaler

- Domestic manufacturer
- Importer
- Other (please specify)

* 2. Where in New Zealand do you operate? (Select all that apply)

- All of NZ
- Auckland
- Bay of Plenty
- Canterbury
- Gisborne
- Hawke's Bay
- Manawatū-Whanganui
- Marlborough
- Nelson
- Northland
- Otago
- Southland
- Taranaki
- Tasman
- Waikato
- Wellington
- West Coast
- Other (please specify)

Building code

Thinking specifically about the Building Code – including the regulation that sets out building performance requirements, and the acceptable solutions and verification methods that are one way of demonstrating compliance.

3. What impact does the Building Code have on **competition** in residential building supplies markets?
- Negative impact on competition
 - No impact on competition
 - Positive impact on competition
 - Don't know

Please tell us why

4. Please describe any areas of the Building Code that are **impacting** competition in the residential building supplies markets.

Please also include *why* you think these areas are impacting on the market.

5. How could the Building Code be changed to **enhance** competition in residential building supplies markets?

Please also include *why* you think the changes should be made.

Building Consent Process

Now thinking about the Building Consent Process.

The consent process covers applying for a building consent from a Building Consent Authority, inspections and the issuing of a code compliance certificate.

6. What impact does the Building Consent System have on **competition** in residential building supplies markets?
- Negative impact on competition
 - No impact on competition
 - Positive impact on competition
 - Don't know

Please tell us why

7. Please describe any areas of the Building Consent System that are **impacting** competition in residential building supplies markets.

Please also include *why* you think these areas are impacting on the market.

8. How could the Building Consent System be changed to **enhance** competition in residential building supplies markets?

Please also include *why* you think the changes should be made.

Standards NZ

Now thinking specifically about Standards New Zealand's regulatory framework (Standards NZ System), including the process to update a standard referred to in the Building Code, an acceptable solution or verification method.

9. What impact does the Standards NZ System have on **competition** in residential building supplies markets?
- Negative impact on competition
 - No impact on competition
 - Positive impact on competition
 - Don't know

Please tell us why

10. Please describe any areas of the Standards NZ System that are **impacting** competition in residential building supplies markets.

Please also include *why* you think these areas are impacting on the market.

11. How could the Standards NZ System be changed to **enhance** competition in residential building supplies markets?

Please also include *why* you think the changes should be made.

CodeMark product certification

Now thinking specifically about CodeMark product certification.

12. What impact does CodeMark product certification have on **competition** in residential building supplies markets?
- Negative impact on competition
 - No impact on competition
 - Positive impact on competition
 - Don't know

Please tell us why

13. Please describe any areas of CodeMark product certification that are **impacting** competition in residential building supplies markets.

Please also include *why* you think these areas are impacting on the market.

14. How could CodeMark product certification be changed to **enhance competition** in residential building supplies markets?

Please also include *why* you think the changes should be made.

Other areas

Please describe any other areas of the regulatory system, not covered in the previous questions, that you think...

15. Are impacting competition *and tell us why*.

16. Could be improved to enable easier use of new or innovative building products *and tell us why*.

17. Could be improved to enhance competition *and tell us why*.

18. If there's anything else you'd like to tell us about the role of the regulatory and standards system in the residential building sector and its impact on competition, please provide it below.

Your company information**OPTIONAL**

You are not required to provide your name or business name when completing this survey, so that your response can be anonymous.

19. What is your company name?

20. If you are happy for us to contact you to discuss any aspects of the survey please provide your contact details below. These contact details will only be used for the Residential Market Studies Team to contact you for follow up about this survey.

Name	<input type="text"/>
Email Address	<input type="text"/>
Phone Number	<input type="text"/>

Thank you for taking the time to complete our survey.

Your response will assist our study into whether competition is working well for the residential building supplies sector.

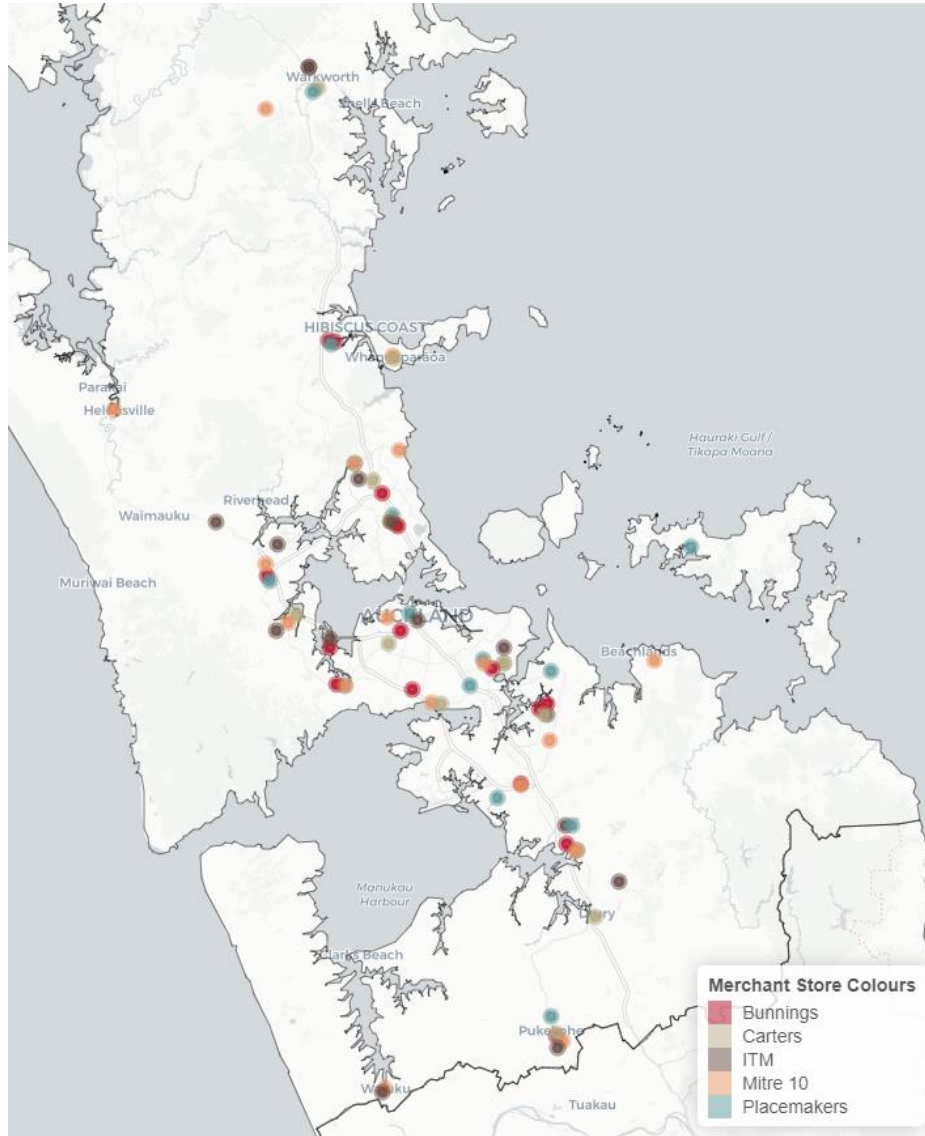
If you want to be kept up to date with progress on the study please [subscribe to our mailing list](#).

More information on our market study can be found on our [website](#).

Attachment H Additional maps of merchant stores

- H1 This attachment includes additional maps showing the location of major merchant stores that sold key building supplies during 2021. Chapter 6 includes similar maps showing merchant store locations for the North Island and South Island.
- H2 Figure H1 below shows the locations of the five major building supplies merchants' stores in in Auckland.

Figure H1 Major merchant store locations in Auckland (2021)

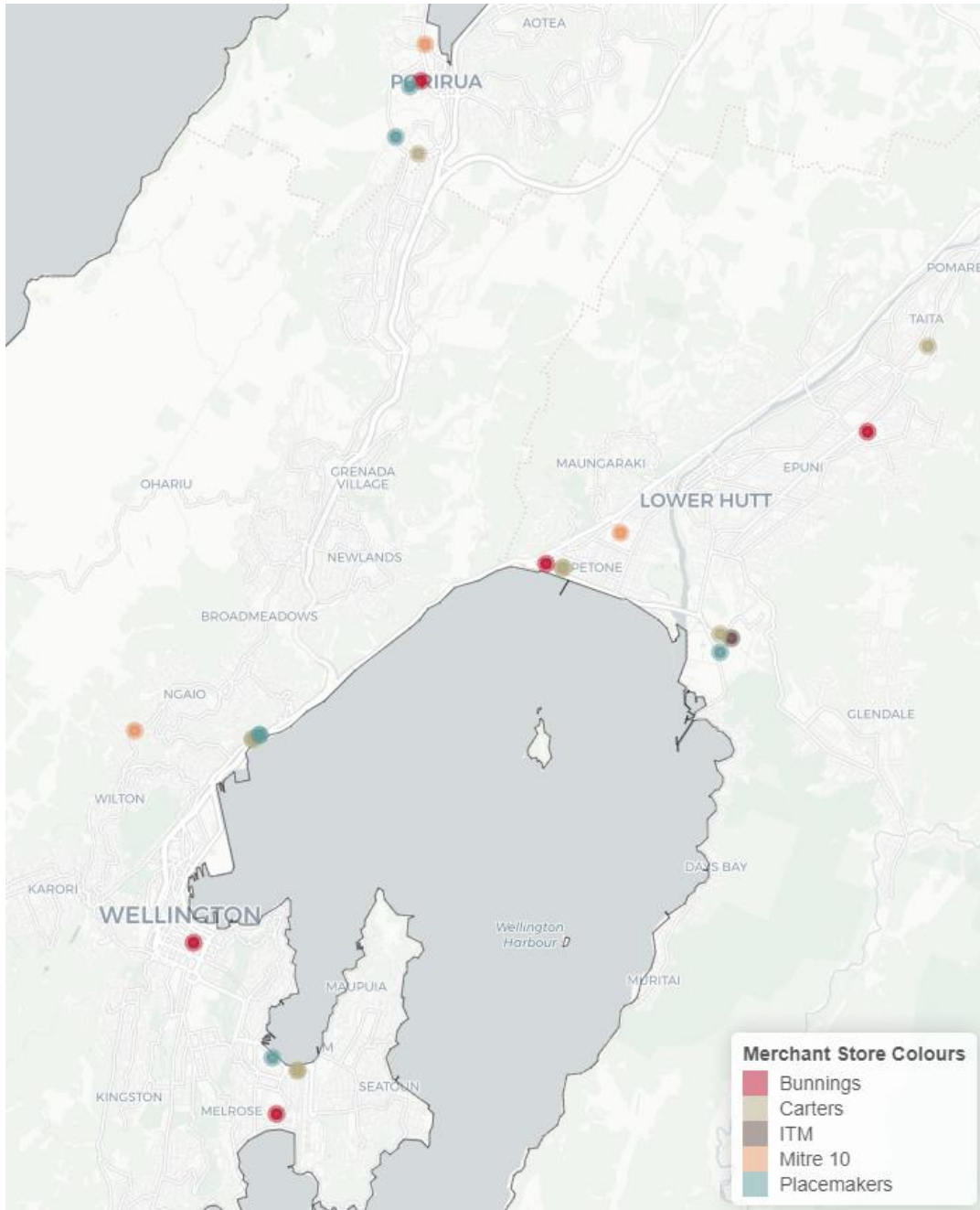


Note: In areas with multiple stores in close proximity, the markers may overlap and hide some store locations.

Source: Commerce Commission analysis of information provided by the major building supplies merchants.⁸⁶⁰

H3 Figure H2 below shows the locations of the five major building supplies merchants' stores in Wellington.

Figure H2 Major merchant store locations in Wellington (2021)

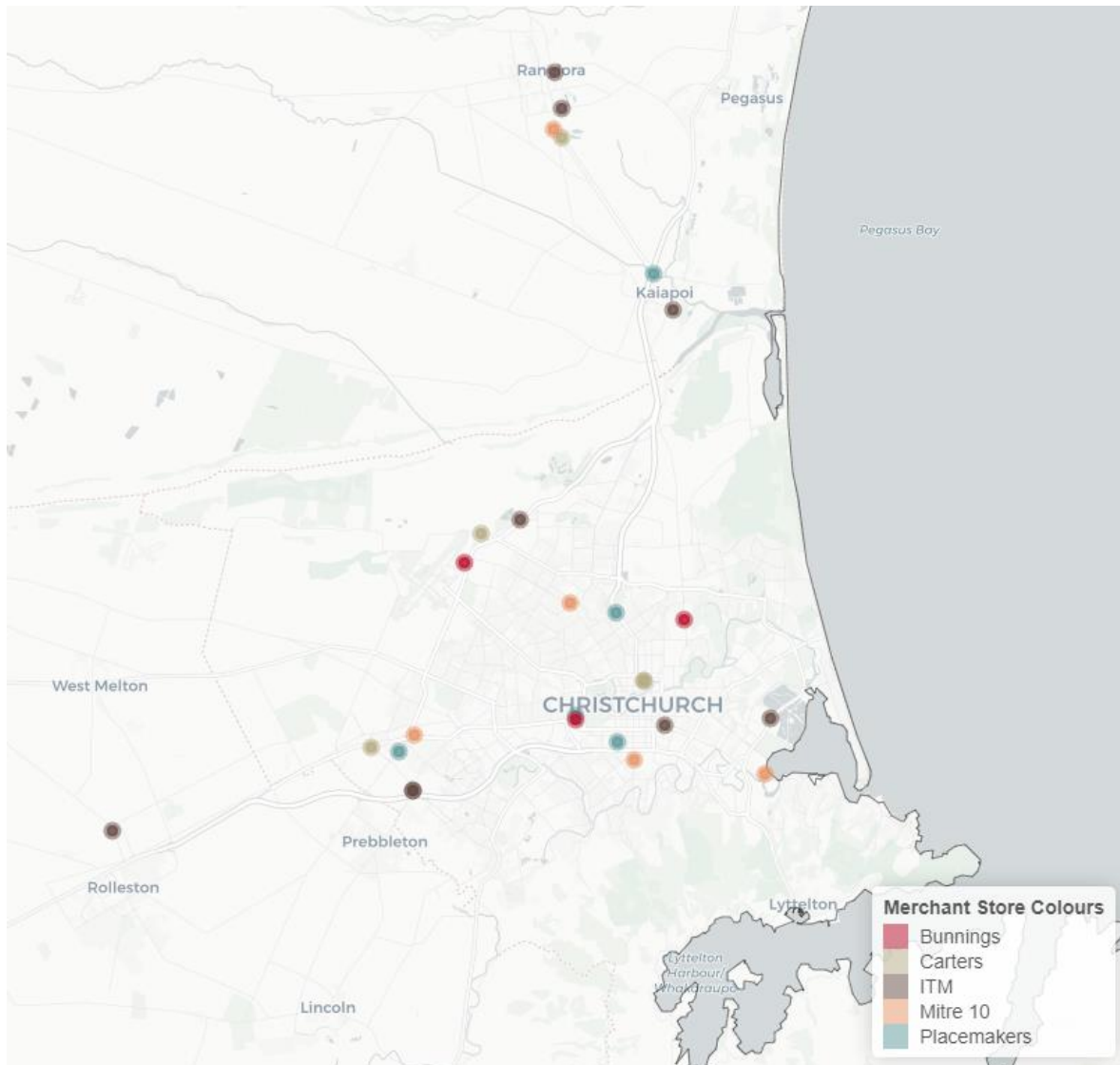


Note: In areas with multiple stores in close proximity, the markers may overlap and hide some store locations.

Source: Commerce Commission analysis of information provided by the major building supplies merchants.⁸⁶¹

H4 Figure H3 below shows the locations of the five major building supplies merchants' stores in Christchurch.

Figure H3 Major merchant store locations in Christchurch (2021)

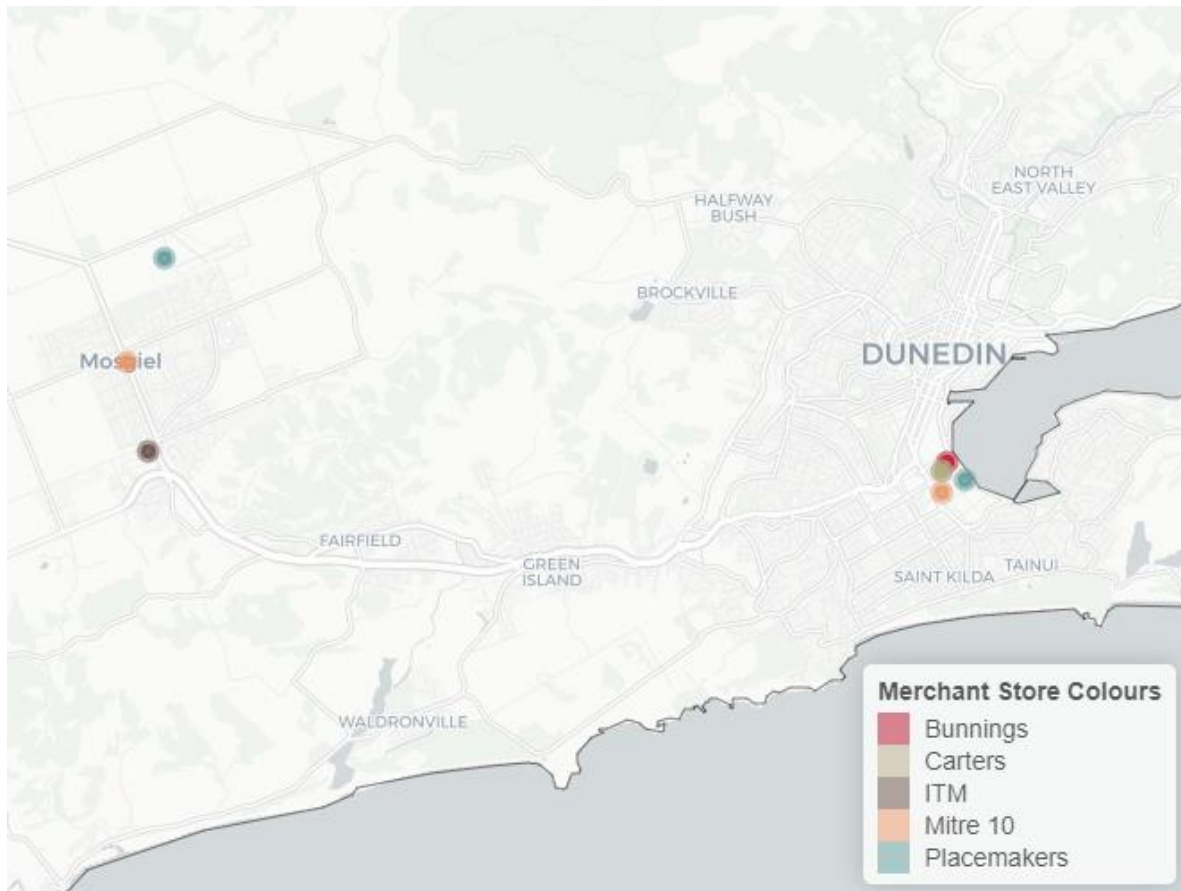


Note: In areas with multiple stores in close proximity, the markers may overlap and hide some store locations.

Source: Commerce Commission analysis of information provided by the major building supplies merchants.⁸⁶²

H5 Figure H4 below shows the locations of the five major building supplies merchants' stores in Dunedin.

Figure H4 Major merchant store locations in Dunedin (2021)



Note: In areas with multiple stores in close proximity, the markers may overlap and hide some store locations.

Source: Commerce Commission analysis of information provided by the major building supplies merchants.⁸⁶³

Attachment I Rebates – stylised example

- I1 As noted in Chapter 7, rebates offered to distributors by a supplier supplying a large share in a market can harm competition by reducing its rivals' ability to compete effectively. Some rebate schemes may induce strong incentives for distributors to achieve a minimum level of sales of the supplier's products, or a given market share. They may even encourage quasi or full exclusivity. This can hinder smaller rivals from competing by raising their costs and restricting their access to sufficient distributors, and ultimately customers, to achieve economies of scale.⁸⁶⁴
- I2 This attachment illustrates the way that different rebate structures can impact merchant decisions using hypothetical examples. For confidentiality reasons we do not use an example from an actual agreement between a supplier and merchant. However, we have observed similar rebate structures for key building supplies.
- I3 This attachment sets out hypothetical examples of:
- I3.1 a tiered retroactive rebate scheme;
 - I3.2 a share of wallet rebate scheme; and
 - I3.3 a tiered incremental rebate scheme.

Example of tiered retroactive rebate scheme

- I4 Tiered retroactive rebates are agreements for suppliers to pay a merchant a rebate based on the total volume of the merchant's purchases from the supplier. The level of rebate varies according to the total volume purchased by the merchant in a set period. These rebate structures can strongly incentivise merchants to stock a smaller range of products, due to the incentives they create at the sales thresholds.
- I5 For example, suppose there is a good that can be purchased from a number of suppliers. The price of a unit of a good is \$10. There is a rebate arrangement between a particular supplier and the merchant for the purchase of the good with the following structure:
- I5.1 At the end of each year, the supplier will pay the merchant a rebate of:
 - I5.1.1 10% on all purchases of the good if the total value of the merchant's purchases of the good in the year are below \$10 million;

⁸⁶⁴ See also, for example, the OECD roundtable discussion, which '*compares the incentives facing a target buyer under two types of discount scheme— incremental and rollback rebates. It also considers how the use of sliding scale discounts with rollback schemes can extend a dominant supplier's influence over a buyer. It argues that rollback rebate schemes provide more scope for profitable foreclosure than incremental rebate schemes.*', OECD "Policy Roundtables – Loyalty and Fidelity Discounts and Rebates (2002) at Appendix 1, available at: <https://www.oecd.org/daf/competition/abuse/2493106.pdf>.

- 15.1.2 11% on all purchases of the good if the total value of the merchant's purchases of the good is above \$10 million but below \$20 million;
- 15.1.3 13% on all purchases of the good if the total value of the merchant's purchases of the good are above \$20 million but below \$30 million;
- 15.1.4 15% on all purchases of the good if the total value of the merchant's purchases of the good is above \$30 million.

16 Table I1 shows the cost to the merchant of buying one extra unit which would take them over each rebate tier threshold. It shows that this rebate structure creates strong incentives for the merchant to make additional purchases of the good when making marginal purchasing decisions around the step levels. This is because once the merchant exceeds the tier threshold, it is paid a higher rebate on all prior purchases, not just the additional volumes. It shows that when approaching each tier, the merchant will often face a negative marginal cost. For example, in the hypothetical example, this means that once the merchant has reached the \$10 million threshold, the decision to buying an extra unit may result in a reduction in total costs of \$99,991 rather than an additional \$10.

Table I1 Hypothetical example of negative price incurred at rebate tier levels

Purchase Value	Rebate level	Marginal cost of buying one additional unit at tier level ⁸⁶⁵
0	10%	
\$10,000,000	11%	-\$99,991
\$20,000,000	13%	-\$399,991
\$30,000,000	15%	-\$599,991

Source: Commerce Commission analysis.⁸⁶⁶

⁸⁶⁵ For example, at the \$10,000,000 purchase value threshold, \$9,999,990 of purchases would cost: $\$9,999,990 \times 0.9$ (10% Rebate) = \$8,999,991. However, if we increased purchases by 1 unit to \$10,000,000 of purchase value, this would cost $\$10,000,000 \times 0.89$ = \$8,900,000. The difference in cost is \$99,991, so the marginal cost of that unit is -\$99,991. This calculation has been repeated for the other two purchase value thresholds.

⁸⁶⁶ [].

Table I2 Example of merchant making purchasing decision at the margins

	Case 1	Case 2
Units purchased	2,999,000	3,000,000
Purchase Value (Units x \$10 Unit Cost)	\$29,990,000	\$30,000,000
Rebate (Purchase Value x Rebate level)	-\$3,898,700	-\$4,500,000
Purchase Cost (Purchase Value – Rebate)	\$26,091,300	\$25,500,000
Difference		-\$591,300

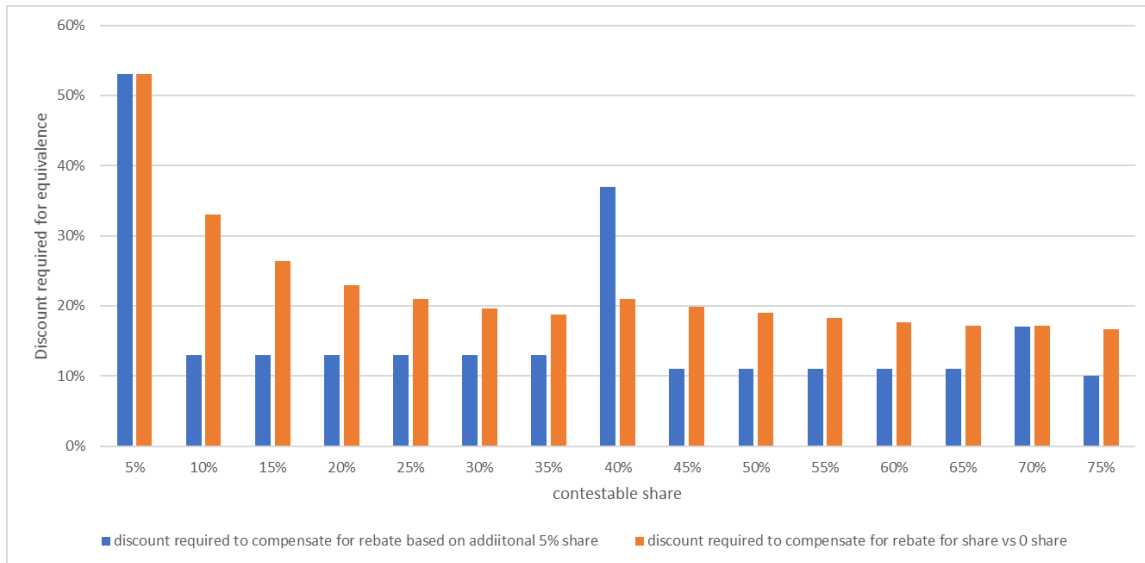
Source: Commerce Commission analysis.⁸⁶⁷

- 17 Table I2 continues the hypothetical example and shows how the rebate structure influences decision making where the merchant has already purchased 2,999,000 units of the good from the supplier and is now considering the purchase of an additional 1,000 units. If the merchant buys the additional 1,000 units from its current supplier, it will reach a new rebate tier (15%) and which applies retroactively to all their purchases, not just the additional 1,000 units. Therefore, even if it does not need these extra units, or could obtain those units from other suppliers, the merchant is strongly incentivised to make additional purchases from the supplier with whom it has a retroactive rebate arrangement. This is because purchasing an extra 1,000 units will decrease the total cost of the merchant's purchases of the good. In the above example, purchasing 1,000 additional units decreases overall purchase costs by \$591,300.
- 18 In order to induce the merchant to switch the additional 1,000 to another supplier, that supplier would not only have to match the rebate tier, but also compensate the merchant for the loss of the retroactive rebate that it would have received had it not switched.
- 19 The effect of the retroactive rebate structure on a merchant's decision making and the ability of alternative suppliers to compete also depends on the volume of the merchant's total purchases of the good that are contestable by other suppliers; that is, the share of total purchases that the merchant is willing to shift to other suppliers. The proportion of sales that are contestable can also affect the incentives created by a particular rebate structure and the extent to which an alternative supplier would need to compensate the merchant for the lost rebate.
- 110 We illustrate these effects by continuing with the hypothetical example.

- I11 We assume that the merchant forecasts demand at 3.1 million units (at a purchase value of \$31 million), and that due to the entrenched position of the incumbent, the merchant is unlikely to be able to switch all the stock to an alternative supplier.⁸⁶⁸
- I12 Assuming the merchant can switch 1.2 million units of purchases (that the contestable share is just under 40%, at a purchase value of \$12 million), the merchant would consider the impact of lost rebates when deciding which supplier to purchase these units from. The merchant would lose the following rebates if it switches to an alternative supplier:
- I12.1 15% discount on the 1.2 million units no longer sold; and
- I12.2 an additional 4% lost on the remaining 1.9 million units.
- I13 The merchant may switch supplier if that supplier is able to compensate the merchant for the lost rebates. However, the alternative supplier faces a disadvantage as they need to compensate for the discount on both lost rebates. An alternative supplier first has to make a 15% discount on the first 1.2 million units to compete with the first lost rebate. There is no asymmetry between the incumbent and the alternative supplier on this rebate.
- I14 However, to compensate for the lost 4% discount on the additional 1.9 million units of sales, the alternative supplier would have to offer a relatively higher discount (around 6%) on the first 1.2 million units than the incumbent supplier offers the merchant.
- I15 This means that unless the alternative supplier is able to offer a rebate of at least 21% on the 1.2 million units, the merchant is unlikely to be incentivised to stock the product (all else equal), which tilts competition in favour of the incumbent.
- I16 In practice, the impact of the rebate tiers varies depending on the expected share of sales the entrant is looking to win (or the merchant is looking to switch away), as well as the forecast for overall sales.
- I17 Figure I1 below shows, for our stylised example, the level of rebate an alternative supplier would need to offer to match the effective discount provided by the incumbent for different contestable shares of supply. If the contestable share of supply is small, the lost rebate can be relatively large due to the contestable share moving total purchases into different tiers.

⁸⁶⁸ We assume that both firms have identical cost structures, and that marginal cost is below average cost. If both firms had marginal cost equal to average cost for the additional units, the entrant would be able to compete with the incumbent's price.

Figure I1 Stylised example, showing the different discounts required for different contestable share levels assuming estimated total purchases are \$31 million for the period



Source: Commerce Commission analysis.⁸⁶⁹

- I18 Figure I1 shows the merchant's expected purchases were 3.1 million with the example rebate structures in place set out in paragraph I4 above. If the contestable share was 5% (that is; a merchant would only ever consider switching 0.155 million units), an alternative supplier would have to compensate for the loss of the additional 2% rebate level across all sales equivalent to approximately \$822k. Since this large cost has to be spread over a relatively small purchase value, an alternative supplier would have to offer a rebate of over 50% to be cheaper than the incumbent's offering.

Example of share of wallet rebates

- I19 A share of wallet rebate is an agreement between a supplier and merchant where the supplier agrees to pay the merchant a percentage rebate based on the total share of purchases from a category that the merchant made from the supplier. The rebate level applies to the total volume of purchases from the merchant in a given period.
- I20 For example, a share of wallet rebate might state that:
- I20.1 a rebate of 4% will be given if a merchant makes at least 60% of its category purchases from the supplier party to the agreement;
 - I20.2 a rebate of 8% will be given if a merchant makes at least 80% of its category purchases from the supplier party to the agreement; and

- I20.3 a rebate of 10% will be given if a merchant makes at least 95% of its category purchases from the supplier party to the agreement.
- I21 Share of wallet rebates have a similar effect on merchants' incentives as retroactive tiered rebates. They can also make it harder to alternative suppliers to compete.
- I22 To see this, using a similar example as above, suppose a merchant's total demand was 3 million units with a unit cost of \$10. If the merchant purchased all units from one supplier, they would get a rebate of \$3 million. If they were considering switching 0.3 million units of their purchases to another provider, their rebate would drop to 8% across all purchases. This would mean that the rebate payments would fall to \$2.16 million, a decrease of \$0.84 million. An alternative provider would need to compensate the merchant for this lost rebate which implies a rebate equivalent to 28% to compensate for the lost rebate.
- I23 On the other hand, share of wallet rebates set lower than 100% provide some headroom for merchants to consider alternative suppliers and some ability for those suppliers to compete for small shares of sales. For example, in this case the merchant would be able to switch just under 5% of their sales to another provider without being affected by the rebate structure.

Example of tiered incremental rebates

- I24 Tiered incremental rebates are agreements for suppliers to pay different levels of rebates back as a merchant reaches different volume levels. Unlike retroactive rebates, the higher tier is only payable on incremental sales above the threshold rather than the entire volume of sales. For example, such an arrangement might state that a supplier each year will pay:
- I24.1 5% rebate back on all sales up to \$10 million;
- I24.2 10% rebate back on all sales above \$10 million but below \$20 million; and
- I24.3 15% rebate back on all sales above \$20 million.
- I25 In this example, if a merchant were to purchase \$25 million of product, they would receive back \$500k rebate on the first \$10 million of sales, \$1 million back on the next \$10 million, and \$750k on the last \$5 million.
- I26 Incremental rebates do not create the same very sharp incentives around tier points as tiered retroactive rebates do. If a merchant with \$22 million of total purchases were considering switching \$4 million to an alternative supplier, the alternative supplier would only have to match the weighted average discount from the proportion of sales at the highest level for and the next level down. While there is still some asymmetry, as the incumbent's average price is still higher than the price the alternative provider needs to provide for the contestable share, the differences are likely to be smaller.