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Residential building supplies market study

Additional paper on the scope of this study

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Introduction

1. The Minister of Commerce and Consumer Affairs has required that we carry out a study under Part 3A of the Commerce Act 1986 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 (key building supplies). 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.[1]

2. The study will consider whether competition is working well and, if it is not, what could be done to improve it. If competition is working well, this benefits consumers through the prices they pay for the key building supplies we consider in the study, the quality and range available, and the level of innovation relating to them.

3. We expect the study will help inform the public, the industry, and Government about the nature of competition for key building supplies and, if we find that competition is not working as well as it could, we may make recommendations that identify ways to improve competition for those supplies.

Purpose of this paper

4. On 17 December 2021 we issued a Preliminary Issues paper which summarised our understanding of the residential building supplies industry in New Zealand at that time and the potential issues we may consider in the study. We invited comment from all interested parties and market participants at all levels of the supply chain to help further our understanding of the sector and decide where to focus our efforts during the study.

5. We received 25 submissions and 4 cross-submissions in response to the Preliminary Issues paper from a range of market participants, trade associations and other industry bodies, business commentators and interested parties. We would like to thank those stakeholders who made a submission or a cross-submission on the Preliminary Issues paper for the study, and we look forward to continuing to engage with them.

6. Having considered submissions, we have refined the approach we are taking to this study. This paper:

   6.1 confirms the scope of this study;

   6.2 explains the approach we will take to this study, as we continue to explore all of the potential issues outlined in the Preliminary Issues paper; and

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[1] 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.

6.3 describes the steps we intend to take for the next phase of this study, in the context of the overall process for this study outlined in the Statement of Process paper.

7. This paper should be read in conjunction with the Statement of Process and Preliminary Issues papers. It does not replace those papers or the potential issues discussed in the Preliminary Issues paper, which we will be exploring in this study. This paper also does not discuss issues or questions that we asked in the Preliminary Issues paper that do not relate to the scope of the study. We will further consider submissions relating to those matters and discuss them in the Draft Report.

The scope of this study

8. As noted above, the terms of reference[2] direct the study to examine 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. The study may also have regard to ancillary matters related to the terms of reference but not expressly referred to in it.

9. Some submitters identified benefits in a study of broader scope and/or longer duration than proposed in the Preliminary Issues paper.[3] However, 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 residential building fall outside the scope of the study contemplated by the terms of reference. So too do the services required for residential building such as professional fees, trades and other labour. 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.

10. The terms of reference for the study focus upon competition relating to key building supplies and whether competition is working to benefit consumers in the prices they pay for key building supplies that we consider in the study, 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.

11. Some commentators and submitters described challenging conditions, globally and domestically, including acute supply chain pressures, materials shortages and price increases at present. 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 the COVID-19 pandemic. While we may identify issues emerging from changing global conditions in recent times, the study will not closely examine factors affecting the international supply chain or short-term impacts of the COVID-19 pandemic on competition. The study will look more generally at supply chain resilience as we explore the extent to which competition is working well.

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[2] Gazette Notice, see n1 above.

[3] For example, some submitted that the study ought to include commercial as well as residential building, and consideration of inputs into residential building other than key building supplies such as labour, financing and consenting costs.

12. 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". We consider that Table 1 from the Preliminary Issues paper (set out below) adequately describes the general type of building supplies that are within the scope of the study. Based on feedback received following the Preliminary Issues paper, reference to "steel joists" now refers to "steel reinforcing" (as marked in the table below).

Table 1: List of building supplies in scope

Major components of residential buildings	Building supplies in major components
Foundation	Concrete, timber, steel ~~joists~~ 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: Commerce 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.

13. Plumbing and electrical supplies are not within the scope of the study. While some submitters considered that the study should include these supplies, their inclusion would add significantly to the scope of the study given the range of products this would include, coupled with the overlay of different regulatory systems. The exclusion of these supplies from the study is not an indication that we have reached any initial views in relation to competition relating to their supply or acquisition.

14. In addition, we invite stakeholders to provide us with information about factors affecting competition for plumbing and electrical supplies where that information may also be relevant to our identification of factors affecting competition for key building supplies which are within the scope of the study. That information may also inform future work planning by the Commission or by Government.

15. The study provides an opportunity to consider whether competition in the supply or acquisition of key building supplies is working effectively at the moment and, if not, how competition could be improved to work better for the benefit of New Zealand consumers over the long term. It will consider how competition is operating at all levels of the supply chain for the key building supplies that we have identified as within scope, and how that might change going forwards, including in response to the legislative change envisaged by the programme of Building Reform being led by the Ministry for Business, Innovation and Employment (MBIE).[4]

The approaches we are taking to this study

16. The study will take two complementary approaches:

    16.1 We will examine factors affecting competition across the range of key building supplies that we have identified as within scope, such as the regulatory and standards systems. We may identify some factors affecting competition for only some key building supplies. Where appropriate we may narrow our focus to a smaller selection of key building supplies to better understand how some factors affecting competition operate in relation to their supply.

    16.2 We will more closely examine the factors affecting competition for three products we have identified.

17. These approaches are described in more detail below.

Factors affecting competition across the range of key building supplies

18. We will examine 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.

19. This will include examining:

    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;

    19.2 the distribution options available to manufacturers/importers of key building supplies and how decisions by distributors are made to stock key building supplies; and

    19.3 the arrangements between the manufactures/importers of key building suppliers and distributors, such as volume-linked rebate agreements.

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[4] We note in this respect both MBIE's Building for Climate Change programme and that MBIE has indicated that it will be carrying out a review of the Building Consent system during 2022. MBIE is the central regulator of building and construction and steward of the Building Code and the review of the Building Consent system is a part of MBIE's ongoing programme of Building Reform. We will liaise with MBIE to the extent that themes raised in this study may be relevant to MBIE's review of the Building Consent system.

20. We will also seek to identify the conditions of entry and expansion for key building supplies including, but not restricted to, new and innovative building supplies, as directed by the terms of reference. This will include:

    20.1 Examining whether or not the regulatory and standards systems create any unnecessary impediments to competition and innovation. We will survey widely – with all stakeholders – to identify regulatory requirements that may be affecting conditions for the entry or expansion into the supply of key building supplies. If there are such requirements, we invite stakeholders to identify the specific issues in relation to key building supplies and possible solutions. We also invite stakeholder submissions on this issue.

    20.2 Considering 'new and innovative' supplies, 'green' building supplies or novel prefabricated products in the context of the broader themes of Building for Climate Change and standardisation (offsite manufacturing, prefabrication and windows). We want to understand whether suppliers and/or potential suppliers are facing challenges in trying to bring new products/approaches to market and/or expanding to compete with existing products and, if so, what those challenges are.

    20.3 Seeking to understand how decisions to choose key building supplies are made. We intend to survey builders and those involved in specifying materials, such as architects, as well as conducting a series of interviews to understand the factors that influence decisions. We will consider how those factors may impact competition for key building supplies.

Factors affecting competition for three key building supplies

21. Within the scope of the key building supplies that we have identified in Table 1, there are hundreds, possibly several thousand, different building supplies. It is infeasible for this study to examine in depth the factors affecting competition for each of those individual supplies.

22. In parallel to consideration of the issues outlined in paragraphs 18 to 20 above, which we will consider with regard to all key building supplies, we will consider three key building supplies in more detail as case studies.

23. The purpose of these case studies is to assist us to more closely consider the factors that may be affecting competition – 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. We have not formed a view that competition for these supplies is not working effectively. We also have not formed a view that competition does appear to be working effectively for other key building supplies.

24. We have identified the following three key building supplies for closer study:

    24.1 concrete (including cement);

    24.2 plasterboard; and

24.3 structural timber.

25. We selected these supplies based primarily on:

25.1 the relatively high proportion of the cost of residential building that these materials represent, compared to other supplies;[5]

25.2 the relatively high concentration of suppliers for these materials;[6] and

25.3 responses from stakeholders highlighting these materials as key and as having limited alternative suppliers.[7]

26. These primary considerations are consistent with the criteria we set out in the Preliminary Issues paper for potentially narrowing down our focus on a subset of key building supplies while still considering factors affecting competition across the range of key building supplies the subject of the study.[8] However, having considered submissions:

26.1 we have placed less emphasis on the extent to which the building supply itself may be new or innovative, as we intend to look at innovation more broadly and may consider further case studies within that work following the approach described above;

26.2 we placed less weight on assessing the substitutability of other materials as we consider this is a factor best suited to detailed consideration as the study progresses; and

26.3 we placed less emphasis on the extent to which the supplies may be available predominantly through one or other of the two major vertically integrated suppliers, having considered initial evidence suggesting there are alternative distribution channels through non-vertically integrated suppliers.

27. Through the case studies we may also consider in more detail other key building supplies to the extent they appear to be substitutable or are linked (for example, they appear to form a system or are an ancillary product). We may also identify other key building supplies for case studies as the study progresses.

28. While this is the approach we currently intend to take to the study, this approach could change as we receive further information during the course of the study.

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5 According to the Deloitte Access Economics report (2018) (commissioned by Fletcher Building), concrete represents the highest percentage of the average value across housing types. Excluding out of scope items, wood and timber and timber framing are the 2nd and 3rd highest value materials and plasterboard is the fifth highest value item. Our initial analysis supports this.

6 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 indicates that plasterboard, cement and structural timber are likely highly concentrated.

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

8 Preliminary Issues paper, paragraph 55.

29. Some of the other themes raised in submissions relating to the scope of the study and analysis that we might or might not undertake, and our responses to those submissions, are summarised briefly in the table in Annex A. However, as noted above, responses to issues or questions that we asked in the Preliminary Issues paper that do not relate to the scope of the study or the approach we will take will be further considered and discussed in the Draft Report. We continue to collect information relating to those matters.

Next steps

30. As indicated in the Statement of Process paper, over the next phase of the study between now and July we will engage directly with, and gather further evidence from, a range of stakeholders. We continue to welcome information from market participants and interested parties in relation to the issues within the scope of study as we work towards a Draft Report around July.

31. In addition, we are issuing **three online surveys**, directed to:

    31.1 the **suppliers of key building supplies** that we have identified to date and have contact details for – to build our understanding of these suppliers and the conditions of entry or expansion;

    31.2 **builders and specifiers** – seeking information about the factors that go to the selection and specification of materials; and

    31.3 **all stakeholders** – seeking to understand whether there are potential regulatory barriers in relation to key building supplies and, if so, the specific issues and possible solutions.

32. In particular, between now and **13 May 2022**, we invite **submissions from all interested parties regarding any regulatory barriers to the entry or expansion of key building supplies**, including those we have identified for targeted case study – what are the specific issues arising and/or the views of those making submissions? If there are factors affecting competition, what are the possible solutions to alter those factors?

33. We will publish all submissions that we receive to the website landing page for the study and so, where appropriate, submitters will need to provide us with public (non-confidential) and confidential versions of these submissions so that the public version can be published.

34. As part of the commitment stated in both the Statement of Process and Preliminary Issues papers to engage with tangata whenua as Tiriti o Waitangi partners and stakeholders in the study, **we propose to host a hui in early May seeking Te Ao Māori perspectives** in relation to building supplies, competition for key building supplies, and whether the regulatory and standards systems appear to be functioning effectively.

Annex A: submissions on analytical approach, and our responses

Submissions on analytical approach	Our response
International comparisons	
There were mixed views on whether international comparisons should be a focus of the study. Some submissions highlighted the benefits of such comparisons and suggested this could be carried out by a third party. Others suggested that, although it could be beneficial, it would involve a lot of challenges and adjustments. Some respondents suggested it would be less revealing than focusing on factors affecting competition.	At this stage, we do not intend to conduct detailed international benchmarking. We plan instead to focus on understanding the factors that may be affecting competition for the supply or acquisition of key building supplies in New Zealand. We remain open to hearing from stakeholders about any differences in outcomes in New Zealand compared to other countries, and what may be causing the different outcomes.
Analyses of profit margins and prices	
There were mixed views on looking at margins and other outcomes. Two respondents highlighted that evidence of poor outcomes would need to be measured objectively to justify more intrusive intervention. Others thought it would be helpful to benchmark margins internationally. Some responses did not think it would be useful, would be overly complex, and at best only provide a clue that competition may not be working as well as it should.	As our Market Studies Guidelines state, "… *markets that are not working well can result in negative effects for consumers, businesses and the New Zealand economy. These negative effects can include higher prices, lower quality, reduced output, reduced efficiency and/or less innovation. In some cases, firms with buyer power may also be able to reduce choice, prices and/or output below efficient levels. This may not be in the long-term interest of consumers*". We will as part of the study consider available evidence on outcomes in asking whether competition for key building supplies appears to be working effectively. At this stage, we do not intend to conduct a detailed benchmarking exercise or to seek to determine the levels of profitability or prices which might be available in other workably competitive markets.

Analysis of innovation	
One submission said there is unlikely to be a single measure of innovation and that we should take a broad and holistic look. Another submission suggested that we should focus on key areas of interest and ask about innovation in these areas.	We agree that innovation can emerge in different forms, including improvements to production efficiency and process improvement. As part of our assessment of the sector we will consider innovation broadly. We intend to consider 'new and innovative' supplies, 'green' building supplies or novel prefabricated products in the context of the broader themes of Building for Climate Change and standardisation (offsite manufacturing, prefabrication and windows), and to ask whether there are impediments to competition and innovation in these areas.
Other assessments	
Some submitters suggested that we should look to understand how consumers behave in the market.	We agree that understanding the demand side of a market is important to understanding how competition is working. We will as part of our study explore how decisions to specify and purchase key building supplies are made, by the various parties that are involved in and/or influence those decisions.
Some submitters suggested that we should undertake targeted engagement with key stakeholders.	We agree. We will be conducting targeted engagement with key stakeholders, in a variety of different ways.
One submission suggested that it is important to recognise the role of government and government-funded entities as scale purchasers of residential buildings and construction services.	We will be considering the government's role and influence as a scale purchaser of key building supplies.