

4 February 2022

Commerce Commission
PO Box 2351
Wellington 6140

Dear Sir/Madam

Re: Residential Building Supplies Market Study – Preliminary Issues Paper

BusinessNZ is pleased to have the opportunity to provide our comments to the Commerce Commission (ComCom) on its preliminary issues paper on the *Residential Building Supplies Market Study* (referred to as the Issues Paper).

The ComCom has stated that the purpose of this market study is to look at whether competition is working effectively within the residential building supplies industry and if not, what might be done to improve it. While BusinessNZ supports well-functioning and competitive industries, we are also conscious of the disruption such studies can cause, not to mention the potential for regulatory outcomes that do not align with any problems identified. Simply put, any market study that the ComCom undertakes needs to be done properly. Therefore, BusinessNZ wishes to raise some key aspects that we believe the ComCom needs to keep in mind going forward with the investigation.

1. Introduction

First, we support the ComCom's move to release an initial Issues Paper for consultation, given the ComCom is to carry out a study under Part 3A of the Commerce Act 1986 (Act) 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). This Issues Paper includes a brief overview of the ComCom's current understanding of the residential building supplies industry in New Zealand and potential issues to be explored. As noted at the start of the Issues Paper, for the purposes of this study the major components of residential buildings are listed as the

foundation, flooring, roof, walls (structural and non-structural, interior and exterior) and insulation. While not explicitly stated, the underlying policy concern of the study appears to be the cost of building a house.

BusinessNZ has always taken the view that for any market study or investigation that has the potential to significantly affect key players in that market, early and extensive consultation is required to achieve quality policy outcomes. In particular, we recommend one-on-one meetings with key market players before any consultation papers are drafted.

Accordingly, BusinessNZ will not comment on the technical detail of the building supply market, leaving this to businesses directly involved in it; instead, as with all recent submissions on the issue of market studies, we wish to raise meta-issues to be considered by the ComCom at an early stage.

2. Early and Meaningful Consultation with Key Stakeholders

Not all sectors are equal in terms of their day-to-day operations and associated complexities. Some markets have a relatively simple structure that a lay person could understand reasonably quickly, while others have a far more complex structure, which means any recommendations require a high level of comprehension and understanding to ensure they minimise the risk of unintended consequences.

BusinessNZ's membership includes a wide and diverse range of businesses, with many participating in or affected by the building supplies sector. We would expect a number of these to provide their own thoughts and insights concerning the Issues Paper, especially the detailed technical aspect of how the sector is to be examined by the ComCom as well as the practical consequences of issues considered. It is crucial that the ComCom listens to feedback from current players in the sector so the market study process arrives at recommendations that are built on a full understanding of the market, high quality analysis, and well thought-through recommendations that minimise the likelihood of unintended consequences.

Paragraphs 42-45 of the Issues Paper list some key players affected by the building supplies study. Paragraph 47 states that the ComCom *“will consider how the supply chain functions, how wider participants interact and how decisions for product selection currently tend to be made. This will involve engaging with a range of industry participants and stakeholders”*. From our perspective, BusinessNZ believes the ComCom needs to be more rigorous in its approach to consultation. The study purports to be one into the building products industry, and given the enormous breadth of that sector and the wide variety of business models within it, BusinessNZ expects ComCom to have taken the time to understand which elements of it may be in need of competitive review before starting the study. Not to do so means that the ComCom may not have a proper understanding of the workings of the various parts of the market, their relative importance to the cost of a house build and the factors that contribute to the efficient working of the market. If the study has been commenced based on

assumptions and not a factual understanding, the economic and political viability of its findings could be drawn into question.

Further, given that specific businesses and organisations have been mentioned in the Issues Paper, BusinessNZ would want to see the ComCom ensuring each of these is properly consulted and kept informed throughout the market study investigation. At the very least, we would have expected each player specifically mentioned to have been contacted by the ComCom already, prior to the Issues Paper being released, in order to give them adequate time to consider and give proper feedback on the contents of the Issues Paper. If this did not occur, we would have at least expected the ComCom to have notified these entities when the Issues Paper was released to ensure adequate time to go through it and answer any relevant questions raised.

3. Timeframes for Proper Investigation

The market study for building supplies was announced in December 2021, with submissions to this Issues Paper due early February. This is to be followed by a draft report to be publicly released for comment in July, and a final report by 6 December. This provides a timeframe of around one year to gather information, talk to major players, provide draft findings, seek feedback from submitters and produce a final report for the Government to consider. BusinessNZ has concerns about the brevity of this timeframe and its overlap with other market study investigations by the ComCom.

In September 2021 the Government extended the timeframe for the final report of the grocery sector market study from 23 November 2021 to 8 March 2022. While BusinessNZ is pleased to see the grocery study timeline being lengthened as suggested in our submission on the draft grocery sector draft report, we believe our concerns around adequate timeframes have now simply moved from one market study to the next. The extension of the grocery study out to March means a direct overlap of two studies over a three-month period. While we would expect the ComCom to do its best to properly allocate resources to both concurrent studies, we are concerned that its resourcing may be stretched too thin, possibly harming the ability of the building supplies market study to receive a solid policy foundation for investigation.

As pointed out previously to the ComCom, the briefing to the incoming Minister of Commerce and Consumer Affairs by MBIE on 4 November 2020 noted, “...*the Commerce Commission has resourcing to undertake one study at a time. Our preliminary view is that a supermarkets study will take approximately 16 months, concluding in May 2022, with the building supplies study to commence in June 2022.*” Despite this recommendation, the incoming Minister David Clark announced a study time of just under 12 months for the grocery sector. As mentioned above, subsequent developments have seen that now moved out to March. However, there was still an expectation that there would be a time gap between the two studies so that all of ComCom’s resources could be applied to one market study at a time.

BusinessNZ is concerned that the ComCom has not been given adequate time and resources for the initial phase of the building supplies market study. We would

welcome the idea of extending the time taken to provide both the draft and final reports to the Government. This would give the ComCom greater ability to take into account feedback from the Issues Paper, making its draft recommendations more likely to contain prudent and appropriate options within a quality regulatory process.

Recommendation: That the timeframes for both the draft report and the final report are extended to ensure a quality regulatory process.

4. Scope of the Study

We note that paragraph 39 of the Issues Paper states that *“building materials have been estimated to be around 20% of overall residential building costs. Land and associated infrastructure costs, labour, GST, professional fees and a range of other costs are also significant components of the overall cost of housing. Those other costs are outside the scope of this study”*. In relation to this, paragraph 48 of the Issues Paper states that *“many different products are used to build residential housing. For example, MBIE’s 2013 issues paper on the same topic notes that there are over 45,000 product lines used in the industry. It is not feasible for this study to consider all of these product lines”*. BusinessNZ agrees that any attempt to consider all or a significant number of these product lines would not be feasible and would risk taking the study down a complicated and laborious path which risks not seeing the wider regulatory picture. However, at the same time the ComCom needs to ensure its mix of in-scope products is fair and consistent to ensure a quality investigation.

To help provide an initial assessment of what could be in-scope for the study, Table 1 in the Issues Paper provides a (non-exhaustive) list of building supplies used in the major components of residential buildings, based on the information the ComCom has reviewed to date. While subsequent consultation will help guide the ComCom to where it may need to narrow or widen its focus, paragraph 55 of the Issues Paper outlines the possible criteria to consider for investigating:

- whether the cost of the building supply comprises a significant proportion of the overall cost of building supplies used;
- the number of manufacturers or suppliers who supply the building supply;
- the extent to which the building supply is able to be substituted for alternatives, including new or innovative building supplies;
- whether the building supply itself is new or innovative, or may be anticipated to become increasingly prevalent (e.g. due to the changing regulatory framework); and
- the views of industry participants and other stakeholders on what constitutes the key building supplies used to build the major components of residential buildings.

BusinessNZ has concerns about which building supplies will be in or out of the ComCom’s focus.

This study is supposed to represent a significant investigation into the cost of building a house, raising questions about the ability of the investigation to move the needle on the total cost of building a new home when 80% of the costs are out of scope.

These concerns are heightened by the fact that the ComCom have already stipulated they may choose to focus on a much smaller proportion of the in-scope products identified. Discussion within the BusinessNZ membership indicates that based on the products outlined in the Issues Paper, the more likely combined percentage representation of total building costs is a small fraction of the cost of a house and probably less than half of the value of building products used in a house build. Furthermore, if the ComCom proposes to focus on only a selection of in-scope products, this would mean the actual proportion of the cost of a house that would be in scope would be even less as a proportion of the total cost.

From our perspective, this represents a very narrow subset of building products with which to investigate whether building supplies competition is working in the best interests of consumers in New Zealand. In essence, the smaller the proportion of costs examined, the less likely any outcome will ultimately benefit consumers, with an increased risk of making the findings of the study unrepresentative and unfairly impacting only a certain set of players in the market. For example, even if the final recommendations by the ComCom moves the cost of the building supplies by say 1 percentage point, that gain is likely to be outweighed by the broader negative impact on the key players (and their employees) in the market, especially given existing stresses and strains on New Zealand's current manufacturing sector? Moreover, at a practical level, small gains from a consumer perspective can easily be wiped out by other factors. The latest annual inflation rate is near 6%, with the expectation that high inflation levels will continue for some time yet. Therefore, any reduction in costs in one area could be negated by a general rise in all forms of building costs, especially when inflation in building products is said to be running at higher levels than the national result.

We'd also like to point out that the building supplies for residential construction are in many cases the same materials used at a greater scale in commercial building construction, which does not appear to be looked at by the study, but where insights could be gained. Where a material is used at a greater scale, this allows greater efficiency in the local manufacturing (sharing of bottom-line costs for example) and in the imported products the ability to attain a better buy price from overseas suppliers due to that scale of purchase.

Last, there would also be concern if there were an inherent bias around what is in-scope in terms of building products. While we are not in a position to recommend what should or should not be included, we would expect that products included should represent the full suite of components of the estimated 20% of total costs for building supplies. We believe the ComCom should be blind to how and where these products are made and who they are provided by, as we see no sound policy justification for including the identity of a supplier when determining which products to focus on. In particular, we would expect the ComCom to take into account the 'vibrancy' of the New Zealand economy. At present, it appears the ComCom will be focussing on products

made and sold in New Zealand more than those imported. Therefore, there is every chance of unintended consequences adversely affecting New Zealand manufacturing jobs, which tend to employ a number of people of particular demographics, including certain regional jobs. Therefore, any work by the ComCom that leads to recommendations that prefer importing over domestic industry need to be handled carefully.

Recommendation: That the ComCom ensures the scope of the study properly reflects the intent of the investigation.

5. Avoiding Regulatory Overreach

BusinessNZ believes that any recommendations made, particularly within the context of a full and deep market study investigation, should not be taken lightly. The full costs and benefits of any recommendation can be significant, along with the likelihood of unintended consequences.

As we have outlined to the ComCom in previous submissions, the recommendations outlined in a market study can often represent a wide range of potential options for the Government to consider. Viewing these from a *regulatory pyramid* perspective (recommending light-handed regulation where appropriate and extending to more heavy-handed options where required), options could be 'light-handed' where market participants and the Government can come to agreements around change, while other options could represent a serious regulatory shift with significant implications for existing players in the market and potential flow-on adverse effects on consumers and on other sectors.

Overall, BusinessNZ supports justifiable measures based on sound evidence to correct specific concerns. A process that begins by making an evidence-based case for change, followed by a considered assessment of how far to move up the regulatory pyramid, would mean the business community would be prepared to have an in-depth discussion about proposals for change. The best outcomes are those where both the public and private sector reach an understanding of what changes need to be made, and what long-run benefit the changes will bring for consumers and the wider economy.

Recognition of the potential for significant upheaval in the sector, including any chilling effects on jobs, government policy on climate change and competition, should mean a very high threshold for regulatory intervention. This is especially the case when the intervention is looking to displace market practice, and the outcome will, by definition, have only a small impact (if at all) on the total cost of building a house. For instance, the regulatory requirements around zero carbon and sustainability could be a significant concern if not targeted correctly, especially if proper recognition around lifetime and recyclability of a number of building supplies produced is not taken into account.

From BusinessNZ's perspective, the process by which a business entity decides to conduct itself in the market should attract as little regulatory intervention as possible.

Any attempt to create regulatory roadblocks should be crystal clear about the justification for such a move. Overall, an extreme response that is disproportionate to perceived problems will inevitably produce a sub-optimal and likely controversial outcome.

A recent and clear example of a controversial outcome that we would deem to be regulatory overreach involves the major changes to the Credit Contracts and Consumer Finance Act 2003 (CCCFA) that came into force on 1 December 2021. These changes have significantly transformed the regulation of consumer credit in New Zealand, increasing the risks and compliance burden for retail lenders. The law changes increased the penalties for irresponsible lending, while requiring lenders to deeply investigate borrowers' finances before granting them loans. Overall, this has driven up lending costs, increased the administrative burden for lenders, borrowers and mortgage brokers, and made it harder for everyday citizens – many of whom are only borrowing relatively small amounts - to get loans. In turn, numerous stories have now been outlined in the public domain around materially longer and more complex application processes across the spectrum, from personal loans to home loans and vehicle finance.

Given the sizeable unintended consequences of the changes to CCCFA, less than two months after the changes came into force, we note the Minister for Commerce and Consumer Affairs has already ordered an inquiry into whether banks have overreacted to new lending laws. To be frank, any review of a policy less than two months after coming into force shows a lack of understanding of the unintended consequences of changes made via regulatory overreach. What makes matters worse is that these issues had already been clearly outlined to the Government during the consultation period leading up to the 1 December changes by a number of those in the sector who would be directly affected.

We highlight this example because of the potential for political views to cloud the best policy path forward. We acknowledge that the ComCom can only recommend policy changes, and it is up to the Government to enact them. However, it is crucial that the ComCom ensures its recommendations represent best policy practice and are very clear around their potential costs and benefits.

6. Vertical Separation

Paragraphs 98-102 of the Issues Paper outline the issue of vertical integration and propose considering the potential impacts vertical integration may be having on competition for key building supplies, and the extent to which non-vertically integrated suppliers and/or merchants are able to compete effectively. In addition, paragraphs 103-113 consider the role of vertical arrangements in the supply of key building supplies, and the extent to which these arrangements may be impacting competition at any level in the supply chain.

Looking at prior market studies, we note that the draft report for the grocery market study also outlined issues regarding vertical integration which culminated in outlining

a possible last resort option to vertically separate the two major grocery retailers. Such discussion has the potential to prompt highly interventionist policy options that could represent a fundamental shift in how sectors operate. While the ComCom did acknowledge that the costs and risks of such options would be significant, discussion around the potential for vertical separation in whatever form still risks radical regulatory overreach, close to the 'heavy-handed' end of the regulatory pyramid, notwithstanding the ultimate step of complete nationalisation of the sector in question.

We are also concerned that the building supply market study is now the second consecutive study to delve into issues related to vertical integration, potentially leading to further heavy-handed recommendations down the track. If such recommendations end up being made in the context of the building supply study, this would be a considerable step up in terms of regulatory intervention from anything that was outlined in the retail petrol market studies, and a worrying pattern going forward.

We acknowledge that the market study into building supplies is at its early phase, and that an Issues Paper is a good early step to set the tone for the subsequent draft and final reports. However, BusinessNZ would be deeply concerned if such options were given priority by either the ComCom in the process ahead, or by the Government in its formal response to it. Furthermore, even with significant caveats, the simple act of including such strident recommendations does not mean they will not be given greater weighting when the Government considers its response. Unfortunately, we have seen that it has been increasingly common practice in recent years for the Government not to acknowledge the proper steps that need to be taken when looking at severe regulatory options to remedy a perceived problem, as illustrated by the CCCFA example above.

Overall, each avenue investigated and each recommendation put forward by the ComCom matters, not only for the sector in question, but also for what may be expected for future market studies. Areas of investigation and recommendations that have not been given full consideration based on sound evidence will no doubt create a chilling effect for not only the sector in question, but also those who might be next in line for a market study. Therefore, the ComCom needs to be very mindful of the broader adverse implications of what is in and out of its investigation parameters, particularly if it opens doors to other severe policy measures.

Recommendation: That the implications of all recommendations are better understood by the Commerce Commission before they are included in the draft and final reports.

In Summary

Overall, we urge the ComCom to continue to engage deeply and often with market participants to ensure that the issues we have raised in this submission are appropriately managed. We advocate for an exemplary process that can be shown to bring improved processes for future Market Studies, and we look forward to engaging with the ComCom as this study proceeds.

Yours sincerely

A handwritten signature in black ink, appearing to be 'KH', written in a cursive style.

Kirk Hope
Chief Executive
BusinessNZ