

Residential building supplies market study

Final report – Executive summary

6 December 2022



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Executive summary

This report sets out the findings and recommendations from our study into competition for residential building supplies in New Zealand. The Minister of Commerce and Consumer Affairs asked us to examine whether competition for the supply or acquisition of key building supplies is working well and, if not, what can be done to improve it.

We consider that competition for the supply and acquisition of key building supplies is not working as well as it could if it was easier for building products to be introduced and for competing suppliers to expand their businesses.

This study has considered the industry structure and nature of competition within each level of the industry supply chain for key building supplies. However, we have focused most strongly on conditions for entry or expansion of new or competing products. In our view, these conditions are critical to the state of competition for key building supplies.

We have identified two main factors negatively impacting competition for key building supplies. These factors make 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 products and methods, and of existing suppliers of those products in highly concentrated markets.

1. The building regulatory system continues to incentivise designers, builders and building consent authorities (BCAs) to favour familiar building products over new or competing products.
2. 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 and increase sales.

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 these objectives, the regulatory system has a number of features which prevent competition from working well.

Despite the building regulatory system including flexibility to use 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 building regulatory system (comprising the Building Act, the Building Code and related instruments, and the consenting system) is applied to building products; and
- the decision-making behaviours of designers, builders, BCAs and government agencies in response to, and in applying, the regulatory system.

Quantity-forcing 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. Under certain conditions they can deter merchants from stocking competing products in their stores, making it more difficult for new or smaller suppliers to get established.

As in previous market studies in the fuel and grocery sectors, we have also identified land covenants and exclusive lease terms benefitting merchants. In some cases, these covenants, exclusive leases and contractual provisions with similar effect may impede competition between merchants.

Our case studies of plasterboard, structural timber and ready-mix concrete (including cement) demonstrate how factors affecting competition apply to a greater or lesser extent in relation to different key building supplies.

Plasterboard has been the subject of significant public commentary over the course of the study as supply shortages have revealed the lack of alternatives for some key building supplies. These shortages have highlighted the risks of being overly reliant on a small number of key suppliers and the benefits of fostering competition from alternative suppliers.

Plasterboard is commonly specified by brand in building plans, and this has made it difficult for builders to substitute competing products to Winstone Wallboards' GIB-branded plasterboard. BCAs throughout New Zealand can take different approaches to consenting decisions, adding to the difficulties in substituting alternative plasterboard (and other) products. Quantity-forcing rebates for plasterboard may also be contributing to difficulties for competing suppliers.

Initiatives employed by the Ministry of Business, Innovation and Employment (MBIE) and the Government appointed Ministerial taskforce for plasterboard (Plasterboard Taskforce) illustrate some ways that regulatory barriers to entry or expansion may be overcome to facilitate greater competition. Some of these initiatives could be applied not only for plasterboard, but also for other key building supplies. For example, the recently established Critical Materials Taskforce is intended to monitor emerging supply chain risks and to provide guidance, advice, data and information to inform MBIE's Critical Materials and Products Work Programme.

In our view, the best options for improving competition involve enabling easier entry or expansion of key building supplies. 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.

Our recommendations include a range of measures designed to:

- **Enhance the regulatory system.** Competition should take a more prominent position in the regulatory system, and decision making within it, to ensure the effective operation of markets for key building supplies and delivery of safe, durable, quality housing for New Zealanders. In practice, this means creating clear compliance pathways for more key building supplies and making it easier for designers and market participants to use new or competing building supplies. The needs of Māori should also be better served.
- **Support sound decision making.** Greater information sharing and stronger coordination across, and in partnership with, government is needed. Our recommendations aim to inform the decisions of designers, builders, BCAs and government agencies involved in the implementation and application of the building regulatory system.
- **Address strategic business conduct.** Increased awareness is needed of the potential for business conduct to affect competition for key building supplies, including by breaching the Commerce Act. In particular, we have concerns regarding quantity-forcing rebates and the use of land covenants and exclusive lease arrangements.

Focus and context of this study

This study has focused on key building supplies used to build the major components of residential buildings. The major components of residential buildings are the foundation, flooring, roof, walls (structural and non-structural, interior and exterior) and insulation. Examples of key building supplies within the scope of the study include concrete, steel and sheet metal roofing, timber and steel framing, weatherboard and other forms of cladding (eg, bricks), window/door framing and glazing, glass wool, polyester and polystyrene insulation and plasterboard.

Consistent with the terms of reference set by the Minister of Commerce and Consumer Affairs, we have looked into:

- the industry structure for key building supplies;
- the nature of competition for these key building supplies, including any industry pricing practices or acquisition requirements that impact on competition; and
- impediments to the entry or expansion of new or innovative building supplies, such as 'green' building supplies or novel prefabricated products.

We have concentrated on factors common to competition for all key building supplies. We have also undertaken more detailed case studies into plasterboard, structural timber and ready-mix concrete (including cement). These case studies have not narrowed the scope of the study and are not 'mini market studies'. Rather they have assisted us to:

- more closely consider the factors that may be affecting competition for key building supplies generally through the identification and use of particular examples; and
- consider observations, findings or recommendations that are able to be applied across key building supplies more generally.

We have considered some issues that have emerged from, or been exposed by, the recent changes in global conditions – particularly where these appear likely to persist into the future. We have also considered supply chain resilience more generally when exploring the extent to which competition is working well. However, we have not closely examined factors affecting the international supply chain, or the short-term impacts of the COVID-19 pandemic on competition.

This study sits alongside several other government-led initiatives, such as:

- the MBIE-led Building System Legislative Reform Programme, including the review of the building consent system (Consent Review), which identifies several issues with the current system which are similar to some of those raised in this study;
- MBIE's Building for Climate Change programme;
- the Government's Emissions Reduction Plan;
- recent actions relating to the plasterboard shortage, including MBIE's guidance for BCAs on plasterboard substitution and the work of the Plasterboard Taskforce; and
- the recent establishment of the Critical Materials Taskforce and the recently announced Productivity Commission inquiry into the resilience of the New Zealand economy to supply chain disruptions.

The focus of this study is on factors affecting competition for key building supplies. Several of the other initiatives listed above also relate to building and construction or to building supplies. While they each have a different focus and objective to this study, there are also many complementarities – particularly between our findings and recommendations and the Consent Review. Where relevant, our recommendations can be considered when developing policies in these reviews.

During the study, we have heard from Māori about their perspectives on the residential building supplies industry as participants in the building system, as purchasers and suppliers of key building supplies, and as builders and major developers. This has helped us to better understand Māori perspectives, concerns and aspirations regarding the industry.

These engagements are important to give proper effect to Treaty of Waitangi (Treaty) obligations and to ensure that Māori needs and priorities are properly heard, understood and addressed to support them to achieve their aspirations within the sector. We expect that supporting Māori in this way will also support improved competition more broadly.



Industry overview

There are many industry participants who play significant roles in the construction process for residential buildings. These include:

- designers (eg, architects), who prepare plans and specify the building supplies to be used;
- builders and building firms, who construct residential buildings; and
- BCAs, who are accredited and registered to issue and assess compliance with building consents.

Most key building supplies are distributed to builders through merchants. There are five major building supplies merchants with a nationwide presence: Bunnings, Carters, ITM, Mitre 10 and PlaceMakers. Outside of the major merchants, several smaller merchants and retailers have varying presence and carry varying product ranges.

The key building supplies sold by merchants are manufactured or imported by suppliers. Some suppliers specialise in one product category such as timber (eg, Red Stag) or ready-mix concrete (eg, Allied Concrete), while others provide a range of different building supplies. Some key building supplies (such as window joinery) tend to be sold directly from suppliers to builders, bypassing merchants.

There are at least two significant vertically integrated groups of companies, whose activities span several levels of the supply chain.

- Fletcher Building manufactures products including plasterboard (Winstone Wallboards), cement (Golden Bay Cement), ready-mix concrete (Firth) and insulation (Tasman Insulation). It also operates a merchant business (PlaceMakers), and is active in residential development and construction (Fletcher Living and Clever Core).
- Carter Holt Harvey (CHH) manufactures products including structural timber (CHH Woodproducts), and also operates a merchant business (Carters).

The majority of residential houses in New Zealand continue to be built by small-to-medium sized builders, although the proportion of houses built by larger-scale builders is growing.



Key findings

We have considered factors affecting competition for the supply or acquisition of key building supplies at two main levels of the supply chain – the supplier (manufacturer/importer) level and the merchant (distribution) level.

Our findings are summarised below.

- Competition for the supply and acquisition of key building supplies is not working as well as it could if it was easier for building products to be introduced and for competing suppliers to expand their businesses.
- There are few competing suppliers for many categories of key building supplies and competition at the supplier level appears limited for some key building supplies because:
 - features of the building regulatory system are making the introduction and expansion of competing building products difficult;
 - designers and builders generally favour familiar products, because their compliance is more easily assured within the building regulatory system; and
 - quantity-forcing rebates used by established suppliers appear, under certain conditions, to be reinforcing difficulties for new or smaller suppliers.
- Māori needs are not well-served by the building regulatory system currently.
- Competition between merchants appears to be working relatively well at the national level, but widespread use of land covenants, exclusive leases and contractual arrangements with similar effect could adversely affect competition.
- Vertical integration can provide a competitive advantage and potentially creates opportunities for certain conduct that can reduce competition. However, it does not appear that this industry structure normally has a material adverse effect on competition for key building supplies at either the supplier level or the merchant level.
- Entry or expansion of new or innovative building supplies (including 'green' building supplies) is likely to be impeded by the same factors affecting competition at the supplier level that are affecting other products.
- Offsite manufacturing (OSM) can add a range of benefits for construction and has the potential to increase competition for key building supplies, but many offsite manufacturers currently face demand uncertainty and lack scale.

Competition at the supplier level appears limited for some key building supplies

There are few competing suppliers for many categories of key building supplies

For many key building supplies, relatively few suppliers have controlled a large share of supply over time. This has led to a lack of choice of key building supplies for designers, builders, and ultimately homeowners.

Some categories of key building supplies, such as plasterboard and fibre cement, have only one main supplier. For nine out of 13 categories of key building supplies primarily distributed through merchants, the three largest suppliers in the category have a combined share of supply to the five major merchants above 70%. However, supplier concentration for some key building supplies (eg, insulation) appears to have fallen in recent years.

Some impediments to entry or expansion for suppliers are beyond the reach of this study. New Zealand's small market makes it challenging for domestic manufacturers to reach efficient scale. The combination of a small market size and isolated geographic location (with associated transport costs) also make it less attractive to import products here, relative to other countries. These inherent structural features limit the number of suppliers who can feasibly operate in the New Zealand market.

Features of the building regulatory system are making entry or expansion for competing suppliers difficult

The way the building regulatory system is applied in practice strongly favours familiar products and makes the introduction or expansion of competing products and the consequent entry or expansion of competing suppliers difficult. Several aspects of the building regulatory system have this effect, including:

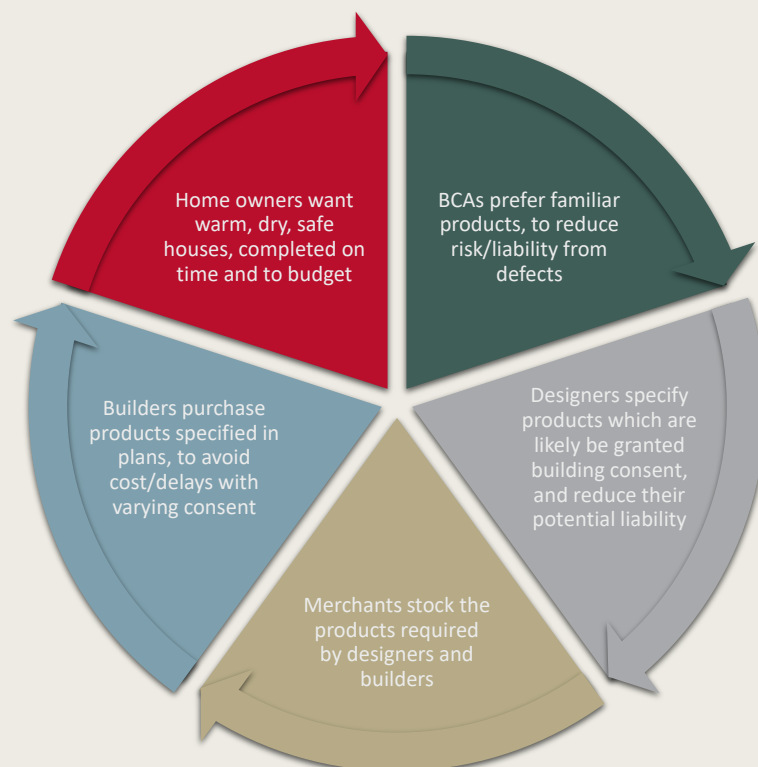
- The Building Code and associated instruments and processes are complex to navigate.
 - The Building Code uses qualitative words and phrases to set performance criteria for building work. For building products, establishing what the qualitative words and phrases mean in practice generally involves starting 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.
 - Clear compliance pathways for building products (through Acceptable Solutions and Verification Methods, and referenced Standards) are narrow and there are few 'streamlined' processes.
- 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 familiar building products over new or competing products.
- BCAs are reluctant to approve use of products they are unfamiliar with due to potential liability. When presented with new or unfamiliar building products, a BCA's response is often to suggest that the applicant provide product assurance such as CodeMark certification or BRANZ appraisal.
- Product assurance pathways (eg, CodeMark certification and BRANZ appraisal) involve significant time and cost, sometimes taking up to 12 months to obtain.
- Key building supplies are often specified by brand in building plans and consent applications. Where this occurs, substitutions 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.

- Market participants observe that decision making by the 67 BCAs can be inconsistent, both between regions, within BCAs and within a single BCA. There is no formal or authoritative system for coordinating consenting decisions between BCAs.
- There is currently no system 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 and innovative products, the basis on which they have been granted consent and any difficulties that have subsequently been encountered when they have been used in consented projects.

Designers and builders generally stick to familiar products, because compliance is more easily assured

The behaviours of designers, builders and BCAs appear strongly mutually reinforcing. Designers and builders anticipate BCA responses to new concepts, and generally choose the path of least resistance when specifying and purchasing key building supplies, 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.

This creates a cycle which reinforces the use of familiar products:



Competing products are less likely to be readily used without a clear compliance pathway. Clear compliance pathways in Acceptable Solutions and Verification Methods have their origins in the National Standards under the Building Act 1991 and, while they are not the only means of complying with the Code, they have become embedded as 'how we build here'.

Clear 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.

Merchants generally stock familiar products in their stores, because these are the products specified in building plans. While merchants offer to source other products on request, shelf presence is important for competing products to become established and gain acceptance. Therefore, barriers to entry for suppliers of new or innovative products can result in fewer choices at the merchant level.

The recent supply shortages may have assisted in changing some of the established specifying and purchasing behaviour to some extent. For example, plasterboard shortages appear to have provided impetus to explore options within the regulatory system to facilitate greater product substitution, including through new MBIE guidance on plasterboard substitutions, the work of the Plasterboard Taskforce and most recently, establishment of the Critical Materials Taskforce. Insights from recent experience may provide useful learnings for the future.

The extent to which designers, builders and BCAs will continue to support alternatives as supply pressures ease remains to be seen and the mutually-reinforcing cycle described above appears to have been a long-term feature of the industry.

The regulatory system and associated decision-making behaviours can impact competition to varying degrees

Through our case studies, we have observed how the impact of the building regulatory system on competition for key building supplies can vary. The case studies reinforce our general observation that where a product has a clear compliance pathway, it is more likely to be specified and used in residential building designs.

For plasterboard, the clear compliance pathway permits wall linings that provide structural bracing. This compliance pathway has become ‘how we build here’, despite plasterboard providing structural bracing being rare in overseas markets. There are alternative design methods which are common elsewhere (eg, framing and other bracing solutions), and alternative products to plasterboard (eg, cladding systems with structural bracing, plywood wall lining, and saveBOARD), but these are not commonly used in New Zealand. Other plasterboard suppliers have struggled to gain scale.

Plasterboard is often specified by brand in building consents. Substitutions are difficult once a product has been specified by brand, despite general guidance on allowing minor variations to building consents.

For structural timber, switching and substitutions for New Zealand timber (treated to New Zealand Standards) are relatively easy due to the commoditised nature of the product. Products are specified by performance characteristics, with designers and builders generally brand indifferent. The structural grading Standards applicable to structural timber (setting out the required strength and flexibility) are performance based. However, the chemical treatments specified in durability Standards are highly prescriptive and unique to New Zealand, so may limit the scope for competition from imported timber (which may be different species of tree, or treated with different chemicals) and certain types of engineered timber substitutes (eg, glued laminated timber framing).

For ready-mix concrete (including cement), the regulatory framework better facilitates competition between imported product and domestic supply. Clear performance measures are stipulated in the compliance pathways. Products are usually tested according to internationally recognised performance measures, rather than by prescriptive input processes which must be followed to achieve performance. These performance measures do not constrain innovation in product formulations.

We have not made recommendations specifically regarding the case study supplies or the applicable Standards. Our observations from the case studies concern the competitive effects of the different compliance pathways and referenced Standards. We encourage the technical experts designing compliance pathways for building products and methods to consider the factors affecting competition that we have identified, and to design pathways that facilitate competition as much as possible without compromising the core objectives required of the building regulatory system.

Quantity-forcing rebate structures used by established suppliers appear, under certain conditions, to be reinforcing difficulties faced by new or smaller suppliers

Certain types of quantity-forcing rebates paid by some established suppliers to merchants appear, under certain conditions, to be creating impediments to entry or 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.

Rebates can provide benefits. For example, they can provide a way for suppliers to pass through lower costs per unit from supplying greater volumes. However, when used by a supplier with a large share of a highly concentrated market, certain rebate structures can harm competition by reducing the ability of smaller competitors or new entrants to compete.

For some key building supplies, the structure of rebates appears to deter merchants from stocking or expanding sales of competing products. This is particularly the case where rebates apply retrospectively across all of a merchant's purchases of a product from the supplier, not just to additional purchases. Under these rebate structures, a supplier offers a merchant a lump sum payment at the end of a set period, with the rebate percentage increasing whenever the merchant exceeds set volume or sales thresholds.

These 'quantity-forcing' rebate structures reduce a merchant's incentives to encourage sales of competing building supplies. Competing suppliers have identified rebates and the resulting lack of access to the merchant channel as a challenge for them in establishing a presence and gaining acceptance for their products.

Two rebate structures appear most likely to make the introduction and expansion of competing products more difficult, due to their quantity-forcing effect – 'tiered retroactive rebates' and 'share of wallet' rebates. Tiered retroactive rebates are very common across a broad range of key building supplies, although the level and scale of the tiers varies. Share of wallet rebates are less commonly used. Illustrative examples of these rebate structures are included below.

Illustrative examples of tiered retroactive and share of wallet rebates

| Rebate structure | Description | Example |
|----------------------------|--|---|
| Tiered retroactive rebates | The supplier pays a percentage rebate based on the total volume of a merchant's purchases, with the rebate level increasing based on the total volume purchased in a set period. | At the end of each year a supplier will pay back: <ul style="list-style-type: none"> • 5% on all purchases, if total purchases in the year are below \$10m; or • 8% on all purchases, if total purchases are above \$10m in the year. |
| Share of wallet rebates | The supplier pays a percentage rebate based on the total proportion of purchases the merchant made in a product category from that supplier, with the rebate level applying to the total volume purchased in a set period. | At the end of each year a supplier will pay back: <ul style="list-style-type: none"> • 4% on all purchases, if a merchant makes at least 60% of its category purchases from the supplier; or • 8% on all purchases, if a merchant makes at least 80% of its category purchases from the supplier. |

Under these types of rebates, a merchant switching sales to a competing product risks missing out on significant rebates from their largest suppliers by not meeting higher rebate tiers. A new supplier seeking to compete would need to not only match the existing supplier's price, but also potentially compensate the merchant for the reduced rebate payments.

Although there are potential efficiency reasons for quantity-forcing rebate structures, we consider that any benefits are generally unlikely to outweigh the potential harm to competition for some key building supplies in highly concentrated markets. There are likely to be other pricing mechanisms that could deliver the same pricing outcomes for merchants and suppliers, without creating the same risk of excluding competing suppliers in highly concentrated markets.

Quantity-forcing rebate structures are more likely to be problematic in the following circumstances, where:

- markets are highly concentrated;
- rebate arrangements cover a larger proportion of the market;
- there are reasons that alternative suppliers may only be able to compete for a partial supply of a merchant's sales;
- the arrangements are tailored to each individual merchant's demand; or
- the highest tiers cover a large proportion of the merchant's sales and the steps between tiers are significant.

Across our case study supplies, tiered retroactive rebates for plasterboard appear to be contributing to difficulties for alternative suppliers accessing the merchant channel. Similar rebate structures in structural timber appear to be having less of an impact, with merchants typically purchasing from multiple suppliers and the commodity nature of the product making switching easier. Supplier-to-merchant rebates are less relevant for ready-mix concrete, which is generally supplied direct to customers (rather than through merchants).

Māori needs are not well-served by the building regulatory system

We heard and acknowledge that Treaty obligations, across government, require the challenges in the residential construction sector to be addressed, and central to this is enabling Māori to do things for themselves.

Māori are active participants across the building industry: significantly represented in the labour component of the industry, but also major residential developers and landlords, and Māori-owned SME building companies are active throughout New Zealand. Māori are also involved in building design and distribution, and actively interested in 'green' building supplies and opportunities in OSM. However, Māori appear to be comparatively underrepresented in sector leadership, for example, at the decision-making and Board level, and it appears difficult to identify and access opportunities for leadership.

Māori experience challenges with the consenting process, rising building costs, and supply chain disruption. Some of these issues reflect a shared experience with other participants in the building regulatory system. Some reflect needs and aspirations that are unique to Māori, including preference for face-to-face communication and challenges building papakāinga on Māori owned land.

Fostering strong relationships is critical and we heard how important this is for Māori, including to support Māori in the sector to build capability and capacity, identify more opportunities for Māori leadership across the sector, and to support Māori businesses to expand and compete at scale.

There are challenges in delivering better housing outcomes for Māori. Although improvement of housing outcomes generally falls outside the scope of this study, we consider that addressing the issues identified, and improving competition, can contribute to this goal.

Competition between merchants appears to be working relatively well, but widespread use of land covenants and exclusive leases could affect competition

Five major merchants compete nationwide to provide the bulk of supplies for residential building in New Zealand – Bunnings, Carters, ITM, Mitre 10 and PlaceMakers.

There is also a fringe of other competing distributors, with varying presence throughout the country. These competing distributors include a sixth national building supplies merchant (BuildLink), a range of specialist and online merchants, and direct supply to builders from some product manufacturers or installers.



The major merchants compete to supply trade customers (such as builders) at two main geographic levels:

- Competition for national customers (eg, group home builders, such as GJ Gardner and Signature Homes). Carters, ITM and PlaceMakers are the three main competitors for national customers. Bunnings and Mitre 10 also compete for some of these customers, but appear to be more focused on smaller local builders and the retail 'do-it-yourself' market.
- Competition for regional customers, which are primarily small-to-medium sized 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.

The number of competing merchants varies between regions. There tend to be fewer competing distributors of key building supplies in less populated regions, reflecting the smaller customer bases in these areas. In some locations there are only one or two major merchants.

We have observed some factors which may be preventing competition at the merchant level from working more effectively, particularly merchants holding covenants on land, entering into exclusive leases with landlords, or entering into commercial agreements containing terms with similar effect.

- In addition to land use restrictions under planning laws, restrictive covenants and exclusive leases can prevent other merchants from opening stores in areas where they might otherwise compete directly.
- We have also encountered instances where merchants are benefitting from covenants, or similar clauses in sale and purchase agreements, which give them preferential rights to quote for supplying building materials for houses to be built on land zoned for residential development.

Vertical integration can provide a competitive advantage, but does not normally appear to have a material adverse effect on competition in this industry

Two of the five major merchants (PlaceMakers and Carters) are vertically integrated with suppliers across several categories.

Vertically integrated businesses may benefit from the competitive advantage afforded by strong relationships and stability of demand and supply from their own related suppliers and merchants. Vertical integration can also create opportunities for certain strategies (or types of conduct), that can limit competition.

Overall, vertical integration does not normally appear to have a material adverse effect on competition at either the supplier level or the merchant level. In our view:

- Vertical integration does not appear to be making it difficult for non-vertically integrated suppliers to access distribution channels to compete. There are a number of non-vertically integrated merchant and other distribution options available. While vertically integrated merchants may favour the products of a related supplier, they also often stock competing products.
- Outside of recent supply shortages, where vertical integration has benefitted some merchants, non-vertically integrated merchants do not appear to struggle to access products from suppliers.
- It does not appear that other strategies – such as inappropriately sharing commercially sensitive information acquired at one level of the supply chain with a related business at another level of the supply chain – are being used by vertically integrated businesses to reduce competition.

Our findings are based on the current level of vertical integration in the sector and its observable effects. However, competitive dynamics could change, for example, if the proportion of vertically integrated to non-vertically integrated businesses changed over time.

Entry or expansion of new or innovative building supplies is likely to be impeded by the same factors affecting competition at the supplier level

Innovation in key building supplies can emerge in different forms. New or innovative building supplies may contribute to more efficient construction processes, or more energy efficient homes.

MBIE's discussion paper for the Consent Review identifies allowing for innovation as a desirable outcome for the building consent system. New and innovative building supplies may be particularly affected by the factors we have identified as affecting competition generally.

We have considered two main types of innovations in this study:

- 'green' building supplies; and
- OSM and prefabricated products.

Significant innovation in 'green' building supplies is likely to be required from the industry

'Green' building supplies contribute to reducing emissions of the construction sector. This includes building supplies that:

- are more environmentally friendly to supply or build with; and/or
- contribute to building more energy efficient homes.

Government-led activities to reduce carbon emissions (most notably MBIE's Building for Climate Change programme) are likely, over time, to require significant innovation from the industry. Building for Climate Change contributes to the Government's Emissions Reduction Plan, which sets out how New Zealand will meet a carbon emissions budget.

If not addressed, the current regulatory settings and patterns of conduct are likely to slow the hoped-for innovation in 'green' building supplies.

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. End consumers may not have sufficient information to make decisions that reflect the longer-term economic benefits of energy efficient homes.

Introducing mandatory energy performance certificates (EPCs) for all residential homes would likely promote greater consumer interest in energy efficient housing, potentially encouraging greater use of 'green' building supplies. However, extending mandatory EPCs to all residential homes would be a significant policy decision given the potential implications for many homeowners, including those building new homes and/or renovating or retrofitting existing homes.

Initiatives to promote more sustainable building supplies are also occurring offshore. For example, there is a programme of work aimed at upgrading European Union building standards, as part of its move towards net zero carbon emissions for buildings. There is an opportunity for New Zealand to seek to align more closely with such international standards.

Offsite manufacturing has the potential to disrupt existing supply chains and generate efficiencies in the construction process

OSM offers a range of potential benefits, including speed of construction, better building performance (eg, air tightness), less waste material, and reduced risk of injury due to working in a controlled environment.

In the past, OSM has faced some challenges with the building regulatory system. In particular, the consenting processes and practices were designed for on-site inspections and did not easily accommodate panelised products or modular builds.

More recently, some BCAs have made significant progress to understand and better accommodate OSM techniques at the consenting stage. Additionally, the BuiltReady scheme, which introduces some of the reforms introduced by the Building (Building Products and Methods, Modular Components, and Other Matters) Amendment Act 2021, is designed to address remaining potential issues by creating a voluntary certification system for offsite manufacturers.

OSM has the potential to increasingly compete with traditional key building supplies and, over time, to disrupt some of the existing supply chain structures in the industry. 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 making the necessary long-term investments to grow capacity to more efficient levels of production while they continue to face demand uncertainty.

Strategic long-term government focus (eg, via procurement or regulatory facilitation) is likely to be critical to ensure that OSM reaches its full potential and delivers innovation for consumer benefit.

Recommendations to enhance competition

Our recommendations aim to provide tangible improvements in competition for key building supplies, without undermining the other key policy objectives of the building regulatory system. They are discussed in three inter-dependent groups designed to:

- enhance the regulatory system;
- support sound decision making; and
- address strategic business conduct.

Enhance the regulatory system

Changes are needed to address the processes that underpin the regulatory framework and how it relates to the various complex compliance pathways for building supplies. The regulatory system does not currently enable timely response to changing markets and innovations in building products.

Recommendation 1: Introduce competition as an objective to be promoted in the building regulatory system

Ensuring the regulatory system continues to deliver quality housing to New Zealanders is critical. The regulatory system is primarily focused on promoting safe, healthy and durable buildings. These are highly desirable aims that we fully endorse.

However, to ensure the effective operation of markets delivering those objectives, we consider that competition should take a more prominent position in the regulatory system and its decision making. We recommend that promoting competition is included as another objective of the building regulatory system, to be evaluated alongside safety, health and durability – without compromising those essential objectives.

Recommendation 2: Better serve Māori through the building regulatory system

Māori who engaged with this study shared a range of perspectives and experiences of the industry. Those who engaged with us described some uniquely Māori experiences of the building regulatory system and some uniquely Māori priorities for building. Other issues described were common across the industry, affecting Māori and non-Māori similarly.



We consider that Māori needs can be better served by:

- Delivering on obligations derived from the Treaty by addressing the challenges faced by Māori within the sector. Greater opportunities are needed for Māori to be actively involved in the identification of any further issues arising, and on the design and implementation of any improvements. This should include the identification of more opportunities for Māori leadership and for mātauranga Māori to play a role in these processes.
- Ensuring that the consenting system provides opportunities for Māori to build productive relationships with BCAs and the flexibility to accommodate Māori building objectives.
- Supporting opportunities for building capability and capacity among Māori including workforce development, identifying opportunities for more Māori leadership across the sector including at Board and decision-making level, and supporting Māori businesses to expand and compete at scale.

Recommendation 3: Create more clear compliance pathways for a broader range of key building supplies

Consenting costs could be reduced, and choice, innovation and competition increased by creating more compliance pathways for a broader range of key building supplies. A range of approaches could be considered, including:

- updating and developing more Acceptable Solutions and Verification Methods, including to better reflect international standards;
- expanding the range of product certification schemes that can issue product certificates deemed compliant with the Building Code;
- investigating reducing further barriers to certification and appraisal – for example, introducing streamlined certification processes for low-risk products; and
- developing guidance that, for key building supplies, identifies the appropriate Building Code clauses and the possible means of proving compliance with those clauses.

Recommendation 4: Explore ways to remove impediments to product substitution and variations

We recommend exploring ways to remove impediments to product substitution and the need for consent variations for minor changes to building design. This includes:

- exploring ways to reduce specification by brand; and
- increasing flexibility in the MultiProof scheme.

Options to reduce specification by brand include expressly allowing product substitution options to be included when plans and specifications are lodged with building consent applications, and/or giving stronger direction about what constitutes a ‘minor variation’ to a building consent.

Making appropriate product substitution easier would prompt more consideration of competing key building supplies and switching where products are, for example, more cost-effective or of 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.

The current MultiProof scheme 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. There may be opportunities to amend the MultiProof scheme so that designers can make small changes to designs without ‘voiding’ the MultiProof.

Ensuring the success of schemes such as MultiProof and BuiltReady will be important to support innovation, enabling building and manufacturing businesses to grow scale, realising the efficiency benefits of more standardisation. We expect this to assist in promoting competition for key building supplies.

Support sound decision making

We also make recommendations to help support sound decision making of designers, builders, BCAs and government agencies involved in the implementation and application of the regulatory system.

Recommendation 5: Establish a national system to share information about building products and consenting

There is currently no national system for collecting and storing product and consenting information, accessible to designers, builders, BCAs and consumers. This means it can be difficult to find information about new and innovative products, and the basis on which they have been granted consent.

We recommend that a national system is introduced to share building product information. Such a system should:

- encourage, enable and incentivise the sharing of information about new or innovative building products and methods;
- include links to Acceptable Solutions, Verification Methods and product certification registers; and
- enable sharing of information about where BCAs have approved new or innovative key building supplies for use in Alternative Solutions, along with any issues that have been encountered in the use of these building supplies in consented projects.

The system would likely need to be developed and implemented in stages, and would require a coordinated approach between government and industry to resource, design, deliver, implement and maintain it.

Recommendation 6: Establish an education and mentoring function to facilitate a better co-ordinated and enhanced approach by BCAs to consenting and product approval processes

It appears there are opportunities for creating greater efficiency, certainty and consistency by improving the ways BCAs work together and share information among themselves. Greater consistency in the application of the Building Code and consenting system would improve the attractiveness of New Zealand as a market, and assist competition for key building supplies. There are also opportunities to share experience, and best practice, when it comes to Māori engagement.

The kinds of best practice initiatives that a new BCA education and mentoring function could pursue might include:

- a risk framework for BCAs to assess non-compliance risk;
- providing clear guidance on applying the 'reasonable grounds' test for granting building consents;
- sharing examples of effective working relationships between Māori and BCAs and applying sound participation and engagement practices consistent with Treaty obligations;
- an online resource for sharing information and case studies about best practice in building consents; and
- promoting uptake of systems across BCAs, such as Artisan which enables remote inspections.

Recommendation 7: Develop and implement an all-of-government strategy to coordinate and boost OSM

The introduction of BuiltReady, MultiProof, and the procurement approach of Kāinga Ora are significant achievements. However, we consider that the pro-competitive shift towards OSM-type technologies and methods is likely to be slow to emerge under current policy settings and government arrangements.

To achieve its potential to provide a viable competitive alternative to familiar building products and methods, we recommend an 'all-of-government' strategy is developed to drive greater coordination between government and industry. This strategy could focus on incentivising uptake of OSM technologies and building methods, by driving greater scale of production. An all-of-government strategy could consider:

- government leading by example through joined up procurement policies, priorities and initiatives across government that promote innovation and OSM;
- use of mandates, targets and other incentives for home buyers and builders using OSM, for example based on pre-manufactured value – the proportion of the value of the building work that is done offsite;
- consumer education regarding the potential benefits and risks of using OSM as distinct from more traditional forms of construction; and
- coordination of government and industry initiatives and programmes to deliver on a wide set of outcomes for markets, businesses and communities.

Address strategic business conduct

Our other recommendations are directed at the strategic business conduct that we have identified as affecting competition in markets for key building supplies. Our recommendations aim to discourage conduct that may harm competition and ensure the rules about misuse of market power and other conduct are understood and are appropriately addressed.

Recommendation 8: Promote compliance with the Commerce Act, including by discouraging the use of quantity-forcing supplier-to-merchant rebates that may harm competition

Some suppliers' use of quantity-forcing rebate structures in their agreements with merchants can potentially create impediments to entry or expansion of some key building supplies.

We do not recommend legislative change to prohibit the use of such rebate structures across the key building supplies industry. This is because:

- rebates can provide benefits;
- whether or not any given rebate structure has the effect of lessening competition is dependent on the specific circumstances; and
- 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.

In our view, the potential effect of rebates on competition for key building supplies is most appropriately addressed under the provisions of the Commerce Act. The Act currently prohibits firms with a substantial degree of market power from misusing it for a proscribed purpose. From April 2023 the Act will prohibit such firms 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.

We encourage all suppliers, particularly those in highly concentrated markets, to review their rebate structures for compliance with the Act, particularly with the amended section 36 which comes into force next year. We have consulted on and will be issuing guidance relating to the misuse of market power. Our guidance will discuss a range of conduct covered by the amended section 36, including rebates, and will be of general application to all businesses. Our views, including from this study, have informed the drafting of the guidance.

Based on information collected in this study, we have opened an investigation and are continuing to consider Winstone Wallboards' rebates.

Recommendation 9: Consider the economy-wide use of land covenants, exclusive leases and contractual provisions with similar effect

Land covenants and exclusive leases have the potential to reduce merchants' ability to access suitable sites and may hinder entry or expansion. In addition, covenants (and similar clauses in sale and purchase agreements) which give merchants preferential rights to quote for supplying building materials, can potentially make it more difficult for other merchants to supply building materials for new houses to be built on land zoned for residential development.

Due to the prevalence of land covenants and exclusive leases, and the use in some cases of other contractual provisions with similar effect, we intend to undertake a compliance programme in early 2023 to promote broader compliance with sections 27 and 28 of the Commerce Act in relation to their use. Independent of this study, we are taking enforcement action in relation to the use of a land covenant in the building supplies industry.

This is the third consecutive market study in which land covenants have been identified as potentially negatively impacting on competition. 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 land covenants and exclusive leases (including other contractual provisions with similar effect), to assess whether a wider multi-sector solution is needed to address their impacts on competition more generally. We are particularly concerned about land covenants, exclusive leases and other similar contractual provisions that:

- have long fixed terms or no expiry date; or
- are intended to influence consumers' choice of which merchant or retailer they purchase from (for example, by giving a particular merchant or retailer preferential rights to supply or quote).



List of recommendations

Recommendations to enhance the regulatory system

1. Introduce competition as an objective to be promoted in the building regulatory system.
2. Better serve Māori through the building regulatory system.
3. Create more clear compliance pathways for a broader range of key building supplies:
 - a. Update and develop more Acceptable Solutions and Verification Methods
 - b. Expand the range of product certification schemes that can issue product certificates deemed compliant with the Building Code
 - c. Investigate reducing further barriers to certification and appraisal
 - d. Develop guidance for key building supplies that identifies the appropriate Building Code clauses and possible means of proving compliance.
4. Explore ways to remove impediments to product substitution and variations:
 - a. Explore ways to reduce specification by brand
 - b. Increase flexibility in the MultiProof scheme.

Recommendations to support sound decision making

5. Establish a national system to share information about building products and consenting.
6. Establish an education and mentoring function to facilitate a better co-ordinated and enhanced approach by BCAs to consenting and product approval processes.
7. Develop and implement an all-of-government strategy to coordinate and boost offsite manufacturing.

Recommendations to address strategic business conduct

8. Promote compliance with the Commerce Act, including by discouraging the use of quantity-forcing supplier-to-merchant rebates that may harm competition.
9. Consider the economy-wide use of land covenants, exclusive leases and contractual provisions with similar effect.