



*Commonwealth
Competitive Neutrality
Complaints Office*



OzJobs

Investigation
No. 10



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The Commonwealth Competitive Neutrality Complaints Office

The Commonwealth Competitive Neutrality Complaints Office is an autonomous unit within the Productivity Commission. It was established under the *Productivity Commission Act 1998* to receive complaints, undertake complaint investigations and advise the Minister for Financial Services and Regulation on the application of competitive neutrality to Commonwealth Government business activities.

Information on the Office and its publications can be found on the World Wide Web at www.ccnc.o.gov.au or by contacting Media and Publications on (03) 9653 2244.



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28 May 2002

The Hon Peter Costello, MP
Treasurer
Parliament House
Canberra ACT 2600

Dear Treasurer

In accordance with section 21 of the *Productivity Commission Act 1998* and the Commonwealth Competitive Neutrality Policy Statement, I have pleasure in submitting the results of the Commonwealth Competitive Neutrality Complaints Office's investigation into OzJobs (a business division of Employment National).

Yours sincerely

Mike Woods
Commissioner

Competitive neutrality policy

Competitive neutrality is a policy which aims to promote efficient competition between public and private businesses. It seeks to ensure that significant government businesses do not have net competitive advantages over their competitors simply by virtue of their government ownership. The Commonwealth, State and Territory Governments have agreed to implement this policy as part of their commitment to the National Competition Policy Reform Package.

The Commonwealth's approach is outlined in its 1996 *Competitive Neutrality Policy Statement* (CoA 1996). Competitive neutrality requirements automatically apply to Commonwealth Government Business Enterprises, designated business units of budget sector agencies and all in-house units that tender for competitive contracts. It may apply to other businesses if the benefits outweigh the costs.

The Commonwealth Government's competitive neutrality arrangements require that its designated government business activities:

- charge prices that fully reflect costs;
- pay, or include an allowance for, government taxes and charges such as payroll tax, the goods and services tax and local government rates;
- pay commercial rates of interest on borrowings;
- generate commercially acceptable profits; and
- comply with the same regulations that apply to private businesses (such as the Trade Practices Act and planning and environmental laws).

The Commonwealth Competitive Neutrality Complaints Office is located within the Productivity Commission and is responsible for administering the Commonwealth's competitive neutrality complaint mechanism. The Office can receive complaints from individuals, private businesses and other interested parties that:

- an exposed government business is not applying competitive neutrality requirements;
- those arrangements are ineffective in removing competitive advantages arising from government ownership; or
- a particular government activity which has not been exposed to competitive neutrality should be.

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1 The complaint

1.1 Nature of the complaint

In November 2001, the Commonwealth Competitive Neutrality Complaints Office (CCNCO) received a formal complaint against the operations of Employment National Limited. Following discussions with the complainant in December 2001 to clarify aspects of the complaint, the CCNCO accepted the complaint for investigation and report.

The complaint, lodged by Mr Martin Buzzza (who is representing a number of labour hire and recruitment companies), alleges that OzJobs — a business division of Employment National — is operating in breach of the Commonwealth Government's competitive neutrality policy. In particular, the complaint alleges that the Commonwealth Government is subsidising the operation of OzJobs and that OzJobs is not paying payroll taxes on a comparable basis to its private sector competitors. Discussions with the complainant also indicated specific concerns that OzJobs may not be paying comparable insurance premiums (including public liability and workers compensation coverage).

Some of the concerns raised in the initial letter of complaint related to the operation more generally of the Commonwealth Government's Job Network scheme. The complainant has also brought these concerns to the attention of the Productivity Commission inquiry into the Job Network. As that inquiry is specifically constituted to consider such matters, the CCNCO's complaint investigation will not deal with those more general concerns. Discussions with the complainant have confirmed that this is an acceptable division of responsibilities.

1.2 Background

Employment National Limited is a 100 per cent Commonwealth-owned company, which was incorporated on 4 August 1997.

Its business is comprised of two segments:

- servicing Government contracts, trading under the brand Employment National Services; and
- fee-for-service work in the private sector, trading under the brand OzJobs.

Although Employment National was incorporated in 1997, it was not until April 2001 that OzJobs was established as a separate division of Employment National. As a Government Business Enterprise, Employment National is automatically subject to the application of competitive neutrality requirements (and thus, OzJobs, as part of Employment National, is similarly subject to those requirements).

The fee-for-service work conducted by OzJobs includes permanent and temporary recruitment, project recruitment and human resources services. OzJobs' web site (<http://www.oz-jobs.com.au/>) advertises that '... OzJobs provides flexible, comprehensive and competitive priced recruitment services for private businesses and government organisations around Australia'.

The competitive neutrality complaint relates solely to the operation of the OzJobs segment of Employment National's business activities.

However, as OzJobs is part of a broader commercial operation, the assessment of the complaint against OzJobs of necessity includes some discussion of the compliance by Employment National with the Commonwealth Government's competitive neutrality policy.

1.3 Conduct of the investigation

In the course of its investigations, the Commonwealth Competitive Neutrality Complaints Office (CCNCO) held discussions with the complainant, Employment National and the Commonwealth Shareholder Unit within the Department of Finance and Administration.

The CCNCO also drew upon the results of a comprehensive internal review conducted by Employment National at the behest of the Department of Finance and Administration. That review was not made available to the CCNCO until 15 May 2002, thus delaying the finalisation of this report.

2 Assessment of issues

2.1 The issues

The complaint alleges that OzJobs is operating in breach of the Commonwealth Government's competitive neutrality policy. In particular, the complainant alleges that the Commonwealth Government is subsidising OzJobs and that OzJobs is not paying payroll taxes on a comparable basis to its private sector competitors.

Employment National's annual report for 2001 publicly records that all of its commercial services are delivered in accordance with competitive neutrality (EN 2001a, p.2). In discussions with the CCNCO, Employment National maintains that its OzJobs division remains fully compliant with competitive neutrality policy and, in September 2001, it advised the Department of Finance and Administration unit responsible for reviewing implementation of Commonwealth competitive neutrality policy of this. Employment National has also stated in its submission to the Productivity Commission's review of Job Network that it operates in accordance with competitive neutrality principles (EN 2001b, p.2).

In addition, Employment National undertook a review of its compliance with competitive neutrality policy as part of a broader internal audit process designed to monitor compliance with relevant government policies. In support of its position, Employment National has made the results of that study — which was completed in mid-May 2002 — available to the CCNCO.

Notwithstanding these assurances, the CCNCO has conducted its own assessment of compliance with competitive neutrality. Although the complaint specifically refers to payroll tax and subsidisation of OzJobs (the latter implying a potential breach of the rate of return requirement), the CCNCO has assessed the performance of OzJobs against all the competitive neutrality obligations required of it. That is, the CCNCO has considered whether OzJobs has:

- attributed all appropriate costs to the activity;
- made the relevant competitive neutrality payments or allowances to achieve tax, debt and regulatory neutrality, or any other adjustments as necessary; and
- included an appropriate rate of return in its cost base for the purpose of setting its prices.

2.2 Attribution of all appropriate costs

In order for a government business to comply with competitive neutrality policy, it must identify and fully account for all attributable costs incurred in undertaking its business activities.

Where an organisation undertakes both commercial and non-commercial activities, an appropriate cost allocation method is needed to ensure that the distribution of costs accurately reflect the commercial operation of the business, and its pricing can be set to fully cover those costs. This is essential to avoid any cross-subsidisation of government business activities from budget-funded non-commercial activities.

Where an organisation's activities are entirely of a commercial nature, competitive neutrality policy does not compel any particular allocation of costs between business units within that organisation. In those circumstances, cost allocation between units is a matter of judgement for that organisation.

In the case of OzJobs, it resides within a Government Business Enterprise whose sole purpose is to undertake commercial business activities. Accordingly, competitive neutrality policy does not require any particular cost allocation — it only requires that all relevant costs are included in the cost base of the consolidated entity so that prices might be set such that, in aggregate, the organisation over a reasonable period earns a commercial rate of return.

However, notwithstanding the above, the complaint lodged against OzJobs expressed concern that the cost base of OzJobs (and thus its prices) were being artificially deflated by a transfer of costs to other areas of Employment National, recognising that these other areas were under contract to the Commonwealth Government. In view of this particular concern, the CCNCO examined the cost allocation process used within Employment National.

All the information provided to the CCNCO in this regard indicates that direct costs are allocated to the activity generating them and, in allocating non-direct infrastructure and overhead costs, Employment National adopts an avoidable cost approach to allocate costs to OzJobs. In view of the proportion of Employment National's total activity represented by OzJobs, the CCNCO considers this is an appropriate basis for allocating shared costs.

The CCNCO therefore finds that the allocation of costs within Employment National to OzJobs is based on a methodology that does not understate the costs incurred by OzJobs or artificially transfer some of those costs to other areas of Employment National.

2.3 Tax, debt and regulatory neutrality

Tax neutrality

The most significant tax for this industry activity is State or Territory payroll tax — a specific target of the complaint levelled against OzJobs. Detailed internal documentation supplied to the CCNCO by Employment National on OzJobs’ payroll tax liabilities and payments for each State and Territory confirmed that payroll tax applies to OzJobs and provided evidence that the tax is paid in accordance with the appropriate rates levied in each of those jurisdictions. Information provided to the CCNCO from the internal review of compliance with Government policy more generally separately confirmed that payroll tax is paid for all staff, including those engaged in the OzJobs division.

As a result of information provided to it, the CCNCO is satisfied that OzJobs is subject to and is paying payroll taxes on a comparable basis to its private sector competitors. In this regard, OzJobs is fully compliant with its competitive neutrality obligations.

Information provided by Employment National to a Department of Finance and Administration review on the implementation of competitive neutrality (a copy of which was made available to the CCNCO) provided confirmation of payments by Employment National for other State and local government taxes such as stamp duty, land tax and council rates, in addition to payroll tax.

With respect to Commonwealth taxes, OzJobs — as part of a Government Business Enterprise — is fully subject to fringe benefits tax and, following the introduction of the Goods and Services Tax, is subject to the same commodity tax regime as its private sector competitors. In addition, OzJobs (as part of Employment National) is subject to company tax on its earnings, and in this regard is treated no differently from its private sector competitors.

The CCNCO found no evidence that the business activities of OzJobs were exempt from Commonwealth, State/Territory and Local Government taxes applicable to equivalent private sector businesses, or that those taxes were not being paid or otherwise accounted for in its cost base. Accordingly, OzJobs’ operations in this regard are fully consistent with competitive neutrality policy.

Debt neutrality

Information provided by Employment National to the CCNCO, and separate information it provided to the Commonwealth Shareholder Advisory Unit within Department of Finance and Administration and viewed by the CCNCO, indicates that for the financial year 2000-01, Employment National (including OzJobs) did not have any interest bearing debt. For OzJobs, this remains the case for the financial year 2002-02. There is thus no issue about whether it currently enjoys any commercial advantage in this regard as a result of its Commonwealth Government ownership. However, if it were to borrow from the Commonwealth, the Department of Finance and Administration has advised the CCNCO that any funds so borrowed would attract a charge which would reflect commercial borrowing costs.

In addition, Employment National's credit terms for suppliers are negotiated on commercial terms and are subject to Commonwealth Procurement Guidelines which require maximum payment terms 'not exceeding 30 days'. This payment cycle requirement may be more onerous than that commonly experienced by OzJobs' private sector competitors.

Accordingly, the CCNCO has found that the operations of OzJobs are not in breach of the debt neutrality provisions of competitive neutrality.

Regulatory neutrality

The regulatory environment facing the OzJobs division within Employment National is the same as that facing OzJobs' private sector competitors. Accordingly OzJobs has no advantages from its Government ownership in this regard and, in the CCNCO's view, is being conducted in a manner consistent with its competitive neutrality obligations.

2.4 Other competitive neutrality adjustments

Discussions with the complainant also raised the prospect that OzJobs may enjoy a commercial advantage relative to its private sector competitors in respect of the cost of insurance for public liability and workers compensation.

With respect to public liability insurance, Employment National is a public non-financial trading company and, as such, is excluded from insuring under the Commonwealth Government's Comcover scheme. Employment National (and OzJobs) selects the insurer for its public liability from those on offer in the general marketplace, and thus the premiums it pays are determined on a competitive basis.

With respect to workers compensation insurance, Employment National as a Commonwealth Government business activity can only have its workers compensation liabilities insured through the Commonwealth Government-owned Comcare Australia. As OzJobs' private sector competitors do not have access to that scheme, this arrangement may represent a source of competitive advantage to OzJobs.

However, in determining the cost of workers compensation insurance for the purpose of pricing its activities, OzJobs had an independent insurance broker determine the premium it would face if it sought insurance outside Comcare — having regard to the nature of the business it was engaged in, the occupation mix of its placement activities, its volume of work and the jurisdictions in which it operated. This market testing determined an insurance premium for OzJobs that was higher than that charged by Comcare.

To ensure competitive neutrality in the light of this difference, OzJobs has added a notional increase to its cost base to reflect these higher workers compensation premiums rather than using those actually applying to it. These higher costs are in turn embodied in the pricing arrangements of OzJobs which are set to cover all attributable costs (including competitive neutrality adjustments where appropriate) and to deliver a commercial rate of return.

Accordingly, the CCNCO finds that OzJobs' accounting for workers compensation insurance costs satisfies its obligations under competitive neutrality policy.

2.5 Commercial rate of return

Competitive neutrality policy requires that publicly owned businesses should make a commercial rate of return on their assets over a reasonable period of time.

OzJobs is not, however, a separate business entity in its own right. Rather, it is part of a broader commercial entity (Employment National). The competitive neutrality policy requirement that a business activity should earn a commercial rate of return over a reasonable period of time applies only to the total activities of the business. It does not mean that each separate part of a business is required to deliver a commercial rate of return.

However, in view of the concern by the complainant that OzJobs is not profitable in its own right (and is being subsidised by other areas of Employment National), the CCNCO sought information on the profitability of the OzJobs division within Employment National to determine if OzJobs was operating in a manner consistent with competitive neutrality principles. (The issue of whether OzJobs is being

subsidised by other areas of Employment National is examined in section 2.2. In that section, the CCNCO found full cost attribution was being applied and, accordingly, that other areas are not cross-subsidising OzJobs by artificially lowering its cost structure).

Information from the internal review of Employment National's operations indicate that OzJobs makes a positive financial return, but that those returns are not yet equivalent to a satisfactory commercial rate of return. (In this regard, satisfactory is considered to be equivalent to the long term bond rate plus a margin reflecting the additional risk associated with the business).

In previous publications (CCNCO 1998, 2000) the CCNCO has noted that the commercial rate of return requirement is not a single year requirement, but rather is an average that should be achieved over a reasonable period. Failure to earn a commercial rate of return in any particular year, or even over several years during the establishment phase of a business, may not necessarily constitute a breach of competitive neutrality.

The CCNCO is mindful that OzJobs is still in the establishment phase, having been in operation for just over 12 months, and that this period coincided with a downturn in the recruitment market coupled with intense competition for market share. Moreover, information from the complainant and OzJobs indicates that the rate of return experienced by many private labour hire and recruitment agencies and by OzJobs over the previous 12 months is broadly similar.

Accordingly, the CCNCO considers the current rate of return performance of OzJobs does not constitute a breach of competitive neutrality principles.

2.6 Findings

As a result of its investigations, the CCNCO finds that OzJobs is currently operating in a manner consistent with its obligations under competitive neutrality policy and no action is required with respect to the competitive neutrality complaint lodged against it.

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