



Competitive Neutrality Complaint Investigation

Final report

Sale of healthcare equipment by

South West Healthcare

6 May 2011

Victorian Competition and Efficiency Commission

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Key points

- In May 2010, the Victorian Competition and Efficiency Commission (VCEC) received a complaint alleging that South West Healthcare (SWH) is not compliant with Victoria's competitive neutrality (CN) policy. SWH operates South West Healthcare Supplies (SWHS), a store located in the Warrnambool Hospital. The complainant alleged that the pricing of goods and services offered by SWHS is not fully cost-reflective.
- The VCEC has concluded that part of SWHS's overall activity is a commercially significant business. This business involves the sale of medical aids and healthcare equipment and short-term equipment hire services to the general public (including businesses and government entities).
- SWH provided the VCEC with two CN costing exercises prepared for SWH by a consultant — the first in December 2010, and the second — a revised exercise prepared in response to the VCEC's draft investigation report — in March 2011.
- The VCEC found that these costing exercises broadly followed the procedures outlined in Victoria's CN Guide to Implementation. However, the VCEC also identified some significant shortcomings. The December 2010 costing exercise:
 - did not apportion costs between SWHS's commercially significant business and non-commercial functions;
 - incorrectly identified and calculated some costs and some of the CN cost advantages and disadvantages;
 - did not itemise or describe cost categories in sufficient detail to enable an assessment of whether the exercise was consistent with CN policy; and
 - incorrectly made an adjustment for revenue forgone.
- The March 2011 costing exercise adequately addressed the last of these issues and partly addressed the first issue. However, the other shortcomings remain.
- Therefore, the VCEC has concluded that, at the time the complaint was lodged, SWH had not fully met the requirements of the CN policy. This finding does not necessarily imply that SWHS prices are not fully cost-reflective. Because of the shortcomings in SWH's costing exercises, it is not possible to determine whether the cost estimates understate or overstate SWHS's commercial costs.
- The VCEC recommends that SWH conduct, by November 2011, a CN costing exercise that:
 - addresses the issues identified by the VCEC in relation to the costing exercise undertaken for SWH by its consultant;
 - itemises the costs in sufficient detail to allow informed external scrutiny of the data, and enable an assessment of whether the costs incurred and cost adjustments made are appropriate; and
 - incorporates all relevant costs of the relocation and operation of the SWHS store in the new Warrnambool Hospital.
- This costing exercise would enable SWH to assess and, where necessary, alter SWHS's pricing structure to fully reflect the costs of operating from the new store. Any revisions should be reflected both in the prices charged through the SWHS retail outlet and in the bids SWHS submits for contracts to supply business and government entities.

1 Competitive neutrality policy

Victoria's *Competitive Neutrality Policy Victoria* was released in October 2000. The policy integrates rigorous financial principles with a strong public interest test and transparency in decision-making.

The objective of competitive neutrality (CN) is set out in Clause 3(1) of the *Competition Principles Agreement* as:

... the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities: Government business should not enjoy any net competitive advantage simply as a result of their public sector ownership. These principles only apply to the business activities of publicly owned entities, not to the non-business, non-profit activities of these entities. (COAG 1995)

CN is achieved by removing unfair competitive advantages that result solely from government ownership of a business activity (Government of Victoria 2000).

In Victoria, it is the responsibility of government agencies and councils to determine if their business activities fall within the scope of CN policy. If the policy does apply, then the government agency or council must put in place CN measures for its business activities if it is in the public interest to do so. The CN policy provides for three measures to implement CN — corporatisation, commercialisation, and full cost-reflective pricing (appendix 1 provides a further description of these measures).

CN policy recognises that it is common for private businesses to coexist with government business and that these do not always compete on equal terms: 'Such inequalities arise from a variety of circumstances and it is the goal of competitive neutrality policy to offset these where appropriate' (Government of Victoria 2000, p. 4). The policy states further:

Competitive neutrality measures will be required where the expected benefits of introducing such measures outweigh the costs, and where there are net benefits from implementing such measures having regard to public policy objectives other than competitive neutrality. (Government of Victoria 2000, p. 6)

Under CN policy, prices should reflect the full cost of producing a good or service, after any adjustments for competitive advantages or disadvantages associated with government ownership. There should also be equalisation of non-price related competitive advantages.

Government businesses within the scope of CN policy are required to document the steps they have taken to ensure that they operate consistently with the policy,

and make this documentation public on request (Government of Victoria 2000, p. 11).

Should CN measures jeopardise other public policy objectives, options for achieving all policy objectives, including CN, must be explored through a fully documented public interest test process.

1.1 Role of the VCEC in the CN process

The Victorian Competition and Efficiency Commission (VCEC) carries out three complementary functions:

- (1) undertaking inquiries into matters referred to it by the Victorian Government;
- (2) reviewing and advising on the economic impact of significant new legislation and regulation; and
- (3) operating Victoria's Competitive Neutrality Unit.

The CN policy states:

It is the role of the Complaints Unit to determine the extent to which an agency's actions comply or do not comply with competitive neutrality policy. (Government of Victoria 2000, p. 12)

The VCEC has investigated this complaint consistent with CN policy, and the *Competitive Neutrality Guide to Implementation* ('CN Implementation Guide') (DTF 2000). The VCEC has no authority to investigate other concerns of complainants, for example those relating to the *Competition and Consumer Act 2010* (Cth).

Compliance with CN policy is about achieving CN or justifying departure from CN, and the VCEC makes recommendations to achieve this end only. VCEC reports are not intended to form the basis of, or contribute to, compensation claims.

1.2 Investigation methodology

The VCEC received a complaint against South West Healthcare (SWH) on 3 May 2010. The complainant raised CN concerns and other concerns about the procurement of equipment, which were not in scope of the CN policy. As part of its pre-investigation process, the VCEC requested additional information from the complainant. After considering the facts and issues, the VCEC wrote to the relevant parties on 6 September 2010 to advise that it had received and accepted a complaint for investigation, and requested that SWH respond to a range of questions by 27 September 2010. On 10 September 2010, SWH's

Director, Finance and Business telephoned to acknowledge receipt of the complaint. SWH requested a deadline extension to help it to prepare its response and also advised that in February 2010 it had engaged a consultant to assess South West Healthcare Supplies (SWHS) in the context of Victoria's CN policy. The VCEC granted an extension.

On 8 October 2010, the VCEC received SWH's response to the complaint. The information provided assisted the VCEC but was not sufficient to conclude the investigation as the CN assessment undertaken by SWH's consultant was not finalised. A copy of the consultant's report was finalised and provided to the VCEC on 24 December 2010.

On 3 March 2011, the VCEC issued a confidential draft report to the complainant, SWH and the Department of Health for their consideration and comment. The VCEC received submissions from the complainant and SWH, and a response from the Department that acknowledged the report. The VCEC considered each submission in its preparation of the final report.

2 Scope of complaint

The CN complaint directed at SWH relates to the sale and hire of healthcare supplies to the general public and other businesses from its SWHS store at Warrnambool Hospital. The complaint was lodged by a private business operator who requested that their identity be kept confidential. The complainant alleged that SWHS is not complying with Victoria's CN policy.

The complainant raised further concerns about the SWH procurement process, including in relation to SWH's role as an issuing centre under the Aids and Equipment Program (A&EP) administered by the Department of Human Services. In general, governance-related procurement issues are not within the scope of CN policy and the VCEC understands that the complainant referred the concern about the A&EP program to the relevant Department for consideration. The VCEC also notes that the A&EP has been replaced by the State-Wide Equipment Program (SWEP), funded by the Department of Human Services and administered by Ballarat Health Services. Suppliers for this program are being selected through a series of tenders being conducted during 2011. These new arrangements mean the initial concerns of the complainant are no longer relevant; however, related CN concerns may still be relevant to the extent that SWHS participates in these tenders.

The complainant also expressed concern about the extent to which the purchasing decisions of the SWH supply department reflected an unfair advantage to SWHS, as a result of its links to SWH. As noted above, governance-related procurement issues are beyond the scope of CN. A CN issue

would arise, however, if SWHS had access to information not available to its competitors or if the bids it submitted were not fully cost-reflective.

In formulating the complaint, the complainant supported their claim that SWHS is a significant business, and that it operates a commercial business in competition with private providers, by supplying the VCEC with copies of advertisements from the local regional newspaper, and advised the VCEC that SWH has advertised SWHS on the local regional radio station.

Whether SWHS is a significant business is discussed in section 4.

The specific CN allegation concerned the pricing of goods and services. The complainant believed that goods and hire services available from the SWHS retail store were not priced in a fully cost-reflective way. The complainant alleged the following costs were not fully recovered by SWHS:

- (i) delivery and set-up costs of specialised hire equipment;
- (ii) rent for commercial retail space at Warrnambool Hospital, the warehouse storage of equipment and for parking areas which it uses; and
- (iii) print and radio media advertising costs.

The complainant also expressed concerns about the extent to which the bids submitted by SWHS for competitive tendering processes, including for subcontracting arrangements (such as for the supply of equipment to the Department of Veterans' Affairs Rehabilitation Appliance Program) reflected fully cost-reflective prices.

The complainant advised the VCEC that SWH planned to open a larger healthcare equipment store in the new Warrnambool Hospital development. The VCEC understands that the new development will be completed in 2011. The complainant expressed concern that SWH may not have considered the application of CN policy to this new development.

The VCEC examined each of the issues raised by the complainant to establish whether SWHS falls within the scope of CN policy, and, where appropriate, has made recommendations to assist SWHS to comply with CN policy, or better demonstrate CN compliance.

3 Background

This section outlines the structure of the public healthcare sector in the south-western region of Victoria and the provision of healthcare equipment by public healthcare service providers. In particular, it examines the obligations on public hospitals to supply medical aids and healthcare equipment. This is done to help identify those activities that are within the scope of CN policy.

3.1 National healthcare agreement

The State of Victoria is a party to the National Healthcare Agreement (NHA) signed by the Commonwealth of Australia and States and Territories. Victorian public hospitals, including SWH, must adhere to this agreement.

Under the Business Rules for the NHA, the services to which public patient charges apply are identified.

Where an eligible person receives public hospital services as a public patient no charges will be raised, except for the following services provided to non admitted patients and, in relation to (f) only, to admitted patients upon separation:

(a) dental services; ...

...

(f) pharmaceuticals at a level consistent with the Pharmaceutical Benefits Scheme statutory co-payments;

(g) aids, appliances and home modifications; and

(h) other services as agreed between the Commonwealth and States and Territories. (NHA Schedule B 10)

The NHA accepts that public hospitals may sell aids and healthcare equipment, and offer short-term equipment hire services to public patients, but does not oblige them to do so. However, the NHA does not specify how public hospitals are to determine charges or fees for medical aids and healthcare equipment.

3.2 South West Healthcare

SWH is a public hospital incorporated under the *Health Services Act 1988* (Vic) and operates two public hospitals, four psychiatric services division offices, and five community health centres and aged care facilities spread across five Local Government municipalities in south-west Victoria — the City of Warrnambool, and the Shires of Corangamite, Glenelg, Moyne and Southern Grampians (SWH 2010a, p. 14). The population of the region serviced by SWH is 102 386 people (SWH 2010d, p. 1). SWH provided 122 medical, nursing, psychiatric, allied health and community health services and employed 1128 people in 2010 (appendix 2 provides additional population and hospital attendance data). The SWH head office is in the Warrnambool Hospital and will be relocated to the new Warrnambool Hospital in 2011.

Table 3.1 shows the number of patients who have attended the two public hospitals that SWH operates — Warrnambool Hospital and Camperdown Hospital — for the three years to 2010. Patients who have been admitted and stay one, or more, nights in hospital are referred to as patients treated. Non-patient attendances refer to people who have attended the hospital for

treatment or medical assessment, which has not required them to be admitted to and stay overnight in the hospital.

Table 3.1 Hospital attendances

	<i>2009-10</i>	<i>2008-09</i>	<i>2007-08</i>
<i>Warrnambool Hospital</i>			
Total patients treated	17 363	16 766	14 921
Non-inpatient attendances	106 816	111 299	108 323
<i>Camperdown Hospital</i>			
Total patients treated	1 793	1 747	1 795
Non-inpatient attendances	24 639	20 839	19 708

Source: SWH 2010d, pp. 10–11.

The attendance data demonstrate that Warrnambool Hospital is the largest public hospital in the south-western region of Victoria.

3.3 South West Healthcare Supplies

The SWHS store, in the Warrnambool Hospital, is part of SWH and was formally established in 1995. SWHS is open on weekdays between 10.00a.m. and 4.00p.m.. SWHS’s services include the sale of medical aids and healthcare equipment, the provision of a short-term equipment hire service, and a product repairs and home modification service.

SWH advised the VCEC that:

SWHS evolved due to a community need for the hire and purchase of medical equipment. At the time it started to first provide equipment SWHS was formed to address a community need that was not being provided on a private/commercial basis due to the relatively small nature of the market. (SWH 2010b)

SWHS will be relocated to the new Warrnambool Hospital development in 2011. As a result, the floor space of the store will increase from 52 square metres to approximately double its current size — 94 square metres for the store, with an additional 6.5 square metres for storage and 8.5 square metres for office space, totalling 109 square metres. SWH advised the VCEC that a larger floor space is necessary as the area of the existing store only comfortably permits a few people to browse at a time.

SWHS stocks a wide range of products for display so that patients may, when accompanied by a hospital occupational therapist, view and familiarise themselves with the equipment required to assist their transition from hospital to home. However, while the range of products is wide, the depth of product type sold or available for hire is narrow, and considered by SWHS to be largely standard equipment.

SWH provided the VCEC with a list of the hire products available to outpatients from SWHS:

Shower Commode (Wheelie Commode), Shower Chair, Shower Stool, Over Toilet Frame, Raised Toilet Seat, Bath Transfer seat, Bed Stick, Bed Cradle, Over Bed Table, Electric, Bed Pressure Care mattress, Bedside Commode, Kingston Chair, Fitzroy Chair, Hi Lite Chair, Lift Chair, Pressure Cushion, Elbow Crutches, Hand Brake Walkers, Push Brake Walkers, Pick up Frame, Lightweight manual wheelchair, Scooter, Hoist - Full Lift, Hoist - Standing frame. (SWH 2010c)

The most common items sold by SWHS include: continence aids, compression stockings, nutritional supplements, over toilet frames, shower stools, hand brake walkers, walking sticks, reaches/small daily living aids, dressings, and baby food. Reflecting changes in the market, SWHS no longer sells or hires enuresis alarms, pressure care mattresses, electric beds, pressure care cushions, or standing frames.

3.4 SWHS customers

SWHS customers fall into two categories — non-paying customers and paying customers. Non-paying customers are public hospital in-patients who, under ‘Hospital Circular 24/1995—Provision of Aids and Equipment and Domiciliary Oxygen’ — issued by the Department of Human Services (DHS) on 11 September 1995 — receive free aids and equipment hire for 30 days following their discharge from hospital (appendix 3 provides further information about Hospital Circular 24/1995).

After 30 days, the non-paying customers may become full paying customers if they continue to require SWHS services (unless they are eligible for a subsidy under another program). Other paying customers include non-inpatient hospital attendees and members of the public. SWHS customers also include private businesses and government organisations to which SWHS might supply equipment or services, including through public tender processes and subcontracting arrangements. In this report, these paying customers are referred to as the general public.

3.5 Medical aids and equipment market

The relevant market in which SWHS operates is confined to Warrnambool and the south-western region of Victoria.

Given the wide range of products SWHS has available for sale and hire, the main competitors of SWHS include pharmacies, furniture stores that sell lift chairs, specialist healthcare equipment/mobility scooter stores, and supermarkets. However, the degree of competition may vary across specific product lines.

4 Does competitive neutrality policy apply?

The threshold issue in any CN investigation is establishing whether the government activity subject to the complaint is a significant business as defined by the CN policy. The CN policy requires that:

An agency or local government should document its determination as to whether a business activity is, or is not, within the scope of the Policy. This documentation should be defensible and will be subject to scrutiny in the event that an investigation is triggered by a complaint. (Government of Victoria 2000, p. 5)

4.1 SWH significant business assessment

SWH advised the VCEC that ‘SWH has not regarded the SWHS as a significant business activity’ and therefore did not believe it to be within the scope of CN policy. SWH further noted that SWHS pre-dates CN policy and that the intention of operating this service was to meet the Warrnambool Hospital’s delivery of care obligation to its patients (SWH 2010b). To support this position, SWH advised the VCEC:

- The sale of healthcare equipment by SWHS is treated by SWH as part of its obligation to provide continuity of care and support for its patients in the transition from hospital to their home.
- SWH’s primary focus is not to make a profit from the sale of equipment by SWH. Rather, the SWHS is considered primarily a service for SWH’s patients. Symbolic of this focus is the fact that allied health staff of SWH have a heavy involvement in determining the type of stock held by SWHS to ensure that the SWHS is able to meet the requirements of SWH’s patients.
- SWH conducts some small amount of community sponsorship and minimal advertising more as a community service rather than as a means to promote the activities of the SWHS.
- No attempt has been made to expand the market or revenue for the SWHS.
- The staff who work in the SWHS have no sales experience.

- The range of equipment available for the SWHS is extremely limited and is restricted to those items which assist the needs of SWH's patients. (SWH 2010b)

SWH also advised the VCEC that, to keep up with growth in the Warrnambool/south-western region of Victoria, SWH is undergoing a major redevelopment (SWH 2010b).

As a result of the hospital redevelopment and the growth of the regional population, SWH recognised that it was appropriate to review the structure of SWHS and ensure that:

- the provision of the SWHS' service remained in the community's best interest; and
- SWHS complied with all applicable legislation and policies such as competitive neutrality. (SWH 2010b)

In February 2010, SWH engaged a consultant to review the structure of SWHS and its activities, including consideration of CN policy. This review was completed in December 2010 and the VCEC was provided with a copy of the consultant's final SWHS CN report (SWH review). The SWH review concluded that SWHS operates as a business but that it was not significant. However, the SWH review also noted that the business status of SWHS might change following its opening at the new hospital.

Despite its conclusion that SWHS is not a significant business, the review included a CN costing exercise to ascertain whether or not SWHS would be compliant with CN policy. The findings of this review are discussed in section 5.

4.2 Is SWHS a significant business?

The VCEC has undertaken its own assessment of whether the activities of SWHS — the sale and short-term hire of aid and healthcare equipment — are significant businesses and, therefore, subject to CN policy.

4.2.1 'Business' status

For the purposes of CN policy, a range of factors needs to be taken into account in determining whether a government activity is a business (Government of Victoria 2000; The Treasury 2004). These include whether:

- the activities of the entity result in the sale of a good or service;
- the costs of providing the goods or services by the entity are predominantly met by users;
- there is an actual or potential competitor; and

- the managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.

As discussed in section 3.4, there is a range of customers who pay for services and a group of customers from whom payment cannot be sought (under Hospital Circular 24/1995). The scope of CN policy concerns the activities provided to the first group of customers. Because the provision of free aids and equipment under the DHS Hospital Circular 24/1995 is a requirement of government policy, and not to make a profit, the activity relating to the delivery of this service to non-paying customers is not subject to Victoria's CN policy.

The VCEC concluded that the sale of aids and healthcare equipment and the short-term hire service that are available to the general public is a business in the context of the CN policy, whether sold through the SWHS retail outlet or as part of a subcontracting or tender process to business or government entities.

- SWHS offers aids and a range of healthcare equipment for sale and hire.
- Based on financial information contained in the SWH review it appears that the costs of providing the goods and services are predominantly met by SWHS customers.
- There are stores in Warrnambool that might compete with SWHS. These stores include pharmacies, furniture stores (for lift chairs) and more specialised healthcare/mobility equipment stores. A number of stores have equipment available for sale and hire.
- SWHS's key business parameters, including its prices, are not regulated by government. Further, in 2010 SWH appointed a Business Manager to oversee the SWHS operation.

4.2.2 'Significance' status

A further necessary condition for an activity to be subject to CN is that the business be significant in the context of the market. The CN policy outlines the factors which might be taken into account in determining whether a business is significant (Government of Victoria 2000, p. 5). They include:

- the size of the relevant business activity in relation to the size of the relevant market; and
- the influence or competitive impact of the business activity in the relevant market.

Size of the business activity

SWH provided the VCEC with financial data relating to the operation of SWHS for the 2009-10 financial year. The financial data are treated as commercial-in-

confidence. Although the VCEC has formed the view that the revenue generated by SWHS appears to be substantial, this information alone is not sufficient to assess the size of the SWHS business relative to the market.

The size of the market for medical aids and healthcare equipment in the Warrnambool and south-western region of Victoria is potentially large, as demonstrated by the number of patients treated and non-inpatient attendees receiving treatment at the Warrnambool and Camperdown Hospitals. A diverse range of suppliers, including pharmacies, furniture stores and more specialist healthcare equipment/mobility scooter stores, together compete with SWHS for patronage from the general public (as defined on page 8 of this report).

However, the market is fragmented where suppliers specialise in specific product categories. There may be fewer suppliers in some parts of the market — e.g. specialist healthcare equipment stores — and more in other parts — e.g. pharmacies.

On the basis of the information provided by SWH and the complainant, the VCEC considers that SWHS is unlikely to be the largest provider of medical and healthcare equipment in the Warrnambool region. However, it is likely that the revenue generated by SWHS from the sale of this type of equipment is greater than the revenue generated by a number of its private competitors from the sale of this type of equipment. Therefore, SWHS appears to be a significant player in this specialised market.

Furthermore, the imminent relocation of SWHS to the new Warrnambool Hospital where it will have significantly increased floor space gives scope to SWHS to grow the business by increasing displays and stocking more items.

Influence of the business activity

The role of a public hospital includes ensuring the product availability for patients being discharged to enable continuing treatment of their ailment. However, a number of actions by SWHS suggest that its role has developed a commercial emphasis as well.

First, it operates a store that displays a range of products prominently positioned within the hospital. The location of the store provides SWHS with a visible presence which will attract patronage from the non-inpatient hospital attendees who may otherwise have shopped elsewhere. Table 3.1 shows the number of non-inpatient attendees over the three years to 2009-10.

Second, it undertakes promotional activities including:

- placing one advertisement per day on the local radio station;
- placing occasional advertisements in the local newspaper, and
- sponsoring community events.

The intent of the wording of the advertising appears aimed at attracting the general public — including customers from off-the street and return patient patronage — and presenting SWHS as an outlet through which healthcare needs can be addressed.

An example of the wording used in SWHS advertisements is:

Hire & Loan equipment and direct sales to the public including wheelchairs, scooters, walking frames, physiotherapy equipment, continence aids, hoists, ramps and more!

Free delivery & pickup in the Warrnambool area.

Open Monday to Friday 10 am to 4 pm

(*The Standard*, Monday March 22 2010, p. 9)

Further, in 2010 SWH developed, for the first time, a business and quality plan for SWHS for 2010-11, which indicated that the new store presented an opportunity to grow SWHS. The plan stated a percentage growth target for the first year and lower growth targets in subsequent years, with advertising and promotion used as the main driver of growth.

The development of the SWHS business plan and the promotion of its activities demonstrate that SWHS is treated as a business that provides services to the general public (including business and government entities). Both local newspaper and radio promotions for SWHS's services — SWHS provided the VCEC with transcripts of its radio promotion — demonstrate its intention to service the broader market.

These factors suggest not only an increasing commercial emphasis by SWHS but also that the operation of the SWHS business could have an influence on the medical and healthcare equipment market in the Warrnambool and south-west region of Victoria.

Conclusion

The VCEC has concluded that SWHS's commercial activity is a significant business because of its size in relation to the market and its private competitors, and its intention to service the general public.

5 Assessment of the complaint

SWH provided the VCEC with two CN costing exercises — the first in December 2010, and the second — a revised exercise prepared in response to the VCEC's draft investigation report — in March 2011. Although the revised exercise attempted to address the shortcomings identified by the VCEC in its

draft report, a number of key shortcomings remain. As a result, the additional information in the revised costing exercise did not alter the report's key findings and recommendations. The assessment in this section takes as its starting point the December 2010 costing exercise. Because it was the version available at the time the VCEC's draft investigation report was prepared, it provides the information relevant to determining whether, at the time the complaint was made, SWH was compliant with CN policy. That said, where the March 2011 costing exercise has addressed the shortcomings highlighted in the VCEC's draft investigation report, this is noted in the assessment. As such, the assessment highlights the areas in which SWH needs to give further consideration to the relevant costs and cost adjustments as part of its preparation of a costing exercise that complies with CN policy.

The focus of the assessment is on determining whether the SWH costing exercise was made in accordance with CN procedures (section 5.1), and assessing whether SWHS's pricing fully recovers the competitively neutral cost adjustment of its significant business operation (section 5.2).

Victoria's CN Implementation Guide summarises the procedure for determining competitively neutral costing and pricing:

- define the output (the good or service);
- attribute full costs to the production of the output (or the provision of the service) including the cost advantages and cost disadvantages of public ownership; and
- derive the net CN adjusted cost.

Only after these steps have been taken is it possible to determine a fully cost-reflective pricing structure, and demonstrate whether pricing is fully cost-reflective.

5.1 CN costing exercise

The December 2010 SWHS CN costing exercise broadly followed the procedures set out in the CN Implementation Guide. The exercise:

- identified the output/service subject to CN;
- identified and calculated the costs attributable to the provision of the service; and
- identified and costed CN advantages and disadvantages to determine a net CN adjusted cost.

The CN costing exercise concluded that SWHS's pricing structure returned a surplus on the whole of the SWHS activity for the 2009-10 financial year, and that its operation was not subsidised by other SWH revenue streams.

However, the VCEC found some key shortcomings in the costing exercise. The exercise:

- did not apportion costs between SWHS's commercial (significant business) and non-commercial functions (section 5.1.1);
- incorrectly identified and calculated some costs (section 5.1.2);
- incorrectly identified and calculated some of the CN cost advantages and disadvantages — including, potentially, a significant underestimate of some of the costs of providing its commercial activities (section 5.1.3); and
- incorrectly made an adjustment for revenue forgone (section 5.1.4).

Of these key shortcomings, the last was adequately addressed by SWH in the March 2011 revised costing exercise, while the first was partly addressed. However, the other key shortcomings remain. The key shortcomings are discussed in further detail below.

5.1.1 Apportionment of costs

CN policy applies to the significant business component of the SWHS activity only. CN policy does not apply to non-commercial activities — in this case, where SWH is obliged to provide services free-of-charge to patients for up to 30 days following their discharge from hospital.

Where the commercial and non-commercial services share resources — such as staff, floor space and information technology (IT) — it is necessary to apportion costs between these services.

The December 2010 CN costing exercise did not identify separately the cost of providing the commercial and non-commercial components of the SWHS service. In isolation, this would lead to an overstatement of the costs necessary to be fully recovered for CN purposes.

The March 2011 costing exercise attempted to address this problem by applying the proportion of income generated from commercial and non-commercial activities to the costs of SWHS, as an indirect way to estimate the costs of commercial and non-commercial activities. To the extent that the proportion of income received from commercial and non-commercial activities is representative of the relative costs of providing the services, this revised approach is consistent with CN policy.

The March 2011 costing exercise did not, however, include sufficient information for the VCEC to assess whether this allocation approach accurately reflects the relative costs incurred by the commercial and non-commercial activities in practice. In particular, it did not explain whether the income

generated from non-commercial services reflects a subsidised price or a price based on the full costs associated with providing those services.

Nonetheless, the information provided suggests that most of SWHS's costs are attributable to the delivery of its commercial services. If this is correct, then the cost estimates in the December 2010 costing exercise are unlikely to have overestimated significantly the costs of the commercial activities of SWHS. Moreover, as discussed in section 5.1.3 below, it appears that some key CN cost adjustments have been estimated incorrectly, resulting in an underestimate of the CN adjusted cost.

5.1.2 Identification of costs

To correctly undertake a CN costing exercise, government agencies have to first identify and calculate the costs of operating the government activity. The complainant provided the VCEC with a list of costs that they believed should be reflected in SWHS's pricing, including wage costs (including sick leave, annual leave, leave loading); staff overheads; costs of goods sold; advertising; freight; building lease costs; fixtures and fittings (including capital/depreciation costs); workshop costs; information technology; vehicle costs; outgoings such as electricity, gas, and building, public liability and professional indemnity insurance; telephone and data costs; staff travel costs; stock costs; industry group membership; and office expenses.

The VCEC's assessment examined whether the costing exercise identified and appropriately considered the specific categories of costs.

In relation to the costs identified, the VCEC found that the CN costing exercise did identify the broad categories of costs highlighted by the complainant, where SWH considered they were applicable. (The March 2011 exercise indicated, for example, that SWHS was not a member of the relevant industry association and did not have the use of a vehicle, so these costs were not included).

In terms of whether the identified costs were appropriately considered, the focus of the VCEC's assessment was on those costs raised as particular concerns by the complainant, that is:

- delivery and set-up costs of specialised hire equipment;
- rent for commercial retail space at Warrnambool Hospital, the warehouse storage of equipment and for parking areas which it uses; and
- print and radio media advertising costs.

(The CN costing exercise also identified some CN cost advantages and disadvantages, to determine a net CN adjusted cost, which are discussed in section 5.1.3.)

Delivery and set-up costs of specialised hire equipment

SWH advised the VCEC that SWHS provides free delivery of equipment to discharged patients for whom it is obliged to provide equipment free-of-charge under the DHS circular but delivers free-of-charge to other customers only when ‘a truck (is) going in that direction and only if that truck has room’. However, the VCEC notes that even where freight is provided free-of-charge to the customer, the service does impose costs on SWHS, and these costs need to be incorporated in the cost estimates.

The December 2010 costing exercise identified the cost of freight but not whether the ‘setting up’ of the equipment delivered is part of the freight service or whether this is a separate service that should be costed separately.

In its response to the VCEC’s draft investigation report, SWH clarified that the freight charge is only for the delivery of goods to a location; drivers assist by unloading and setting up equipment at their discretion. SWH advised further that, should equipment require setting up to meet the needs of the patient, the patient’s occupational therapist will visit to do this.

SWH also advised that paying customers can choose to pay for more immediate delivery, where the customer is billed for the delivery rather than SWHS.

For CN purposes, the cost of freight — inward and outward delivery and set-up — needs to be apportioned between the commercial and non-commercial services, and the cost attributed to the commercial services factored into SWHS overall pricing of its commercial services. Moreover, any CN costing exercise needs to explicitly state what is included in each of these cost categories.

Rent

In the December 2010 costing exercise, rental of business premises was identified as a CN cost advantage and included in the full competitively neutral cost adjustment. The review did not specify whether charges for warehouse storage facilities and parking facilities for delivery trucks and customer/staff vehicles were included in the rental charge. If rent has not been calculated for the use of warehouse storage space and parking facilities by SWHS for its significant business operation, then SWH should revise the rental charge to reflect all relevant costs.

Future calculations of rental cost by SWH will also need to be based on the floor space of the new store and that of any other areas used by SWHS in the provision of its commercial activities — including storage, parking and office space. It will be necessary to document the method used to estimate the commercial rent.

Print and radio media advertising costs

In the SWH review, advertising and sponsorship were identified as direct costs and included in the full competitively neutral cost adjustment. This covered costs of radio and newspaper advertisements and sponsorship.

The identification of these costs is consistent with CN policy requirements.

Itemising and describing costs

The VCEC has concluded that both the December 2010 and revised March 2011 costing exercises failed to itemise or describe costs in sufficient detail to enable an assessment of whether the cost estimates are consistent with CN policy.

5.1.3 Identification of CN adjustments

The SWH costing exercise (December 2010) identified CN cost advantages and disadvantages and attributed costs to these, as is required by CN policy.

Cost advantages

The CN cost advantages that SWH identified included cost of finance, land tax, council rates and municipal charges, payroll tax, rental of business premises and overhead costs (management salaries and overheads, electricity and water, rental estimate for office furniture and equipment, IT, communications, human resources, accounts payable services, public and product liability insurance, business contents insurance, supply services).

The VCEC found that several small cost adjustments need not have been calculated. For example, the CN Implementation Guide states 'if the calculation of full costs includes a documented and defensible estimate of commercial rent' no adjustment needs to be made for land tax or local government rates (DTF 2000, p. 22). Yet adjustments were made for land tax and local government rates. This issue was addressed in the March 2011 costing exercise.

Cost disadvantages

The CN policy makes it clear that:

The key factor in assessing whether a disadvantage constitutes a competitive neutrality issue is that the constraint (on the conduct of the public business) is externally imposed on the agency and it exceeds that likely to be faced by a private sector business supplying the same goods or services. (Government of Victoria 2000, p. 4)

The CN Implementation Guide notes further:

As a starting point, there is a presumption in the costing guidelines that the public sector does not face conditions which would constitute a competitive disadvantage vis a vis a private sector competitor ... Notwithstanding this

presumption, the cost disadvantages faced may be very real and agencies should *set out clearly the basis for the determinations they make*. (DTF 2000, p. 24, emphasis added)

The CN Implementation Guide notes, moreover, that ‘to the extent that cost disadvantages are identified, there is ... an onus on the agency to seek to minimise the additional costs of public provision’, and that the agency needs to:

- establish a case that it does face higher costs solely due to government ownership;
- investigate arrangements for removing the source of the high cost; or
- if the cost disadvantage is unavoidable, estimate the magnitude of the cost burden to offset against the estimated competitive advantages. (DTF 2000, p. 31)

The CN cost disadvantages that SWH identified included IT services that would be cheaper had they been sourced through a private provider, employment remuneration, and accountability and reporting requirements.

IT services. SWH uses the South West Alliance of Rural Health (SWARH) IT system to help it to deliver its activities, including SWHS. The charge attributable to SWHS is set at 1.5 per cent of SWHS’s annual turnover. Based on an estimate that SWH obtained from a private provider, SWH observed that the IT cost attributed to SWHS significantly exceeded the cost it would face if sourcing IT services externally. It, therefore, considered the difference in costs to be a CN disadvantage. However, as noted above, for a specific cost to be considered a CN cost disadvantage, it must be demonstrated that the higher costs result from an externally-imposed constraint, with the onus being on the agency to investigate arrangements for removing the source of the high costs. These factors should be considered in the CN costing exercise.

Employment remuneration. The rationale for the inclusion of employment remuneration as a competitive disadvantage is explained in the SWH review in terms of the difference between private-sector award rates and the higher SWH rates of pay. In relation to this issue, the CN Implementation Guide states:

A public agency may find that its wages and/or salaries are higher than the private sector competitor. However, this cost disadvantage can *not* be reflected in the competitively neutral price unless the employer can demonstrate that it is bound *by law* to pay a higher award than the private sector. If it is simply industry practice for the public agency to pay higher wages, but this is not reflected in award conditions, this is not considered to be a disadvantage accruing as a result of public ownership. (DTF 2000, p. 25)

Given this guidance, SWH should give further consideration to employment remuneration and whether it can be regarded as a cost disadvantage in this case.

The rationale for its finding should also be documented, including reference to relevant legislation. In doing this, it must demonstrate that:

- SWHS is bound by law to employ staff at an award that exceeds the private-sector rate of pay; and
- the number, skills, qualifications and experience of the staff employed by SWHS are equivalent to those employed in similar private sector operations. So, if a similarly-sized private-sector operator would hire two junior staff, the estimate of any disadvantage should be based on the difference in wages that would be paid to SWHS employees at that level (where bound by law).

Accountability and reporting requirements. SWH correctly classified greater accountability costs due to its public sector reporting requirements, as a *potential* cost disadvantage. It did not, however, record any accountability costs for 2009-10 because it had not viewed SWHS as being a significant business.

In considering whether, and how, to account for adjustments for these requirements in future, SWH will need to:

- identify specific regulatory requirements that are more onerous for the private sector than for the public sector (such as corporate governance requirements under Corporations Law);
- quantify the differences in compliance costs between these requirements and the equivalent requirements faced by the public sector (such as under the *Financial Management Act 1994* (Vic)).
- demonstrate that regulatory requirements in a specific area are more onerous than those faced by the private sector; and
- demonstrate that any additional requirements have a measurable impact on the cost structure of SWHS relative to equivalent private-sector competitors. (DTF 2000, pp. 31, 49)

CN adjustments — summing up

The VCEC has concluded that the SWHS CN costing exercise may have incorrectly identified and calculated some CN cost adjustments. To the extent that this is the case, it will have resulted in an incorrect competitively neutral CN cost adjustment.

5.1.4 Adjustment for revenue forgone

To demonstrate whether SWHS was earning an appropriate rate of return, SWH's December 2010 costing exercise also made adjustments to revenue:

- calculating the revenue forgone on services provided to SWHS's non-paying customers (i.e. for its non-commercial role); and

- treating this revenue forgone as a CN pricing disadvantage, adjusting the SWHS operating result by adding a notional amount calculated as revenue forgone into SWHS's operating revenue.

This was, however, an incorrect interpretation of the application of CN policy. No reference is made in either the CN policy or in the CN Implementation Guide to a CN pricing disadvantage or to a procedure requiring that revenue forgone be added to operating revenue. This shortcoming was rectified in the March 2011 costing exercise.

5.1.5 Costing exercise conclusions and recommendations

The VCEC has found that, although the December 2010 CN costing exercise prepared for SWH broadly followed the procedures outlined in the CN Implementation Guide, there were some significant shortcomings, including that:

- costs were not apportioned between SWHS's commercially significant business and non-commercial functions,
- some costs and CN cost advantages and disadvantages had been incorrectly identified and calculated;
- cost categories were not itemised or described in sufficient detail to enable an assessment of whether the cost estimates are consistent with CN policy; and
- it incorrectly made an adjustment for revenue forgone.

Therefore, the VCEC has concluded that, at the time the complaint was lodged, SWH had not fully met the requirements of the CN policy.

Of these key shortcomings, only the last was adequately addressed in the March 2011 costing exercise submitted by SWH in response to the VCEC's draft investigation report, while the first was partly addressed.

This finding does not necessarily imply that SWHS prices are not fully cost-reflective. An assessment of this will only be possible after a revised costing exercise has been undertaken that addresses the remaining issues raised above. Further, given the imminent relocation of SWHS to the new hospital, any CN costing exercise and subsequent price adjustments should be made in this context.

Recommendation One

That South West Healthcare (SWH) undertake a revised competitive neutrality (CN) costing exercise, consistent with the CN Policy and CN Guide to Implementation, to calculate the CN adjusted cost attributable to the operation of the significant business component of South West Healthcare Supplies (SWHS).

That this exercise be completed by November 2011, and incorporate the relevant costs associated with the relocation and operation of the SWHS store at the new Warrnambool Hospital site.

That, in undertaking this task, SWH take the following steps.

- Identify and calculate the costs incurred in operating the full SWHS operation (not including CN adjustments).
- Determine, apportion and attribute the costs of operating SWHS between its commercial (significant business) and non-commercial services.
- Identify and calculate the CN competitive advantages and disadvantages to determine the net CN cost advantage of the services attributable to SWHS's significant business activities.
- Add the net CN cost advantage to the costs attributable to SWHS's commercial services to determine the full CN adjusted cost of operating SWHS's significant business.

In revising its SWHS costing exercise, SWH must:

- document clearly the basis on which it apportioned costs between the SWHS commercial and non-commercial services;
- explain the rationale for which costs have been attributed to SWHS's significant business component, and how this was determined;
- explain the rationale for any CN adjustments made; and
- clearly itemise and describe each of the cost categories.

That SWH consult with the Victorian Competition and Efficiency Commission for guidance when undertaking this process.

5.2 SWHS — pricing methodology

To support its allegation that SWHS's pricing of goods and hire service is not fully cost reflective, the complainant provided the VCEC with copies of a SWHS equipment product price list and price lists from three private healthcare aids and equipment retailers for comparison. The information provided showed that

some, although not all, items for sale and hire by SWHS are offered at lower prices than are charged by the private retailers.

When queried, SWH informed the VCEC that the product price list was not current and, when it was released in 2005, had been intended as a broad pricing guide only. SWH advised the VCEC that it does not stock equipment and that the large items of equipment are kept in-store for display purposes only. The SWHS sale price for healthcare equipment is dependent on what price SWHS's equipment suppliers charge for a product at the point of a sale made by SWHS. Once the equipment supplier's price is known SWHS will determine its sale price.

SWH provided the VCEC with a description of the methodology used to price healthcare equipment that it sells.

Where SWH does charge patients for the supply of equipment, the pricing adopted is the recommended retail price or a 30% mark up. The fees are intended to cover the costs of supplying the items and the associated administrative and overhead costs. (SWH 2010b, p. 2)

SWH advised the VCEC that SWHS prices medical aids and healthcare equipment, which are for sale, in a manner it believes to be consistent with market prices. However, SWH also believes that it prices some items above that of its competitors because SWHS does not have the same bulk buying power compared with private competitors who specialise in some products.

In relation to SWHS's pricing of its equipment hire service, the SWHS Manager advised the VCEC that the prices it charges are due to be reviewed. The revenue generated from the equipment hire service is four per cent of total revenue.

As noted above, the complainant also expressed concerns about the extent to which SWHS competes on a fair basis when participating in external tender processes, such as for the subcontracting arrangements for the provision of equipment to the Department of Veterans' Affairs Rehabilitation Appliance Program, and SWEP. These concerns are covered in section 5.2.1 below.

5.2.1 Pricing methodology conclusions and recommendations

As noted above, the shortcomings in the SWHS CN costing exercise mean that, at the time the complaint was lodged, SWH had not fully met the requirements of the CN policy. However, this finding does not necessarily imply that SWHS's prices are not fully cost-reflective.

Indeed, due to the shortcomings in the SWHS CN costing exercise — which potentially contribute to overstatement and understatement of costs and overstatement of revenue — it is not possible to conclude whether the SWHS

pricing structure is fully cost-reflective, either in terms of its sales from its retail store or in relation to its tenders/bids to supply equipment to other businesses or government entities.

An assessment of this will only be possible after a revised costing exercise has been undertaken that fully addresses the shortcomings raised above. As outlined in recommendation one, given the imminent relocation of SWHS to the new Warrnambool Hospital site, any CN costing exercise and subsequent price adjustments will need to be made in this context.

Recommendation Two

That, subject to the outcomes of the revised CN costing exercise, South West Healthcare Supplies adjust the prices of its commercial activities — those conducted from its retail store, and through competitive tendering processes and business contracts — to be fully cost-reflective.

Should SWH consider that any adjustment of prices, which would be required to comply with the CN policy, would jeopardise other non-commercial policy objectives, then SWH may consider conducting a public interest test to justify why it should not apply fully cost-reflective pricing.

6 Conclusions and recommendations

In its investigation of the allegations made against SWH and its operation of SWHS the VCEC considered:

- (1) whether SWHS operates a significant business activity to determine if it is within the scope of Victoria's CN policy;
- (2) whether the CN costing exercise prepared by SWH's consultant correctly followed the CN guideline procedures; and
- (3) the specific cost concerns raised by the complainant — i.e. delivery and set-up costs of specialised hire equipment; rent; and print and radio media advertising costs — and other costs and CN cost adjustments identified in the CN costing exercise prepared by consultants for SWH.

The VCEC made the following conclusions.

- Part of SWHS's activity is non-commercial and so outside the scope of CN policy, but part of SWHS's activity is a commercial business. SWHS's commercial activity is a significant business because of its size in relation to the market and its overall influence in the market.
- The December 2010 SWHS costing exercise:
 - did not apportion costs between SWHS's commercial (significant

- business) and non-commercial functions;
 - incorrectly identified and calculated some costs;
 - incorrectly identified and/or calculated, or did not adequately justify inclusion of, some CN cost advantages and disadvantages; and
 - incorrectly made an adjustment for revenue forgone.
- The March 2011 costing exercise submitted by SWH in response to the VCEC’s draft investigation report adequately addressed the last shortcoming and partly addressed the first shortcoming identified above in relation to the December 2010 costing exercise. However, the other key shortcomings remain.

Due to the significant shortcomings in the CN costing exercise, a conclusion cannot be made as to whether the pricing structure adopted by SWHS is fully cost-reflective.

To assist SWHS to achieve or demonstrate its compliance with CN policy, the VCEC has recommended that SWH review and revise its SWHS CN costing exercise, in the context of the move of the store to the new Warrnambool Hospital site in 2011. The steps that SWH will need to consider are outlined in recommendation one. Subject to the outcomes of the revised CN costing exercise, the VCEC recommends that SWH review and adjust the pricing for SWHS’s commercial services — for sales to individuals through its retail store and for contracts to supply business and other government entities — to be fully cost-reflective.

The VCEC will follow up with SWH its implementation of the final report recommendations in November 2011, the date by which the VCEC has recommended that the costing exercise be completed. The VCEC will also be available before this time to provide advice, if required, to help SWH prepare a revised costing exercise that complies with the CN policy.

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Appendix 1: Competitive neutrality measures

The CN policy provides three measures for implementing competitive neutrality — corporatisation, commercialisation, and full cost-reflective pricing.

Corporatisation

‘Corporatisation involves the creation of a separate legal business entity to provide the relevant goods and services’ (Government of Victoria 2000, p. 7). The following characteristics of a corporatised entity are described in the CN policy:

- clear and non-conflicting objectives;
- managerial responsibility, authority and autonomy;
- independent and objective performance monitoring; and
- performance-based rewards and sanctions.

Corporatisation is the preferred way to address CN issues when the government agency operates a business in a market in which it has statutory monopoly functions. Full separation through corporatisation ensures the agency does not face conflicting objectives between its statutory monopoly functions and commercial objectives.

Commercialisation

Commercialisation ‘involves organising an activity along commercial lines without creating a separate legal business entity’ (Government of Victoria 2000, p. 7).

CN policy notes that commercialisation is typically achieved by applying a set of ‘commercial practices’ to the business functions of a government agency. These practices may include:

- clear delineation of commercial and non-commercial activities, typically through a business plan;
- clearly defined commercial performance targets and financial reporting requirements;
- separate accounting for, and funding of, non-commercial activities;
- separation of regulatory functions from commercial activities;
- an appropriate financial return on the assets used in the commercial activity;
- application of a tax equivalent regime; and
- appropriate financial arrangements for allocating profits from the commercial activity. (Government of Victoria 2000, p. 7)

Commercialisation is less costly than corporatisation. It is, thus, likely to be the preferred model for addressing CN issues when the government agency does not

have statutory monopoly functions or decision making powers that significantly affect the profitability of its business and competitors, or when the costs of corporatisation are high relative to the benefits. Examples of where commercialisation can be an effective instrument for achieving competitive neutrality include council-operated aquatic and recreation centres.

Full cost-reflective pricing

Full cost-reflective pricing takes into account all of the costs that can be attributed to the provision of the good or service (including the cost of capital), as well as the cost advantages and disadvantages of public ownership. The CN policy notes:

The intention of full cost-reflective pricing is to offset any net competitive advantages a government business may enjoy, thereby ensuring that resource allocation decisions are made on the basis of comprehensive and accurate costing. (Government of Victoria 2000, p. 7)

Full cost-reflective pricing, without corporatisation or commercialisation, may be sufficient if the main CN issues relate to cross subsidies between commercial and non-commercial activities of government entities. It does not, however, address non-pricing concerns. It is the preferred model for addressing CN issues when the government business is small and the issue does not warrant taking on the relatively large costs involved in corporatisation or commercialisation. An example of where full cost-reflective pricing may be an effective measure to achieve CN would be the operation of a small cafeteria in a public hospital.

Appendix 2: Population of Warrnambool and hospital attendance data

SWH advised the VCEC that the population in Warrnambool has grown in recent years and that at present approximately 34 000 people live there. Other data estimate that the total population of Warrnambool City was 29 630 in 2001 and that this is expected to increase to 36 038 by 2016, at an average annual growth rate of 1.31 per cent.

Based on available data, the VCEC has calculated that the population of Warrnambool has increased by 14.75 per cent between 2001 and 2010.

The VCEC accepts the assumption that, as Warrnambool's population increases, there will also be an increase in the demand for public healthcare services. This assumption is supported by data that show that there has been an increase in patient attendances at the Warrnambool Hospital over ten years between 2000-01 and 2009-10 (refer to Table 6.2). The number of in-patients treated at Warrnambool Hospital has increased by 39.4 per cent (from 12 455 to 17 363), the total number of days that patients have been in beds increased by 13.5 per cent (from 45 663 to 51 843), while the number of non in-patient attendances increased by 42 per cent from (75 224 to 106 816).

Table 6.2 **Warrnambool Hospital attendances**

	<i>Total patients treated</i>	<i>Total patient bed days</i>	<i>Total non-patient attendances</i>
2009-10	17 363	51 843	106 816
2008-09	16 766	52 565	111 299
2007-08	14 921	51 873	108 323
2006-07	15 216	50 538	92 570
2005-06	14 929	50 195	90 828
2004-05	14 311	47 740	70 946
2003-04	13 469	48 398	71 864
2002-03	13 389	46 584	72 782
2001-02	12 662	44 706	72 547
2000-01	12 455	45 663	75 224

Sources: SWH 2010d, p. 10; SWH 2005, p. 27.

The data also reveal that the average stay by patients treated at Warrnambool Hospital has decreased from 3.66 days in 2000-01 to 3 days in 2001-10 (calculated by dividing the number of 'total patient bed days' by the number of 'total in-patients treated' — for example, 45 663 divided by 12 455 equals 3.66 days average patient stay in hospital for 2000-01).

Appendix 3: Hospital Circular 24/1995

SWH advised the VCEC that, among its range of obligations, it is responsible for the continuity of care of patients who have been discharged from hospital. The basis of this obligation is 'Hospital Circular 24/1995–Provision of Aids and Equipment and Domiciliary Oxygen' which was issued by the Department of Human Services on 11 September 1995. The circular states:

Public hospitals have a responsibility to provide aids and equipment (including domiciliary oxygen) required by patients for a safe and effective discharge. This equipment may be defined as that which is necessary for recuperation and, if not provided, would result in either continued hospitalisation or readmission to hospital.

For admitted patients who do not have a certifiable permanent or long term disability, hospitals must provide any aids and equipment necessary to enable discharge for as long as these are required. This shall be at no cost to the patient for a period of 30 days. Hospitals may charge fees for these aids and equipment after the expiry of the 30 day period as stipulated in the Hospital Conditions of Funding with respect to outpatient services. (DHS 1995)

Although SWH is responsible for this obligation, the program is managed and delivered through SWHS.