

RUGBY, SHEEP AND WORKS UNITS (3 things to learn from the Kiwis)

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Paper Summary

Local Government faces pressures from rate pegging, cost shifting from state government, growing community expectations and aging infrastructure. Operating a commercialised business unit that delivers competitive services to council as well as generating additional revenues is a means of improving financial sustainability, increasing service levels and delivering other community benefits. This paper discusses the development of the business unit of Tumut Shire Council, Snowy Works and Services, and also reviews lessons learned from a study tour of five 'council-controlled trading organisations' which have been operating in New Zealand for the past 15 years.

Background

Tumut Shire is located between the Australian Capital Territory and Wagga Wagga City, on the western side of the Snowy Mountains. Its area is 4,500 sq km with a population of around 11,500.

Almost two thirds of the Shire is non rateable, being primarily State Forest or National Park.

Principal economic activities in the Shire are plantation timber growing and processing; horticulture (primarily apples); tourism; grazing; electricity generation (via the Snowy Scheme) and storage of waters for power generation and downstream irrigation.

The towns in the Shire are (in order of size) Tumut (6500 people), Batlow (1400), Adelong (1000), Talbingo (350), Brungle (100) and Cabramurra (100), which is the highest town in Australia, owned by Snowy Hydro.

Tumut Shire Council employs around 130 FTE staff. In July 2002, Council established Snowy Works and Services as the 'business arm' from Council's works department.

The SnowyWS Board was established as a committee of Council under section 355 of the Local Government Act. The Board included two Councillors, the General Manager and Manager of Finance for Tumut Shire Council, a Community Representative, the CEO of SnowyWS and a SnowyWS Staff Representative.

An Instrument of Delegation from Council outlined the functions, powers and duties of the Board. A partnering agreement set out the scope of services to be delivered by SnowyWS to the other Council departments and the nature of the relationship – basically SnowyWS was the preferred supplier of all services, paid on a cost recovery basis.

We opened our own bank account, began invoicing Council for work done and paying them commercial rates for the use of depots, gravel pits and plant. This effectively 'ring

fenced' the unit so we could account for external works on a full cost recovery basis.

The unit became 'self contained' with finance, HR and administration staff transferred to an office at the main depot. Only IT services were still supplied by Council (which were paid for).

Over the next five years, SnowyWS staff numbers grew (up from 70 to 85) and our markets expanded. We took on a significant volume of external works to the extent that in 2006/07 these made up one third of our revenues.

In early 2007 (having been with Council for seven years, two of which as CEO), I realised that we were at a 'crossroads'.

We were in the middle of a large (and challenging) subdivision contract, which we had taken on after the RTA told us that funding for a major road construction project was not going to eventuate (of course, three weeks after we won the tender for the subdivision it did, so we had that too), then we had a two week job for Forests NSW that turned into five, and were in the middle of a large utilities contract for Snowy Hydro.

In the end, 2006/07 was our most successful year yet: we returned our largest dividend to Council from external works, had kept our staff employed in what had the potential to be a very lean year had we been reliant on Council work alone, we had excellent plant utilisation, achieved noticeable cultural improvements in terms of team flexibility, commercial focus and general productivity.

But I realised that things had to change: we had not matched our contract management resources to our growing external works – this had forced delegation (which is good), but had diverted attention away from continuing to improve management systems and also from strategic planning (which is bad).

In August 2007, Council resolved to engage consultants Morrison Low to carry out a strategic review of SnowyWS.

Malcolm Morrison, who carried out the review, suggested that given that there are no real parallels to SnowyWS in Australian local government, a delegation from the board should visit New Zealand.

Malcolm had been part of New Zealand's outsourcing of road works that occurred in the early 1990's and still works with many councils over there as well as in Australia.

He arranged visits for us with five council-controlled trading organisations and the councils who own them in February 2008.

The delegation included Cr James Hayes (Deputy Mayor of Tumut Shire Council and Chairman of the SnowyWS Board), Chris Adams (General Manager of Council), Allan Tonkin (Manager of Corporate Services at Council) and myself. I'd like to thank the Engineering Foundation for funding my portion of the tour.

New Zealand Study Tour

The Council-Controlled Trading Organisations (CCTOs) we visited are not guaranteed work from their councils and have survived the last 15 years on their own.

Government grants for roads are significantly higher than in Australia (making up two thirds or more of many council's roads budgets). In the mid 1990's, the New Zealand government legislated the compulsory tendering of all road works with government funding in an effort to improve the competitiveness of service provision.

Councils were forced to set up companies that could tender on the work or divest themselves of their operational workforce, plant and so on. The transition period was around three years.

The five councils and CCTOs were:

- Infracon and Tararua District Council
- QRS and Wairoa District Council
- CityCare and Christchurch City Council

- Whitestone and Waitaki District Council
- Inframax and Waitomo District Council



Infracon

Infracon began life as Tararua Roothing with around 90 staff. They now employ around 320 and have a turnover around \$45M.

They have grown largely through acquisitions (private companies and a neighbouring CCTO) but also through a merger with the CCTO from neighbouring Central Hawkes Bay Council. The resulting organisation is two thirds owned by Tararua and one third Central Hawkes Bay.

They operate under the charismatic leadership of Gordon Tripp ('Truppy') who has no office other than a Holden Commodore, dividing his time between their four divisional offices. Trippy has spent his life in the 'dog-eat-dog' industry and is a great example of the no-nonsense, stripped down approach of a "real" contractor.

Trippy told me about some advice he got from Bill Higgins, his former boss and owner of one of the larger contracting companies in NZ: "Trippy, don't create a monster... because then you've got to feed it".

This, said Trippy, is what he is now faced with as he tenders for one of their key council

contracts which he says will generate significant competition.

Tararua District Council

Tararua District Council showed no particular favouritism toward Infracon, although they appeared to have a good relationship.

The financial arrangements for the ownership of Infracon were set up to be tax-friendly, with Council borrowing money to fund Infracon so that they could claim the interest as a tax deduction against the dividend earned.

QRS

QRS is based in the North Island at Wairoa, which has a population smaller than Tumut.

They began with around 70 staff, which was trimmed back to 50 while at the same time doubling the workload over a three year period during which the company was set up and work gradually tendered out.

In 2001, they were faced with having no maintenance contract with their parent council. The successful tenderer, however, appeared to have gone in too cheap and later sold the contract to QRS. Council now lets contracts in a staggered fashion to reduce the impacts on QRS if one is lost.

Three years ago, QRS directors realised that they were not cost effective at the current size (for example, the compliance costs associated with operating a company), and made a decision to expand north to Gisborne (which is around two hours drive away) and gain some economies of scale.

QRS has now doubled its turnover to around \$16M (much of this in capital works) and employs 90 staff.

QRS staff advice was to “get good before you get big”.

Wairoa District Council

Wairoa District Council has a very high Maori population, and gave us a wonderful traditional welcome, which would have gone a little smoother if I had known more about the customs, so here's a tip: if you find yourself at a traditional Maori welcome, you rub noses with the *men* and the ladies kiss *you* on the cheek!

Three years ago Council tried to sell QRS; however this was rejected by the community, who wanted to keep it to ensure local employment and the capability to respond to emergencies. I should point out that New Zealand has community consultation processes which govern decisions like this.

Wairoa's treatment of QRS is arguably quite harsh, apparently due to a fear at Council of appearing to favour them. However, Council often only has two tenderers and recognises that it is important to maintain competition.

CityCare

CityCare is the CCTO for Christchurch City Council, the only place we visited that had a totally different scale to Tumut. They deliver water, sewerage, parks and road works.

CityCare was formed in 1999 with 330 staff and 90% of their revenue coming from Council. It now employs 900, has \$120M in revenues (only half of which is from Council, half of which is in open-tendered road construction) and operates in a number of locations distant from Christchurch.

Citycare had impressive information systems. All reactive service vehicles have PDA's with GPS capability, which are used to dispatch work, streamline data input and facilitate collection of additional asset information such as material types and condition, which the client has access to via the web.

Christchurch City Council

Christchurch City Council staff acknowledged that historically, Council has been too soft in the management of CityCare. With a changeover of staff, they have moved to a full contractor relationship – Council wanted them to be “match fit” when contracts came up. Still, council recognises the importance of the revenues from their businesses (which also include a port, buses, broadband and timber plantation) that make up 20% of their revenue.

Whitestone Contracting

Whitestone is located in Oamaru in the South Island and is owned by Waitaki District Council.

In 1997, Whitestone bought Mackenzie Council’s CCTO and in 2003 a private earthmoving company. They now have 160 staff and turn over around \$19M.

Around half their work is for Waitaki and 10% for Mackenzie. Most of the remainder comes from small jobs such as landscaping, which helps keep them going in slow periods.

Whitestone and Council have just entered into a single invitation, open book contract for maintenance of parks and gardens following the purchase of Councils parks department by Whitestone for the value of the assets.

They noted that the ‘wheel is turning’ in New Zealand and there is a trend to bring services not subject to the compulsory tendering legislation back in-house because Councils without an in-house provider are paying high prices or not getting the services delivered they need to.

Waitaki District Council

Waitaki District Council was formed from the amalgamation of three or four councils about the same time as the compulsory tendering legislation was introduced.

Council commented that it has taken a long time to understand why they own Whitestone.

It started out simply based on financial reasons, however now they recognise there are other significant community benefits.

Inframax

Inframax was arguably the real eye-opener in terms of what a CCTO can achieve. Staff numbers at Inframax have grown from 80 to 350, which is phenomenal when you consider that Waitomo Council itself only employs 45. Their turnover is around \$55M all of which is in road works.

They expanded through acquisitions, first an ailing CCTO that went pretty cheap, and then later a private business which was larger and more expensive, as well as being a significant geographic expansion, almost to Wellington.

Inframax (like a number of the others) is vertically integrated – controlling the supply chain from gravel to pavement construction to sealing, including crushing.

Waitomo District Council

Ironically, the (arguably) best-managed CCTO is owned by the Council who is perhaps in the worst position.

Waitomo have utilised the dividend from Inframax for non-discretionary funding and at the same time eaten into their reserves and kept rates too low.

They are now faced with massive increases in rates and one would guess they are seriously thinking about selling off Inframax to get them out of trouble. This will be a tough decision though; they considered the sale two years ago and the company is now worth double what it was then.

General Lessons Learned

All of the CCTOs had benefited from the strategic direction and management of a commercial board with the appropriate range of skills, and the commercial orientation provided by a company structure.

All had recognised the need to grow to become more competitive.

All CCTOs had started out with councillors on the board, and all had moved away from this due to the 'irresolvable conflict' that wearing these two hats created.

It seems like councils eventually became comfortable setting performance targets in the 'Statement of Business Intent' and leaving the professional boards to run the business.

The 'Long Term Community Consultation Plans' introduced a few years ago (that focus on asset management and sustainability) were a reaction against the deferred maintenance which resulted from the 'compete on price, cheat on quality' environment that is created when legislation requires 'lowest cost conforming' tender acceptance.

Most maintenance contracts were based on a schedule of rates. Performance-based contracts were not popular due to difficulties with administration.

Transit New Zealand's national highway maintenance contracts are sized beyond the capability of individual CCTOs. However construction projects are let on the basis of individual projects, which were a key market for most CCTOs.

Two companies (Works Infrastructure, which incidentally started life as the New Zealand Department of Works, and Fulton Hogan) appear to hold a major portion of the civil construction market across the country.

Of the 40 or 50 CCTOs that were established in the 1990s, the five we visited were among only 15 or so that remain. From second-hand observations and comments, it appears that those CCTOs that did not survive either:

- Were bought up by other CCTOs or privately-owned companies who wished to expand

- Failed to develop a commercial focus and understand what was required to succeed in the market
- Failed to retain their key contracts such as those with their parent council, or
- Were in less remote areas, more easily penetrated by the larger players. A related issue is the impact of relying upon these larger players for supplies of gravel, sealing and asphalt.

The Value of a Council-owned Commercialised Service Provider

Obviously someone from the RTA has been over to New Zealand at some stage, because they make the suggestion every now and then that their work should be competitively tendered.

But I don't see preparing for this as the most important thing to learn from the New Zealand environment. Rather, it is the value that local government can derive from a council-owned commercialised service provider.

And Australian local government is in the fortunate position of not having to award a contract to someone other than your works department to the detriment of council and the community, but rather can leverage off this base workload to secure the benefits of a council-owned commercialised service provider including:

Competitiveness of Service Provision

Increasing your turnover increases plant utilisation and spreads your overhead costs further, which mean lower costs for council.

Exposing staff to the 'real world' market gets them thinking more about costs and performance.

While this is difficult to quantify, its importance should not be underestimated. The culture change in our staff since SnowyWS was

established has delivered real increases in competitiveness.

Contribution to the Community

A local business delivering services increases local jobs, payments to local suppliers and provides competition, giving the community better value for money when they buy these services. Like the CCTOs in New Zealand, SnowyWS contributes significantly to local community projects, donating over \$210,000 in the last five years.

Increase in Council's Revenue Base

Local government is facing aging infrastructure, additional responsibilities from state government cost shifting and tougher legislation, as well as higher community expectations.

Yet their income is restricted by rate pegging, so alternative revenue sources are vital.

Recruitment and Retention of Resources

While I can't say I've had much luck attracting another engineer (if there's anyone suitable in the audience who wants to live in the best country town in Australia, see me afterwards), I am happy to say that SnowyWS is successful in attracting employees for other positions locally.

I believe our employees enjoy the challenge. They are proud to work for SnowyWS and not be seen so much as 'shovel-leaning council workers'. Remuneration wise, most work basically as much overtime as they want, because we have plenty of work. They see that SnowyWS improves working conditions and job security.

From council's perspective, resource levels can be maintained through external works in years when their own programs are small, but are available to deliver large programs for council when funds are available, such as the current year when we've got lots of Auslink funding, as well as RTA work.

Ensuring Emergency Response Capability

This is something that came through loud and clear in New Zealand, where many councils had suffered significant floods in recent years. Unless you control the resources and have them locally, you risk not having them when you need them.

Demonstrating Best Practice and Responding to State Government Initiatives

I would like to think that Tumut Shire Council stands out in that we are innovative in a number of areas, not least of which is SnowyWS.

When the State Government looks at Tumut, I hope they see us as a model of best practice, and that this means they won't go mucking around with Tumut's water and sewerage services or imposing any other bright ideas.

Conclusion

In closing, I want to say that I don't believe local government should be in the business of taking risks and perhaps that is immediately what some of you think when you consider operating a contracting business.

But we are in the business of delivering services and that means we have capabilities in water, wastewater, roads, bridges, parks, plant maintenance and whatever else.

And we don't ever have enough money. So to me, running a commercialised business arm aligns perfectly with local government's reason for being.

But I will say that you need to recognise that you are running a business. Councils role is (like other functions of local government) setting objectives via the management plan. Matching this from the business side must be the skills required to manage risks and operate commercially.

Biography

Ben Lawson has worked with Tumut Shire Council for the past eight years, the last three of which in the role of CEO of Snowy Works and Services, Council's business arm. Ben comes from a long line of engineers – back to his great, great grandfather, and sees that an engineer having (arguably, even needing) an MBA suggests as much as anything the 'change in climate' in our industry that is the theme of this conference. Ben has also been Chair of the South West Group of the IPWEA for the past three years, and Secretary for a couple of years prior to that.

