



Competition in public transport in Great Britain

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Abstract

Britain offers a case in which much greater experience of competition in the public transport sector can be seen than in other European countries. Examples are drawn from this experience, showing that outcomes differ between the long-distance and local markets, price competition functioning much more effectively in the former. In many respects, the competitive bidding process may be seen as more important and extensive than direct ‘on the road’ inter-operator competition within the same mode over the same routes. Experiences from competitive tendering and franchising are reviewed. Contradictions between competition policy and wider transport policies remain to be resolved.

Keywords: Competition; Tendering; Franchising.

Introduction

The public transport system of Great Britain has experienced a greater degree of privatisation and deregulation than any other in Europe, commencing with the Transport Act of 1980, which deregulated the express coach market. Such competition has occurred both within modes (for example, between bus operators over the same route), and between modes (for example, between express coach and rail, and between public and private modes). The most obvious form of such competition from the passengers’ point of view is that where competing operators offer services over the same route, sometimes referred to as ‘on the road competition’, or ‘competition in the market’ in the road transport sector. However, the extent of this is not particularly great, and has tended to diminish. The other form, which has closer parallels with that found elsewhere in Europe, is that ‘for the market’ or ‘off road’ competition, in which a single operator is given a contract to run a service, but a competitive bidding process takes place. The principal example is the bus network in Greater London. Such bids are usually invited at the level of individual routes in the bus sector, but at the level of substantial networks in the rail franchising process.

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The main sequence of events

Until the late 1970s public transport in Britain was provided largely by publicly-owned operators, especially in terms of the scheduled service network. The national rail system was operated by British Rail (BR), a nationalised industry. Most urban bus services were provided by operators owned and controlled directly by their local authorities (the 'municipals'), with most rural and regional services provided by subsidiaries of state-owned holding companies - the National Bus Company (NBC) in England and Wales, and Scottish Bus Group (SBG) in Scotland. London Transport directly controlled and owned the underground (metro) system and bus services within Greater London.

In many respects the situation was similar to that found elsewhere in Europe at that time (and to some extent still today). There were, however, some differences: no significant use was made of sub-contracting services to private operators within a state-owned network (which was well-established in the regional bus networks of Belgium, for example). While most long-distance express coaches were run by NBC and SBG subsidiaries, and very few all-year-round services by smaller private companies, there was substantial competition between coach and rail on many routes, unlike the situation in most other European countries even today. Within the non-scheduled market (for example, contracts for transport of schoolchildren awarded by local authorities) strong competition has existed for many years, and small private operators played a major role.

During the 1970s increased levels of financial support were paid to public transport operators to ensure continuation of services in low-density areas, to fund capital spending, and in some urban areas to finance substantially lower levels of fares and higher levels of service than would be justified commercially (notably the South Yorkshire conurbation). Concessionary fares (i.e. fares specified for certain categories of person at a level lower than operators would charge commercially, in some cases permitting free off-peak travel) had become important, especially for pensioners. However, there were concerns that large sums were being paid to incumbent operators with little influence over their operating efficiency. Innovations in types of service were also limited. A shift to a deregulated and privatised market was therefore seen by some as a means of offsetting these dangers.

Coach and Bus Deregulation

Following the election of a Conservative party government in 1979 a marked shift in policy took place. The Transport Act 1980 deregulated the express coach and tourist sector, removing the need for route licences or authorisation of fares to be charged. However little privatisation initially took place in the public transport services as such: for example, the dominant express coach operator, National Express, was not privatised until 1988 – the early 1980s period of intensive competition between it and British Rail was thus a case of competition between operators both still within the public sector.

Control of London Transport was transferred in 1984 from the then Greater London Council to a state-appointed board. While bus services were not deregulated, a policy of private sector tendering for all services was introduced.

A more radical change emerged through the Transport Act 1985, which deregulated local bus services (other than in London and Northern Ireland), removing both fares and

service controls. Network-wide financial support was removed, although operators were compensated on more consistent basis than before for revenue loss due to concessionary fares. It was accepted that not all services would be operated commercially, even if sharp reductions in costs occurred, and a system of competitive tendering was introduced for those services (for example, in low-density rural areas). Privatisation of NBC companies took place in the period 1985-1988, followed by that of the SBG subsidiaries. The process was more gradual in the 'municipal' sector, and about fifteen such operators remain today.

Rail privatisation

The Railways Act 1993 introduced a complex system of privatisation for the national rail network. The infrastructure was placed under a separate company, Railtrack plc (succeeded from 2002 by Network Rail, a semi-public organisation). Freight operations were sold directly to private sector businesses, together with the passenger rolling stock under rolling stock leasing companies (ROSCOs). The passenger rail services were placed under twenty-five area franchises, for which private sector operators were invited to make bids. While some of the changes (notably separation of infrastructure and operations) could be seen as requirements imposed by EU policy, Britain went much further than any other European country in placing both under private sector ownership. As mentioned above, a distinction should be made between privatisation and deregulation – in the rail case, it could be argued that *greater* regulation was introduced at the time of privatisation - for example, in control of some fare categories, and detailed specification of service levels for passenger operators - than had been the case previously, under BR control. Apart from some services in the Passenger Transport Executive areas (major cities outside London), revenue risk in rail franchising is taken by the franchise operator

Change since 1997

The election of the 'New Labour' government under Mr Blair in 1997 did not see a significant reversal of these policies. Privatised companies have not been returned to public ownership and some further small-scale privatisation has taken place in the municipal bus sector. A greater emphasis has been placed on integration of services, but a striking conflict is found between this aim and the stringent competition policy applied in the economy as a whole, which has yet to be satisfactorily resolved.

Under the Transport Act 2000 rail franchising was transferred to the Strategic Rail Authority (SRA), and powers were introduced to permit 'Quality Contracts' (QCs) and statutory 'Quality Partnerships' (SQPs) to be set up, under which some elements of re-regulation of bus services would be reintroduced. QCs enable arrangements similar to those in London to be established in other parts of Britain, while SQPs would enable formal quality partnerships to be set up between bus operators and local authorities. So far, no QCs have been set up although considerable interest has been expressed in their potential by the Passenger Transport Executives. Only one SQP has been set up, in Scotland, but informal quality partnerships play a useful role in many areas. The SRA has itself been abolished under subsequent legislation, and franchising is now handled

directly by the Department for Transport (DfT). Changes under the 2000 Act have in practice had relatively little effect, representing a change of emphasis rather than substance to changes introduced in the previous two decades.

A policy of greater significance enacted by the New Labour government has been that of devolving powers to elected bodies in certain regions of Britain – the Scottish Parliament, the Welsh Assembly and the Greater London Assembly. The directly-elected Mayor of Greater London also has extensive transport powers. In London, a much higher level of financial support for public transport has been introduced, enabling lower real fares and higher service levels to be offered to users, and the congestion charge introduced in 2003 has also assisted public transport. However, the principle of competitive contracting of bus services to private operators has been retained.

Urban Railways

The London Underground system remains under public ownership, but subsequently under Labour a ‘Public Private Partnership’ (PPP) was introduced in 2003, under which thirty-year contracts have been made with two private consortia for maintenance and renewal of infrastructure and rolling stock, while direct operations remain under public control – in effect, the opposite of the policy adopted in Stockholm for the metro (the ‘Tunnelbana’) in which competitive franchising has been introduced for service operations, but the infrastructure remains under public ownership and control (White and Ball 2003). Some small urban rail networks in Tyne & Wear and Glasgow remain wholly under public sector control. New light rail systems have been introduced in several cities, all operated by private sector companies, with various arrangements for funding (most ultimately from the public sector) and duration of franchises. The latter may conflict with current European Commission proposals, notably the Croydon Tramlink in London, which has a franchise running to 99 years

The long-distance market

The role of competition in the long-distance market differs radically from that in the local market, generally with more scope for commercially-viable operation. Most of the express coach, and domestic air, networks are operated commercially with little need for public tendering or franchising except in some very low density areas. Inter-modal competition is a striking feature, with rail, air, and coach serving the major trunk routes, while rail and coach compete for many lower-density flows. In addition to this, price competition appears to function much more effectively than in the intra-urban and local markets, associated with a high short-run price elasticity (in the order of -1.0) and a greater tendency by users to pre-plan their journeys.

A partial exception can be seen in the case of long-distance rail services. Under the BR structure, the inter-city sector was marginally profitable, on the basis of costing system then used (even though it was allocated the great majority of infrastructure costs on those routes it shared with regional and freight traffic, on the ‘prime user’ principle). However, the separation of infrastructure and rolling stock provision under the

framework of rail privatisation (see above) resulted in greatly increased costs, as result of which the five principal long-distance franchises all required financial support from the state at their inception in 1996/97. An exception to this was the 'Gatwick Express' service between central London and Gatwick Airport (which had been part of the 'Inter City' sector under BR ownership, but is now classified with London & South East regional franchise operators), which operated commercially from the outset, and has paid a premium back to the state (Strategic Rail Authority 2002).

Express coach deregulation

The outcome of express coach deregulation in the early 1980s illustrates the rapid change that can occur in the long-distance market, especially in price levels. The main incumbent operator, National Express (NE, a subsidiary of NBC) faced competition from many smaller operators entering the market from October 1980. However, it in turn was able to make immediate changes in services and fare levels as a result of deregulation, both in response to newcomers in the coach sector, and the railways.

In contrast, the experience of smaller operator entering the coach market was very mixed. Many of their new services did not survive beyond a 2-3 period year after deregulation in 1980. While offering low operating costs, and in some cases innovations in service quality, they faced difficulty in advertising their product. At that time, much coach travel was sold through traditional travel agents, and many new operators did not establish such sales outlets from the start of operations. In some cases, a period of loss-making operation might be necessary in order to build up demand. Even when NE increased its fares substantially in the late 1980s, resulting in a substantial loss of traffic broadly consistent with the -1.0 elasticity mentioned above, very little new independent competition emerged. Subsequent real fares reductions by NE stimulated a recovery in its total passenger volume (White 1999).

While almost all coach services are operated commercially, this sector nonetheless offers an interesting example of competitive tendering within the private sector. National Express (in England and Wales) and the similar Scottish Citylink network are largely operated by vehicles and drivers contracted in from other operators, while offering to the public common brand name, through ticketing and an integrated network. Contracting operators include regional subsidiaries of major bus groups such as Stagecoach, but also smaller independent firms. Hence, advantages may be obtained through use of locally-based operators, and competitive bidding to control cost levels and stimulate service quality. Revenue risk is taken by the network operator, but contractors are appraised on service quality provided as well as costs. Conversely, in the local bus market very little of this type of operation is found, contracting occurring at the initiative of public sector bodies where commercially-viable services are not registered by bus operators.

Rail privatisation in the long-distance market

At privatisation, the five major service groups in this sector were franchised separately, becoming known by the names of the successful bidders as Great North Eastern (GNER), Midland Main Line (MML), Virgin West Coast, Virgin Cross Country

and First Great Western (FGW). Aggregate ridership and financial data for this group is broadly comparable in definition with that for the intercity sector under BR (apart from Gatwick Express as mentioned above). In addition, some other regional franchised train operating companies offer long-distance services (for example, Scotrail between major Scottish cities). Direct competition between the five major long-distance franchises is very limited, although in some cases regional franchises offer competition from parallel routes, notably Chiltern Railways between London and Birmingham with Virgin West Coast.

All franchises were awarded as a result of a competitive bidding process, primarily geared to offering year-on-year reductions vis a vis the level of financial support offered to the corresponding businesses at the time of privatisation. All five long-distance franchises required net financial support from the state when they began (although the intercity sector had earlier been profitable) as a result of much higher access charges (paid to Railtrack) and rolling stock leasing charges than the equivalent costs within the integrated BR structure. However, benefiting from substantial ridership and revenue growth, GNER and MML were paying a surplus ('premium') back to the state by 2001-02. FGW also greatly reduced the net support required (Strategic Rail Authority 2002). All three businesses have been profitable to their owners, after allowing for the net effects of franchise payments and premia. By and large existing infrastructure and rolling stock has been used, with some additional high-speed trains delivered to MML and FGW, and minor infrastructure improvements. New franchises recently awarded to GNER and FGW involve substantial and premia being paid over the next ten years, clearly assuming large revenue growth, especially in the former.

A much more mixed pattern has been found in respect of the two Virgin companies, whose bidding strategy was based on assumptions of very large ridership and revenue growth. These in turn depended on successful implementation of major changes in infrastructure and rolling stock to permit much more frequent and faster high speed services. Especially in the case of Virgin West Coast, this process was much slower than expected, resulting in severe shortfalls in ridership and net revenue vis a vis forecast. In 2002 both franchises were re-negotiated with the SRA, with a fixed profit margin for the operator (Transit 2006a, 2006b).

Table 1 shows trends in total rail use for the long-distance services and other sectors. Note that growth in the long-distance sector has been lower than in others, especially in terms of passenger-km, in part due to strong domestic airline competition. However, the higher proportion of costs already covered at the time of privatisation enabled the revenue growth to be sufficient to bring some of them into profitability during this period.

In aggregate, ridership on the five main long-distance franchises grew strongly between 1997 and 2000, but was then seriously affected by the consequences of a major accident at Hatfield (on the GNER route about 30 km north of London). This was caused by a failure to maintain track adequately, and resulted in an emergency programme of track renewal over much of the network, which severely disrupted long-distance services. Growth subsequently resumed. Total passenger-km on the five franchises rose from 10,100m in 1994/95 to 13,400m in 2004/05 (by 33%). Journeys rose somewhat more, from 54m to 84m (i.e. by 55%), indicating a reduction in average journey length from about 187 to 160 km, probably associated with a shift for longer journeys to air. Further comment on the franchise process as such is made later in this paper.

Table 1: Trends in Rail Ridership in Britain 1994-95 to 2004-05.

<i>Year</i>	<i>Sector</i>		<i>All operators</i>	
	Long-distance			
	Passenger trips (m)	Passenger kilometres ('000 m)	Passenger trips (m)	Passenger kilometres ('000m)
1994-95	54	10.1	735	28.7
1999-2000	72	13.2	931	38.5
2004-2005	84	13.4	1088	42.4
<i>% change</i>				
94/95 – 04/05	+55%	+33%	+48%	+47%

Source : SRA National Trends 2004-04, Tables 1.1b and 1.2b

'Open access' rail competition

There is also an element of direct competition permitted within the privatised rail sector, through the possibility of 'open access' operators gaining new services. These are train operating companies introducing new services, as distinct from franchises based on existing areas of operations, with which they tend to compete. The principal example to date is Hull Trains (now a subsidiary of First Group), which introduced a through service between Hull and London via the East Coast Main Line (ECML) in 2000 (Perren 2006). It serves a large regional city otherwise offered only a very limited through frequency by GNER, or reliant on connecting services. It has become successfully established, enhancing its original frequency and buying new 200 kph trains. A further open access operator hoping to start service shortly is Grand Central, offering services from Sunderland in North East England, also using the ECML.

However, a major problem arises in the use of track capacity when such operations are introduced. The ECML south of Doncaster (junction for Hull) has limited track capacity, used mainly by GNER. Additional operators limit the number of train paths available for GNER to expand services, or for freight operations. The issue of track cost allocation also arises – franchises bear the existing track costs for routes they serve, while open access operators pay a much smaller variable charge (in effect, a lower average charge per train-km than the franchised operator). This raises questions of 'fair' competition – in contrast to Germany, for example, there is no generally-published tariff of track access charges in Britain. Additional trains on a congested route also impose an 'opportunity cost' by displacing other trains, as well as direct costs in terms of track maintenance, etc. (Nash et al 2004).

A particular issue in the EMCL case is that GNER has recently won a new franchise for a ten-year period, based on assumptions of strong revenue and volume growth, linked with additional trains between London and Leeds which will use the London - Doncaster section. It is uncertain whether capacity will exist for these, given a decision by the Office of Rail Regulation to propose permitting operations by Grand Central. A conflict clearly exists in that Network Rail has disputed whether sufficient capacity exists on ECML for operations additional to those already planned by GNER, and GNER's own franchise bid was accepted by the government on a basis on additional

Leeds services being feasible over the infrastructure available. Different public agencies appear to be acting inconsistently in this respect.

Competition in the local transport market

The local transport market is taken here as that within urban areas, and from surrounding regions into urban centres. It contrasts with the longer-distance, or interurban, market in several respects. Within public transport modes in particular, relatively inelastic journey purposes (such as work, and education, etc.) tend to dominate, resulting in low overall short-run price elasticity of around -0.4 (Balcombe et al 2004). Hence, unless there is very much higher price cross-elasticity between operators, overall real fare reductions are unlikely to sustain aggregate revenue levels. While demand certainly responds to lower real price levels, this may require substantial increases in public expenditure to provide the necessary financial support, as can be seen in London since 1999.

In contrast to long-distance journeys, there is much less tendency by the user to plan ahead, although some journeys may display habitual patterns (such as the timing of the home to work trip). Given the high frequencies offered on many urban services, the rational user will arrive at stops or stations independently of the scheduled timetable, since the 'search time' taken to compare timetables or other information may be high relative to waiting time thereby saved. Where bus services run around 5 times per hour or more, this appears to be the general pattern (White, Turner and Mbara 1992). Taking a typical revenue per trip of 80 pence (an average allowing for child and off-bus tickets) a 25% reduction would bring the average revenue down to 60p, i.e. by 20 pence. Although bus users have low values of time, there is strong evidence that a greater weighting is attached to walk and wait time. For example, given an in-vehicle value of time of £3 per hour (approx Euros 4.50) and a walk/wait time weighting of 1.7 (Balcombe et al 2004, tables 7.1 and 7.14), wait time would be valued at about £5 per hour (Euros 7.50), or about 8 pence per minute. Hence, it would be only worthwhile for a user to wait an additional 3 minutes to catch the lower-fare bus.

A parallel may be drawn in this respect with taxi services, in which price competition for services hailed on street or at ranks appears to be similarly limited by the search time offsetting price benefits.

There are severe practical limits to the complexity of pricing policy, especially where fare collection on the vehicles results in high boarding times, thus affecting service speed. In many respects simplified fare structures may stimulate higher ridership by improving convenience to the user, although scope certainly exists for peak/off-peak differential pricing to spread demand, and for price discrimination by user group (such as lower fares for those aged 16-19).

Local bus deregulation in Britain

The Transport Act of 1985 introduced a system of 'deregulation' from October 1986, except in Northern Ireland and Greater London. Instead of the incumbent operator receiving direct financial support from local authorities, operators were encouraged to register services as 'commercial', i.e. at a fare level set by the operator itself, all costs

would be covered, without the need for specific financial support. It should be stressed that where compensation is paid in respect of revenue foregone due to concessionary fares, this is regarded (quite reasonably) as commercial income by the operator, rather than a 'subsidy'. Also, in the British case, bus operators pay a low net rate of fuel duty (20% of that applied to other road transport), which effectively reduces total costs by around 10%.

In addition to removing any control of fares for 'commercial' services, the Act also introduced a simple registration procedure (at the time, requiring 42 days' notice) whereby an operator registers the intended route and timetable, without other operators being able to raise objections. Hence, competition was permitted in that more than one operator could register a service over the same route, and by the ability of operators to specify their own fares.

It was accepted that not all services could be operated commercially. Where a local authority wishes to see services offered that are not registered commercially, it is free to specify the service required. Where only a small expenditure is involved, *de minimus* rules apply, i.e. a contract can be negotiated without the need for competitive tendering (this might cover, for example, diversion of a rural service via a village off the main route). However, in the early years of deregulation in particular, this was a very low figure, and the greater majority of tendered services are the subject of a competitive bidding process, typically generating around three bids per contract (ATCO 2005). There is no compulsion on local authorities to provide a level of service additional to those run commercially, except for the obligation to provide free travel between home and school for children living above certain distances (3 miles, or 4.8 km, in the case of those aged 8 upward).

In practice, many rural services are secured through a competitive tendering process (in some cases combining the school journeys with other services in a single contract). The tendering process also applied to some urban services, notably at times of low demand (evening and Sundays). Hence, the same route may be operated commercially for part of the week, but as a tendered service (and not necessarily by the same operator) at other times.

Overall, about 84% of registered local bus vehicle-km outside London were operated commercially, the remaining 16% as contracted services. This proportion remained stable for about fifteen years, although it has now risen to about 22% as a result of additional rural services being introduced and 'deregistrations' of commercial services no longer considered viable by their operators. Table 2 indicates trends.

Table 2: Trends in commercial and contracted bus kilometres, Great Britain outside London

Year	Bus-kilometres		Percentage of total	
	Commercial	Contracted	Commercial	Contracted
	(m)			
1990-91	1803	340	84.1	15.9
1994-95	1937	357	84.4	15.6
1999-2000	1934	373	83.8	16.2
2004-05	1689	456	78.3	21.7

Source: Derived from Transport Statistics Bulletin SB(05)31 'Public Transport Statistics Bulletin GB: 2005 Edition' Department for Transport, London, September 2006, Annex A, table 3.

While the extent of direct 'on the road' competition between bus operators is limited, and absent in most areas, it can be argued that the threat of competition, and the stimulus to register services as 'commercial' certainly helped to stimulate a radical reduction in operating costs, which fell by over 40% in real terms per bus-kilometre by the late 1990s (an average for the whole network, both commercial and tendered), although rising since then (White 2005).

The London case

As mentioned above, London is an exception in that bus operations were not 'deregulated' under the 1985 Act, but a system of competitive contracting for services was introduced from about the same time. Initially, most bus operations remained under public ownership, but subsequently the bus companies owned by London Transport were privatised in the early 1990s, competing with each other and with newcomers for service contracts. The process of extending competitive contracting over the whole network was relatively slow, in contrast to the abrupt changes introduced outside London in October 1986. However, almost all services now operate on this basis. The only public sector operation remaining is a small company owned directly by Transport for London, 'East Thames Buses', which can bid competitively with the private sector operators and also serves as operator of last resort where private sector operators are unwilling to bid, or failed operators have to be replaced at short notice.

Unlike the deregulated areas, there is no separation of 'commercial' and 'tendered' services, the whole service on each route being the subject of a single contract. Fares policy is determined for the network as a whole, enabling a very high proportion of off-bus ticketing, notably through the use of the 'Oyster' smartcard with stored value capacity. Very comprehensive passenger information on services is provided by TfL.

The London system can thus be seen as having parallels with National Express in offering a single integrated network to the user, while enabling a system of competitive bidding to control costs and raise service quality. In the early years, the over-riding objective was to minimise costs, but more recently a greater emphasis has been placed on improved service quality (especially reliability) through the use of 'Quality Incentive Contracts' (QICs). A recent review by a scrutiny committee of the London Assembly has endorsed this approach (London Assembly 2006). About three bids for each contract are now attracted on average, but in some cases competition has been more limited.

A limitation on the degree of competition in London has resulted from the sale of existing operating depots with incumbent companies when the London Buses subsidiary companies were privatised. Given high property values and difficulties in obtaining planning consent, it may be difficult for newcomers to set up new operating centres on a substantial scale. In some cases, existing coach operators with operating bases in London were well-placed to expand into bus operations (such as Armchair in West London). In some cases, TfL has retained ownership of depots, which has assisted incoming operators in setting up operations.

Rail franchising in regional and London and South East region services

The rail franchising process described above in respect of long-distance operators applied in similar form to services in the London & South East region, and in other regions. The former comprise franchises based on segments of the radial commuter network into London which also operate local services in their areas (such as South West Trains, covering routes from the regions south west of London into Waterloo terminal), together with one cross-London route, Thameslink, recently incorporated into the 'First Capital Connect' franchise. The latter comprises networks of services in regions outside London, generally serving much lower-density markets even when operations in major cities outside London are included (such as Central Trains, covering the West Midlands conurbation and a very large rural region in central England).

The first round of franchises let in 1996/97 was generally based on accepting the bids involving the lowest network costs to the government, either in terms of reducing subsidy payments, and/or ability to provide premia. Within the London & South East region, this approach was generally successful, since services already covered a high proportion of costs and substantial ridership growth (associated with increased employment and economic activity in London, as well as initiatives by operators) provided similar growth in real revenue. Some franchises were able to move into paying premia back to the state : Thameslink, and First Great Eastern (SRA 2002). Only in one case, Connex South East, did substantial financial problems develop, resulting in services reverting to a state-owned operation until being refranchised in 2006 to a new private sector operator.

Conversely, the regional franchises outside London and the trunk routes ran into substantial difficulties, and eventually all had to be rescued by the state within the first franchise period as a result of optimistic bids. While substantial revenue growth did occur, the lower proportion of total costs covered by fares revenue meant that only modest reductions in subsidy payments were possible. For example, in the case of a London & South East franchise covering 80% of costs from passenger revenue in its first year, revenue growth of 25% would enable it to cover all costs. A regional franchise covering only 30% of its total costs in the first year would only cover 37.5% of its total costs given corresponding revenue growth, and would thus remain highly dependent on subsidy. While some cost reductions were possible in franchised operations, these were far less dramatic than in the case of bus operations, given that the great majority of costs were incurred through access payment to Railtrack, and rolling stock leasing, and most changes in financial performance have come about through revenue growth.

Under the second round of franchising, the boundaries of some franchise areas have been changed, mainly to enable greater operational integration. For example, three operators serving the East Anglia region were merged into a single franchise, now operated by the 'one' company. The generally strong financial performance of the long-distance and London & South East operators, especially given further projected revenue growth in these sectors, has highlighted the poor financial performance of the regional franchises. They now represent the majority of all state financial support to franchised operators, but only small share total of passenger-km on rail.

Some observations on tendering, franchising and competition policy

In many respects, there is more competition within the public transport industry in Britain for the right to operate services than ‘on the road’ (or rail) between operators. This applies to almost all bus services in London, the franchising process for national rail services and most of the 22% of bus-kilometres in deregulated areas run on contract to local authorities (plus the very large school contract market).

Under such conditions, it may also be easier to displace an operator whose performance has proved unsatisfactory through termination of contract and seeking an alternative provider, than may be the case in deregulated markets where one operator is clearly dominant in an area but is providing a poor service. While in theory other operators could then enter the market, in practice doing so on substantial scale may be difficult.

In bidding for a contract (generally applicable to individual routes) or a franchise (generally applicable to entire rail networks) a prospective operator needs to make a realistic estimate of costs. This would include allowance for possible operating efficiency gains, and likely input costs levels (for example, in labour costs), although in some cases elements are indexed in contract agreements, such as fuel (ATCO 2005). Where only the ‘cost risk’ is being taken, and revenue is treated separately, then the contract is generally referred to as a ‘gross cost’ contract, i.e. the operator is paid the total operating costs for a specified service, while revenue (if applicable) is received by the contracting authority. A long-established example is contracting for school bus services, on which passengers are carried free of charge and hence no direct revenue is received. This may also be applicable to many other forms of competitive contracting, such as road maintenance or refuse disposal.

In such cases the operator clearly needs to make a sensible estimate of the costs involved. Where too low an estimate enables a contract to be obtained, yet costs cannot be covered from the anticipated payments, the “winner’s curse” may be said to exist, in which the successful bidder ultimately may have to withdraw from provision of the service, even where contractual penalties are incurred as result.

In many cases, the bidding process also involves the ‘revenue risk’ being taken by the bidder, i.e. a ‘net cost’ bid is made for the sum required to make up the difference between costs and revenues. In theory, this incentivises the operator to maximise revenue once a contract has been awarded (for example, through greater attention to service quality and marketing), since the revenue gain is received directly. However, imposition of greater risk may accentuate the “winner’s curse” effect where over-optimism has occurred in both cost and revenue calculations – regional rail franchises are one example, and the decision by National Express to pull out of a franchise for part of the tramway network in Melbourne is another (see Stanley, 2006). In some cases, an authority seeking to secure bids may obtain better value for money by using gross cost rather than net cost methods, since the former imposes less risk on operators and hence smaller firms (often with lower operating costs) may be more inclined to bid (White and Tough 1995).

In the case of rail franchising, bidding has generally been on a ‘net cost’ basis, i.e. revenue risk is borne by the operator, except for some urban rail franchises in the first round after privatisation. However, this is in the context of a growing market, and the ability to spread revenue risk over a substantial network rather than a single route, which may be the case with bus service contracts.

A further issue arising in the British case has been the role of competition policy. The Transport Act of 1985 removed previous exemptions from competition policy as it then existed. Subsequent further Acts have greatly strengthened the powers of bodies involved in the implementation and enforcement of this policy, notably the Office of Fair Trading (OFT) and the Competition Commission. Collusive behaviour (such as price-fixing or market sharing) is deterred by strong penalties. Which arguments may exist for such policies in the economy as a whole to stimulate competition and hence efficiency, it is debatable whether their strict application to the public passenger transport sector is necessarily appropriate, given the limited scale of 'on the road' competition in practice. Many critics have pointed out the contradiction between the strict enforcement of competition policy in Britain with transport policies per se, notably those directed to greater co-ordination and of integration of services. Some changes have been introduced, notably the 'Block Exemption' of the OFT for certain types of ticketing, which enables operators to offer interavailable return tickets and travelcards, but it remains difficult for operators to co-ordinate services over common sections of route.

A particularly curious feature of the implementation of competition policy has been its application to cases of rail franchising after franchises have been allocated, as noted by Finney (2006). For example, in the case of recent franchise awards to National Express for services throughout East Anglia, and to First for services in Scotland, subsequent investigations were mounted by competition authorities into the implications for competition within the areas concerned (for example, in respect of National Express Group controlling both rail and express coach services in the same region, and First running many bus services as well as the rail network in Scotland). At the very least, it would seem appropriate for such enquiries to be conducted in advance of, or in parallel with, the process of franchise allocation.

Conclusions

Britain offers a case in which much greater experience of competition in the public transport sector can be seen than in other European countries. This applies in different ways in the long-distance and local markets, price competition functioning much more effectively in the former. In many respects, the competitive bidding process may be seen as more important and extensive than direct inter-operator competition within the same mode over the same routes. The degree of risk taken by bidders may be important in determining the number of bids received, and the ability to operate for the whole duration of a contract. Contradictions between competition policy and wider transport policies remain to be resolved.

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