The British way of long distance transport

Coach, Intercity, Franchise, Long distance transport, Deregulation

Similarities and fundamental differences – both diagnoses are appropriate comparing the British and German long distance land transport sectors. Whereas the British rail franchising system is unique in Europe, the coach sectors have converged in a remarkably short period since the deregulation in Germany in 2013. Learning from the British case is instructive – particularly in the light of a proposed Long Distance Passenger Rail Act.

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In the decades after the war railways were huge, state-owned companies. They retained a more or less unrivalled position in the long distance markets, while coaches did not play an important role. The rise of the car and later of aviation changed the big picture: governments started to reorganise their transport industries. Starting with the British coach sector in the 1980s the long distance transport markets were gradually liberalised. The railways followed in the 1990s, and in 2013 the German coach sector was deregulated – a few years earlier almost non-existent, the coach has already begun to strongly compete with the other modes of transport.

In this article the development and structure of the British long distance rail and coach sector is described. At the end conclusions from the British case for Germany are drawn.

British coach market

The recent history of the British coach sector can be divided into two parts: the first part lasts till the deregulation and privatisation respectively in the 1980s, the second part since then until today is affected by an open market and the continuing domination of the largest operator National Express.

From 1969 on, as a result of a merger, the market was dominated by the state owned National Bus Company (NBC), which itself controlled 93 bus companies and 21,000 vehicles [1]. Since the 1970s NBC used the common brand name 'National Express' increasingly for their intercity services. In Scotland the Scottish Bus Group (SBG) had a similar position. For both NBC and SBG competing with British Rail (BR) proved to be difficult, as they could not easily adjust fares or timetables due to the regulatory regime [2].

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After winning the General Election in 1979, the Conservative Party promptly implemented their neoliberal manifesto and deregulated the coach sector with important legislative acts in 1980 and 1986 [2]. NBC remained in public ownership till 1988, when it was eventually privatised and split into several small companies, one of which was National Express [3]. This period of management-buyouts and mergers culminated in an oligopolistic market for local buses, whilst National Express became by far the biggest player in the coach market.

In 2009 an EU report called the British coach sector "the most liberalised of any large member state" [4]. This claim leans more on the few existing barriers to entry and the regulatory arrangement than on the plurality of operators, as National Express today still holds a dominant position. It is by far the largest operator with the exception of Scotland, where Scottish Citylink has a similar dominant position. However, it is difficult to express their dominance in distinct market shares, because data is hardly available and in statistics coach and bus services can often not be easily distinguished. It is estimated that National Express has a market share of about 60 % and its most important competitor Megabus some 10 % [3]. National Express is the only operator which runs a nationwide network, serving 1,000 destinations or so. Thereby 80 % of the services are operated by contracted third-party companies [1].

Megabus, a Stagecoach subsidiary, has established a comprehensive network all over Britain as well, albeit less extensive and with lower frequencies. The company follows a no-frills low-cost strategy, targeting mainly low income but internet savvy groups, so that distribution channels are mainly located online. With its distinct yield management techniques Megabus achieves a comparatively high load factor [5].

The British coach network is concentrated on the main centres, as services have to be commercially viable. Non-business travel purposes, i.e. holiday, leisure and 'Visiting Friends and Relatives', can be held responsible for 92 % of all journeys. Accordingly, the key segments of the coach operating companies are people who

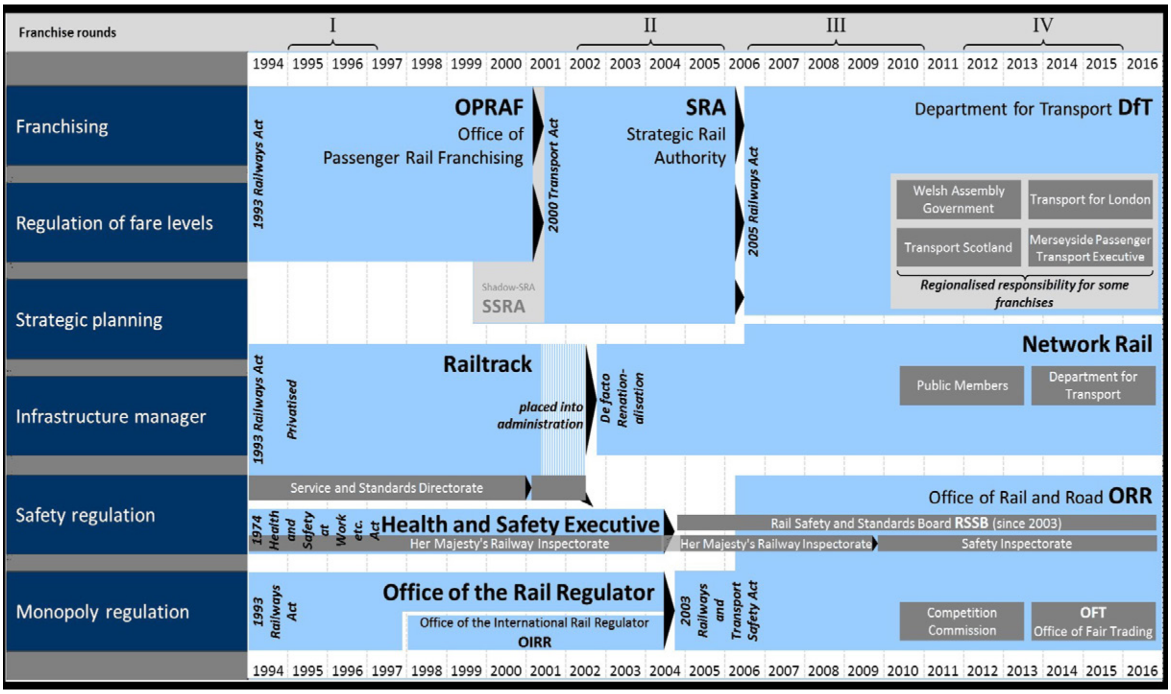

Figure 1. Development of British railway sector

are too young for a driving license, students and senior citizens [3].

The coach sector implements virtually no regulations: Operators can start services without any foregoing notification, as long as they fulfil the qualitative licensing requirements [6]. However, there are barriers to entry in operational terms, although they do not seem to be specific to Britain: Operators need a large customer base, as most customers use to travel infrequently with coaches. This leads to high marketing costs.

The deregulation has made market access for new companies easy. The downside is that incumbents can react to emerging competition very quickly as well, as National Express demonstrated time and again. A problem of decreasing (but still relevant) importance concerns the distribution channels: In the 1980s one of National Express' main advantages over its competitors was its widely spread ticket outlets [3].

The access to coach terminals can constitute a barrier to entry as well, especially because some coach stations are in possession of National Express. A key issue here is how slots are distributed in case of capacity restrictions. Regarding the case of the publicly owned Victoria Coach Station, the major coach station of London, there frequently occur capacity restraints in peak periods; operators have to apply for slots every year – thus, there are no grandfather rights. However, Victoria Coach Station offers volume discounts of up to 54 %, which inevitably constitutes a barrier to entry for entrants, as they usually cannot profit from the maximum discounts [4]. Some operators avoid the main coach stations in order to get closer to their target group or because of lower costs.

The British coach market represents a substantial share of mobility and is likely to grow overall. However, the prospects for small independent operators to successfully enter the market are limited, despite the regime being based on market initiative.

Long distance trains in Britain

Controlled by a state-owned monopolistic company, BR, the British railway sector developed quite similarly to virtually all of its European counterparts until the beginning of the privatisation process in 1994. However, a remarkable political incoherence led to the contemporary structure: starting with modernisation and rationalisation processes in the post war era, followed by the high speed train program in the 1970s, the sectorisation in the 1980s and an utterly radical deregulation and privatisation scheme in the 1990s, which had to be reformed several times since as *figure 1* shows. [7] This has been subject to many disputes and investigations henceforth and shall not be further discussed here. It implemented, however, one important feature: the franchising system.

Basically, a franchise is a geographical restricted and limited concession for passenger services, competitively tendered. Profitable franchises are let to the bidder offering the highest annual premium, unprofitable franchises to the bidder with the lowest need for subsidies [8]. There are also some open access operators, although market entry outside the franchising system is seriously restricted and to date there are not many success stories [9]. The exclusivity of the franchise operators widely restricts 'competition in the market', but causes an intensive 'competition for the market' – supported by the fact that the Train Operating Companies (TOCs) were privatised without significant assets. Rolling stock ownership is centralised within specialised companies, the staff has to be transferred from an inferior company to its successor [10].

Out of initially 25 franchises 5 were emphasised on long distance services, which implies comparatively long journey distances, high average operating speeds and high passenger volumes [10]. The composition of the franchises has been altered frequently with the overall number being reduced to 17. However, the long distance franchises have largely stayed untouched (current oper-

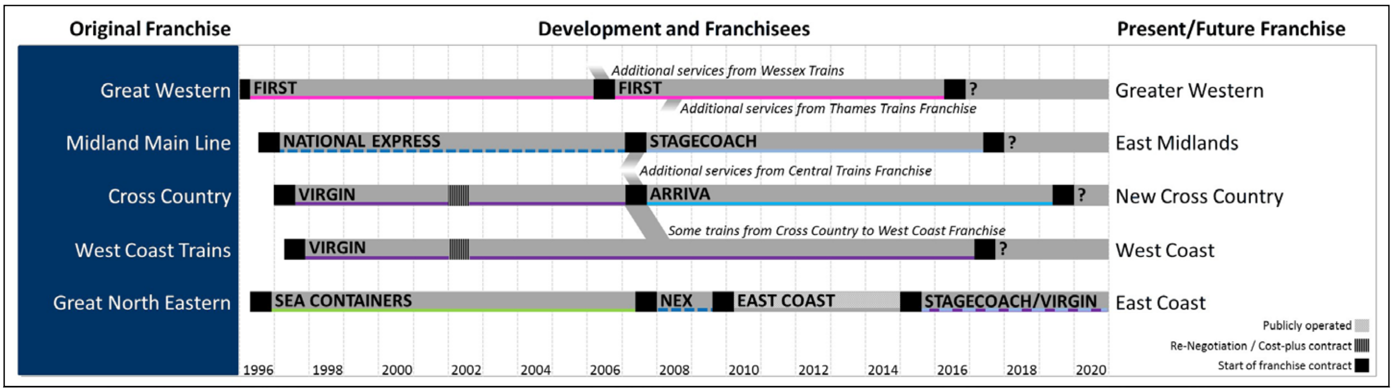

Figure 2. Development of the long distance franchises from 1996 on

ator in parentheses): Greater Western (First), East Midlands (Stagecoach), New Cross Country (Arriva), West Coast and East Coast (both Virgin and Stagecoach). *Figure 2* illustrates their development.

One outstanding case of the recent franchising past was the take-over of operations by Directly Operated Railways (DOR) on the East Coast franchise. DOR is a publicly owned 'operator of last resort', whose only purpose is to run train operations transitionally in case of franchisee failures [11]. The other case was the successful legal challenge of Virgin to the award of the West Coast franchise to First in 2012, which was caused by faults inside the Department for Transport (DfT), costed more than 55 Mio. GBP and caused the stop of all ongoing franchising procedures [12].

Summing up, Britain faces an intensive competition for the market with more than two applicants in almost every tender so far. Number and composition of TOCs in the long distance sector changed over the years. Open access is distinctly restricted, so that today only two commercial operators offer their services. Interestingly, Britain is one of the only countries which tender long distance services.

Summary and lessons to learn

The coach industries of Britain and Germany have converged at terrific speed since the deregulation of the German coach sector in 2013. At the outset of this process Britain was decades ahead, as the first steps of deregulation occurred no later than 1980. Today, with a market share of over 90 % (based on timetable kilometres [13]) Flixbus has gained a market leadership position, which might make even National Express slightly jealous.

Thereby Flixbus relies on a huge number of independent operators and acts as a planning, pricing and marketing network – as well as active and former competitors, of whom no one owns or operates a bus fleet independently. [14]

In terms of market share, doubts about the competitive sustainability of the wild first years in the German market turn out to have been legitimate [15]. In these years, German passengers could enjoy low fares, high frequencies and a level of service, which has been partly superior even to the glamorous ICE trains (cf. Wi-Fi standards). With respect to the market share of Flixbus, the future development is uncertain. However, the market leader has already started consolidating its network; DB Fernverkehr on the other hand have has increased the amount of discount tickets considerably, whilst successfully improving punctuality and travelling comfort.

Thus, so far both rail and coach have benefited from competition in terms of passenger numbers [16]. Plus, the British case might be relieving: Although market leader for many years, National Express fares are still low, especially compared to the railways. This could indicate the presence of a contestable market, which would require e.g. the absence of sunk costs, standardised products and the impossibility of an incumbent to react to a market entry, before the entrant can costlessly exit.

Especially the latter aspect is controversial concerning the British coach market, as National Express proved repeatedly their swiftness in fighting actual or potential competitors. Besides, market entry requires high marketing costs, as companies need a large customer base [3]. However, intermodal competition could ensure efficiency in the sector anyway [17].

In addition to possibly decelerating intramodal competition in the German market, uncertainties for the sector can be found in a shortage of trained bus drivers, deficiencies in the terminal infrastructure and a possible integration of coaches to the HGV toll scheme.[14].

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Die Deregulierung des deutschen Fernbusmarktes 2013 hat zu einer rasanten Angleichung an die Verhältnisse in Großbritannien geführt, wo der Markt bereits in den 1980er Jahren geöffnet wurde: Hier (Flixbus) wie dort (National Express) hat sich ein klarer Marktführer etabliert. Im Schienenpersonenfernverkehr (SPFV) sind die Unterschiede hingegen fundamental: Der britische Fernverkehrsmarkt ist einer von wenigen, in denen SPFV-Leistungen wettbewerblich ausgeschrieben werden. Diesem Franchising-System steht ein freier Marktzugang in Deutschland gegenüber, der jedoch seit der Bahnreform 1994 zu keinem nennenswerten Wettbewerb geführt hat und der Deutschen Bahn einen Marktanteil von 99 % beschert. Vor- und Nachteile des britischen Systems sollten bei einer möglichen Neuausrichtung des SPFV, beispielsweise im Rahmen eines jüngst vorgeschlagenen Schienenpersonenfernverkehrsgesetzes, in Deutschland berücksichtigt werden.

A completely different situation can be observed in the rail industry. Both countries initiated a reform process in the first half of the 1990s, with Britain's franchising system on the one side and a mixed system in Germany on the other: competitive tendering for regional passenger rail services and open access in the long distance sector. Regarding the latter, a market share of 99 % for the incumbent DB Fernverkehr is the result of 23 years of (no) competition, neglecting HKX (Hamburg – Cologne) and Locomore (Berlin – Stuttgart) as drops in the ocean. [18] At the same time there is no dominant player in the British market, but an intensive 'competition for the market'.

As a matter of course, the British Franchising system has its very own flaws, well documented in the Brown review and elsewhere, whilst positive impacts like growing passenger numbers can be hardly attributed to the franchising system but mostly to exogenous conditions. Exemplary problems of the franchising rounds to date are declining competition, strategic bidding and an ambiguity about the objectives, the contract length or risk distribution [19].

If there is ever going to be a Long Distance Passenger Rail Act in Germany, as suggested in December 2016, these defects are to be avoided. The British system leads to significant transaction costs, which might be even higher in the German case, e.g. due to federalism and network length. System transition would take a long a time, as a coordinating body at federal level had to be implemented and potential entrants would need preparation time. Handling of DB's rolling stock in upcoming tenders would have to be discussed, as well as cases of integrated long distance and regional passenger rail services, e.g. Stuttgart-Zürich or Bremen-Norddeich, to avoid struggling for competences between regional and federal authorities. International services would have to be reorganised, as they are to date usually built upon bilateral alliances.

Positive experiences from tendering regional passenger rail services make the British approach charming, even more regarding the opportunity of controlling the supply with long distance services. Technically this is asked by the German constitution since 1994 (Article 87e(4)) but has never been implemented, although many cities and whole regions lost their long distance connection in this period. Sometimes those services have been replaced by publicly funded regional rail services. Besides, international services are partially insufficient (especially to Germany's eastern neighbours). Of course, a better supply would cost additional money: EUR 100 to 500 million, according to the initiators [20]. ■

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