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Transport Select Committee Inquiry

**Competition Commission's report on  
the local bus services market**

Consultation response

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## Contents

1. Introduction/background.....	1
2. Has the Competition Commission addressed the issues of most importance to the bus passenger? .....	1
3. How effective are the remedies proposed by the Competition Commission likely to prove? .....	2
4. Is sustained head-to head competition feasible or desirable? .....	2
5. What role should Quality Partnerships play? .....	4
6. Has the Competition Commission adequately considered the franchising option? .....	4
7. What action should local government and central government now take?.....	6
8. Observations on the conduct of the CC inquiry .....	6

## 1. Introduction/background

- 1.1. **pteg** represents the six Passenger Transport Executives (PTEs) which between them serve more than eleven million people in Tyne and Wear, West Yorkshire, South Yorkshire, Greater Manchester, Merseyside and the West Midlands. Leicester and Nottingham City Councils, Transport for London and Strathclyde Partnership for Transport are associate members, though this response does not represent their views.
- 1.2. Over one billion bus trips were made across the six PTEs in 2009/10, representing 37% of the bus market in the area covered by the Competition Commission's (CC) investigation. Bus networks provide a vital connection to jobs, services and facilities for the 33% of households in metropolitan areas who do not own a car. Our analysis shows that public transport accounts for more than half of all morning peak trips into the largest city centres in England. If all these trips were to be made by car, traffic levels would double and cities would grind to a halt. Ensuring that public transport networks remain competitive, relative to the private car, is therefore critical if we are to avoid congestion spiralling out of control in the future.
- 1.3. We welcome the CC's conclusion that in many areas bus operators face little or no competition, leading to passengers facing less frequent services and, in some cases, higher fares. We also note that the majority of the CC's estimate (between £115 million and £305 million) of the study area detriment for passengers from market failure is likely to occur in PTE areas. Some of the CC's proposed remedies have the potential to bring benefits for passengers, but as an overall package we do not believe that the remedies will make a significant overall contribution to improving bus services for passengers, and that the main focus of the CC's recommendations - a further attempt to stimulate more on-street competition - does not serve passenger interests in large urban areas.

## 2. Has the Competition Commission addressed the issues of most importance to the bus passenger?

- 2.1. No. At the early stages of the inquiry it appeared that the CC was going to take a more rounded view of passenger priorities but by the time of the final draft remedies the CC reverted to type by arguing that the overriding priority was to stimulate competition between bus operators on the streets. This on the grounds that, as consumers, what bus passengers must want is a choice of operators on their local bus route providing a different quality of service and different fares. In our view this is a very simplistic and inappropriate view to take of urban public transport. It is also not clear to what extent the CC tested their view of the primacy of on-street competition against what real bus passengers actually think.
- 2.2. Indeed there is considerable evidence to show that passengers (particularly in large urban areas) attach a high value to the wider benefits of the provision of an integrated public transport network with simple smart ticketing<sup>1</sup>. The success of London's Oyster card is the most prominent UK example. Research shows<sup>2</sup> that there is a psychological cost in making complex journeys. By removing much of this complexity, integrated tickets can effectively reduce the overall effort and cost of making a trip. It is also instructive to note that London is excluded from the CC's investigation but that if the CC's goal of on-street competition were to be applied to London (where the CC itself is based) then simple Oyster card ticketing (as we

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<sup>1</sup> See Aecom (2009) and Booz (2009) for more on the impact on passengers of simplified ticketing and other quality factors.

<sup>2</sup> For a summary, see Bonsall et al. (2007)

know it today) would disappear overnight; as indeed would many other features of London's integrated transport provision (including high quality standards and service stability).

- 2.3. Our view is that to compete with alternative modes bus services need to be not only cheap, frequent and fast but also convenient, clean, comfortable, secure and, more critically, easy to use. Almost by definition, unfettered on-street competition will generally fail to deliver on some of these attributes.
- 2.4. The CC failed to recognise that making a bus journey is not simply like buying a fridge, or flying to New York. Its objective to replicate what works for those very different markets in the local bus market is disappointing and is as doomed to failure as all the previous efforts of the competition authorities have been in seeking to achieve a vision of perpetual bus wars on Britain's streets.

### **3. How effective are the remedies proposed by the Competition Commission likely to prove?**

- 3.1. Although some of the measures set out in the report do have the potential to bring benefits, the report does not present a case for how the individual measures will combine effectively as a package over a realistic timescale, or for the cumulative benefits of the individual measures<sup>3</sup>. Our overall view is that the proposed set of remedies is very unlikely to produce any significant impact on the local bus market in metropolitan areas, let alone tackle the cost to passengers and tax-payers of the current market structure.
- 3.2. Of all the remedies presented it is those on ticketing that could bring most benefits, and if supported by appropriate legislation, the proposed set of measures could make a positive contribution towards more integrated ticketing, lower prices and greater fare certainty and simplicity. However, there are a number of barriers and potential risks which could limit the effectiveness of this remedy as a market opening measure.
- 3.3. First of all, Local Transport Authorities (LTAs) already have the powers to introduce most of these measures, in agreement with operators, as set out in the Local Transport Act 2008 (LTA 2008). Given that several LTAs have already attempted, and failed, to introduce them due to opposition from operators, it is unlikely that this remedy could be implemented without further statutory powers. At the same time, the process for parliamentary legislation can be extremely protracted. For example, the time taken from initial consultation through to enactment of the associated orders on the last major piece of buses legislation (the LTA 2008) was two years and nine months. This does not include the time taken to find a parliamentary slot in the first place (and it is our understanding that this could prove difficult for any new buses legislation) and for the take up of the measures by operators and local transport operators once the legislation (and associated guidance and orders) is available.

### **4. Is sustained head-to head competition feasible or desirable?**

- 4.1. The experience after twenty five years of bus deregulation is that significant head-to-head competition between rival bus companies is increasingly rare. The main exception, inevitably, being where routes converge on the approaches to city centres. Where there is deliberate head-to-head competition (ie where two or more companies are competing for a route or

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<sup>3</sup> Paragraph 507 of the provisional decision on remedies: "It is not possible to quantify with precision the customer benefit associated with increased competition. We have not been able to quantify every aspect of the detriment resulting from the AEC, nor are we able to quantify with precision how much of this detriment would be removed by our package of remedies."

market) this competition is often short lived, unstable and disruptive. It can also contribute to wider traffic congestion for other road users.

- 4.2. Even if stimulating new and extensive head-to-head competition on the streets of large urban areas was feasible, or likely, we do not believe it would be desirable. The evidence from the post-deregulation period on the effects of on-street competition is overwhelming. Metropolitan areas had seen stable patronage for the five years preceding deregulation in 1986, whereas five years on from deregulation patronage had declined by a quarter<sup>4</sup>. White (1997) has shown that a substantial proportion of this decline was due to the high degree of service instability that resulted from the initial high degree of on-street competition in many areas<sup>5</sup>.
- 4.3. We note that the CC itself recognised in its provisional findings that stable on-street competition is not necessarily likely to arise in the deregulated bus market<sup>6, 7</sup> ("*our provisional finding is that head-to-head competition tends towards instability the closer the competition between operators becomes*"<sup>8</sup>). The CC's final report does not explain why, and on what basis, the CC eventually changed its view.
- 4.4. In our responses to the CC, we have drawn on existing research<sup>9</sup> to explain why new entry into a typical bus route is unlikely to be profitable and therefore likely to be short lived. In simple terms, if a new entrant chooses to run a competing service between the services of an incumbent it will face similar costs but will only be able to attract around half of the demand, effectively meaning the service will be loss making. Large scale entry would make all services loss-making for both operators until one eventually decided to abandon the market. The CC failed to acknowledge this evidence in its final report. Effectively, the CC's final position ignores much of its earlier analysis and our own evidence and seems to be based on assertion.
- 4.5. But even if the limited set of remedies proposed were to produce a material change in some less concentrated markets and stable on-street competition somehow materialised it seems at best optimistic to expect that they will make a change everywhere. The CC's own analysis classifies close to three quarters of all urban areas as either '*near monopoly*' or '*near duopoly*'. These are areas where there is little or no meaningful competition at present and where we would not expect to see competition in the future without fundamental changes to the existing market structure or the local regulatory framework. The CC has given us no reason to believe that its relatively modest package of remedies will stimulate that significant increase.

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<sup>4</sup> DfT Bus Statistics

<sup>5</sup> See also Fairhurst and Edwards (1996)

<sup>6</sup> Paragraph 39 of Summary of Provisional findings: "*We found that there were factors in the market which tend to make head to head competition unstable*".

<sup>7</sup> Para 41 of Summary of Provisional findings: "*(...) competition can result in a costly period of rivalry between operators which is likely to be loss-making, and so culminate in the exit of one operator. This occurs because both operators have an incentive to increase the number of services to attract more passengers from their rivals, leading to oversupply on the route. (...) While these actions can be beneficial to consumers, they can sometimes be extreme in order to weaken rivals, and tend to persist only in the short term*". We would argue that this instability is not in itself beneficial to consumers as demonstrated by White's (1990) welfare analysis of the post deregulation period in metropolitan areas.

<sup>8</sup> Paragraph 42 of Summary of Provisional findings

<sup>9</sup> See, for example, Evans, A. (1987), "A theoretical comparison of competition with other economic regimes for bus services", *Journal of Transport Economics and Policy*, 21, pp. 7-36

## 5. What role should Quality Partnerships play?

- 5.1. **pteg** believes that it should be for local transport authorities to determine the most appropriate measures for improving bus services in their areas and that the measures in the LTA 2008 (ie Voluntary Partnerships, Qualifying Agreements (QAs), Statutory Quality Partnerships (SQPs) and Quality Contracts (QCs)) give LTAs a set of tools which can be used depending on local need and priority.
- 5.2. PTEs have already been using the voluntary and statutory partnership tools to bring about real improvements for passengers. For example, in Merseyside SQPs and QAs have been used to ensure even frequencies and more inter-available ticketing between operators. Passenger satisfaction ratings are now higher on such routes than for the wider network. In South Yorkshire, since a QC became a more realistic option the operators have agreed to measures that they refused to contemplate before, including coordinated timetables and more inter-available ticketing. Meanwhile the introduction of SQPs has led to significant growth in patronage in both North Sheffield and Barnsley compared with decline across the wider network.
- 5.3. However, we are concerned that the CC risks casting a shadow over high end partnerships (ie partnerships that are based on raising quality and performance standards) because the CC attaches greater priority to creating the conditions where lower quality bus services could enter the market. In the CC's own words: "(...) *there is a risk that partnerships have the potential to [...] restrict competition if they specify unnecessarily high quality standards (...)*"
- 5.4. We believe this is a dangerous and fundamentally misguided approach that could set the industry back to the stasis that existed before the LTA 2008. This is because it could act as a deterrent to operators entering into partnerships based on quality if they feel that the competition authorities might act against them in the future. It is also misguided because the CC is in danger of undermining what works today and what benefits passengers (partnerships based on quality) in favour of keeping open, what is in most cases only a hypothetical possibility, of a low quality operator starting up on a route. Low quality operators will often also rely on older, dirtier buses which has implications for urban air quality and traffic congestion. We already have evidence from PTE areas that some operators are expressing more caution about entering into high end partnerships specifically because of the tone and language of the CC report.

## 6. Has the Competition Commission adequately considered the franchising option?

- 6.1. The PTEs believe that the introduction of some form of franchising could effectively inject greater competitive forces into the market. Indeed, this was recognised in the 2000 Transport Act, whose provisions in respect of QCs were later reinforced in the LTA 2008. We therefore welcome the CC's acknowledgement<sup>10</sup> that there is a clear legal basis for utilising franchising and that LTAs, in considering this option, need to take into account wider objectives brought about by its statutory duty to "*secure the provision of such public passenger transport services as the Authority for the area consider appropriate*"<sup>11</sup>.
- 6.2. However, we believe the ideological position that the CC has taken in favour of on-street competition has meant that it has not fairly judged the merits of QCs (which by definition are about competition for a market rather than on the streets). We believe that the CC has overstated the impact of its proposed remedy package, while understating its costs and

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<sup>10</sup> Paragraph 435

<sup>11</sup> Section 9A, Transport Act 1985

implementation timescales. On the other hand, we feel that the CC has overestimated the costs and risks of franchising but not taken into account the efficiencies that will offset such costs as well as the wider consumer benefits that could result.

6.3. Although we have provided extensive evidence to support these views and the likely benefits of franchising in the UK bus market, the final CC report makes little reference to this. We therefore feel it is worth re-stating some of the key arguments:

- Franchising has great potential to simplify and provide far greater 'legibility' of local bus services, making it more attractive to passengers and growing the bus market.
- There is an extensive evidence base<sup>12</sup>, not least from London, which demonstrates that franchising can drive similar productivity improvements as "competition in the market", while ensuring that most of the benefits flow back to passengers and the tax-payer rather than shareholders.
- Franchising has the scope to remove inefficient duplication of services and head office functions by competing operators. It can also ensure that proceeds from profitable parts of the network are used to fund social 'lifeline' services elsewhere in the network and hence improving the financial sustainability of local networks overall.

6.4. There are a number of reasons why "competition for the market" is likely to be particularly appropriate in PTE areas (although the CC took a one-size fits all to the study area):

- Complex demand patterns, with a significant degree of multi-operator and multi-modal trips, highlighting the importance of integrated, easy to use networks.
- Critical importance of bus networks in tackling congestion.
- High degree of operator concentration and excess profits (for some operators their monopolies in large urban areas are in effect a cash cow for their wider business). Analysis commissioned by the DfT<sup>13</sup> shows profit margins amongst large bus operators to be highest in PTE areas, where they are at least 9% above market-efficient levels.
- Existing critical mass within PTEs in terms of knowledge, skills and monitoring capabilities with substantial experience with tendering of non-commercial services, light and heavy rail networks/services, all of which have attracted a significant degree of sustained competition to date<sup>14</sup>.

6.5. A number of PTEs/ITAs (SYPTe, Nexus, Metro) are actively considering the introduction of some form of franchising and have developed detailed evidence-based proposals on how this could be implemented so as to maximise the degree of competition both initially and in the longer term. Both Metro and Nexus have produced estimates of the total social benefits that could be expected from a QC model, and how that would compare with the current scenario and existing partnership proposals. In both cases, a QC model could lead to substantial growth in patronage relative to the alternative scenarios. Part of this would arise from the introduction of improvements such as simplified/integrated ticketing and marketing, partly funded from a more efficient allocation of resources. More importantly, this would be achieved at a broadly similar cost as at present.

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<sup>12</sup> See: Hensher, 2007; Longva et al., 2004; Longva et al., 2005; Amaral et al., 2010; SDG, 2001; SDG, 2002; Alexandersson et al., 1998; Jansson, 2002; Dalen and Gomez-Lobo, 2003; Mathisen and Solvoll, 2005; World Bank and PPIAF, 2006.

<sup>13</sup> <http://assets.dft.gov.uk/publications/review-of-bus-profitability-in-england/review-of-bus-profitability-england.pdf>

<sup>14</sup> Despite these arguments, the CC insisted in its final report that "franchising will cost more than at present"

6.6. For example, **pteg's** analysis suggests that if all bus passengers were to switch to pre-paid tickets, bus operating costs could fall by 3% due to lower journey times and demand would increase by 3.8%. Despite the obvious benefits, few operators are yet to adopt network-wide pre-paid ticketing, discrediting the idea that competition necessarily leads to innovation.

## 7. What action should local government and central government now take?

7.1. The Government should take the lead on reviewing and consulting on the implementation of the CC recommendations with particular priority given to the recommendations on ticketing which we believe offer the biggest opportunity for significant and positive benefits. We also believe that the approach set out in the LTA 2008 is the right one - in that it provides four tools for LTAs (voluntary partnerships, QAs, SQPs and QCs) whilst giving LTAs discretion to use those tools in a way which meets local circumstances and aspirations. The Government should build on these existing tools.

7.2. As set out in paragraph 5.2, voluntary partnership and SQP powers are already being used to improve services for passengers. We would also contend that although QCs have not yet been used, their potential for use has led to a significant improvement in the offers that operators are making on the service levels and quality that they will seek to provide. There remain however some significant challenges in implementing QCs which could be eased by legislative change (particularly on a smooth transition to an initial QC, and from a first QC to a subsequent QC). Given the threats being made by some operators to oppose QCs through both legal action and what could be termed as 'scorched earth' threats to close depots and withdraw services if a QC were to be promoted, then it would be helpful if the Government were to take a more supportive, rather than an agnostic approach to QCs. This would help overcome 'first mover disadvantage' issues, enable some initial QCs to be established and for judgements to then be made on their effectiveness in practice.

## 8. Observations on the conduct of the CC inquiry

8.1. We found the way in which the CC carried out the inquiry to be unsatisfactory in the following ways:

- The CC consistently missed their own deadlines for producing draft reports and then gave respondents wholly inadequate response times for consultation as a result (typically three weeks to respond to hundreds of pages). Furthermore, the tone and direction of the provisional decision on remedies changed substantially (towards on-street competition) from its earlier draft making it very difficult to respond fully and effectively in the limited time available.
- On 1st November the CC issued the most damning evidence of blatant collusion - the North East investigation, where for example one major operator, Go Ahead, told another, Arriva that: *"The offer I'm making is that from whatever date you agree to come to the party we will do nothing that in any way causes you grief, and we will seek to implement changes to our mutual benefit."* This was less than a month after the CC had already issued their provisional decision on remedies (ie these remedies could not be substantially changed as a result of the North East findings)
- The CC also made a basic error in its calculation of the costs of market failure, which was identified by **pteg** in its response to the provisional decision on remedies. In November the CC accepted this error which led to a doubling of its estimate to as much as £300m per year (equivalent to around 7% of total industry turnover). Had this error been spotted earlier then it is possible that the remedies might have been different.