Economic PERSPECTIVE

SCOTTISH EXPRESS COACH SERVICES - LOSS LEADERS AND ANTI-COMPETITIVE PRACTICE

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INTRODUCTION

Over the last 16 years, the Scottish express coach industry has undergone dramatic changes. Legislation almost completely reversed the effects of the 1930 Road Traffic Act and removed quantitative controls in the industry. Express coach services were deregulated in 1980 and then privatised in 1985-86.

This short paper examines structure, conduct and performance in the industry and draws conclusions about the nature of competition and the success of privatisation and deregulation.

THE STRUCTURE OF THE INDUSTRY

After deregulation and privatisation, what had been a state owned monopoly became 9 distinct regional operators, an express service operator and 2 maintenance/coachbuilding companies. The express service operator, Scottish Citylink Coaches, was already facing a large amount of competition, both cross-border (with Stagecoach Caledonian Express and National Express) and on a number of intra-Scottish routes (especially on routes in Highland region). This has all changed with the subsequent consolidation of regional operators and mergers between express operators.

The structure of the industry is now, for practical purposes, a duopoly. Two operators provide almost all express coach network services in Scotland, National Express through it's "Scottish partner" Scottish Citylink and Stagecoach through it's regional operations Fife Scottish, Western Scottish and Northern Bluebird. Of the two, Scottish Citylink provides almost twice as many services in terms of vehicle mileage. Cross-border services to English towns and cities are operated solely by National Express. Neither of the operators are competing against each other on the same routes, indeed Stagecoach Western Scottish occasionally provide coaches for duplicate services to Scottish Citylink.

The method of operation for services in the industry is of interest. Scottish Citylink do not own, garage or maintain any of the coaches used on their routes. Instead they contract independent coach operators to run the services on their (Citylink's) behalf. In 1993 at the time of their merger with National Express Citylink had contracts with 14 operators. All of these were retained but recent additions to the network may have increased this number. These contracts are for specific and detailed schedules of services and are for a fixed price no matter how many passengers are carried. Most contracts are also short-term lasting for six months at a time, but occasionally longer contracts are awarded to cover the provision of new vehicles. The contracts generally ensure that vehicles operate in Citylink livery and that the operator is responsible for all running costs, including drivers, insurance, fuel and maintenance.

It is believed that Stagecoach use similar methods of operating, using it's own regional operators as Citylink uses independent operators. This is difficult to confirm as internal accounting procedures are not available, although since all the express services operated by Stagecoach use the Stagecoach Express livery rather than regional operators livery it is possible that Stagecoach now does treats express coach services as a separate business.

BARRIERS TO ENTRY

Barriers to entry have a powerful effect on the structure and conduct of the operators in both the express coach industry and the wider bus service industry. On examination they fall into two broad categories exogenous, or externalised, barriers and endogenous, or internalised, barriers.

The principal external barriers are capital requirements, economies of scale, differentiation, integration and absolute cost advantages. In the express coach industry these are of relatively little consequence when compared with the levels of such barriers in other industries. In the coach industry, almost all of the exogenous factors can be offset by leasing or operating second hand fleets and garaging facilities and the question of absolute cost advantage, certainly in terms of factors of production, is practically non-existent.

Internal barriers, on the other hand, are much higher and hence more limiting for potential competitors. Retaliation, pre-emptive responses, consumer loyalty (or at least consumer familiarity) and the superior knowledge of incumbent operators are all typical. Combined these endogenous factors make success in the industry difficult for potential entrants in general and impossible in specific cases where current operators act to exclude new operators.

THE MARKET FOR SERVICES

The market for long distance transport is dominated by the car. Challenging this domination is difficult and in the light of Department of Transport statistics practically insurmountable (80% of all passenger journeys over 50 miles are by "private light vehicle"). Of the remaining sources of long distance travel, rail is by far the most important alternative with just over 10% of the market compared with coach services at 3.6%. The balance is by ferry and air with air travel significantly poorer than coach for the in the market for long distance journeys.

The bulk of coach patronage is passengers in the lower socio-economic groups (42% C1 and 35% C2DE according to independent research carried out for National Express). Assuming that price is a primary factor in determining both the decision to travel and the choice of mode and that in general coach journeys are cheaper than equivalent rail journeys, we can say with a degree of certainty that typical coach users are impecunious or infrequent users without access to a car, for example students, backpackers or senior citizens.

CONDUCT IN THE INDUSTRY

Conduct in the industry is certainly oligopolistic, and in some specific cases on certain routes monopolistic. The large operators (specifically Scottish Citylink) "co-opt" smaller operators (like Skye-Ways and West Coast Motors) into their network through leasing agreements and strategic partnerships. The Stagecoach approach, in contrast, is to buy the smaller operator outright and compete away any other incumbents. The large operators themselves appear to collude over which services to operate (for example, when Western Scottish was bought by Stagecoach, Citylink which operated it's Ayrshire services using Western Scottish buses pulled out of competition with the new Stagecoach services)[1].

Although aspects of competitive behaviour are oligopolistic or monopolistic, pricing policies on express services are still competitive. The reason for this is, of course, that while the industry could be seen as a collusive duopoly, the market in which the industry operates is actually competitive.

Railway competition is perceived by the coach operators to be their principal source of commercial competition. Evidence of this is clear in the reactions of express coach operators to changes in rail services. Generally speaking, where rail services on a route similar to an express coach service are frequent the frequency of the coach service is high. For example, the introduction of the half hourly "Shuttle" service from Glasgow to Edinburgh prompted Scottish Citylink to double it's Glasgow - Edinburgh service frequency to four per hour. Other high frequency coach routes are self evidently routes in competition with the principal Scotrail/Intercity services, for example the Inverness and Aberdeen services.

In addition to the close correlation between service frequencies in both long distance coach and rail travel additional evidence of the perceived competition between rail and coach is seen in the pricing of services. Research already carried out (Sinclair 1996) shows that, for services with rail competition of an appreciable level, price per mile is significantly smaller than on those routes with little or no rail competition.

PERFORMANCE

In order to establish the way in which the companies behave, details of the performance on each of the routes was required. Detailed accounts of the performance of the bus operators by route are generally not available, so primary data collection was necessary.

To ascertain demand by route, on-bus counts were taken over a number of days in both summer and winter and at a variety of locations throughout Scotland. Although the passenger numbers showed substantial variation by day and season, it is believed that the sample size (600 observations) was

[1] It has since been revealed that Stagecoach in fact paid a "consideration" to Scottish Citylink to deregister the services.

sufficiently large to give a reasonable estimate of the mean passenger numbers by route.

The approach to estimating the operating revenues for routes is similar to the approach taken by McGeehan (1984). For each node to node section a mean fare has been estimated. The basis for the average varies on different nodes. For most nodes with relatively short distances between them an average of all fares at all stages along the route has been taken (principally because of relatively high levels of commuting). In the case of node to node sections with a greater distance (over 90 or 100 miles) the fares have been weighted with around 55% being direct node to node fares and the remaining 45% being shared equally between all the other fares. By multiplying the resultant mean fare by the estimated passenger journeys established from the loading surveys, a reasonable estimate of operating revenue on the node to node sections can be estimated. When the node to node sections are summed then a reliable estimate of the route revenues is obtained. These revenue estimates were then reduced by between 25 and 33% to reflect the numbers travelling at a reduced fare (returns, student cards, child fares etc.)

Costs were estimated by a considerably simpler method than the one described above for revenues. Costs were identified for services in general (principally variable and semi-variable costs such as labour, fuel, insurance and licenses) and then estimated based on available industry figures. Then by closely examining past financial figures the magnitude of fixed costs (such as administration, management, promotion and property maintenance) was established. The operating costs were then apportioned on the basis of vehicles per route and the fixed costs on a mileage basis (the accepted CIPFA practice when peak usage cannot be established).

Throughout the analysis of revenues and cost it is assumed that the contracts with private hire coach companies under which route services are operated are reasonable and fair. As a consequence it is also assumed that Citylink does in fact shoulder the burden of losses on those routes where losses are in fact made.

The combined revenue and cost patterns are shown in Table 2.

The most interesting points brought up by these figures are the difference between operating (before apportioned overhead) and route (after apportioned overhead) profits and the large number of routes which run at an overall loss.

A major factor in the difference between the operating and route profit figures is the method used to calculate the apportionment. The mileage basis considerably favours shorter less frequent journeys (more common in staged services than on express routes) and thus makes these seem more profitable. Nevertheless, even with this deficiency in the apportionment of costs the results are still reasonable estimates given that other methods of apportionment give similar results. Essentially, the loss making routes are always the same regardless of the method used to estimate the apportioned cost. This result then begs the question why are so many routes run at a loss?

Theory suggests a number of reasons why this could happen.

Firstly, the loss making services may be run to discourage competition. Citylink may see loss leaders as necessary to stop other firms from establishing themselves in the express coach service market. This would maintain market share and protect already tight profit margins. On the selected routes which have been or may become attractive to new entrants, Citylink will be engaged in a limit pricing strategy to discourage competition while still maintaining market share and overall profitability. Comparing the fares of selected coach services and comparable rail services gives a difference in ticket price which appears to be more than just competition with the rail operator. For example the Glasgow to Edinburgh fares (return) are £5 and £8 for bus and rail respectively, for a journey which differs in time by only ten minutes. Inverness to Thurso shows a similar disparity, where for £13.50 by bus and £19.50 by train, you can save not only the money but 30 minutes of time travelling by bus. Even allowing for the difference in "quality" between services, this suggests that Citylink depresses it's prices below what the market will bear, and so supports the suggestion that limit pricing is a deliberate policy on certain coach routes.

Another reason is that Citylink could also be running these services to provide a contribution to the asset costs and fixed overheads. Although capital outlay can be offset, Citylink has a policy of new, comfortable buses on it's services and so may incur higher fixed costs than other less stringent operators. In order to overcome this, Citylink may run services to spread the costs as "thinly" as possible (£500,000 over 10 routes is a better situation than £500,000 over 4 routes).

Finally, Citylink's objectives are unlikely to be profit maximisation in the short run. Revenue or passenger-journey maximisation is a possible objective given the evidence but a more likely objective is that of maximising the "competitive appearance" of coach services in comparison with railways. This means, essentially, that Citylink is attempting to maintain a comprehensive Scottish express coach service with regular, reliable services in order to provide a viable alternative to the Scotrail network, with a long run opportunity of eventual monopoly.

This last point raises interesting questions about the comparisons between express coach and rail services. The Scottish "inter-city" rail network and Citylink's coach network are remarkably similar. In fact only Fort William - Skye, Inverness to Ullapool and the Kintyre peninsula have no significant rail competition; elsewhere train services run parallel to coach services (almost literally in some places). In addition, as pointed out above price per mile between coach and rail services is closely correlated, though typically the coach fare is considerably lower than the rail figure. This is not surprising on either account, correlation can be expected to be high between competitors and rail services cost considerably more to run (infrastructure and fuel costs are significantly higher) and so higher fares must be charged to ensure operating profit margins are at least similar to the coach operators margins. Finally, the similarity in the profit margins of individual routes is remarkable. In practically all cases the coach routes that are making the highest losses are the same as the rail routes that are making the highest losses. The notable exception is the Glasgow - Edinburgh route where coach services are suffering the largest losses while conversely this is the rail operators' most profitable route.

In terms of other performance criteria, Scottish Citylink compares favourably with competitors and industry averages. Broadly speaking, the financial position of the company is sound with gearing and liquidity ratios well within the norms for the industry. Sales growth is unremarkable but in a mature saturated market with little scope for growth except through merger and acquisitions (which is difficult given the industry structure) such figures are not too untoward.

An examination of the company's efficiency would be the work of another study but on a superficial level efficiency would seem to be improving. Turnover to vehicle and staff ratios improved between 1995 and 1997. When comparing performance across the industry Citylink's costs per bus kilometre (71 pence) and passengers per bus kilometre (41.6) compare very well with industry averages (*cf.* Cowie and Asenova, 1998). These figures could be as much a consequence of the method of operation Citylink uses, with long distance services operating at higher road speeds at a comparatively lower frequency to staged, urban services. However, there is almost certainly some element of efficiency improvement involved in the figures.

RECENT DEVELOPMENTS

In the past year National Express Group, the parent company of Scottish Citylink, acquired the franchise for the Scotrail passenger rail operation. This was seen as a conflict of interest and a threat to competition. The franchise arrangements were referred to the Monopolies and Mergers Commission. Based on their own investigation and on views expressed (some of which utilised the analysis in this paper) the MMC recommended divestment of the Scottish Citylink coach operations. The company was subsequently sold in two deals with other coach operators, Metrolines purchased Scottish Citylink and Rapsons purchased Highland Country Buses (a subsidiary of Citylink's).

Given these developments the impact on the analysis is not particularly significant. Citylink's revenue and cost patterns may change over time but in the short run are unlikely to see major changes. The question of competition between coach and rail operations is still the central issue of the analysis of conduct in the industry/market (hence the recommendation for divestment). The sale of Citylink will probably not have any significant impact on the situation either. Metrolines should continue operating the services on the current caontracting basis, having no significant fleet of it's own. The sale to Rapsons, however, is interesting insofar as Scottish Citylink 'competed' Rapsons out of express coach services between Glasgow and the North of Scotland in the early 1990's. Broadly speaking this sale will have no significant material effect on the industry position either.

CONCLUSIONS

The Nature of Competition

From the point of view of the express coach industry in Scotland, the analysis of structure, conduct and performance shows that there are two levels of competitiveness. There is entry to the market, which with low exogenous barriers to entry and few sunk costs is relatively easy. Once in, though, entrants face a duopoly of immense market power willing to utilise limit (or monopoly) pricing and using patently unfair competitive practices. The market is easily contestable but highly uncompetitive, and new entrants may enter at their leisure but do so at their own risk.

On the other hand, from the point of view of the inter-city travel market, there is clear evidence of a highly competitive but concentrated structure, where rail and coach services compete directly. Entry into this market is almost impossible (coach operations for the reasons above and rail operations because of the passenger rail franchising process), and even if a new entrant was to manage entry survival is likely to be impossible.

Future levels of competition are likely to be even lower than they are now. In the coach industry there is no driving force for competition and so more concentration may take place. Further acquisitions of local operators may cause more competition (at least between the two incumbent operators). Citylink has chosen not to compete with Stagecoach in areas where Stagecoach has taken over the Citylink contractor, but were Stagecoach to acquire an operator in a more commercially sensitive area Citylink could well be forced into competitive action.

In the rail industry there is regulation (ensuring minimum levels of service and maximum fare levels) but again no driving force for competition. Given also the likelihood of a coach operator acquiring the rail franchise (as has happened with a number of franchises south of the border) competition seems even more remote.

The "Success" Of Privatisation

The Buses White Paper and the subsequent Transport Act, 1985, set out to privatise the holdings of the Scottish Bus Group with a view to meeting certain objectives, typical of privatisation. Goals like eliminating monopoly power, widening share ownership, removing restrictive regulation and supply side options such as freedom of competition for capital and labour market competitiveness were all high on the list of reasons to privatise the "monolithic" state owned bus companies.

Monopoly power has not been eliminated to anywhere near the level it should have been with two or three very large operators controlling not only intercity but urban services as well. This point also reduces the effect of widened share ownership as shares have become concentrated in the hands of management or the large companies who wholly own the express service operators and most of the urban service operators. The tendency for this concentration is due to the lack of regulation. This state monopoly was privatised without the creation of a regulatory "watchdog" unlike the utilities or the current privatisation of British Rail.

The Future

What was a state owned monopoly is now a privately owned monopoly. The removal of subsidies for express services, the lack of competition regulation and the absence of drivers for change in the competitive structure of the industry point to more of the same. Ultimately, without the imposition of stronger regulation, uncompetitive practices in intercity travel are bound to continue with further concentration and consolidation and little hope for the future of services which are likely to be poor financial performers in the face of a consolidated market.

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TABLE 1: PRICE PER MILE FOR TYPICAL COACH AND RAIL SERVICES

	Coach	Train
Edinburgh-Inverness	11.491	16.578
Glasgow-Edinburgh	13.333	24.468
Glasgow-Ft. William	10.472	21.705
Glasgow-Inverness	11.143	16.854
Glasgow-Oban	17.021	24.020
Glasgow-Wick	8.834	11.612
Inverness-Thurso	11.638	10.598
Aberdeen-Inverness	9.174	19.231
Inverness-Kyle	16.707	25.275
Edinburgh-Aberdeen	15.000	23.077
Correlation Coefficient	0.696	

TABLE 2: ESTIMATED FINANCIAL PERFORMANCE OF THE CITYLINK NETWORK

SUMMER REVENUE-COST PATTERNS FOR CITYLINK SERVICES				
	ADJUSTED REVENUE	OPERATING COSTS	APPORTIONED COSTS	ROUTE PROFIT
Edinburgh-Aberdeen	1039104	158247	225759	655098
Edinburgh-Ft. William	118416	37909	33739	46768
Edinburgh-Inverness	532416	211491	279595	41330
Ft. William-Mallaig	23760	33393	10915	-20548
Ft. William-Oban	137280	72285	49617	15378
Glasgow-Aberdeen	1286937	247157	444821	594959
Glasgow-Campbeltown	147204	124765	112383	-89944
Glasgow-Dundee	566496	76464	89311	400721
Glasgow-Edinburgh	846720	451811	547033	-152124
Glasgow-Inverness	379209	190188	347323	-158302
Glasgow-Kyle	380827	149236	133223	98368
Glasgow-Oban	121996	102811	69960	-50775
Inverness-Ft. William	192096	115401	102708	-26013
Inverness-Kyle	89088	39284	40686	9118
Inverness-Ullapool	54427	99690	30266	-75529
Inverness-Wick	122323	146141	107173	-130991
TOTALS	6038301	2256280	2624521	1157514

TABLE 3: COMPARATIVE PERFORMANCE FIGURES FOR SELECTED COACH AND RAIL SERVICES

	Coach Costs	Rail Costs
Edinburgh-Inverness	92.24%	292.34%
Glasgow-Edinburgh	117.97%	143.08%
Glasgow-Ft. William	74.17%	521.11%
Glasgow-Inverness	141.75%	292.34%
Glasgow-Oban	141.62%	521.11%
Glasgow-Wick	157.68%	593.28%
Inverness-Thurso	207.09%	894.21%
Inverness-Kyle	89.77%	597.37%
Edinburgh-Aberdeen	36.96%	258.75%
Correlation Coefficient	0.5902	