TTF
AUSTRALIA
Tourism & Transport Forum

PUBLIC TRANSPORT, PRIVATE OPERATORS

DELIVERING BETTER SERVICES THROUGH FRANCHISING

JULY 2012

L.E.K. L.E.K. Consulting

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Trent Zimmerman, Martin Gray and Luke Turner of TTF
Simon Barrett, Tamir Chen, Marc-Antoine Cousin, Josh Gluckman, Carl Irwin, Nick O'Brien, Damilola Ogundeji, Monica Ryu and Chris Single of L.E.K. Consulting
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The members of the TTF Passenger Transport Panel.

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For further information, please contact:

Tourism & Transport Forum (TTF)
Level 8
8-10 Loftus Street
Sydney NSW 2000
T: +61 2 9240 2000
www.ttf.org.au

Trent Zimmerman
Deputy Chief
Executive Officer
Director, Transport Policy
E: tzimmerman@ttf.org.au

Martin Gray
Policy Officer, Transport
E: mgray@ttf.org.au

L.E.K. Consulting
Level 26, 88 Phillip Street
Sydney NSW 2000
www.lek.com
T: +61 2 9323 0700

Monica Ryu
Partner
E: m.ryu@lek.com

Dr Simon Barrett
Regional Head – Asia
E: s.barrett@lek.com

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Many of Australia's largest public transport systems remain government owned and operated. These include very large operators such as RailCorp[1], Queensland Rail, Sydney Buses and Brisbane Transport. However, there is also significant and growing private sector delivery of public transport, including the tram and train franchises in Victoria, and ferry services in Sydney and Brisbane. The private sector also delivers bus services in every state capital.

There is a considerable weight of evidence to demonstrate that, relative to government-run public transport services, the private sector has stronger incentives to use infrastructure more efficiently, deliver better operational performance, and improve the customer experience. Private companies are able to deliver these benefits because they can leverage significant, often global, experience from involvement with multiple public transport networks, and they are better equipped to attract and retain high quality staff. This can be reinforced by financial incentives to realise efficiencies and deliver high levels of customer satisfaction. In contrast, public operators in monopoly markets tend to lack strong incentives to improve services for customers and increase efficiency.

There are many different ways the private sector can be involved in the provision of public transport services, including outsourcing, franchising, privatisation and public private partnerships (PPPs). Under franchising, the government retains ownership of the assets (particularly for rail) and generally retains significant control over fares, routes and service standards. To achieve contestability and maintain reasonable control over fares and routes, the franchise model is generally seen as best suited for public transport.

The evidence supporting the benefits of franchising in public transport is compelling but is not definitive. There are significant implementation requirements that need to be met in order to realise the potential benefits from franchising. Private sector service delivery is by no means a panacea, and needs to be viewed as one element of a broader package that typically includes implementing industry reforms and having political support. In addition, there are examples of government-run transport systems where the potential benefits from franchising are relatively minimal. For example, Transperth's strategy in rail has been to outsource many major functions, including above-rail and below-rail maintenance as well as some security staff. They have developed in-house skills in structuring, procuring and managing these major outsourcing contracts. These contracts have delivered value for money and, as a result, the incremental benefit from franchising in this instance may not be substantial.

The Potential Benefits of Franchising

Experience in Australia and internationally has shown that, when carefully designed and managed, franchising public transport services can lead to significant benefits. While these benefits are not always dependent on franchising, it can be a valuable catalyst for bringing a clearer focus on performance using strong commercial incentives. The three main beneficiaries from franchising are:

- **Customers:** Improving the customer experience through private sector innovation and investment, use of contractual incentives to increase focus on customer satisfaction, and a stronger customer-focused workforce culture.
- **Governments and Taxpayers:** Reducing public subsidies enabling reinvestment in services as well as other non-financial benefits to government such as clarification of transport priorities and greater certainty over future transport budgets.
- **Employees:** Increasing employee job satisfaction and career development through opportunities available in the private sector.

The government plays a central role in setting the desired outcomes from franchising through the design of the contract, particularly in the area of incentives. These have an impact on the level of benefits that are delivered and the relative priorities among the beneficiaries.

Requirements for Successful Implementation

There are also significant challenges in successfully implementing a franchise model. Many cities that have moved to franchising have stumbled in the first or second round, before settling on a more successful model. A poorly executed franchising process can result in unnecessary cost and disruption.

Based on lessons learned from franchising around the world over the last 20 years, a number of important settings and pre-conditions must be in place to realise the benefits from franchising. These are summarised in the following ten requirements:

1. **Having a clear strategy for transport delivery and the political will to follow through**
2. **Having realistic expectations**
3. **Being well prepared**
4. **Choosing the most appropriate franchise structure**
5. **Creating contestability**
6. **Getting the contract right**
7. **Balancing financial and other objectives**
8. **Having the right people and skills to manage the relationship effectively**
9. **Being flexible and willing to adapt to change**
10. **Bringing the community along**

[1] Transport for NSW announced in May 2012 that RailCorp will be split into Sydney Trains and NSW Trains, replacing the terms CityRail and CountryLink. For the purposes of this report, we have used the terms RailCorp, CityRail and CountryLink.

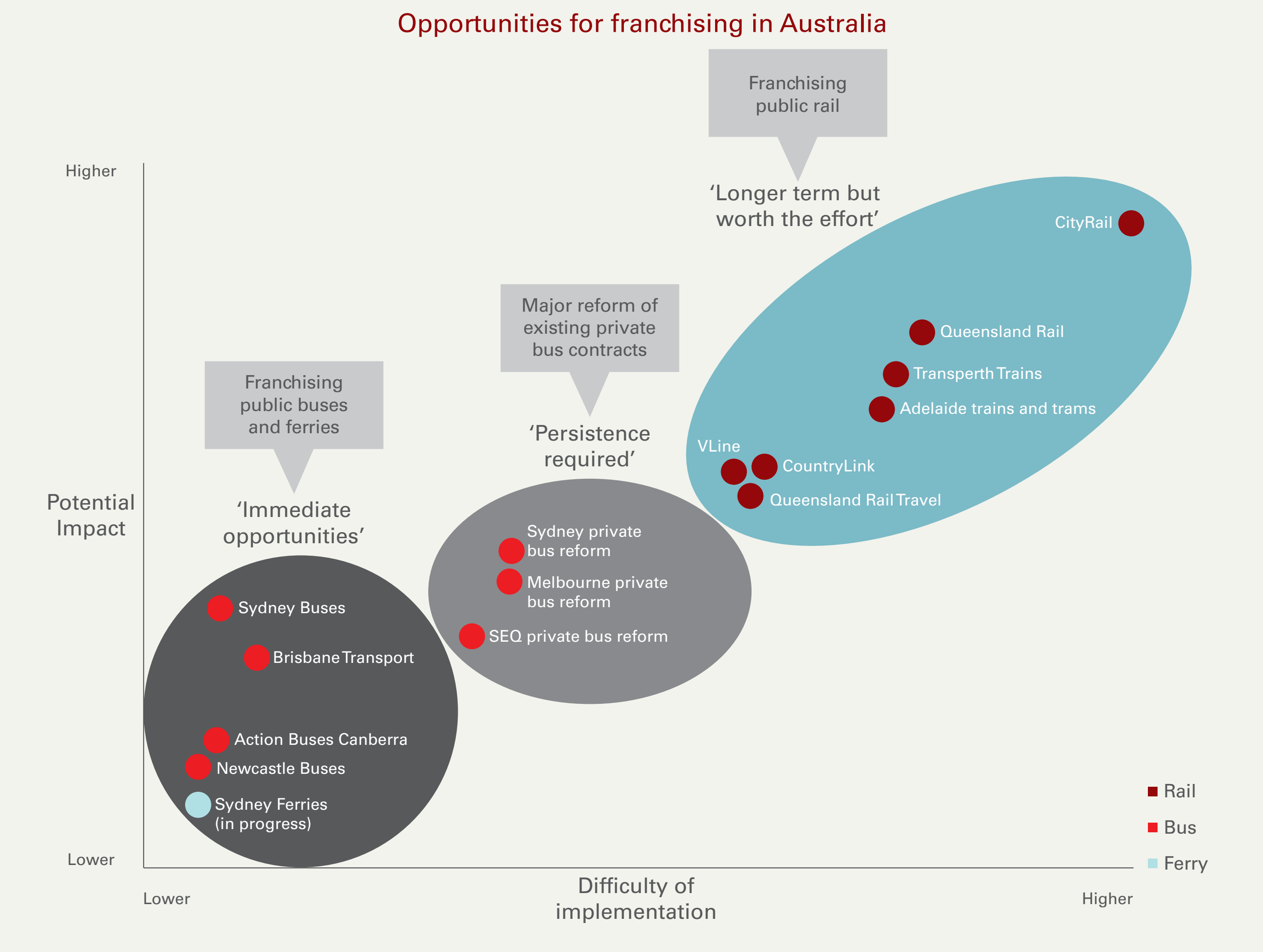
What are the Opportunities for Franchising in Australia?

There are many large and smaller public transport systems in Australia that could benefit from adopting a franchise approach:

- **Immediate opportunities:** Franchising public ferries and buses: These opportunities would be relatively straightforward to implement. These include ensuring the smooth transition of Sydney Ferries to the new private operator by end of July 2012, as well as opportunities to franchise the large government-run bus systems in Sydney, Brisbane, Canberra and Newcastle. Consideration should be given to implementing these opportunities immediately.
- **Persistence required:** Reform of existing private bus contracts: These opportunities offer considerable potential impact, but will require longer timeframes to realise the full benefit. The main opportunities are to reform and modernise the existing private bus contracts in Sydney, Melbourne and Brisbane. Creating effective contestability for the contracts will be an essential part of these reforms. Implementation of these changes will necessarily occur over a longer timeframe due to a range of contract expiry dates and practical difficulty in achieving change. Transport for NSW recently announced the competitive tendering for private bus operator regions in May 2012. This process will be staged over two tender rounds over three years, commencing July 2012.
- **Longer term but worth the effort:** Franchising government run rail: These are longer-term opportunities due to the need to prepare the organisation for franchising as well as implementation challenges, but they would have a high potential impact. Franchising CityRail and CountryLink could deliver significant benefits to rail users and the wider community, although implementation is challenging and the timing would likely be impacted by the rail reform program currently underway. Other opportunities include the franchising of Queensland Rail, Transperth trains, and trains and trams in Adelaide. The potential impact of these opportunities will depend in part on the extent to which core activities are outsourced to the private sector (e.g. some rail maintenance activities are outsourced in Adelaide and Perth). The regional rail networks also offer opportunities for franchising, either together with the metropolitan networks (in the case of Sydney and Brisbane) or separately. As smaller, more contained networks, they would be easier to franchise on a standalone basis.

In addition, there are ongoing opportunities to fine tune existing franchise arrangements, including rail and tram in Melbourne, buses in Perth and Adelaide and ferries in Brisbane.

Figure 1: Opportunities for Franchising in Australia



Source: L.E.K. analysis

2.0 INTRODUCTION

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A well-run public transport system is at the heart of ensuring Australia's major cities are productive, sustainable and inclusive. By reducing congestion, improving job access and increasing urban liveability, public transport delivers a number of important economic benefits. By helping to reduce greenhouse gas emissions, air pollution and oil dependency, public transport also contributes towards a number of important environmental goals. Well-designed public transport systems can also strengthen social inclusion and deliver a range of health and safety advantages.

Budgetary constraints have put increased pressure on the funding of public transport. At the same time, many governments want to increase their investment in infrastructure and introduce more customer-focused management approaches. In this increasingly strained environment, how best to deliver these public transport services is an important topic for debate.

The purpose of this report, commissioned by the Tourism & Transport Forum and prepared by L.E.K. Consulting, is to encourage an informed debate on the merits and risks of franchising in public transport. It has been prepared based on research available in the public domain, a customer market research program conducted by GA Research and an interview program that includes the perspectives of public and private operators, government and industry experts.

The report comprises four main sections:

- **Section 3** ('Public and Private Sector Involvement in Public Transport') describes why the franchising model is particularly well-suited to public transport and provides an overview of private sector involvement in Australia and internationally.
- **Section 4** ('The Potential Benefits of Franchising') explains the types of benefits franchising can deliver to customers, taxpayers and government, and employees, and illustrates these benefits using case studies.
- **Section 5** ('Requirements for Successful Implementation') highlights the challenges associated with implementing a franchise arrangement and identifies best practice.
- **Section 6** ('What are the Opportunities for Franchising in Australia?') summarises the potential opportunities for further franchising in Australia.

Image courtesy of Yarra Trams

Photo courtesy of Transit Systems Australia

3.0 PUBLIC AND PRIVATE SECTOR INVOLVEMENT IN PUBLIC TRANSPORT

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3.1 Forms of private sector involvement

There are a number of different ways in which the private sector can be involved in the operation of public transport services. Broadly speaking, these include outsourcing, franchising, privatisation and public private partnerships (PPPs). These four models can be thought of as points along a continuum of participation, differing in the scope of the contracts, who owns the assets and the level of risk the private company takes on.

Outsourcing in public transport can include activities like security, cleaning, call-centre and information technology services. It can also include core activities such as rolling stock and infrastructure maintenance. Outsourcing particular business activities has been widely used as a way to decrease costs and/or improve service quality as outsourced providers often have access to specialist skills, expertise and cost efficiencies (e.g. higher levels of productivity, economies of scale).

Franchising represents a more significant level of private sector involvement. Under a franchising model, governments contract out the operation and maintenance of a public transport service for a set period but retain ownership of the assets and infrastructure (i.e. trains, track, stations, buses or ferries). Governments also generally retain significant control over fare levels (particularly setting maximum fares) and service levels (e.g. setting minimum requirements for timetables, routes and service standards).

The term 'privatisation' has a wide range of definitions. In this paper, full privatisation is defined as involving the outright sale of assets to the private sector. However, governments will typically still maintain significant control over fares, routes and timetables, although this can vary. In public transport, full privatisation is difficult as public transport provision usually requires ongoing subsidies and governments generally prefer to maintain long-term control of assets. This is particularly the case for rail, but can also be true for buses and ferries. An example of privatisation is the breakup and sale of the UK rail

Figure 2: Types of private sector involvement in public transport

Low — Levels of private sector involvement — High

	Outsourcing	Franchising	Full privatisation	Public private partnership
Description	• Suppliers contracted to provide an activity previously undertaken internally, e.g. cleaning	• Public sector contracts out operation of public transport service for a set period	• Outright sale of a service or asset to the private sector	• Design, build and operate contract
Asset Ownership	• Public sector retains ownership and control of assets	• Public sector retains ownership of public assets	• Private operator owns assets	• Typically transfers to government after initial term
Government Oversight	• Contract is directly with government operator	• High level of government oversight and management of performance through contract terms	• Generally some oversight of performance and fares. Uncommon in public transport to have only regulatory obligations	• Generally limited oversight (only regulatory obligations)
Risk Allocation	• Private sector bears cost risk on narrow activity only	• Many different models. Cost risk typically borne by operator; revenue risk typically lower when future revenues are more uncertain	• Many different models, although private sector typically takes on higher levels of revenue and cost risk for greater returns	• Private sector bears construction risk, operating cost and performance risk. May or may not take revenue risk
Examples	• Railcorp IT systems • Transperth rail maintenance	• Melbourne trams and trains • Perth buses	• UK rail systems (assets and operations separately privatised)	• Gold Coast Light Rail

Source: L.E.K. analysis

system in the 1990s. This resulted in the transfer of assets to the private sector, although ownership of the below-rail infrastructure has subsequently been returned to the public sector following major safety issues. The most common examples of full privatisation in public transport are systems that are confined to commercially viable parts of networks (e.g. commercial bus routes in the UK) or less complex modes with dedicated new infrastructure (e.g. light rail and monorail in Sydney).

Another model is a public private partnership (PPP), where a public sector authority and a private entity form a partnership to provide a public service or project. PPP projects generally involve two phases: a construction phase and an operational/maintenance phase, each being very different in character and requiring separate consideration when contracting. Contracts tend to be much more complicated, as they need to cover all possible outcomes and contingencies. As a result, in public transport, a PPP is difficult to implement and is often confined to discrete infrastructure such as a new light rail line (e.g. Gold Coast Light Rail or the North West Rail Link in Sydney).

The main focus of this paper is franchising, which is a widely used model around the world and is applicable for large scale existing public transport operations.

Within franchising, a range of contract models exist with different approaches to allocating risk between the government and the private operator (e.g. management, gross cost and net cost contracts). These are described in more detail in Section 5.

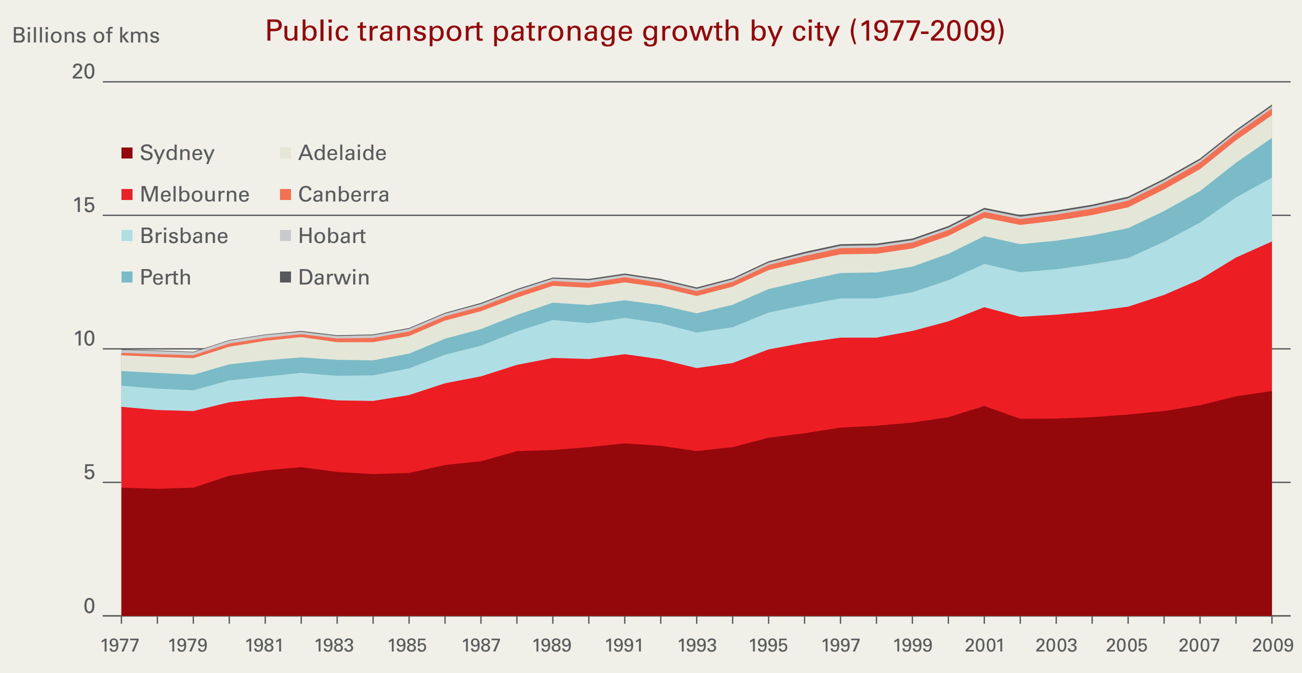
3.2 Public transport provision in Australia

Public transport use has experienced strong growth in Australia, particularly over the last decade. From 1977-2009, patronage grew by 92 per cent[2], compared to population growth of 49 per cent[3] (Figure 3). From 2004 to 2009, the year on year growth of passenger kilometres was 4.5 per cent per annum. Recent growth has been strongest in Melbourne, Brisbane and Perth, where it has exceeded 6 per cent per annum. This high growth rate has created a challenging environment for managing service levels and maintaining affordability for government.

Rail is the largest public transport mode in Australia with a 60 per cent[4] share of passenger kilometres, compared to buses at 33 per cent (Figure 4). Ferries and light rail have a much smaller national share, but remain important in the local areas that they serve. Rail is the dominant public transport mode in the larger cities of Sydney, Melbourne and Brisbane, although buses play an important role in providing services to lower density areas and connections to rail. Buses have the largest share in Perth and Adelaide which have smaller rail networks. Darwin, Canberra and Hobart are currently serviced by buses only, although some cities are considering the development of light rail lines.

In an environment of constrained budgets and rising expectations of service delivery, the benefits and challenges of franchising are being actively debated across all states.

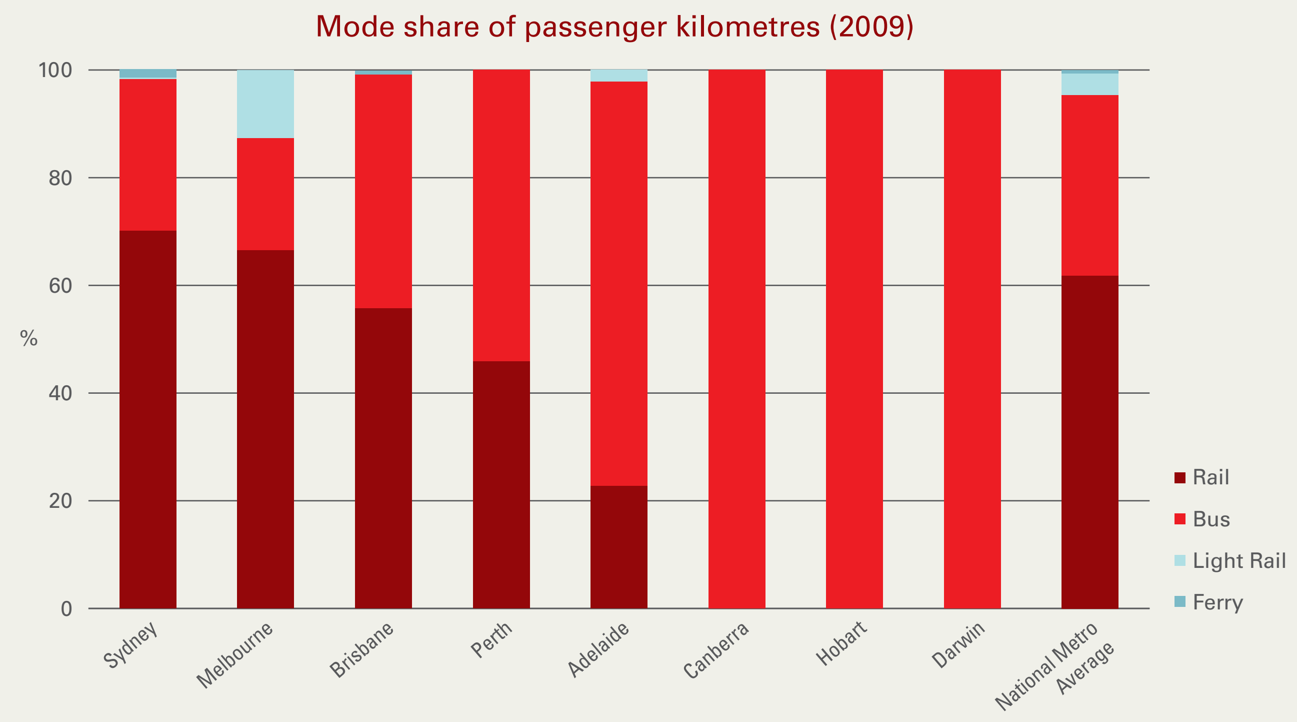
Figure 3: Public transport patronage growth by city (1977-2009)



Source: BITRE

[2] State and territory capitals only
[3] Australian transport statistics yearbook, Bureau of Infrastructure, Transport and Regional Economics, 2009; ABS, cat. no 3105.0.65.001
[4] State and territory capitals only

Figure 4: Mode share of passenger kilometres (2009)



Source: BITRE

While a considerable proportion of public transport delivery is undertaken by the private sector (particularly buses), most of Australia's services are still provided by government owned operators. Bus systems in almost all states are fully or partly privately run. Some cities (Adelaide, Perth) have completely franchised their bus services to the private sector, while others (Sydney, Brisbane, Canberra) retain large publicly owned bus operations. With the exception of Melbourne, all major metropolitan rail operations are publicly owned and operated (Figure 5).

Private train, tram and bus operators delivered 97 per cent of passenger boardings in Melbourne in 2010 (Figure 6: Passenger boardings by mode of transport and ownership in major cities (2010)). Private operators also account for the majority of passenger boardings in Perth and Adelaide via privately-run bus services. Private operators account for a much smaller share in Brisbane and Sydney where governments have retained ownership of their large publicly-run rail and bus services.

3.3 Public transport provision internationally

Australia is not alone in increasing the involvement of the private sector in delivering public transport. Governments around the world are increasingly franchising service provision with the aim of reinvigorating and improving service delivery and customer service, and reducing inefficiencies.

Across leading international cities there is a mix of public, private and mixed operating/ownership models (Figure 7). UK rail operations, for example, are largely privatised, while other cities such as New York retain greater reliance on the public sector.

Bus services internationally and in Australia are more frequently franchised than rail. In part, this is a consequence of franchising practicalities, and the fact that it is easier to create separate franchise areas for buses than it is for more integrated and interdependent rail systems.

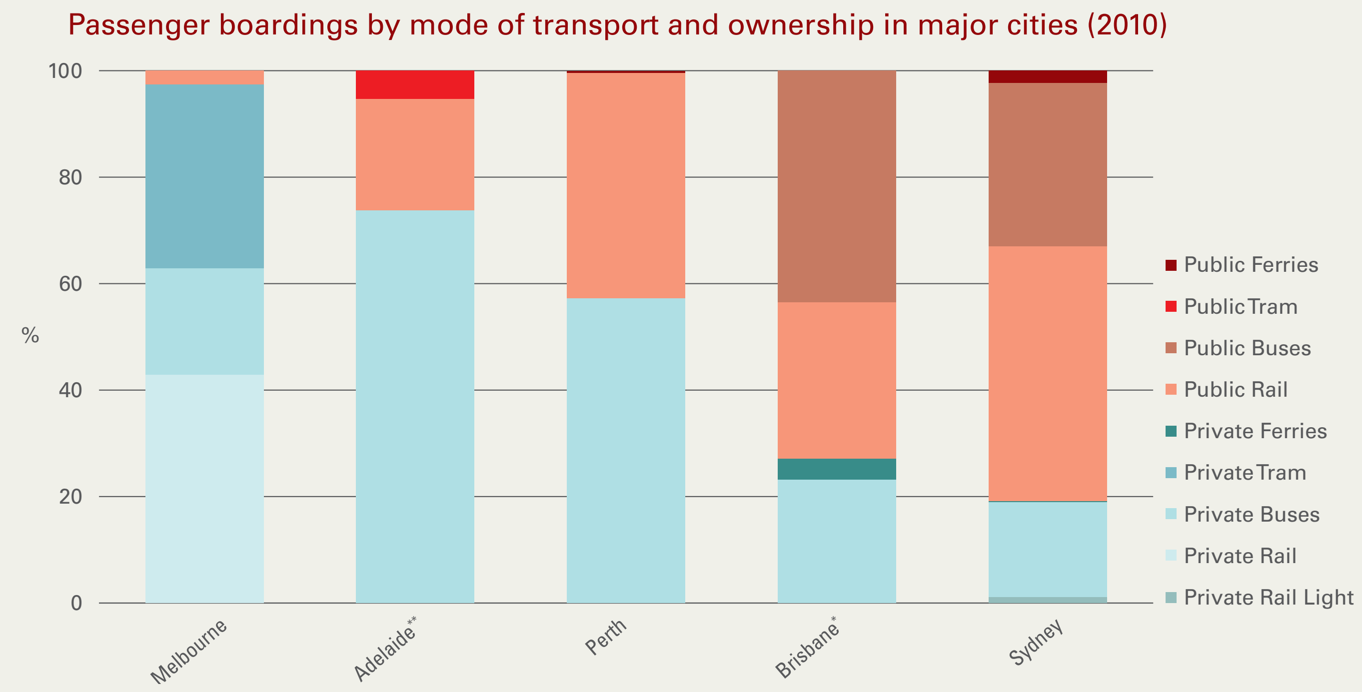
Franchising arrangements differ not only for the mode of transport, but also for technical, socio-political, and economic factors in cities where private sector involvement is considered. As such, benefits delivered to stakeholders will vary based on the model selected.

Figure 5: Australian public transport operators by State

Modes		New South Wales	Victoria	Queensland	South Australia	Western Australia
Government Body		Transport for NSW	Dept. of Transport	Dept. of Transport and Main Roads	Dept. of Planing, Transport & Infrastructure (DPTI)	Dept. of Transport
Rail	Public	CityRail CountryLink	V/Line (Regional)	QR Citytrain QR Citytrain (Regional)	Adelaide Metro	Transperth TransWA (Regional)
Rail	Private		Metro Trains Melbourne			
Bus	Public	Sydney Buses		Brisbane Transport		
Bus	Private	>25 operators including Busways, ComfortDelgro Cabcharge, Westbus	>25 bus operators including Dyson, Grenda, National Bus Company, Ventura Bus Lines	Logan City Bus Service Surfside Bus Lines Veolia Transdev	SouthLink Transfield (Light City Buses) Transit Systems Australia (Torrens Transit) Transitplus	PathTransit Transit Systems Austalia (Swan Transit) Veolia Transdev (Southern Coast Transit)
Light Rail	Public				Adelaide Metro	
Light Rail	Private	Veolia Transdev Sydney (Light Rail & Monorail)	Yarra Trams (KDR)	GoldLinQ (Gold Coast Light Rail)		
Ferry	Public	Stockton Ferry				
Ferry	Private	Sydney Ferries (Harbour City Ferries – Veolia Transdev and Transfield Services) Manly Fast Ferry / Sydney Fast Ferries 6 other small private operators in NSW		TransdevTSL (CityCat & City Ferry) Transit Systems Australia (Bay Islands Transit, Big Red Cat, Stradbroke Ferries) Gladstone Harbour Ferry		Captain Cook Cruises

Source: Operator and relevant government body websites

Figure 6: Passenger boardings by mode of transport and ownership in major cities (2010)



Note: *Brisbane Ferries owned by Brisbane City Council and operated by TransDevTSL, **Includes O-Bahn
Source: Company and government annual reports and websites

Figure 7: Comparison of international cities ownership / operative model

Cities	Scale of network*		Heavy Rail	Light Rail	Bus	Ferry
	Rail**	Bus				
London	2,400m	2,300m	Inter-city franchised to multiple private operators London Underground publicly operated	Docklands Light Rail – privately operated	Nearly fully operated by multiple private operators	Privately operated
Stockholm	400m	300m	Predominantly franchised to private operators Main Metro service operated by MTR Corporation	Three light rail lines and one inner city tram line all run by private operators	Operated by a number of private operators Private operators were first introduced in the 90s	A mixture of public and private operators Largest service is publicly operated inner city boat line
Hong Kong	1,300m	200m	Mass Transit Railway system operated by MTR Corporation Limited^	Large system operated by MTR Corporation Also several smaller privately owned and operated systems	Five major franchised bus companies No publicly operated bus services	Commuter services operated by multiple private companies
New York	1,600m	800m	Multiple commuter railway lines operated by the Metropolitan Transport Authority (MTA)	Limited commuter services available	Multiple bus lines operated by MTA Some small scale private sector participation e.g. Nassau Inter-County Express (NICE)	Limited commuter services available Majority are small scale private operators
Paris	1,500m	350m	Metro and RER system operated publicly	Four tram lines run by two public operators (RATP & SNCF)	Public entity RATP operates majority of buses in Paris and many lines in suburbs Other suburban lines operated by a private consortium	Limited commuter services available
Tokyo	N/A	N/A	Mix of 30 private and public operators	Small number of light rail lines operated by private companies	Mixture of public and private operators Buses generally serve a secondary role, feeding bus passengers to and from train stations	Limited commuter transport, although some private sector participation
Chicago	200m	300m	Managed publicly through subordinate agencies representing the Regional Transport Authority	Limited commuter services available	Managed publicly through a subordinate agent representing the Regional Transportation Authority	Limited commuter services available
Amsterdam	N/A	N/A	Amsterdam Metro operated by the municipal transport company (GVB) Intercity lines in Amsterdam regions operated by NS	Operated by municipal transport company (GVB)	Mixture of public and private operators	Operated by municipal transport company (GVB)
Madrid	1,000m	500m	Metro and suburban rail both operated publicly	New light rail system operated predominantly by private consortium with some public sector involvement	Urban routes managed publicly by the Municipal Transport Company and suburban routes by private franchisees	Limited commuter services available
Melbourne	230m (train) 175m (tram)	100m	The main Metro service is privately operated by Metro Trains Melbourne The small regional V-line is publicly operated	Yarra Trams privately operated by KDR	A number of private operators No publicly operated bus services	Limited commuter services available
Sydney	300m	260m	Main Metro service operated by CityRail	Small light rail network and a monorail operated by Veolia Transport Sydney	Mixture of public and private operators The largest operator is (public) Sydney Buses	Predominantly operated publicly by Sydney Ferries Two private firms compete on the Manly fast ferry route

Note: *Scale of network defined as passenger trips in 2010; **With the exception of Melbourne (where tram is split out for illustrative purposes) the rail total is the sum of heavy and light passenger trips; ^MTR Corporate is publicly listed on the Hong Kong stock exchange. However, the Hong Kong government is the majority stakeholder

Source: Company and government annual reports and websites

Photo courtesy of Public Transport Victoria.

4.0 THE POTENTIAL BENEFITS OF FRANCHISING

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Experience in Australia and internationally has shown that when carefully designed and managed, franchising public transport services can lead to significant benefits. While these benefits are not always dependent on franchising, it can be a valuable catalyst for bringing a clearer focus on performance using strong commercial incentives. The three main beneficiaries from franchising are:

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- **Governments and Taxpayers:** Reducing public subsidies enabling reinvestment in services as well as other non-financial benefits to government such as clarification of transport priorities and greater certainty over future transport budgets.
- **Employees:** Increasing employee job satisfaction and career development through opportunities available in the private sector.

Government plays an essential central role in setting the desired outcomes from franchising through the incentives it incorporates into the contract. These have an impact on the level of benefits that are delivered and the relative priorities between the beneficiaries.

In this section, we describe the key benefits of franchising and illustrate these by using best practice examples from Australia and overseas.

4.1 Benefits to customers

Customers want reliable services that get them to where they want to go, when they want to go. Ease of use and cost are also critically important factors. In a franchised system, some of these factors are within a franchisee's control, but many are not and remain controlled by government. Examples of aspects of the customer experience that are outside a franchisee's control include off-peak frequencies, dedicated lanes for transit (e.g. priority bus lanes), integrated ticketing between modes, network-wide real time information and quality of the rolling stock and vehicles.

For the aspects of the customer experience that an operator can control, private operators are typically better able to meet these customer needs via franchising because:

- The private sector is usually better at innovation.
- Well-designed incentives can give greater priority to customer outcomes.
- The private sector is more likely to create a 'customer first' culture.

4.1.1 Service innovation

A key rationale for involving the private sector in the provision of public services is to harness its expertise and innovation to improve the way services are provided and respond flexibly to user demands[5].

> "With franchising, Australia is no longer an island. International operators bring ideas from overseas that would simply not happen otherwise."

Private sector companies are frequently better placed to identify and introduce innovative customer service ideas given their ability to leverage significant, often global, experience from involvement with multiple public transport networks.

> "The new operators saw people as customers, much more so than the government operator."

Australia and international jurisdictions provide numerous examples of innovative customer service measures that have been introduced by the private sector. Some of these are discussed below. While innovation is not the exclusive domain of the private sector, experience shows that government run operators are slower at implementing innovations, often risk averse and more limited in the scope of the new ideas they are prepared to embrace.

> "It's not that innovation isn't possible in the public sector, it just hardly ever happens!"

Under the right contractual conditions, one of the great benefits from franchising is the focus that private operators bring to the question of what is best for the customer and what are new ways to meet these needs. In contrast, public sector operators can become process and system driven, with the needs of the customer becoming a lower order priority.

[5] Reforming Rail Franchising; UK DfT consultation paper 2010

Yarra Trams (Melbourne): Customer service innovation

Yarra Trams has introduced a number of innovative customer service initiatives since it started operating Melbourne's tram network in 1999. Transdev and now KDR Victoria (a partnership between Keolis and Downer EDI) have been able to leverage their global expertise to bring these innovations to Melbourne.

Photo courtesy of Public Transport Victoria

The Premium Line

The Premium Line concept is a key operational strategy of KDR Victoria, the current operator of Yarra Trams.

> "Hubert Guyot [Yarra's initial CEO] was able to mobilise stakeholders in a way that the government wasn't able to. He also brought a European vision for light rail that the public transport division couldn't have had by itself."

KDR's vision for the Premium Lines is to transform Melbourne's tram network into a modern light rail system that enhances the customer experience and delivers operational benefits. Expanding on a successful initiative called 'Superstops' originally introduced by Transdev (the previous operator of Yarra Trams), the Premium Line concept includes:

- 100 per cent low floor trams
- 100 per cent level access stops
- Priority at traffic signals
- Segregation from motor vehicles
- Termini with shunts for two trams
- Semi-resilient track
- Better connectivity with other modes
- Enhanced real-time information
- High frequency service

KDR has started the rollout of the Premium Line on Route 96. The Route 96 project involves a series of enhancements across the full 14 kilometres of the route linking East Brunswick with St Kilda Beach. Upgrades to accessibility, travel times, service levels, safety and reliability will coincide with an $809m program to introduce the new generation of low floor trams to Melbourne. This project has been supported by the Victorian government.

By concentrating investment on this Premium Line, Melburnians will see the benefits of light rail compared with the traditional tramway operation in mixed traffic. The Premium Line will improve the speed and reliability of the network by segregating trams from motor vehicles.

tramTRACKER

In response to growing use of text messaging and the desire for real-time information, Yarra Trams introduced tramTRACKER in 2006. tramTRACKER provides customers with access to real-time information on the next three trams arriving at a particular stop to augment scheduled timetables.

Originally available by phone call and SMS, tramTRACKER now includes a range of online and mobile channels, including a popular iPhone application released in June 2009.

This innovation brought real-time mobile information to Melbourne's tram users. Currently there are more than one million tramTRACKER data requests made per month. Applications on other platforms such as Android are in development. The tram service data is also utilised by Public Transport Victoria's (formerly Metlink) journey planner.

Yarra Trams Premium Line and tramTRACKER illustrate another benefit of franchising: the ability for government to access global management talent.

Image courtesy of Yarra Trams

Manly Fast Ferry (Sydney): Innovation and efficiency

The introduction of competition on the Manly fast ferry route in 2009 has proved to be a great win for customers. These services were put out to tender in 2008 after government-run JetCat services were withdrawn. Privately-owned Bass and Flinders began running the new service under the 'Manly Fast Ferry' brand. The fast ferry is a premium service that runs alongside the regular, publicly-operated service to Manly.

Photo courtesy of Bass & Flinders Cruises

Manly Fast Ferry quickly gained support from commuters, due to its innovative service changes, including:

- **Comfort and amenities:** drink and snack bars on board that serve coffee in the morning and alcoholic beverages in the evening.
- A unique **Smartcard ticketing system**.
- **Innovative fares:** discounted 'against the flow' tickets, providing cheaper tickets for customers travelling in the opposite direction to peak customer flows.
- **Customer information:** SMS service notification system to inform customers of ferry running times and provide alerts when ferries are running late.
- **Free Wi-Fi** on-board the ferries.

One of the results of this private sector involvement has been strong passenger growth, leading to overall growth in the market. Last year, the two private ferry services operating the Manly route carried 80 per cent more passengers than the Sydney Ferries JetCat in its last year of operation.

The two private fast ferry operators are also able to achieve superior cost efficiency in comparison to Sydney Ferries (Figure 8), enabling them to compete without government subsidies.

Figure 8: Sydney Ferries price comparison

Circular Quay-Manly	Ticket Price (Full fare adult)	Unsubsidised Price	Subsidy	Journey Duration
Sydney Ferries	$6.60	$13.97*	$7.37	30 minutes
Manly Fast Ferry	$8.50	$8.50	–	17 minutes
Sydney Fast Ferries	$9.00	$9.00	–	18 minutes

Note: Prices as at Aug 2011. *Based on 2004-2010 data illustrating that on average a full fare adult ticket contributed 47 per cent of total expense. This understates higher welfare subsidies that exist for some concession holders (e.g. students, pensioners, low-income groups). Manly Fast Ferry and Sydney Fast Ferries offer fewer off-peak services so they do not represent a strictly like for like comparison with the Sydney Ferries unsubsidised price.

Source: Centre for Independent Studies Issue Analysis: Free Trade Ferries: a case for competition

TRANSIT SYSTEMS: Innovative service improvements

By bringing expertise in the area of route planning and system optimisation, Transit Systems was able to rapidly improve service levels and better match services to customer demand. This has resulted in significant increases in patronage in the Marmion Bus Contract area in Perth's northern coastal suburbs.

Transit Systems started operating the Marmion Bus Contract in Perth in 2011 after winning the nine year contract in a competitive retendering process. The contract operates 5.3 million service kilometres using 124 buses and represents one of the first two contracts to change operators in Perth since services were first franchised in 1996.

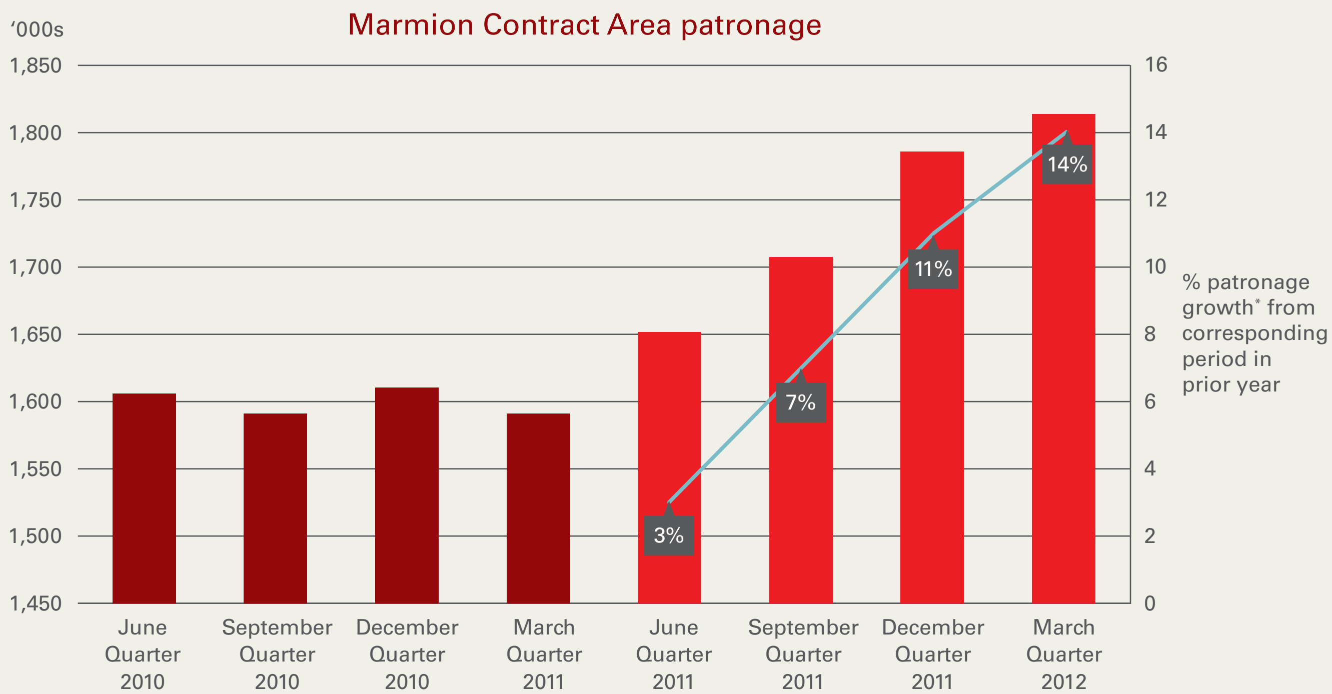
After a smooth transition, Transit Systems conducted a review in order to identify opportunities to provide better, more efficient services to customers. Utilising its expertise and innovations in route planning and service frequency optimisation, Transit Systems (in close cooperation with the Public Transport Authority of WA) implemented new timetables and revised route patterns across the contract area between July and December 2011. These revisions focused on:

- Simplifying the route patterns
- Matching timetables to improve frequencies and deliver achievable running times; and
- Ensuring convenient connections with trains at the four railway stations the contract area serviced

These changes contributed to service improvements for passengers, reflected in strong passenger growth of 14 per cent in Q1 2012 over the prior year period, as demonstrated in the figure below.

Photo courtesy of Transit Systems Australia

Figure 9: Marmion contract area patronage



Note: *Per cent growth is measured from the corresponding quarter in the previous year
Source: Transit Systems

Private sector participation does not in itself guarantee innovation. Operators at risk of not having a contract renewed are typically much more motivated to deliver innovations that benefit customers. The public sector is also capable of generating new ideas and innovations. For example Sydney Buses introduced cashless 'prepaid only' buses in 2006, reducing embarkation times and allowing the operator to run more trips and carry more passengers in a given time period. Cashless buses have subsequently been expanded to more than 45 routes in Sydney, providing the foundation for an eventual cashless bus network (i.e. as part of a smartcard system) and associated reductions in financial administration costs.

However, in the public sector, implementation is often a major hurdle. This can be due to lack of direct incentives for change (which can be built in to private sector contracts), workforce resistance and a culture more inclined to risk aversion.

4.1.2 Incentives to focus on customer service

Focus on customer service can be strengthened when operators have direct financial incentives to maintain (or improve) customer satisfaction. Performance incentive and penalty regimes enable a transport authority to direct an operator's focus towards key service attributes, ensuring that both parties' priorities are aligned.

Performance regimes reward or penalise operators on their performance relative to targets over and above any other revenue incentives. In other words, while net/gross-cost contract structuring may provide commercial incentives for performance (see Section 5), the operator can also be financially rewarded or penalised depending on whether agreed performance targets are met. Performance regimes are typically applied to service attributes such as on-time running (punctuality), cancellations, ticket machine availability or outcome measures like customer satisfaction.

While measuring the standalone effectiveness of performance incentive regimes is difficult (as they are frequently introduced at the same time as broader structural and contractual changes), there are nevertheless a number of examples where they have been used to good effect.

Performance regimes can also be applied to public operators. However, less effective rewards and penalties can be applied in such circumstances. Inherently there is a conflict in having a single entity act as funder, owner, operator and safety regulator – a system which does not create the same tensions and motivations to deliver on performance contracts.

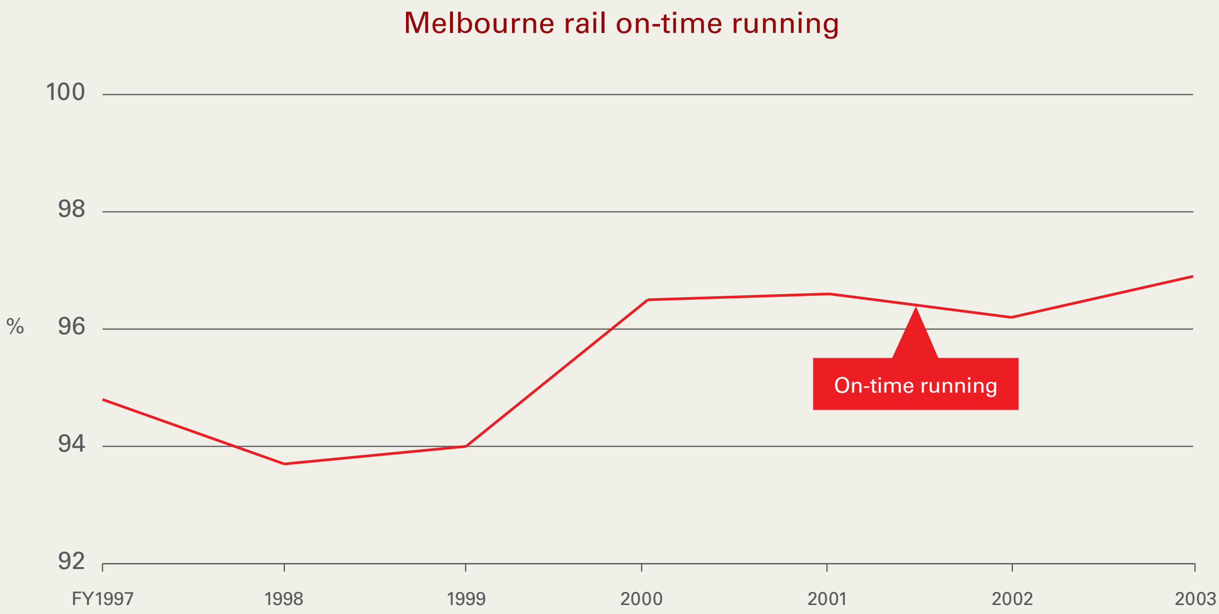
As with many other aspects of franchising, careful scheme design is critical, and this is discussed further in Section 5.

Image courtesy of Public Transport Victoria

Melbourne: Rail franchise incentive regimes

In Melbourne, the introduction of a performance incentive regime has been identified as one of the main early successes of passenger rail franchising. By linking financial rewards to the punctuality and reliability of trains and trams, the franchisees were incentivised to reduce delays and cancellations by an average of 35 per cent over the four years of the original franchise arrangements (Figure 10).

Figure 10: Punctuality improvement in Melbourne post-franchising



Source: Department of Transport Annual Reports FY1997-FY03

Subsequent rounds of franchising have seen this incentive regime evolve further. The current Metro Trains Melbourne contract includes:

- Bonus and penalty payments linked to highly granular, passenger-weighted measures of punctuality and reliability.
- Incentive payments linked to customer satisfaction scores via regular surveys and audits of assets (e.g. cleanliness, general condition).
- The ability for the transport authority to withhold specified operator payments if identified customer-focussed initiatives (e.g. station upgrades, employee training) are not delivered.
- Diminished operator re-negotiation rights if certain Flexible Performance Benchmarks, set annually, are not met over the duration of the contract (e.g. incident response times, fare evasion levels).

The Customer Experience Performance Regime (CEPR) is a monitoring and incentive/penalty regime that was introduced in 2009. It covers critical aspects of the customer experience including removal of graffiti, repair of damage and vandalism, maintaining cleanliness and the provision of clear and relevant information. Performance is assessed based on an audit of rolling stock and infrastructure assets along with customer surveys. Government and operators agree that the CEPR has succeeded at holding the private sector accountable for providing a high quality customer experience through greater transparency and accountability for performance.

"If it is publicly operated, then the incentive by government will be to make excuses for poor performance."

Docklands Light Railway (UK): Performance regime

The use of performance incentive regimes is also common in UK rail franchises with targets for punctuality, cancellations, available capacity and passenger satisfaction. A good example is the performance regime included in the contract for the privately operated Docklands Light Railway, one of the UK's best performing railways.

This regime includes financial penalties and rewards for reliability, journey times, availability of certain equipment (e.g. ticket vending machines, escalators, information displays, elevators) and customer satisfaction pertaining to cleanliness, safety, information and staff. Serco, the operator, has consistently met or exceeded the vast majority of these targets since its appointment in 1997[6].

[6] Transport for London website: www.tfl.gov.uk/corporate/modesoftransport/dlr/1536.aspx

4.1.3 'Customer first' culture in the workplace

Private operators are more likely to have the experience, motivation and flexibility to embed a 'customer first' culture within their workforce, particularly when they are accountable for customer satisfaction or have financial incentives for growing patronage. With the right leadership, this is one of the areas where private operators can have the greatest positive impact for customers. This cultural change is achieved by encouraging middle management and front line staff to identify issues and develop solutions, and then empowering them to implement these solutions.

Many companies going through the transition to a more customer-focused culture have invested heavily in customer training programs resulting in improved customer satisfaction.

Veolia Transdev (Australasia): Customer service focus

Veolia Transdev operates: buses in Sydney, Brisbane, Perth and the south west region of Western Australia; ferries in Brisbane; the light rail and monorail systems in Sydney; and the heavy rail system in Auckland. The company began an initiative to change its workforce culture in 2011 through a change in approach from being a transport operator to a customer focused organisation with a service delivery-orientated structure.

The cultural change begins with recruitment. New staff are now selected based on attitude rather than skill, acknowledging that while you can improve someone's skills through training it's much harder to change their attitude. Change also includes a number of training programs that have been introduced including a 'Going for Green Customer Service Program' and the nationally accredited Certificate III in Transport and Distribution. In addition, a number of software programs are also being used globally to provide training in global best practice and leverage international expertise. The goal of the training is to ensure employees are equipped with the skills required to deliver a high level of customer service.

Another initiative first developed in Melbourne and now implemented around the world is 'Meet the Managers', where senior management teams spend three or four days a year interacting face to face with passengers. This gives senior management a more complete picture of customer satisfaction, complaints and areas where customers wish to see improvement. This first-hand feedback enables senior management to make decisions that will have a meaningful impact on the customer experience and ensure front-line employee incentives are aligned with strong service delivery outcomes.

Image courtesy of Veolia Transdev

Merseyrail (UK): ‘Fast Lane’ initiative

In the UK, the independent public body, Passenger Focus, conducts bi-annual National Passenger Surveys (NPS) of national public transport services. A 2009 survey revealed that scores relating to on-board service remained low, despite Merseyrail having been consistently rated as one of the highest scoring train operators in the NPS.

The survey identified negative perceptions in relation to the helpfulness and friendliness of staff on trains and stations, as well as their availability. Guards were not seen walking through the train regularly enough to provide a visible presence and were viewed as giving insufficient priority to passenger assistance.

To address the situation, Merseyrail management decided to work with guards to devise a customer service improvement plan called ‘Fast Lane’ – the intention being to instil a sense of customer service ownership by giving guards a lead role in the development of the project. Guards took part in extensive customer service training sessions that emphasised:

- Minimum standards of behaviour, including calling mobile cleaning teams if trains became heavily littered.
- Reminders for staff to greet customers.
- Route points where announcements should be made.
- Clearly indicating where ticket checks should begin.
- Greater emphasis placed on maintaining a smart appearance and using open body language.

Following implementation of the program, subsequent surveys found that helpfulness and attitude ratings of staff increased substantially from 49 to 67 per cent. Over the same period, satisfaction with staff availability on trains increased from 33 to 48 per cent.

4.2 Benefits to governments and taxpayers

In Australia, public transport operating costs amount to over $5bn per annum and, on average, fare revenues typically cover only 36 per cent of these costs (although this varies widely by city and mode) with government subsidies covering the remainder (Figure 11). Capital costs are also funded by governments, which have ranged from $1 to 3bn per annum over the last ten years. This makes transport a significant budget item for state treasuries. As demand grows and new infrastructure is required, significant financial pressure is placed on government.

There are measurable financial benefits to taxpayers and government from franchising public transport services in the form of reduced government subsidies. This reduction is primarily a result of faster revenue growth and lower operating costs (i.e. the private operator can provide the services more efficiently than government), even after factoring in a profit margin for the private operator. These savings can then be either passed on to taxpayers or reinvested by government to improve services.

Two key areas of benefit are discussed here:

- Financial benefits to governments and taxpayers: Benefits associated with the competitive introduction of private sector participants. The magnitude of savings on transition and the sources of efficiencies are discussed below.
- Other benefits to government: There are other, substantial non-financial benefits to government such as clarification of transport priorities and greater certainty over future budgets.

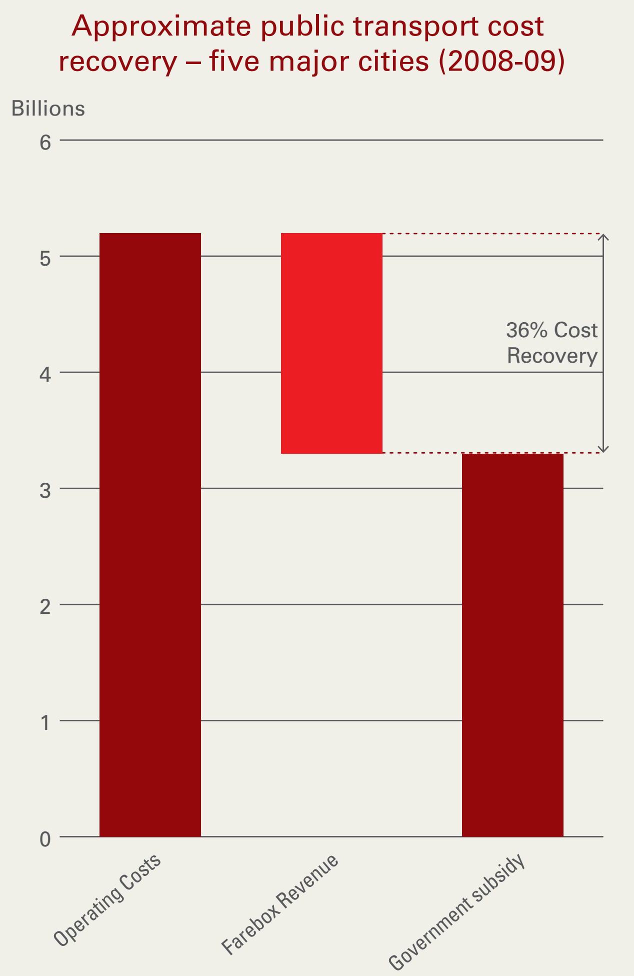
4.2.1 Financial benefits to governments and taxpayers

Savings on transition

Past experience has demonstrated that when a service is franchised for the first time, there can be a step-change in operating costs leading to significant upfront cost savings that are generally not repeated during subsequent rounds of franchising. The main factors driving this step-change are competitive tendering and operator efficiency. It is also worth noting that initial franchising is often preceded by broader reforms that can have a significant impact on operating costs (see Section 5).

It should be recognised that initial savings from franchising may be lower in systems that have already outsourced major activities. For example in rail, Transperth's strategy has been to retain train control and drivers in-house, but outsource many other major functions, including above-rail and below-rail maintenance as well as some security staff. They have developed in-house skills in structuring, procuring and managing these major outsourcing contracts and they have delivered value for money. In this context, the incremental benefit from franchising may not be substantial.

Figure 11: Approximate public transport cost recovery gap for five major cities (2008-09)

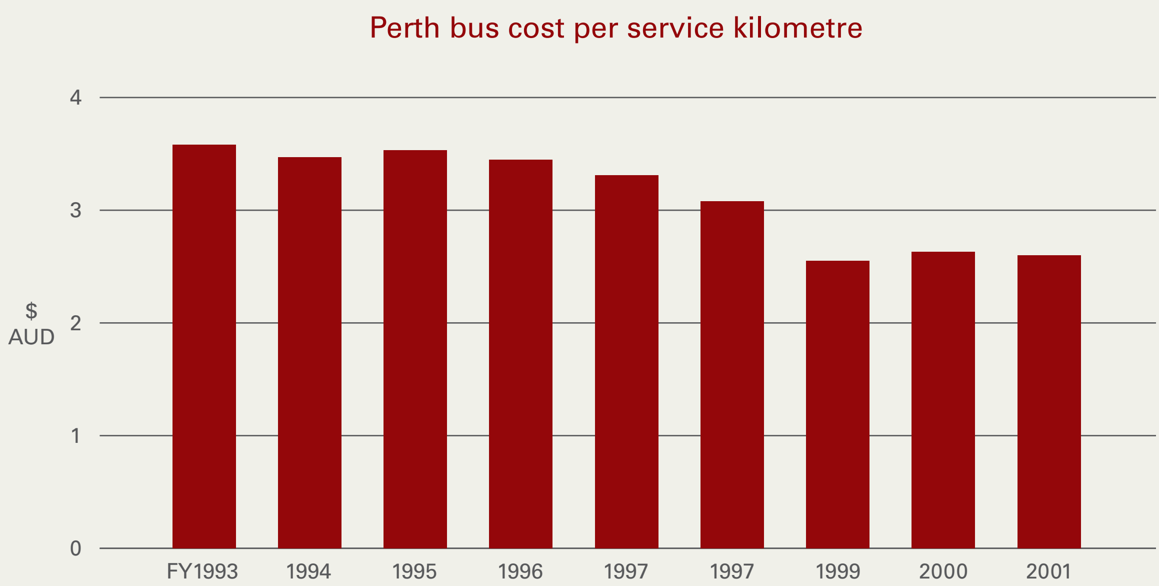


Source: L.E.K. analysis

Transperth (Perth): Franchising the bus system

Following a 1993 review that identified major inefficiencies in the monopoly public bus authority, the Perth bus system was put out to competitive tender in two stages. Approximately half of the system was franchised in 1996, and the remainder in 1998[7].

Figure 12: Decline in government subsidy per service km following privatisation of Perth buses



Note: Figures for FY2000 and FY2001 are estimated

Source: Bus reform: further down the road; a follow on examination into competition reform of Transperth bus services, Auditor General of Western Australia, 2000

[7] Bus Reform: Further down the road, Auditor General 2000

The aim of the reforms was to reverse long-term trends of increasing costs and decreasing patronage. The franchising model adopted saw the ownership of buses and infrastructure remain with the state (along with route, fare and service controls), while private companies were responsible for the operation of services.

This franchising program delivered substantial cost reductions while total service kilometres increased. One of the key gains was an improvement in staff productivity. The level of government subsidy per service kilometre reduced by 29 per cent, from $3.58/km in 1992-93 to $2.55/km by 98/99 (Figure 12) demonstrating the significant saving franchising was able to achieve.

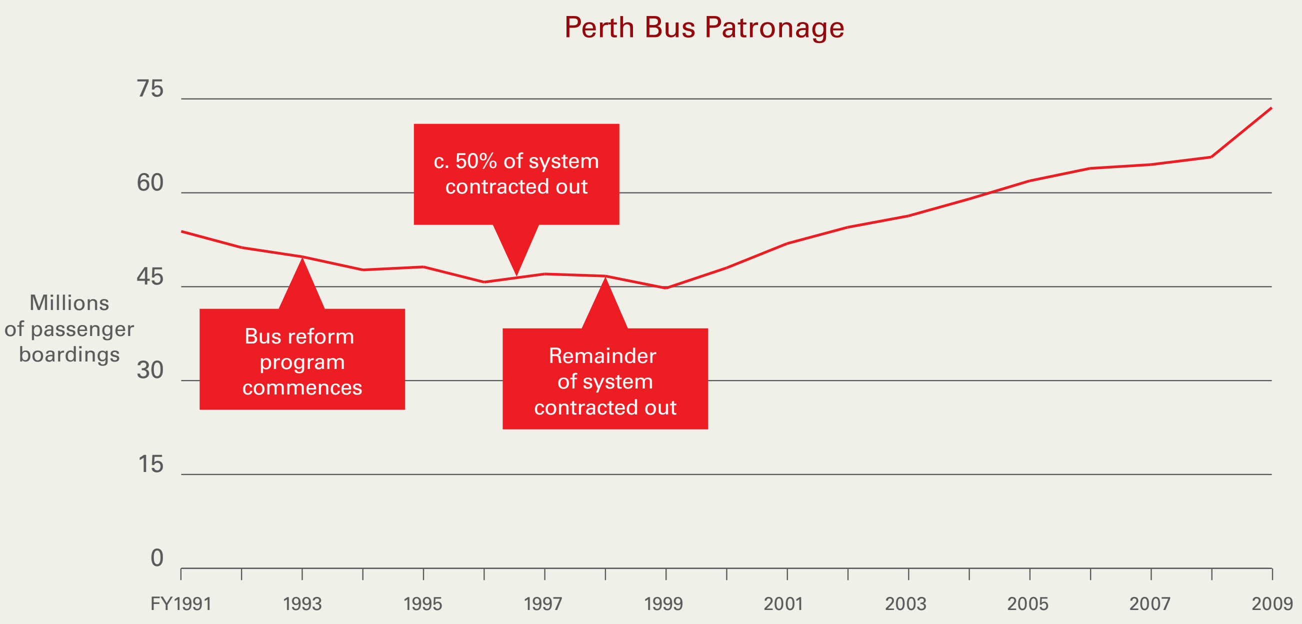
Strong patronage growth and continued operational efficiencies over the last ten years have been driven in large part by a range of initiatives led by the private sector. These include:

- Innovations in route planning and optimising frequency: This involved cutting some routes, introducing new routes and changing frequencies. This has resulted in improved asset utilisation and closer alignment of services to customer needs.
- New depot management strategy: This involved the strategic placement of smaller depots closer to areas of operation. This has reduced dead running time and has also resulted in a more empowered and dynamic culture within each depot.

Competition between operators has given the industry a renewed focus on high customer service levels.

The Transperth model has remained largely unchanged in the last 15 years and is widely regarded as a success in franchising.

Figure 13: Perth bus patronage (FY1991-09)



Source: WA Public Transport Authority Transperth Annual Report 2008/09

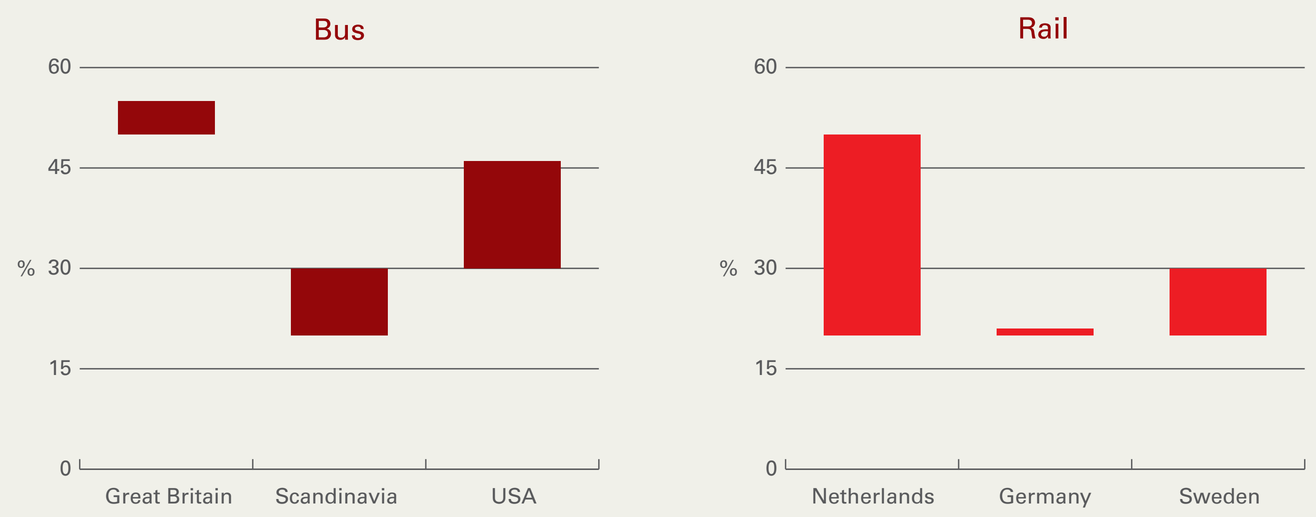
International Examples: Savings achieved through competitive tendering

There are numerous examples worldwide of the upfront cost and efficiency savings achievable through competitive tendering. As noted by Hensher et al., after contracts were put to tender in 1995, bus services in Britain experienced unit cost reductions of 50-55 per cent as patronage and farebox recovery increased. Elsewhere in Europe, Swedish buses and trains were able to reduce costs by up to 33 per cent while passenger trains in the Netherlands benefited from efficiency increases of 20-50 per cent. The United States bus industry was also able to realise substantial cost savings of between 30-46 per cent.[8,9]

Figure 14 summarises the range of savings realised by various bus and rail industries internationally. Efficient operation is particularly important in a public transport context as a 1 per cent reduction in operating costs has approximately 3 times the impact on an operator's cost position as a 1 per cent increase in farebox revenues (see Section 4.2).

On the basis of both Australian and international experience there is very strong evidence that transitioning from government run to privately run services has the potential to deliver significant cost reductions for government.

Figure 14: Unit cost reduction range (%)



Source: D.A. Hensher. I.P. Wallis, Competitive Tendering as a Contracting Mechanism for Subsidising Transport – The Bus Experience, Journal of Transport Economics and Policy, 2005; UK DfT Rail Value for Money Study (2010)

[8] Cited in UK DFT Rail Value for Money Study 2010 p34, citing EU Conference of Ministers of Transport: Competitive Tendering of Rail services 2007
[9] A Hensher, I Wallis, Competitive Tendering as a Contracting Mechanism for Subsidising Transport: The Bus Experience, Journal of Transport Economics and Policy 2005

4.3 Sources of efficiencies

Key sources of efficiency typically include:

- Improved staff productivity;
- Better asset utilisation; and
- Efficient procurement of services.

Improved staff productivity: Labour costs typically represent 60 to 80 per cent of total operating costs for a rail operator and 40 to 60 per cent for a bus operator[10] . The private sector may be more inclined (and able) to use performance incentives (for example, bonuses) to drive increased workforce productivity. Commercial imperatives also mean that private operators bring a more disciplined approach to managing contracts, wages and growth in staff numbers.

> "Connex was able to increase the available fleet by 15 trains, which was equivalent to $300m of extra trains. They did this by increasing maintenance workshop utilisation and efficiency, and putting in strict controls around the trains released for projects, among other initiatives."

Better asset utilisation: Asset utilisation is also a major driver of operating efficiency. Asset management and maintenance and related costs such as depreciation represent over 50 to 60 per cent of the cost base[11]. The private sector therefore has a strong incentive to ensure efficient asset utilisation by leveraging experience and innovative solutions. Some of the levers that operators can use to increase asset utilisation include:

- Re-scheduling maintenance activities to free up vehicles at critical times.
- Optimising vehicle and carriage configurations to improve the productivity of existing routes in line with passenger volumes.
- Re-defining the types of incidents that can remove a vehicle from service.
- Optimising routes within and across modes to increase public transport relevance to a greater number of patrons.

For example, Connex was able to deliver a significant increase in asset utilisation in Melbourne in 2007 freeing up rolling stock to help accommodate rapidly growing patronage.

Efficient procurement of services: Finally, the private sector has advantages over the public sector when it comes to the procurement of parts and services, including greater functional procurement and contracting experience and expertise, as well as lower bureaucratic and political constraints.

> "Cost savings can be in the order of 20-30 per cent compared to government-run operations, in part because suppliers build in a margin just to deal with the bureaucratic government procurement process."

Many of Australia's publicly-owned transport operators offer significant scope for improved efficiencies that could be reinvested in transport services. RailCorp, Sydney Buses, Sydney Ferries, Queensland Rail and Brisbane Transport all appear to demonstrate inefficiencies typical of government-run services.

[10] Meeting the Funding Challenges of Public Transport, Tourism & Transport Forum Australia 2010
[11] Tourism & Transport Forum (2010) ibid.

CityRail (Sydney): Efficiency review

A 2008 cost review of Sydney's CityRail for IPART describes examples of the types of inefficiencies that frequently exist within a public operator – particularly in the area of staff productivity.

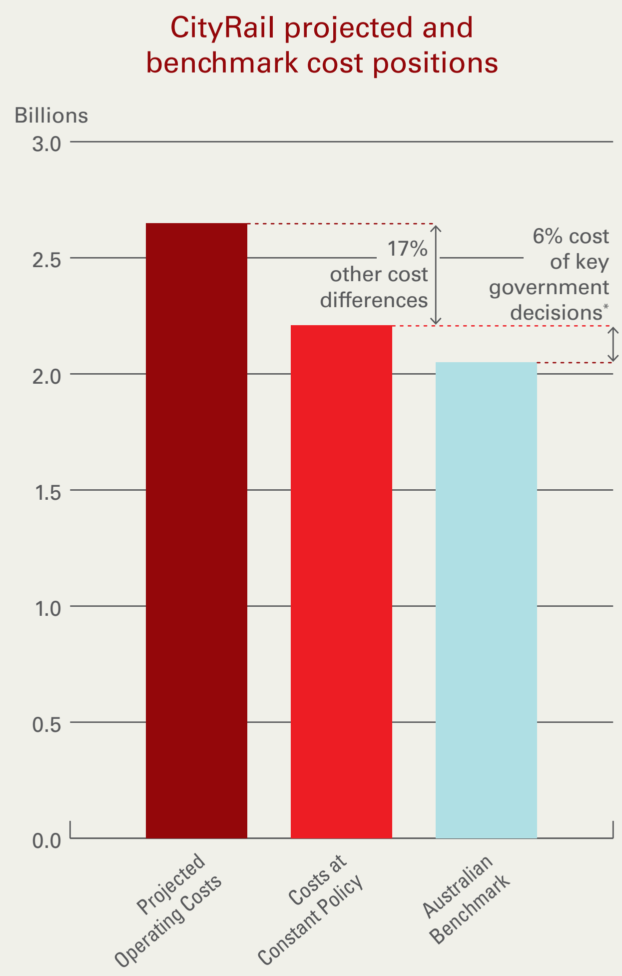
The review outlined mounting operating costs and identified inefficiencies in a number of areas including rolling stock maintenance, overheads and crewing and station costs. The review found that even after allowing for differences in government decisions (e.g. the presence of guards and staffing of very low patronage stations), total cost savings of $450m or 17 per cent could be achieved (or $330m within 5 years)[12].

Specifically, it was identified that material savings could be achieved in the area of crewing costs as CityRail's drivers were spending only 35 per cent of their on-shift time driving scheduled services, with footplate time lagging behind comparable operators by more than 60 per cent.

CityRail's station costs per passenger were found to be more than twice as high as those of comparable operators, with CityRail having a much lower ratio of station staff to station management. In particular, the comparable private Melbourne operator was able to operate a much higher proportion of unmanned stations despite similar passenger densities to CityRail.

CityRail was also found to have particularly high levels of head office and corporate staff, with head office costs per service kilometre more than twice those of local comparators.

Figure 15: CityRail projected and benchmark cost positions (2011/12F)



Note: *Includes station staffing and guards, infrastructure maintenance and rolling stock maintenance.

Source: L.E.K. Analysis

[12] IPART Cost Review of CityRail's Regular Passenger Services 2008

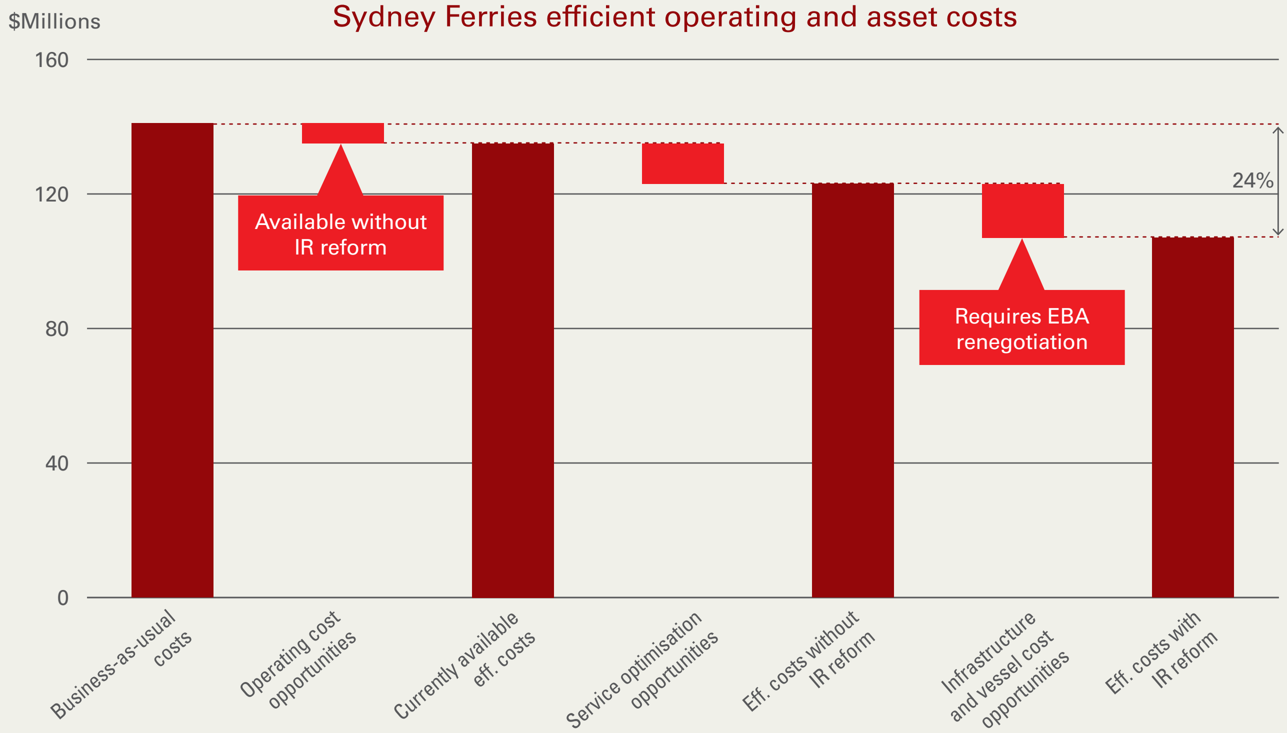
Sydney Ferries: Efficiency review

A recent benchmarking review for IPART found that if Sydney Ferries were to be operated as efficiently as other ferry operators, by 2015/16 cash costs could be reduced by 24 per cent from a 'business as usual' forecast of $141 million to $107 million[13] (Figure 16).

Key findings included that:

- Vessel and wharf operating costs could be reduced by around $6 million through improvements in labour productivity without requiring IR reform.
- Off-peak service reductions or shortening of routes for Parramatta River services, coupled with upgrades to vessels (to reduce maintenance and fuel costs) could deliver an additional $13 million in cost reductions.
- Industrial relations reform, bringing vessel, wharf and shipyard labour productivity in line with benchmarks could achieve a further cost reduction of around $15 million (Figure 16).

Figure 16: Sydney Ferries cost efficiency opportunities



Source: Independent Pricing and Regulatory Tribunal (IPART) Sydney Fast Ferries Cost Review 2012

[13] Or from $125 million to $95 million excluding assumed inflation of 2.5% per annum

Sydney Buses: Labour efficiency

In Sydney, private bus operators are able to operate at 20 – 30 per cent lower labour costs than public operators[14].

A total cost review of regular bus services conducted by IPART[15] found that there were inefficiencies at Sydney Buses relating to:

- Driver working conditions, such as general leave provisions and non-leave driver utilisation (award conditions and associated costs, including payroll leave provisions and work practices such as sign-on/off, Work As Directed (WAD) and others such as meal breaks).
- Working conditions of administration staff and mechanics.
- Onerous governance and procurement practices (e.g. writing ministerial briefings, preparation of papers for the Director-General, Minister, Cabinet and participation in inter-agency activities, internal and external audits, and significant accountability provisions as a state government agency).
- Other head office administration was also identified as a substantial source of inefficiency.

"In 2005, STA had 430 people in head office for 1,000 buses, compared to a private operator that had 25 people in head office for 3,000 buses. By 2007, the STA had reduced to 270 staff members, but there is still scope for further efficiencies."

Image courtesy of City of Sydney

4.3.1 Other benefits to government

Governments also benefit from franchising in a number of non-financial ways:

- **Clarification of transport priorities:** Franchising places a higher obligation on governments to have a well-articulated transport strategy which provides clarity for prioritisation and decision-making.
- **Greater certainty over long-term transport budgets:** Because the franchise bidder builds their case around certain funding projections and commitments, this makes it contractually difficult for governments to revert from planned investments over the period of the contract.
- **Greater accountability:** Franchising enables the government to hold the operator to account more effectively than if the operator is part of the public system.
- **More focus on outcomes:** Government is better able to focus on ensuring the right outcomes from the public transport system without having to micro-manage operations.
- **Ability to access industry leading expertise:** The private sector can leverage significant, often global, expertise that is much harder for governments to access due to more restrictive hiring practices (for example, salary levels). This can result in a number of benefits, including the introduction of customer service innovations and access to global management talent.
- **Clarity of the role of government:** Franchising removes a potential conflict of government acting as both the regulator and operator of the service.

4.4 Benefits to employees

Successful private operators have the confidence, experience and flexibility to positively transform the culture of an organisation, resulting in a more customer focused, dynamic and empowered workforce. While franchising may involve initial pain from workforce reductions to realise efficiencies, the end result is often a more focused organisation that has clear benefits to employees, including:

[14] Independent Public Inquiry – Long Term Transport Plan for Sydney, Christie et al 2010
[15] IPART – Indec – Total cost review of regular bus services operated in Sydney's four largest regions 2009

- **Greater autonomy and roles in decision-making:** The private sector is better at empowering its staff and understanding the benefits that this can bring to an organisation. Several examples include:
  - Front-line staff are closest to the customer and empowering them to identify and implement solutions can have a positive impact for employees as well as customers.
  - Middle management is crucial in setting a positive, performance-based culture. In public hands, they are often not empowered to make real decisions. In the private sector, they are typically given greater responsibility and autonomy for decision-making.
- **Opportunities for advancement:** The private sector has more flexibility to move and promote people based on achievement. Global firms can provide employees with opportunities overseas or in different divisions of their companies. In a culture that rewards success, high-performing individuals rise to the top.
- **Rewards and incentives:** The private sector has more flexibility to reward individual achievement. It is more difficult for government operators, for example, to award adhoc bonuses to individuals for exceptional performance due to pay grade restrictions.
- **Training opportunities:** A skilled workforce is the foundation for a more efficient and effective organisation. There is a greater focus in the private sector to provide focused training opportunities to ensure people have the skills necessary to succeed in a performance-based culture.
- **Company pride and job satisfaction:** Employees are proud to work for organisations that make a difference, and job satisfaction is higher when employees know that customers are happier. How this applies generally to different types of organisations is a matter of subjectivity; for example, it is difficult to 'prove' that the private sector generally has higher job satisfaction and there are some who will take a contrary view. However, franchisees are structurally set up to have greater incentives to improve performance and focus on customer satisfaction, which may lead to a more satisfied and encouraged workforce.

By contrast, the public sector generally displays more risk-averse behaviour and does not necessarily have the same incentives to drive change. Where this is the case, it may not be beneficial to show initiative as an employee. The attitude in some public operators is "you'll never lose your job if you are over-budget but you will lose your job if you stuff up and it ends up in the paper". There may be a general lack of performance culture and employees do not face the same 'at risk' drivers of performance as exist in the private sector.

There can also be positive outcomes from franchising for unions. It can be more straightforward and quicker to negotiate with the private sector than with government.

"The unions found that there were advantages to having government out of the way. Before, decisions took a long time because they got caught up in whole-of-government wage negotiations. Now, they pick up the phone to the CEO and get agreement.

Yarra Trams (Melbourne): 'Zero Harm'

Since taking on the Yarra Trams franchise, KDR has introduced a 'Zero Harm' safety drive across the organisation. This includes improved incident reporting and evaluation, as well as an expanded system of proactive maintenance to detect and rectify potential areas of concern before they impact safety and operations. By focussing on how to avoid incidents happening again in the future, as opposed to simply allocating blame, the intention is to engage employees more fully in delivering safety objectives and developing a safety culture.

Northern Rail (UK): ‘Northern Stars’ initiative

Northern was formed in December 2004 when Serco and Abellio won the franchise contract to operate train services in the north of England. These services had historically experienced low levels of customer satisfaction largely due to stagnation and low infrastructure investment.

Since 2004, operators have invested over £30 million in rolling stock, stations and customer service initiatives. One such initiative is ‘Northern Stars’, which aims to promote quality customer service. Staff are nominated as a ‘Northern Star’ by customers, with successful nominees recognised at an annual awards event, incentivising high levels of customer service.

As a result of Northern Rail’s efforts, service patronage increased 38 per cent from 64 million passenger trips in 2004, to 88 million in 2011. During that time, on-time running increased significantly from 84 to 90.7 per cent. Northern Rail was also awarded UK Train Operator of the Year 2010 and UK Transport Operator of the Year (Rail) in 2011.

Image courtesy of Yarra Trams

5.0 REQUIREMENTS FOR SUCCESSFUL IMPLEMENTATION

5.0 REQUIREMENTS FOR SUCCESSFUL IMPLEMENTATION

While the potential benefits of franchising are well established, experience from Australia and internationally is that a number of important settings and pre-conditions must be in place to realise these benefits. Many cities that have moved to franchising have stumbled in the first or second round, before settling on a successful model. A poorly executed franchising process can result in unnecessary cost and disruption. However, there is now sufficient experience from around the world for governments to be able to minimise the risk of these problems.

This section summarises some of the key lessons learned from franchising around the world over the last 20 years to distil the key requirements for success.

Successful implementation of franchising arrangements is contingent on:

1. **Having a clear strategy for transport delivery and the political will to follow through:** Realising the full benefits from franchising requires government to have a clear vision and strategy for public transport delivery and strong political will to make hard decisions and changes that may be seen as risky or unpopular. This commitment must be sustained over time.
2. **Having realistic expectations:** Governments need to have the right expectation for what can and cannot be achieved through franchising.
3. **Being well prepared:** Governments need sufficient preparation to run a smooth and informed tender process. The operating entity needs to be well prepared for franchising, consistent with the franchise model being adopted. In the case of major transport systems, this may require several years of preparatory work and reform.
4. **Choosing the most appropriate franchise structure:** Selecting a model that provides for a commercial motivation to meet customer needs and government objectives, and an optimal long-term industry structure.
5. **Creating contestability:** Ensuring that there is genuine contestability for the first and subsequent contracts. Contestability provides a strong incentive for operators to innovate and outperform. Without periodic competition for the franchise, the benefits are likely to be considerably reduced.
6. **Getting the contract right:** Setting up contracts from the outset that are robust, appropriately allocate risk and align incentives between operator and government.
7. **Balancing financial and other objectives:** Making sure financial considerations alone do not dominate franchise bid evaluation. This can lead to financially unsustainable franchises or failure to deliver benefits due to "buying cheap".
8. **Having the right people and skills to manage the relationship effectively:** The most effective and mutually beneficial relationships between government and operator are often based on a relationship-style approach to contract management, particularly for large-scale, complex franchise agreements. This requires specialist skills.
9. **Being flexible and willing to adapt to change:** Over the life of a multi-year contract, the broader political and social environment will change, requiring government and operators to be flexible.
10. **Bringing the community along:** It is important to understand and address community concerns over franchising which could influence decision-making.

Each of these will now be discussed.

1. Having a clear strategy for transport delivery and the political will to follow through

Franchising works best when government has a clear vision and strategy for transport delivery. In addition, successful franchising requires public support and backing by the right sponsors.

- *Franchising is most effective when implemented within the context of a broader strategic vision for transport driven by government.*

  One of the fundamental roles of government is to define a high-level strategy for the delivery of public transport services and a roadmap for the future. This sets the context in which franchise arrangements are established, providing clarity on government's goals for franchising and establishing boundaries for contract design. However, it is important this is accompanied by a willingness by government to engage with operators who can bring valuable perspectives as the primary service provider. In addition, the overall vision should be underpinned by strong governance (i.e. the ability for government to deliver outcomes).

- *In most cases, the Premier and the Minister(s) play an important role in making the case for change and being the driving force behind the necessary reforms.*

  This needs to be founded on a strong belief in the case for change, a willingness to take measured risks and a level of resilience to withstand potential opposition by trade unions and some community groups. Franchising must be underpinned by communicating clearly and concisely the benefits, outlined in Section 4 of this paper. To date, limited political support has been a major barrier to more widespread franchising of public transport in Australia.

- *Franchising in Australia has often been driven by catalytic events that have prompted government action.*

  In Melbourne, the Kennett government was elected with a strong mandate for change, and a major industrial dispute during the Melbourne Grand Prix provided additional impetus for moving to a franchise model. Bus franchising in Perth, which commenced in 1996, occurred under similar circumstances as part of a broader reform agenda. In Sydney, the findings of the Walker Report released in 2007 provided strong rationale for pursuing private sector involvement in Sydney Ferries, ultimately providing the foundation for the current franchising process.

2. Having realistic expectations

While franchising can result in significant service benefits to customers and financial benefits to taxpayers, the limitations of what franchising can achieve must also be recognised.

- *Wholesale IR reforms in a highly unionised workforce require government support and this is often best done before franchising.*

  The most significant efficiency improvements in the Melbourne rail system were implemented by the Kennett government prior to franchising, with relatively limited reforms achieved post-franchising. Between 1992 and 1997, the government reduced the PTC workforce from 19,000 to 8,000, streamlined maintenance practices, rationalised workshops and removed train guards and conductors on trams. The reform process lasted approximately three years and involved cost savings of $250m over four years (over 20 per cent of annual costs).

  The private sector can bring specific skills and expertise in working with unions and managing IR issues and can be well-equipped to implement IR reforms, provided the government has set out a clear IR framework within which the private operator can work. For large scale reforms, the government must play an active role and it can be better to do this as part of the preparation process to get the full benefit from franchising.

- *Major investment decisions in infrastructure (and the consequential service quality) almost always reside with government, although franchisees do have a role to play.*

  Franchisee incentives to invest in major capital programs are generally insufficient to meet the needs of public transport systems, particularly in shorter-term contracts. With private operator contracts generally running between seven and ten years, franchisees are unable to justify major capital investments which can run into billions of dollars. Examples of major infrastructure projects include Busways in South East Queensland (over $1 billion), myki in Victoria (smart card ticketing system, $1.35 billion) and the North West Rail Link in Sydney ($7-9 billion).

  In addition, major infrastructure investments require consideration of broader strategic objectives that need to be determined by government, such as intermodal integration, land-use planning and social benefits. For these reasons, prioritisation of major investments needs to be driven by government, and funding is typically provided by government or other vehicles such as PPPs.

  However, private operators are well positioned to identify opportunities, advise on project scope and design as well as manage small to medium sized projects.

- *Certain political risks cannot be fully transferred, although there is some benefit in having service operation more at arm's length.*

  Under a franchise model, the government retains ultimate responsibility for ensuring a safe, reliable and accessible public transport system. As a result, major disruptions and public dissatisfaction always have political ramifications. However, franchising enables government to hold the operator to account more effectively than if the operator is part of the public system. In addition, because franchising provides greater role clarity between purchaser and provider, there is less scope for political interference for short-term gains and more emphasis on long-term requirements over the life of the contract.

- *There are material costs involved in franchising, and some degree of contractual complexity.*

  Franchising large, complex transport systems requires significant investments of time and money in planning, preparation, bid process management, contract design and risk assessment. Rail franchises are inherently more complex than bus or ferry contracts.

- *Even if a franchising arrangement is well executed, there are some issues inherent to a franchising model that still need to be managed.*

  Once implemented, the franchising model has some inherent challenges that need to be considered. First, major changes of direction and strategy are more difficult to implement under a single party negotiation. This underscores the importance of governments to set strategy and priorities prior to franchising. Second, in situations where contract performance is below bid projections, there can be a tendency to cut costs and to stop investing and innovating, regardless of who is at fault. Finally, despite best efforts, it is often difficult to get a true picture of asset condition and infrastructure maintenance requirements across the entire asset base during the bid process. Some flexibility may therefore be required in setting the right maintenance strategy once franchised.

3. Being well prepared

Governments need to have a clear and accurate understanding of what is being franchised and be adequately resourced with the necessary skills and capabilities to run an effective tender and evaluation process.

- *Franchising obliges the government (purchaser) to be very clear on what it wishes to buy, how much it is willing to pay, how it will measure and pay for success.*

  It is critical for government to be an 'informed purchaser'. This can require policy decisions in a wide range of areas to give certainty to the contract in areas like fares regulation, service level standards, DDA, heritage etc.

  > "In the period leading up to the franchise, we would meet senior ministers every week to present them with policy decisions that had to be made quickly. The challenge for preparing the system for franchising should not be underestimated."

  The more certainty a franchisee has the less risk premium they will have to build into the bid price. This level of certainty increases as governments become more experienced with franchising.

However, it is also important that governments do not over-specify requirements to the point of stifling innovation. In Perth, for example, buses have been franchised for the past 15 years. The model hasn't changed significantly, so there is a high level of certainty over the financial/cost models and payment schedules. Innovation continues to occur through a partnership between operators and government.

- *Franchising requires a solid understanding of the current asset base and its condition as well as a maintenance strategy.*

  Transparency and accuracy of the asset condition is a fundamental requirement for a successful bid process, and is one of the most challenging parts of setting up a robust and complete data room. Governments must prioritise full disclosure, and building this understanding often requires a significant investment of time and money.

  In Perth, for example, understanding asset condition and maintenance requirements for the rolling stock maintenance outsourcing contract took upwards of a year to complete, including an internal audit on the condition of the railcars, midlife refurbishment requirements, detailed assessment of fleet requirements and depot locations.

  > "It took us 12 months just to get agreement on how many route and track kilometres we had. Some of the assets on the register simply didn't exist anymore."

  The asset management strategy that government wants to pursue is also important to articulate, such as "fix when fail" or "full preventative maintenance schedule". Assets typically have operating lives of 30-40 years and franchise terms are significantly shorter, so government needs to be clear on its long-term approach.

- *Government needs to be adequately resourced with the right skills and capabilities to manage an effective franchising tender process.*

  Running a successful tender process requires a significant investment of time and resources by people with the right skills and capabilities. In some cases, this means government should look externally to access this expertise. People who have first-hand experience running a franchise tender process bring invaluable perspectives and lessons learnt. This is particularly important in 'first-time' franchising.

  Key areas of preparation include:

  – Preparing the assets for franchise.
  – Developing an effective tender brief.
  – Setting up a robust data room.
  – Structuring franchise contracts.
  – Defining incentive and penalty regimes.
  – Negotiating skills.

- *Developing a public sector comparator (PSC) enables government to assess value for money from franchising.*

  A public sector comparator (PSC) estimates the hypothetical, risk-adjusted cost if a project were to be financed, owned and implemented by government. In the case of franchising, PSCs provide a benchmark that can enable government to assess value for money in the bidding process, promote full cost pricing, act as a management tool during the procurement process and encourage bidding competition by creating confidence in the financial rigour and probity in the evaluation process[16].

  A PSC should represent the 'full and true cost to government of meeting the output specification under a public procurement method'. This includes a costing of the base capital and operating costs as well as an assessment of the value of transferred risks, the cost of retained risks and an adjustment for competitive neutrality (removal of any net competitive advantages from public ownership)[17].

4. Choosing the most appropriate franchise structure

The structure of the franchise is fundamental to the success (or failure) of a franchise agreement. The most appropriate franchise structure will depend on several factors, including transport mode, scale of operation and level of sectorisation vs. integration. The main elements of franchise structure to consider are:

- **Vertical integration:** In rail, an alignment between passenger service operations and below-rail track maintenance is critical for maintaining a safe and reliable system. In a vertically integrated system, the entity responsible for passenger service delivery is also responsible for infrastructure management and maintenance (which may include rolling stock ownership). In Melbourne, track infrastructure is leased from the government and the franchisee is responsible for ongoing maintenance. It is more straightforward to align operational and below-rail maintenance activities (e.g. maintenance scheduling, safety and maintenance procedures, standards) in a vertically integrated system, although it may require contractual mechanisms to manage shared infrastructure where above-track competition exists.

- **Scale:** Setting contracts of appropriate scale is critical to maintain operator efficiency while encouraging competition. In rail, the optimal scale of the contract is a factor of the size of the system and whether it is franchised as a single contract or broken down into multiple contracts. Separating the system into multiple contracts only works in systems that are able to be sectorised and are of sufficient scale that each contract is large enough to enable an operator to realise scale efficiencies in areas such as asset utilisation and train control. There are also trade-offs to having single vs. multiple rail operators which are discussed below in 'operator concentration'. In buses, the ideal fleet size for a contract is 100-250 buses in major centres. Below this, there are fewer economies of scale.

- **Contract scope:** For rail, this means the routes or lines that are included in the contract. Separating a rail network into different franchise areas requires a network that can be sectorised as well as a system of sufficient scale to enable operators to realise efficiencies with number of depots, depot location and asset utilisation (see above comment on 'Scale'). In Australia, most of the metropolitan rail systems are integrated networks and are of a scale that makes franchising the system as a single entity more logical. There are very few examples of standalone sectors that could be

[16] Partnerships Victoria – Public Sector Comparator Technical Note, June 2001
[17] Partnerships Victoria (2001) ibid.

franchised separately. In buses, an area-based system that incorporates a limited number of route-based contracts for trunk services has advantages over purely route-based contracts. The area franchisee should not be able to 'block' new route-based services going through or stopping in franchise area (e.g. dedicated busways).

- **Operator concentration:** There are trade-offs around different levels of operator concentration which can vary from one to many. Having multiple operators has the advantage of encouraging competitive tension. However, in rail, practical considerations may outweigh these benefits. In the first round of Melbourne franchising, the train and tram networks were each divided into two franchise areas. This had unintended consequences, such as procurement of different rolling stock that limited asset efficiency. In addition, decision making can become harder with multiple operators. In subsequent rounds of Melbourne franchising, the number of operators was reduced to one for trains and one for trams. For buses, multiple operators (i.e. a minimum of two or three) are preferable in large metro areas. This encourages competition, enables performance benchmarking and helps to ensure a contestable system in the medium and long term. Single partnerships are possible in smaller geographies, although end of term arrangements must be carefully considered.
- **Roles and responsibilities:** These need to be clearly defined between government and operators. Ideally, government should retain primary responsibility for strategic planning activities (transport strategy, high-level network design etc.), but it is valuable for government to get input from operators (e.g. ideas on innovations that may be introduced). Operators should primarily be responsible for service provision. Tactical and system-wide activities are best carried out collaboratively, including service planning, route optimisation, system marketing and customer information. Once the roles and responsibilities have been defined, it is important for government to step back and let the franchisees 'get on with it' and resist intervening for political or other reasons.
- **Asset and infrastructure management:** Requires strong oversight by the government in rail, even if these functions are implemented by the operator. In cases where a franchisee subcontracts rolling stock and/or below-rail maintenance to a third party, it is important for government to have visibility over these third party contracts to ensure appropriate alignment of incentives. In buses, it is important for the government to retain control of the assets (i.e. buses and depots) to ensure certainty and continuity of services to the public in the event of contract default and to provide greater contestability. Asset ownership gives the government a lever to ensure true contestability in subsequent rounds of franchising, while private ownership of assets may act as a barrier to entry for new operators who are not able to purchase or build buses and depots. This is particularly important for depots in strategically important locations. Governments are tackling this issue in several ways. The options include buying existing depots, building new depots on Crown land sites and ensuring a level playing field in competitive tendering by adding in capital obligations for all bidders.
- **Inter-operator collaboration:** Explicit and well thought through institutional arrangements need to be put in place to enable inter-operator integration. One key risk of franchising a public transport network into separate agreements (either by mode or within a mode) is the potential loss of coordination and integration across the network. Prior to franchising, it is important for governments to consider how to ensure consistency across network-wide functions such as passenger information, marketing, branding and ticketing. Within NSW, these functions are now being coordinated by Transport for NSW.

  In Victoria, Metlink was established in 2003 during the second round of rail franchising. It was owned by the rail and tram franchisees and was responsible for marketing, providing information to passengers, managing complaints, collecting data and protecting revenue (e.g. reducing fare evasion). Metlink encouraged network-wide coordination and efficiency (previously these functions were distributed among three bodies), delivering improved services and reducing role duplication. Metlink's functions have now been rolled into the newly formed Public Transport Victoria (PTV).
- **Network integration:** The transport network must remain integrated from a commuter's perspective to provide a seamless customer experience (for example, ticketing, service information, intermodal connections, branding). Providing a seamless journey to customers requires inter-operator coordination supported by a clear decision-making structure. In addition to reliability, aspects of the journey experience that are very important to customers are intermodal connectivity and integrated ticketing. An integrated network must also be supported by harmonisation of timetables across modes and real-time multi-modal passenger information.

  Government should ideally retain oversight of these aspects of the customer experience through a central, customer-facing, integrated public transport authority. For example, Transperth's bus network is franchised to three private operators and its train network is publicly operated. These services are branded Transperth and have a single ticketing system that operates across modes.

5. Creating contestability

- *The actual or perceived threat of contestability is a critical part of the franchising model.*

  Monopoly providers of services, whether public or private, lack strong incentives to innovate and strive to overperform. Successful franchising of public transport relies significantly on competition for the franchise contract from time to time. This provides a critical additional incentive for operators to deliver superior performance during the term of their contract, so as to win the right to a further term. While revenue and other incentives during the term of the franchise can influence operator behaviour, the real or perceived threat of contestability is a critical part of the franchising model.

  In practical terms, this means governments need to have sufficient ownership or control of key franchise assets and a clear legal basis for tendering the franchises. In the initial franchising of government-owned operations, assets need to be leased to the incoming operator, rather than sold, with appropriate regimes to ensure reasonable maintenance of the assets. Melbourne rail and tram franchises, and the Perth and Adelaide bus contracts have all been structured in this way.
  Where public transport is being delivered by private companies (e.g. many of the bus contracts in Melbourne, Sydney and Brisbane), governments do not typically own the buses and depots, and the legal basis of tendering is somewhat unclear. This has historically made it practically impossible for governments to tender these contracts.

To get full benefits from private sector operations, competition for the contracts is essential.

6. Getting the contract right

Realising the benefits from franchising requires an effective contracting regime. This is a particular issue when systems are franchised for the first time. Some of the most important dimensions of a contract to get right are discussed below:

- *Thoughtful risk allocation is critical.*

  While there can be some overlap in contract features and multiple specific variations exist, there are generally three types of contracts used in franchising:

Management contracts	Operational cost and revenue risks are retained by government, with the operator paid an agreed management fee, typically on a cost-plus basis whereby the operator is reimbursed for the c osts incurred and is paid an agreed margin. This type of contract may or may not be accompanied by additional performance incentives. It is most often used when systems are going through a period of significant change and risk transfer is difficult.
Gross cost contracts	Operational cost risks are transferred to the operator, with revenue risks retained by the government. This includes the setting of routes and fares. Gross cost contracts are often accompanied by incentive regimes to give operators a greater 'stake in the game', and ensure aligned authority and operator objectives. In addition to minimum service standards, this may include some revenue sharing or patronage incentives.
Net cost contracts	A much larger portion of operational cost and revenue risk is transferred to the operator (although there may be capping). This provides the franchisee with direct incentive to maximise franchise profitability, but requires that the operator has a relatively high degree of control over key commercial levers (e.g. predictability of fares or some control over fare levels – albeit within a regulated environment). These are best applied in situations where there is a reasonable level of stability and predictability of future revenues.

  In selecting the best contract type, the simple rule of thumb is that risks should be allocated to the party best placed to manage them. In general, operators have the greatest control over costs, while the government plays a central role in the setting of fares. In addition, there are a number of other factors which can drive patronage growth or decline that is not within an operator's control (e.g. macro-economic trends, city-shaping planning, congestion strategies etc.). However, operators should have an incentive to grow patronage and reduce fare evasion.

  Any revenue sharing arrangement must be accompanied by a simple farebox revenue allocation mechanism that allows for robust calibration and straightforward measurement. For example, use of passenger surveys to calculate flexible revenue sharing can be complicated and ambiguous, leading to disputes between operators and government, as opposed to simple percentage allocation of farebox revenue.

  Taking these factors into consideration, net-cost contracts with revenue risk-sharing and quality incentives appear to balance risk appropriately between operator and government. Alternatively, gross-cost contracts with patronage and quality incentives also provide private operators with similar encouragement to improve performance.

  It is important for government to retain the ability to re-set contract parameters in circumstances where there are unforeseen outcomes or a risk of an operator going into default.

- *Performance incentives and penalties need to be carefully applied with particular attention to behaviours that should be encouraged.*

  There are some important lessons in designing effective performance regimes. Ideally contracts should:

  - Include incentives (in addition to penalties) to encourage desired outcomes. Capping should be considered to avoid an imbalance in incentives (e.g. over-investing in growing patronage at the expense of other measures) as well as a downward performance spiral for penalties.
  - Create genuine incentives by avoiding over-complication and setting realistic targets.
  - Use actual data for setting performance regime thresholds.
  - Structure incentive systems to avoid perverse outcomes or 'gaming', including ensuring that the operator does not focus on meeting an incentive target at the detriment of broader service delivery (e.g. disincentive to grow patronage because of a risk of lower customer satisfaction measures due to crowding).
  - Allow for adjustments in circumstances reasonably beyond the operator's control (e.g. extreme weather events, road congestion).
  - Minimise administration costs through measurement and reporting efficiencies.
  - Allow for flexibility in the nominated KPIs.
  - Reward strong performance with an exclusive right to renegotiate for the next contract which focuses effort on delivering against the KPIs.

    It is important, however, to ensure that the performance regime does not become overly complex or onerous, and simplicity and transparency in identifying the measures and setting targets is critical.

- *To facilitate the implementation of service modifications, the contract should include a simple formula for small adjustments and clear process for major changes.*

  For small variations, an adjustment rate should be agreed (e.g. $ per incremental revenue km for buses). For major variations, a transparent process should be established. This should include a no net cost/net gain philosophy as well as third party involvement to facilitate a fair outcome.

- *Appropriate accounting treatment of the assets needs to be considered when assets owned by the operator are transferred to government.*

  This applies in systems that are already franchised but undergoing contract restructuring. There are several changes that can trigger a transfer of asset ownership to government:

  - Revenue risk is transferred from the operator to the government.

– The government exercises step in rights to get control over assets (e.g. buying back bus depots).

Complications can arise from transferring significant assets back to government.

- *A well thought through ownership and governance arrangement within the franchise structure.*

  Having a clear ownership and governance structure enables government to properly monitor and scrutinise franchisee performance, ensuring proper accountability. This is important for understanding how the franchisee will manage internal oversight and quality control and should be included in the overall assessment process. This is particularly true for rail rolling stock and infrastructure maintenance activities which are fundamental to the safety of the system and often involve subcontractors. Subcontractor incentives must be aligned to those of the overall franchise, and government needs to retain visibility over these contracts and understand the nature of the franchisee's relationship with the subcontractor. Joint ventures and alliances bring the major subcontractors into the 'top box' which has worked well in some jurisdictions.

- *Appropriate end of term arrangements are required to prepare a system for effective contestability at the end of the contract term.*

  Competition is a critical element of a successful franchise model; the benefit of contestability is that operators don't just strive to make profits, they also strive to get a second contract term.

  > "Without competition, you simply substitute a public monopoly for a private monopoly."

  This is a particular issue where the operator owns the assets, such as with buses and depots with many of the private bus contracts in Sydney, Melbourne and Brisbane. To manage this effectively, contracts should include mechanisms to ensure contestability at the end of the contract. These mechanisms can include: early tender (i.e. in the order of two years prior to contract commencement), obligation to lease buses and depots to incoming operator for one to two years, options for government to buy at market value (and sell to incoming operator).

- *Contract length and extension provisions have a significant impact on incentives and behaviours.*

  Contracts should be long enough to enable operators to invest in innovating and realising efficiencies, but not so long as to allow operators to become complacent. For buses, contracts of seven years with an additional seven-year renewal period (7+7) appear to work well. In these cases, there is period contestability (in this case every 14 years) with the option of holding a competitive tendering process after seven years. In rail, contracts are typically longer due to the scale of operation and level of investment required. There is a trend towards longer contracts of 15 years as the default length in the UK, although the potential range of revenue outcomes in the latter years of a 15 year contract can be large. Protection mechanisms to cover this revenue risk should be considered in the overall design of the contract.

7. Balancing financial and other objectives

When evaluating bids for franchise contracts, both financial and non-financial criteria must be considered. Not surprisingly, given the significant amounts of money involved, financial considerations can play a significant role in decision making, particularly when state treasuries are under financial pressure.

- *Carefully balancing financial and non-financial criteria is important for sustainable franchises and realisation of benefits.*

  There are a number of potential dangers in being drawn to the lowest bid, including:

  – Financially fragile franchises that cannot endure the inevitable ups and downs in performance.

  – Choosing bids that underestimate the challenges and cannot deliver on the promised benefits.

  – Franchisees that are forced to underspend on maintenance and other areas to make up for poor financial performance in other areas of the business.

- *Tender evaluation processes need to include considerable scrutiny of the offers and to give appropriate weight to non-financial factors.*

  Bid evaluation teams need to have sufficient qualified resources and adequate time to appropriately scrutinise the bids to ensure they are credible, grounded in an understanding of the existing operations and likely to deliver the promised benefits. Financial and non-financial criteria need to be separately reviewed, and an informed choice made between the value for money offered by different bids. Simply choosing the lowest price is unlikely to deliver anticipated benefits.

8. Having the right people and skills to manage the relationship effectively

People with experience in franchising from both government and the private sector state that one of the most important success factors is having a partnership-style relationship between government and a franchisee.

- *A partnership-based approach to managing the relationship between franchisees and government, as opposed to a strictly contract-based approach, is seen by both parties as an important factor in a successful outcome.*

  Governments that implement franchising for the first time often view their role in a 'command and control' context in which it is the government's responsibility to closely monitor and hold the operator accountable to the letter of the franchise contract. This can have negative consequences, including inefficiencies and time wastage through over-emphasis on the mechanics of the process instead of a focus on delivering overall outcomes, as well as a stifling of private sector innovation. It can lead to risk-averse behaviours and result in an adversarial relationship when things go wrong.

  > "Originally we failed to treat the contractual relationship as a partnership, and we were also too black and white in our application of things. We have learned that it is important for the government to play a constructive role."

  In a relationship-based approach, government and operator work collaboratively with a focus on achieving desired outcomes. There is a recognition that trade-offs will have to be made. This approach is also based on a tight contract, but the emphasis is on simplicity and clarity of terms that align incentives between operators and government. Although it is still the government's responsibility to ensure delivery of service standards and value for money, there is an element of trust between both parties that enables them to work together to solve problems.

  > "A good franchise agreement is one where you don't need to continually refer back to the agreement to resolve issues, it is one where you can sit down and discuss solutions together."

- *In addition, there are a number of requirements that underpin a successful partnership-based approach.*

  – Managing a contract with a partnership-based approach requires a different skill set and mindset to traditional contract management in government. This may require upskilling or recruiting contract managers with experience managing large, complex contractual relationships in a collaborative manner. It is also likely to involve a cultural shift within the authority and the government department that empowers contract managers to make required trade-offs.

    > "Rather than seeing things as lots of micro wins and losses, you need to see the big picture portfolio and be willing to make trade-offs. You need a public sector risk culture where public servants are willing to be flexible and make pragmatic calls."

  – In the bid evaluation process, government needs to be as focused on assessing the experience, capabilities and management style of the leadership team as on the financial details of the proposals. Although it is difficult to assess cultural fit in a competitive bid situation, some approaches include conducting joint workshops and simulations during the evaluation process to assess fit and shared objectives.

  – The design of incentives can also make a difference. Linking flexible performance benchmarks to contract extension and renewal can help encourage a collaborative, partnership-based approach.

9. Being flexible and willing to adapt to change

Given contract lengths for buses can run for seven years (with an additional seven year extension) and contracts for rail can be substantially longer, it is important for operators and government to be willing and capable of adapting to change.

- *Existing operators (with the required support from government) need to be able to adapt to new directions and initiatives in transport strategy and policy, particularly over a medium-term timeframe.*

  Public transport is usually a high-priority issue for politicians and their electors and a different policy agenda often accompanies a change of government. Some of these changes can have a direct or indirect impact on the existing transport network. Operators must be willing and capable of adapting to change, and government must provide the support to make the change. Examples include changes to fare structures, concession cards, ticketing systems, expansion of modes (e.g. light rail, regional rail), passenger service standards/charters (e.g. frequency) and congestion relief strategies (e.g. congestion charging).

10. Bringing the community along

The community is the largest public transport stakeholder as it represents both the users and the funders of public transport (indirectly through rates, taxes etc.). Despite a lack of awareness of whether public transport is run by government or the private sector, it is still important to understand community perceptions when implementing a franchise structure to address community concerns.

- *Educating the public and the media about franchising is important for successful implementation.*

  When commuters understand what franchising is and how it differs from privatisation, they are generally quite receptive to the model and recognise that there are benefits to be realised. People are most concerned about the government losing control of routes and fares, but when it is explained that in a franchise model these remain the responsibility of government, they are typically more supportive. The media plays an important role in delivering and reinforcing these concepts, so it would be beneficial for government, operators and the media to use consistent definitions and information.

- *Proactive communication with the community about franchising can be effective if it is simple, straightforward and easy to understand.*

  Educating the public about franchising through the use of passenger charters (or similar communication mechanisms) can help alleviate public concerns. This approach was adopted successfully in Victoria[18] where such a charter was released prior to franchising to dispel myths. This charter had a simple message: no fare increases, no cuts in services, concessions are protected.

[18] Public Transport Partnerships: An overview of passenger Rail Franchising in Victoria 2005

What are the community's views on franchising in public transport?

Image courtesy of Veolia Transdev

One common hypothesis is that the community has strong reservations about franchising public transport services to the private sector. However, a recent market research study conducted exclusively for this report by GA Research shows that this is not necessarily the case. This research program was based on three focus groups conducted in February 2012 in Sydney. Participants were selected randomly from the community and represented a mix of people from different parts of Sydney. Groups were segmented according to age (under 30; 30 to 49 and over 50 years) and contained a spread of bus, train and ferry users, as well as participants who primarily travel by car.

The key conclusion from this research was that once people understand the fundamentals of the franchising model, they are generally supportive of franchising public transport services and believe the pros outweigh the cons. The most important elements of the model are that government retains some control over fares and routes, and maintains ownership of the assets, particularly in rail.

> "I like the definition of franchising. The government is the one that regulates the timetables and routes. Because those are the things I'm scared they'd change. So that made me think franchising is a good thing."

The main findings from the study include the following:

What is the current state of Sydney's transport system?

Overall there was a mildly positive view of Sydney's public transport system. When asked whether the standard of public transport had improved, got worse or stayed the same in the last few years, most participants either said it had stayed the same or improved. People mentioned increased frequency and better reliability as positive developments.

> "I've been travelling on transport for the past 25 years. I think there's been a huge improvement. Trains are more frequent. With buses the problem is traffic congestion. But I've seen the timetables change. They seem to be more on time".

What are the main issues facing public transport?

While most participants were happy with the way things currently are, there was general consensus that the public transport system is currently stretched and without significant infrastructure investment and planning the system could deteriorate dramatically in the next five to ten years.

According to the study participants, the main issues facing Sydney's public transport system were:

- **Extra infrastructure needed:** There were concerns that the public transport system as it stands would not be able to keep up with Sydney's growing population.
- **Lack of long-term planning:** Linked to participants' desire to see extra infrastructure investment was the need for better long-term planning of public transport. This was seen to be something governments had not done well over the last 10 to 20 years and the reason why things were now at 'breaking point'.
- **Congestion:** Participants agreed that road congestion is a major issue affecting the efficiencyof Sydney's bus system.

What are the pros and cons of involving the private sector?

Public transport users generally believe that private sector involvement can deliver benefits including:

- **Efficient services:** The private sector is more commercial and more efficient in comparison to government,
  which is seen as slow moving and bureaucratic.
- **Improved services:** The private sector can fill some gaps in the network, while introducing innovation and utilising international expertise to improve services.

- **Quicker delivery of infrastructure projects:** Private companies can plan and build public transport infrastructure more quickly than government.
- **Access to fresh ideas and expertise:** The private sector can draw upon experience (often international) to bring in new ideas and innovations.
- **Other potential benefits:** Lower fares through competition and an overall reduction in the cost to the taxpayer.

However, some of the key strengths of the private sector (e.g. international experience and commerciality) were also seen as areas of concern. These concerns include:

- **Reduced frequency:** Profit motive may lead to cancellation of less profitable services or prevent new services. (e.g. non-peak times, lower patronage routes).
- **Higher fares:** Concerns that a drive to increase revenues/profits and returns to shareholders may lead to high levels of fare inflation.
- **Profits and jobs going offshore:** There was a concern with multinationals that the profits would flow to offshore headquarters and that jobs would be filled with imported labour rather than Australians.
- **Service disruption if private operator defaults:** Risks associated with operator failure (e.g. bankruptcy) and uncertainty about who has ultimate responsibility to ensure continuity of service.

In the case of franchising, some of the areas of concern identified above can be mitigated through contract design and specification. Others, such as service disruption if a private operator defaults, have been shown not to be issues through experience in markets such as the UK. Once the concept of franchising was explained, study participants recognised that these concerns were mitigated, as discussed below.

Is the community supportive of a franchising model?

The majority of participants in the study were generally open-minded about the idea of private sector involvement and could see some benefits as it relates to improving the public transport system. However, there were initial concerns from some of the study participants about the private sector becoming more involved in government services and public transport in particular. This was based on negative perceptions around 'failed' Public Private Partnerships (PPPs) such as the Cross City and Lane Cove Tunnels and around the term 'privatisation'.

"I do get a bit worried when they start selling off public assets."

Public transport users have limited understanding of what franchising actually entails. Confusion about terms such as franchising, privatisation and deregulation, for example, may result in unwarranted concerns about fare inflation and service discontinuation.

However, when given an explanation of the fundamentals of the franchising model, public transport users are supportive of franchising public transport services and generally believe the pros outweigh the cons. The most important elements of the model to customers are that government retains control over fares and routes, and maintains ownership of the assets, particularly in rail.

Improved understanding of how public transport funding works, and how franchising can result in lower costs for government and taxpayers, also helps to alleviate concerns. Finally, an understanding that franchising is not new to Australia, and has been used to good effect in a number of areas (e.g. numerous bus networks, Melbourne rail and trams) can also improve levels of community acceptance.

6.0 WHAT ARE THE OPPORTUNITIES FOR FRANCHISING IN AUSTRALIA?

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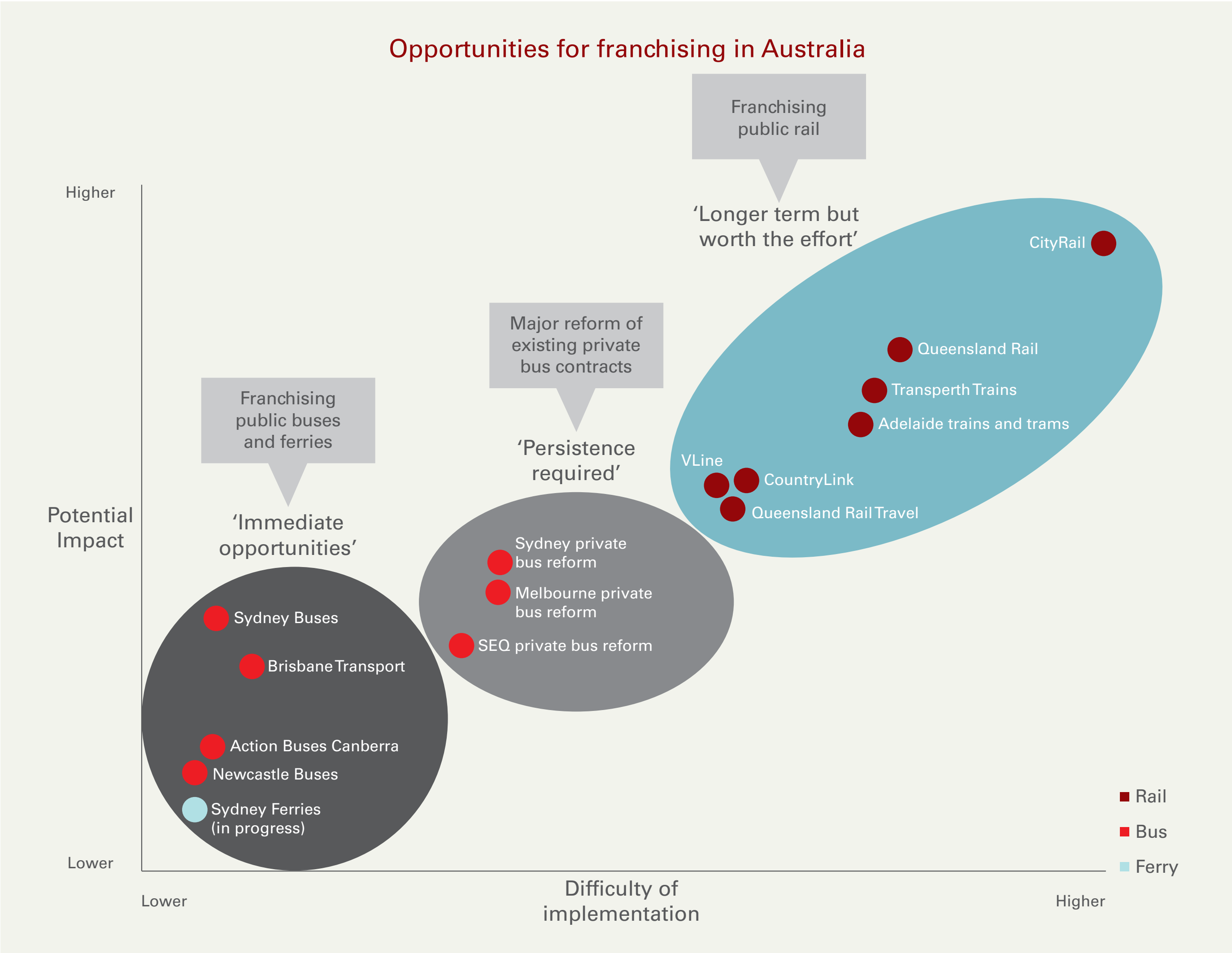
There are many public transport systems in Australia that could benefit from adopting a franchise approach. These opportunities can be categorised on the basis of their potential impact and the likely difficulty of implementation.

- **Immediate opportunities:** Franchising public ferries and buses: These opportunities would be relatively straightforward to implement and include ensuring the smooth transition of Sydney Ferries to the new private operator by end of July 2012, as well as opportunities to franchise the large government-run bus systems in Sydney, Brisbane, Canberra and Newcastle. Consideration should be given to implementing these opportunities immediately.
- **Persistence required:** Reform of existing private bus contracts: These opportunities offer considerable potential impact, but will require longer timeframes to realise the full benefit. The main opportunities are to reform and modernise the existing private bus contracts in Sydney, Melbourne and Brisbane. Creating effective contestability for the contracts will be an essential part of these reforms. Implementation of these changes will necessarily occur over a longer timeframe due to a range of contract expiry dates and practical difficulty in achieving change. Transport for NSW recently announced the competitive tendering for private bus operator regions in May 2012. This process will be staged over two tender rounds over three years, commencing July 2012.

Figure 17: Opportunities for franchising in Australia



Source: L.E.K. analysis

- **Longer term but worth the effort:** Franchising government run rail: These are longer-term opportunities due to the need to prepare the organisation for franchising as well as implementation challenges, but they would have a high potential impact. Franchising CityRail and CountryLink could deliver significant benefits to rail users and the wider community, although implementation is challenging and the timing would likely be impacted by the rail reform program currently underway. Other opportunities include the franchising of Queensland Rail, Transperth trains, and trains and trams in Adelaide. The potential impact of these opportunities will depend in part on the extent to which core activities are outsourced to the private sector (e.g. some rail maintenance activities are outsourced in Adelaide and Perth). The regional rail networks also offer opportunities for franchising, either together with the metropolitan networks (in the case of Sydney and Brisbane) or separately. As smaller, more contained networks, they would be easier to franchise on a standalone basis.

In addition, there are ongoing opportunities to fine tune existing franchise arrangements, including rail and tram in Melbourne, buses in Perth and Adelaide and ferries in Brisbane.

There are several next steps that could be implemented in the next 12 months that governments should consider:

- **Sydney:** Franchising is currently topical in Sydney with activity in ferries and buses and the potential for private sector involvement in rail. The priorities and opportunities include:
  - Ferries:
    - » Transition Sydney Ferries to new private operator, Harbour City Ferries (Veolia Transdev and Transfield Services) by end of July 2012. Priorities are to ensure smooth transition, establish constructive working relationships and focus on starting to deliver improvements in operational efficiency and customer service.
  - Buses:
    - » Reform existing private bus contracts: Commence competitive tendering for private bus operator regions as announced by TfNSW. The implementation will be staged over two tender rounds over three years, starting in July 2012.
    - » Franchise Sydney Buses: Prepare Sydney Buses for franchising (contract scope, terms, length, incentives etc.) and develop implementation plan. This process is tentatively underway with transfer of the STA services operating on the Liverpool T-way to the private sector as part of the reform of existing private bus contracts.
  - Rail:
    - » Implement priorities as outlined in the rail reform program.
    - » Assess franchising options: Consider franchising CountryLink first (then RailCorp in the medium term once rail reform program has been implemented). RailCorp could also be sectorised and franchised.
    - » Assess opportunities for private sector involvement in PPPs through the North West Rail Link and the expansion of the light rail network.
- **Brisbane:** Opportunities for franchising exist in both buses and in rail.
  - Buses
    - » Reform existing private bus contracts in SEQ: Consider the opportunity to reform existing private bus contracts in order to increase operator incentives and accountability.
    - » Franchise Brisbane City Buses: Consider options for franchising the 65 per cent of the network (based on patronage) that is operated by Brisbane City Buses. Relative to private operators in South East Queensland, there are opportunities to realise cost efficiencies through better asset utilisation and more competitive wage rates.
  - Rail:
    - » Consider franchising Queensland Rail Travel first, then Queensland Rail in the medium term, but this would require preparing the network).
- **Melbourne:** The only city in Australia that has franchised virtually all of its public transport services with the exception of V/Line.
  - Buses:
    - » Commence reform of existing bus contracts to improve value for money and increase incentives to focus on customer service outcomes. Approximately 40 per cent of the contracts are coming up for re-tender in the next 18 months.
  - Rail:
    - » Consider tendering V/Line (currently publicly operated).
- **Adelaide:** The bus system was franchised to three private operators in late 2011, while rail is operated by the public sector.
  - Buses:
    - » Work with bus franchises to overcome current concerns abour performance in some areas.
  - Rail:
    - » Consider tendering Adelaide trains and trams (currently publicly operated).
- **Perth:** The bus system is currently franchised; significant parts of the rail system are outsourced so there may be less benefit in franchising this system.
  - Buses:
    - » The bus network in Perth has been franchised for the past 15 years and is a good example of a success story (see Perth buses case study, Section 4.2.1).
  - Rail:
    - » The rail system is operated by government, although its approach has been to outsource rolling stock maintenance, below rail maintenance and some security functions. The government operates train control and drivers in-house and these may represent future opportunities for further outsourcing.
    - » The strategic vision for transport in Perth includes plans for a light rail. Consideration should be given to the nature of private sector involvement, possibly in the form of a PPP.

Figure 18: Considerations for franchising in Australia

Type	Opportunity	Mode	Type	Difficulty of Implementation	Potential Impact
Immediate Opportunities Relatively straightforward to implement	**Sydney Ferries**	Ferry	Franchising (public to private sector)	Low – Harbour City Ferries (Veolia Transdev and Transfield Services) to commence services by late July 2012. Government to retain ownership of existing assets and full control over fares and service levels	Low – relatively small network
	Sydney Buses	Bus	Franchising (public to private sector)	Low – within control of government	Medium – 2000 buses
	Brisbane Transport	Bus	Franchising (public to private sector)	Low – within control of government	Medium – 1200 buses
	Action Buses Canberra	Bus	Franchising (public to private sector)	Low – within control of government	Low – 215 buses
	Newcastle Buses	Bus	Franchising (public to private sector)	Low – within control of government	Low – 170 buses
Persistence required Potential to have considerable impact, but requires longer time frames to realise full benefit	**Sydney private bus reform**	Bus	Contract reform (private sector)	Medium – introduction of competitive tendering for private bus operator regions announced in May 2012 and will be staged over two tender rounds over three years, commencing July 2012	Medium – approximately 30 private operators in the greater Sydney area
	Melbourne private bus reform	Bus	Contract reform (private sector)	Medium – approximately 40% of contracts will be retendered in the next 18 months. Changes could include introducing patronage risk	Medium – over 20 private bus companies
	SEQ private bus reform	Bus	Contract reform (private sector)	Medium – entrenched existing operators, political sensitivity and relatively slow reform process. Often requires several steps of reform, each step every 5–7 years upon contract expiry.	Medium/Low – over 15 private bus companies
Longer-term but worth the effort Longer-term opportunities due to the need to prepare the organisation and implementation challenges, but worth the effort due to high potential impact	**CityRail**	Train	Franchising (public to private sector)	High – franchise options include (1) CityRail as a single entity, (2) sectorise CityRail network and franchise parts separately (e.g. Sector 1 vs rest of CityRail). Benefit of Option 2 is speed. Timing impacted by reform program underway. Could also be franchised at the same time as CountryLink (together or separately).	High – large, complex network with significant potential for efficiency improvements. CityRail: 295m boardings in 2010/11; 307 stations, over 1,650 carriages.
	Queensland Rail	Train	Franchising (public to private sector)	Medium / High – requires preparing the network for franchising and managing political sensitivities.	Medium / High – 51m boardings in 2010/11; over 200 trains and 145 stations.
	Transperth Trains	Train	Franchising (public to private sector)	Medium / High – requires preparing the network for franchising and managing political sensitivities.	Medium / High – 59m boardings in 2010/11; 234 railcars and 70 stations. Have outsourced some core functions already, so cost benefits from franchising may be lower.
	Adelaide Trains	Train (regional) and coach	Franchising (public to private sector)	Medium / High – requires preparing the network for franchising and managing political sensitivities.	Medium – 12m train boardings in 2009/10; 99 railcars
	VLine	Train (regional)	Franchising (public to private sector)	Medium – requires preparing the network for franchising and managing political sensitivities.	Medium – 15m trips in 2010/11; over 300 carriages and 84 stations.
	CountryLink	Train (regional)	Franchising (public to private sector)	Medium – could be franchised as a separate entity (easier to implement, could be done prior to franchising CityRail) or together with CityRail (complexity and timing driven by CityRail).	Medium – 2m boardings in 2010/11.
	Queensland Rail Travel	Train (regional)	Franchising (public to private sector)	Medium – could be franchised as a separate entity (easier to implement, could be done prior to franchising Queensland Rail) or together with Queensland Rail (complexity and timing driven by Queensland Rail).	Medium – 900k trips; 11 trains and 75 stations.
	Adelaide Trams	Tram	Franchising (public to private sector)	Medium – requires managing political sensitivities.	Medium – 3m boardings in 2009/10; 17 trams.

Source: Company and government annual reports and websites

Image courtesy of Yarra Trams

7.0 APPENDIX

CASE STUDY: Franchising of Melbourne Rail

Early years and reform

The origins of Victorian public transport reform can be traced back to 1992 and the election of the Kennett government with a strong mandate for change.

Public bus services were franchised soon after the government was elected. The assets, depots and bus licences were sold to a private operator, and the bus workforce was moved from a public transport union to a private bus union.

The government did not yet have any intention to franchise the rail and tram networks. Instead, authorities sought to radically cut costs and improve productivity with a series of far-reaching reforms that included:

- Rationalisation of workshops.
- Removal of guards on trains, conductors on trams, and other staff efficiency initiatives.
- Removal or replacement of infrequent long distance services with buses.
- Outsourcing of a number of functions.

The reform process continued until 1997. During this time, the number of Public Transport Corporation (PTC) staff fell from 18,000 to 8,400, contributing to a reduction of operating costs of almost $250 million per annum[19]. The scale of these reductions was a strong illustration of the over-resourcing and inefficiencies which had existed for many years.

First franchising round

While the major reforms were a success, by 1997 the government had identified that further improvements to the system could occur only through privatisation of rail and tram services. A major industrial dispute during the Melbourne Grand Prix provided added impetus for this change.

A franchised system was selected in lieu of full privatisation as it was recognised that rail and tram services were heavily dependent on public funding and required continuing oversight. The PTC's five rail entities (two metro trains, two trams, and one regional) were to be separately tendered, with franchisees responsible for both above-track and below-track operations. This "vertically integrated" model saw franchisees lease infrastructure (from VicTrack), which they were required to maintain, and was intended to minimise contractual disputes in the event of poor performance.

The franchising process began in 1999 and was met with a great deal of interest from local and international bidders. Five contracts were awarded to three private companies: National Express (Bayside Trains and Swanston Trams), Connex (Hillside Trains) and Metrolink (Yarra Trams). It was thought that having two train and two tram operators would encourage competition and service improvements. Relatively long contracts (15 years metro train, 12 years tram) were intended to support rolling stock procurement and infrastructure works. Winning bidders laid out aggressive plans for patronage growth, cost reduction, rolling stock delivery and performance improvement. The government considered that all substantial commercial risks had been effectively passed to the franchisees, and cost savings of $1.8 billion were anticipated as base contract payments reduced over the franchise terms[20].

Initial results were positive, with significant improvements in punctuality, reliability and customer service observed. The new operators improved on time running and reliability by 35 per cent, increased service frequency by 10 per cent and patronage grew by 3 per cent per annum[21].

However, after two to three years, the public transport system found itself in financial crisis. Despite the improving operational performance, the operators were not meeting their bid projections, achieving lower revenue growth, and limited cost reductions. A number of factors contributed to this situation, including (most significantly) overly ambitious assumptions by bidders in relation to anticipated patronage growth and cost reductions that could be achieved.

The private operators were trending so far away from bid projections that the contracts were viewed to be unviable. They approached the government to re-negotiate the contracts. Part way through the negotiations in 2002, National Express chose to walk away from its contract rather than face ongoing uncertainty.

Second franchising round

While the government considered taking the operations back into public ownership (and did so for V/Line, the country passenger business), it was viewed that contracting out had positives for passengers, and the (now Labor) government chose to stick with the model.

Rather than go through a new competitive tendering process, the government chose to renegotiate with the incumbent franchisees. The decision was based on an assessment of market interest and a willingness to retain knowledge held by the existing operators. Yarra Trams and Connex negotiated on an exclusive basis to take over the full tram and rail systems, respectively, and new franchise arrangements were put in place in 2004. These arrangements saw substantially reduced contract terms (5 years plus options for renewal), and the transfer of a greater share of revenue risk back to government.

The operators successfully merged the two halves of the tram and train business and achieved good performance outcomes in the early years. From 2005 onwards very strong patronage growth of 10 per cent per annum was experienced on the rail network. However, as rail patronage continued to surge (by 50 per cent over the four years to 2009), pressure on network capacity and operational capacity continued to grow. This, in combination with problems with new Siemens trains (ordered by National Express), presented ongoing challenges for the operator and government.

[19] Department of Infrastructure, An Overview of Passenger Rail Franchising in Victoria. Public Transport Partnerships 2005
[20] Department of Infrastructure (2005) ibid.
[21] Department of Infrastructure (2005) ibid.

Third franchising round

In 2007 the government announced that it would run a global competitive tender, leading to the appointment of two new franchise operators in 2009. KDR (Keolis/Downer EDI) and Metro Trains Melbourne were awarded the right to operate Victoria's trams and trains respectively under 8-year contract terms (with 7-year options for further renewal). This refranchising round saw a number of 2004 features retained, however further modifications were made to the allocation of revenue risks (including cap and collar and reset mechanisms), an improved performance incentive regime was introduced and greater time was spent during the tendering process, enabling bidders to make more informed forecasts.

Summary of lessons learnt

Despite a number of challenges along the way, the Victorian Auditor General has described the Victorian transport operators as providing "good value for money"[22] and overall Melbourne's rail franchising is widely considered to be a "qualified success"[23].

It is also a case study that provides a number of insights for authorities considering public transport privatisation:

- **Electoral mandate and political conviction:** The importance of the Kennett government's strong initial mandate for change.
- **Pre-franchising reforms:** The value in undertaking large-scale organisational reform prior to franchising, as private operators may be constrained in their ability to tackle certain industrial challenges.
- **Thorough planning and realistic assumptions:** The importance of accurate patronage forecasts and estimates of opportunities for cost savings. Victoria's latest franchising round saw government and operators take much more of an "open book" approach.
- **Appropriate risk sharing and transfer:** The importance of well-structured contracts between the government and operators and appropriate risk allocation.

[22] Franchising Melbourne's train and tram system, Auditor General of Victoria 2005
[23] Victoria's public transport: Assessing the results of privatisation, Institute of Public Affairs 2007

AUSTRALIA
Tourism & Transport Forum

8TH FLOOR
8-10 LOFTUS STREET
SYDNEY NSW 2000
T +61 2 9240 2000
F +61 2 9240 2020
WWW.TTF.ORG.AU