Enhanced partnerships will need new strategies

With the Bus Services Bill becoming law, and giving authorities powers to introduce franchising, many operators see new enhanced partnerships as a preferable alternative. But these present their own problems, says **David Leeder**

Local authorities have tended to prefer projects such as smartcards to traffic management policies that favour buses

For decades, UK bus operators have sought to contain economic regulation, while local authorities have consistently argued for increased powers. As with some medieval siege, nobody can quite remember when the fighting broke out, and entire careers have been spent on policy battles without either side giving up an inch of territory. It is not inaccurate to say that this Hundred Years' War has its origins in the 1920s, with regulatory victories for the authorities in 1930 and 1968, and the operators in 1986.

The Bus Services Bill is now law, and will give English local authorities new powers to control bus services in their areas, and the first metro-mayors have been elected. The existential threat of London-style operating contracts has led most operators to welcome any alternative to the franchise model. In my view, enhanced partnerships, which the new Act also introduces, are likely to be challenging for both sides, and will involve some difficult maths.

The first problem will be to build some consensus about scheme objectives. This ought to be straightforward. Both sides would benefit from passenger growth, which would generate the social benefits desired by the public sector, and would swell the coffers of the operators, leading to greater financial returns. However, there are several obstacles.

What is passenger growth intended to achieve? In the early 2000s social inclusion was a key priority. Then the agenda moved towards decongestion, then economic growth. Now environmental improvement is the policy priority. Objectives will need to be stabilised if any kind of economic model is to be constructed that involves risk capital over extended periods.

For many in the public sector, a desire for control is an end in itself. Anything that gives too much flexibility to the operators will be difficult to accept. In practical terms, this will lead to differences of opinion on a variety of topics, including fare setting, marketing and the all-important question of economic returns. Operators will need to move the agenda on to measurable outcomes around which a consensus can be built.

The second problem relates to the interventions needed to achieve growth. The partners will need imaginative but achievable plans for growth. This will be difficult. Contrary to the general opinion among local authorities, passenger growth is hard won, and operators already have powerful incentives to increase volumes. It is now clear that best-in-class businesses such as Stagecoach, Go-Ahead and TfL are struggling with the problems of congestion and unhelpful demographics, even in cities with an otherwise benign operating environment. In recent years, local authorities have tended to evade the kind of tough traffic management measures that are unpopular with motorists and cyclists, and have placed their faith in second-order projects such as smartcards and low-emission buses, which increase costs with minimal revenue benefit.

There is in fact remarkably little doubt about the policy menu that would improve bus patronage. The winning policy mix has been fairly clear since the Oxford Balanced Transport Strategy of the 1970s. Such a strategy would be founded on traffic management, coordinated parking management, and planning policies that favour development in key nodes. The difficulty will be to reach a local political consensus over such a menu. In many regional centres economic growth is anaemic, at best. Authorities are prepared to grab whatever developments they can, regardless of the impact on travel demand. Hence the slow drift towards out-of-centre office parks, retail strip malls and suburban regional hospitals.

It should now be apparent that the unfavourable demographics of many English urban areas make devising a growth plan a non-trivial issue. Operators in many areas face significant headwinds, including population decline, weak urban centres, and fundamental changes to demographics (such as heavy bus-using 85-year-olds being replaced by low bus-using 63-year-olds). None of this will alter as a result of bus regulation, and London is now comprehensively proving that even highly favourable demographics can be negated by traffic management policies that prioritise cycling and walking.

Bus lanes remain politically problematic, often generating vocal public objection, without the association with moral virtue and elite support associated with cycling priority.

The failure of the bus industry to mobilise middle class opinion in its favour remains a significant issue.

The evidence from places such as Sheffield (and now London) demonstrates that partnership schemes without decisive traffic management policies that favour buses are insufficient to generate meaningful passenger growth.

The third and largest set of issues is economic. Both sides seem to have a shaky grasp of the financial architecture of a true partnership. Many local politicians (and a good many officials) confuse profits with dividends. This explains the widespread view that any profit-making local bus operation can fund an infinity of "nice things", such as real fare cuts, increased capital investment and staff pay rises. Some authorities genuinely think that they can have all these things, and extract large dividends for themselves.

They will quickly discover that such wishlists far exceed the ability of current revenue streams in most local bus markets to bankroll them. Meanwhile, most operators are offended by the idea that they should ever share their revenue streams with the authorities.

This financial problem is made worse by implicit commitments to greater capital expenditure (for improved buses, bus stations and bus priority measures) and for "development mileage". Experienced hands will realise that the last is the most expensive item of all. A good rule of thumb is that any new route will be unlikely to break even without £1m-3m investment in running empty buses until demand catches up with the new supply.

Furthermore, many authorities cling to the ancient idea that there is something wrong about running high levels of service on busy routes, and therefore "wasteful" bus miles can be moved around the map without an impact on demand and revenue. Cutting "oversupply" on busy routes is in fact likely to depress demand and reduce revenue, with a corresponding impact on network finances.

Network economics will need to be modelled in new ways, to isolate these issues and devise workable cashflows for all parties. Hard maths, and clear thinking, will be needed to resolve them, and highlight the trade-offs needed to devise a viable plan.

Issue four might be termed "dividing the spoils". The current arrangements, both in London and outside, have avoided the need for formal, utility-style regulation of operator returns: by the threat of on-the-road competition outside London, and competition for contracts in the capital. For a partnership arrangement to work, there will need to be some kind of formal mechanism to measure, regulate and allocate returns. Moreover, authorities will need to accept that operators' profits will need to go up (as in water and airports) if they are being asked to deploy more capital and or take more risk.

A true partnership model will have to address the issue of "excess returns" (if any), and allocate cashflow between operators and authorities in a fair manner. In practical terms, this means finding solutions to:

1. Remunerating capital expenditure in buses and fixed equipment (including highway measures)
2. Sharing profits from bus operation, and dividing them between operators and authorities
3. Stabilising the basis for subsidies to specific passenger groups – for example concessionary fares
4. Determining a means to regulate fare levels, in the absence of on the road competition
5. Creating an incentive for operator cost efficiency
6. Incentivising local authorities to deliver their part of any bargain.

Britain's impending exit from the EU could be helpful, as it will allow UK bus policy to be decoupled from EU rules concerning public procurement and transport subsidies that limit the scope for creative solutions to this question. Greater flexibility in this area may allow authorities to enter into longer, more flexible franchises or route licences. But creativity will also intensify the need to codify economic regulation.

In conclusion, true partnerships between bus operators and local authorities create the opportunity to transform the outlook for urban public transport, and to address the severe economic challenges facing the UK bus sector. But both sides will need to adopt much more flexible thinking, and climb out of the policy trenches.

The issues are both economic and mathematical. In the absence of competition (or the threat of competition), operators will have to accept some form of economic regulation. Authorities will have to learn hard lessons about the real cost of capital, the cash needed for speculative mileage, and the allocation of risk. The two sides will need to agree a menu of highway and service improvements that is simultaneously tough enough to decisively improve the relative speed and reliability of bus travel, and appealing enough to command the political support necessary.

None of this will be easy, and the winners will require analytical and political skills that may change market shares and operator returns dramatically over the next ten years.

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