

KICK START

Better value, better bus services

STAGECOACH *GROUP*

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Executive summary

Stagecoach Group has developed an innovative proposal for a new dedicated fund to pump prime specific bus improvement projects. This approach – which already has a proven track record in New Zealand – can attract car users to the bus. It is driven by the entrepreneurial expertise of bus operators, who carry the business risk and have an incentive to grow passenger volumes, rather than by local authority planners.

Central and local government already play a key role in developing non-commercial, socially-necessary bus services by working in partnership with bus operators and providing public support. However, we believe there is a compelling case for a new partnership approach that will tap a latent commercial market across the country that cannot be accessed by bus operators without Government support.

Kick Start is a practical, quick-win initiative that we hope will open a dialogue with Government. We are confident the Kick Start approach can attract people out of their cars and into buses, deliver better value for taxpayers, produce better bus services for our communities and help Government achieve its growth targets on the UK's bus network.

Kick Start

Kick Start is a simple concept, which involves:

- a new Government fund, which would deliver efficient “one off” short-term public investment in otherwise unviable bus projects, such as increased bus frequencies on existing routes.
- a contract between the bus operator and Government which commits to a specified level of service linked to an agreed public investment profile
- risk carried by the bus operator, rather than perpetual subsidy provided by Government that delivers little growth
- incentives for bus operators to use their entrepreneurial skills to bring forward suitable schemes to improve bus services and generate passenger growth
- an approach specifically designed for the provincial bus network outside London
- particular benefit to peripheral communities where the current level of service is not sufficiently attractive to car users

Kick Start funding would bridge the critical gap between project launch and commercial sustainability, a process that can take up to three years. Public investment would be focused in Year One of the project, where costs of a project are highest, with staged reductions in Years Two and Three as passenger volumes increase and the service becomes established. Crucially, at the end of the three-year funding period, the enhanced service can operate without public support.

Bus operators would have a contractual agreement with Government to operate a specific level of service over the three-year period. Government would sign up to a public investment profile based on passenger growth projections.

The Kick Start fund would cover the difference between the projected revenue and cost of the project. However, the risk would be borne by the bus operator, so that if passenger volumes and revenue do not rise in line with projections or costs increase beyond forecast, the bus operator would be contractually bound to absorb the loss.

Benefits

As well as providing value-for-money for the taxpayer, Stagecoach believes Kick Start has a number of key attractions to Government:

- higher quality bus services
- increased passenger numbers
- modal shift from cars to buses
- reduced congestion and emissions
- increased social inclusion
- new employment opportunities
- additional vehicle investment

The New Zealand experience

The Kick Start concept is already working in New Zealand where regional councils receive funds from central Government for bus service improvements that will deliver passenger growth. In Auckland we have achieved passenger growth of up to 27% as a result of this approach to public funding.

The Perth experiment

Stagecoach has already carried out a successful trial of the Kick Start concept in the UK in Perth where we introduced frequency enhancements for which traditionally there would have been no business case.

The initiative focused on a poor performing low frequency bus route, which had a profile of aged owner-occupiers with high car dependency and was about to benefit from a bus priority scheme introduced by Perth and Kinross Council, which included new bus shelters and transponders to provide priorities at traffic light-controlled junctions.

Stagecoach doubled the frequency of the bus service, introduced new low floor buses, re-zoned and simplified fares and put in place a comprehensive marketing strategy, including an innovative telesales campaign that was the first for a bus company.

Passenger growth on the service for the first two years of the project has been 56% and we are forecasting cumulative growth over a three-year period of 63%, with substantial modal shift from private car to bus. Market research has reported high user satisfaction levels, with a significant proportion of non-users indicating they were likely to turn to the bus.

Financial performance has moved from a loss of £120k in Year One, to £43k in Year Two and forecast loss of £30k in Year Three, with break-even in Year Four. Under Kick Start, the company would have bid for sufficient funding to cover these additional costs, which equate to a subsidy per passenger of only 18.5p. This represents excellent value when compared with other Government subsidy schemes, such as for rural buses, where each extra passenger costs up to £5.30.

Implications for the UK bus market

We consider around 10% of the existing Stagecoach route profile meets the necessary criteria and the development opportunity across the UK-wide bus network could be of similar proportion. Stagecoach estimates that a modest fund of £140m, spread over three years, would achieve passenger growth of 2% per annum across the whole UK network. The Government's 10-year 10% growth target would be delivered quickly, with a dramatic upsurge in provincial areas outside London. We estimate that some 169m car journeys per annum and 228,000 tonnes of CO₂ noxious emissions per annum would be saved, making a significant contribution to the Government's environmental targets.

Next steps

Stagecoach recommends that the Government should:

- carry out a best value assessment of Kick Start compared to other more long-term subsidy dependent schemes.
- establish a small Kick Start fund, to be administered by the Department for Transport, in early course to allow a best value assessment of the concept in relation to other more capital intensive projects.
- select a number of trial areas to test the innovation and ability of bus operators to bring forward suitable pilot schemes.
- choose pilot schemes from bids submitted by bus operators, based on a range of criteria, including value for money, potential to deliver higher quality services, increased patronage forecasts, delivery of modal shift from cars to buses, contribution to social inclusion and environmental objectives and creation of employment opportunities.
- consider a full roll out across the UK if the pilot schemes are successful.

Stagecoach believes Kick Start is an imaginative operator-led initiative, which will deliver the aspirations of the Government and those outlined in the Transport Select Committee report on the bus industry, published in September 2002.

What is Kick Start?

Stagecoach believes bus companies have unique market knowledge concerning routes and opportunities and a system of public investment that encourages risk and enterprise is the most efficient way of generating passenger growth.

Existing approaches to public funding start with local authority planners. Under current legislation, local authorities are able to provide for services that are not commercially viable and that they deem to be socially necessary. However, it is the nature of these routes that there is little prospect of passenger growth or commercial sustainability and that they will require on-going taxpayer support.

We fully support public funding for socially necessary routes, but we believe there is also a strong case for the Government to draw more widely the rules that cover current public investment, such as Rural Bus Grant and Rural and Urban Bus Challenge funding, to improve other parts of the bus network.

It is our view that additional public funding should be made available by Government to pump prime bus improvement projects that are not commercially viable in the short-term but which can be developed into commercially sustainable services over three years as a result of “one off” public support.

Kick Start would:

- replace endless, non-incentive subsidy with short-term, targeted public investment encouraging enterprise and risk.
- generate passenger growth rather than allow passenger levels to stagnate.
- fund running costs and marketing ideas, as well as servicing capital and interest payments, rather than produce no return.
- improve the quality of bus services, rather than perpetuate lower standards.
- stimulate demand from current non-users, and achieve modal shift from the car, rather than cater solely for the current user market.
- help increase social inclusion by improving access to work, health, education and leisure.
- create new jobs in bus service operations and vehicle manufacture.

How the system worked in New Zealand

The Kick Start approach already has a proven track record in New Zealand where Stagecoach has developed the initiative in partnership with the Government. Both partners recognised that bus priority measures alone were insufficient to develop rapid organic passenger growth.

The New Zealand system incorporates:

- Transfund, a Government-established central funding body, which makes payments to regional councils to enable authorities to contract bus operators to introduce service increases
- short-term investment over three years to fund public transport improvements until they attract sufficient new passengers to make these services sustainable.

Each project must meet efficiency criteria set by central government and must be centrally approved. At least 50% of expenditure under this scheme must be on additional services, and in practice most projects have been of this nature. Projects may also be for infrastructure improvements and public transport marketing initiatives.

The majority of Kick Start projects have arisen from ideas for service improvements developed by bus operators and then submitted to regional councils.

New contractual arrangements between regional councils and operators have been put in place which allow Kick Start funded service improvements to be introduced on the basis of negotiated short term contracts specific to those improvements. It is anticipated that, at the end of these short-term special contracts, the service improvements concerned will, if they are deemed to be successful, either be contracted out under the normal tendering process or be registered as commercial by the operator.

To date, the most successful projects have related to increasing frequency on existing routes. Encouraging patronage increases - up to 27%¹¹ over a 20-month period - have resulted on some of the main corridors in Auckland, where the provision of extra capacity and frequency has uncovered a latent demand.

Case study: Perth, Scotland

Following the success of the New Zealand scheme, the Stagecoach management team decided to undertake the first pilot of this approach in the UK to test whether similar results could be achieved.

Stagecoach identified a poor performing, low frequency bus route in Perth, a Scottish city with a population of around 50,000 people, as a candidate for the Kick Start approach. The route had a profile of aged owner-occupiers with high car dependency.

Perth and Kinross Council was about to introduce a bus priority scheme on the route, the first major use of such a scheme in the city. Further complementary local authority measures included new bus shelters and transponders to give buses priority at traffic light controlled junctions.

Stagecoach supported these steps by:

- doubling the frequency of the bus service and introducing low floor buses, although there was no business case in terms of historic profitability and the additional cost involved.
- re-zoning fares to make them simple and more understandable, resulting in a number of sizeable fare reductions.
- devising and implementing a detailed marketing strategy.
- distributing launch publicity and direct marketing to householders.
- undertaking follow-up door-to-door interviews with potential customers, including a discussion of the Government's environmental targets, the new bus lanes and Stagecoach's new service.
- offering free trips to prospective customers.
- launching a programme of on-bus marketing, children's competitions, pensioners' lunches and other promotions.

In Year Two of the project, non-users were targeted through a tailored direct marketing campaign to offer the bus as a transport mode of choice⁵.

Results of the project were:

- passenger growth of 56% on the service for the first two years (see Figure 1 below)
- forecast of 63%¹ cumulative growth over a three-year period (see Figure 1 below)
- modal shift from private car to bus.
- break-even point forecast for Year Four, following a pattern of improved financial results: from a loss of £120K² in Year One to a £43k loss in Year Two to a loss of only £30K in Year Three (see Figure 2 below)

Figure 1: Case study: Perth, Scotland: Patronage growth post service change

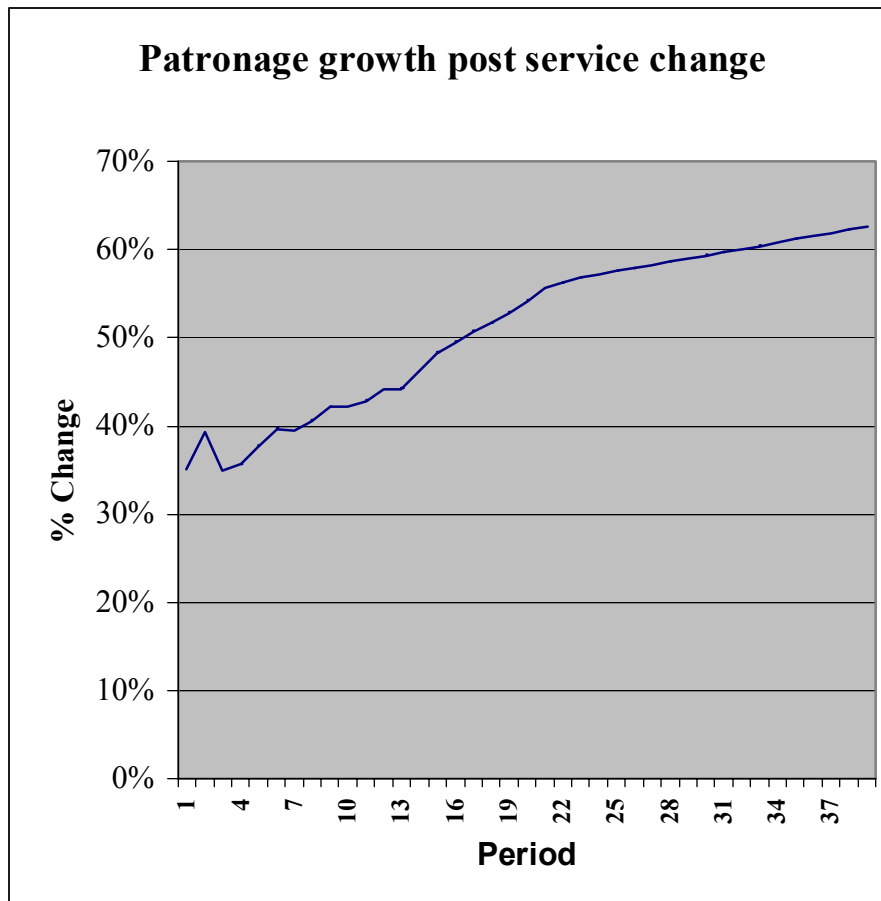


Figure 2: Case study: Perth, Scotland: Route profitability (£'000)

Years ending Period 6	Total Revenue	Total Costs	Mktg Costs	Total profit pre finance	Finance* charge	Total profit post finance
2001 Actual	342	341	0	1	0	1
2002 Actual	462	492	66	-95	25	-120 YEAR 1
2003 Projected	546	553	11	-18	25	-43 YEAR 2

* Note: This represents a Return on Capital of 8% on additional capital required for the project

Revenue growth over the period has matched pricing as fares returned to original levels, with no elasticity observed. On the basis of primary research undertaken in Perth³, new users in Perth are less price sensitive than in other areas of the UK.

Market research undertaken in Perth nine months into the project showed:

- high user satisfaction levels of 89%³, significantly better than the DTLR Quality Indicators Report, which recorded average overall satisfaction levels of 82%⁴ across the UK.
- positive perception of the service by existing non-users, with 46%³ of non-users stating they would “definitely” or “very likely” use the Stagecoach service within the next few months.

Using this information, Stagecoach tailored a telephone-based direct marketing campaign specifically targeted at these non-users to persuade them to travel by bus. This resulted in the conversion of 8%⁵ of those in the contact database to public transport and latterly feedback from these new customers has been very positive.

A Kick Start fund would have enabled the company to bid for sufficient support to cover the project costs outlined above.

The costs of the Perth project equate to a subsidy per passenger of only 18.5p, (See Figure 3) which represents excellent value when compared with other Government subsidy schemes where each extra passenger costs up to £5.30¹².

Figure 3: Case study: Perth Scotland – Equivalent subsidy per passenger

Route 7 Passenger journeys	Total Passenger journeys '000	Passenger Journey Increase '000
Base Year (prior to service change)	634	
Year 1	915	281
Year 2	1,001	367
Year 3	1,031	397
Total Increase in Passenger Journeys over 3 years		<u>1,045</u>
Route 7 net loss over 3 years (see Figure 2)		£193,000
Cost/passenger journey	193/1,045 =	18.5 pence per passenger journey

Kick Start's UK potential

The Stagecoach management team believe that the results of these projects illustrate that there is a large, latent market of non-users who are prepared to change modes.

Service expectations are much higher with these new customers and service delivery and marketing need to be tailored and innovative. Our research indicates that a potential 40%⁶ of the population of the UK have a suitable demographic profile for similar conversion to bus travel (87% of these live within 6 minutes of a bus stop with a service at least once an hour⁷). In terms of suitable routes, we estimate that 10% of the existing Stagecoach route profile across the UK meets the necessary criteria and the market opportunity across the country could be substantial.

The commercial reality, with the vast majority of bus operations run by transport groups with responsibilities to investors, is that no company would be in a position to attempt to roll out such a three-year programme due to the impact on profits and margins.

However, if the Kick Start project was replicated across the UK, the Stagecoach management team believe it could transform the existing pattern of bus use across the country to one of organic growth.

We estimate that a modest total fund of £140m would cover the three-year project period across the UK. This estimate was based on determining the level of Kick Start funding needed for Route 7 in Perth as a % of revenue in the last full year prior to the service change. The funding required for Route 7 to break even over the first three years is £193k. This equates to 56% of revenue in the base year. This percentage was then applied to the relevant amount of UK non-London revenue to arrive at an estimate for the industry.

Non London revenue was calculated as follows:

Non-London revenue 1999/00	2,196 ¹³
Add non-London concessionary fare reimbursement	350 ¹⁴
	<u>2,546</u>

Suitable market is 10% of non-London, i.e. £250m revenue

Kick Start funding therefore would be £250m x 56% = £140m.

We believe a Kick Start fund of £140m to cover the three-year project period would:

- boost annual patronage numbers by 2% per annum across the whole network (see figure 4 below).
- deliver the Government's 10-year 10% bus passenger growth target quickly.
- save some 169M⁹ car journeys per annum and approximately 228,000¹⁰ tonnes of CO₂ noxious emissions per annum, making a significant contribution to the government's environmental targets.
- deliver an additional £200m of investment in new Euro III standard buses (see Figure 5).
- create approximately 5500¹⁰ jobs.
- facilitate social inclusion in Public Transport.

At the end of the Kick Start funding period, the above benefits would continue to flow year on year as the bus services have become fully commercial and self-supporting.

Figure 4: Kick Start - Passenger growth potential for UK bus industry

Non-London passenger journeys in 1999/00 - 2,972m ^a		
Suitable market is 10% of Non-London; i.e. 297m passenger journeys		
Growth based on Route 7 experience		
Base Year	297m	
By Year 3 (Base + 63%)	484m	
Growth	187m	
Non-London growth for UK Industry	187/2,972	6.3%
This equates to compound annual growth of		2.1%
^a	Bus Industry Monitor 2001 Volume 1	

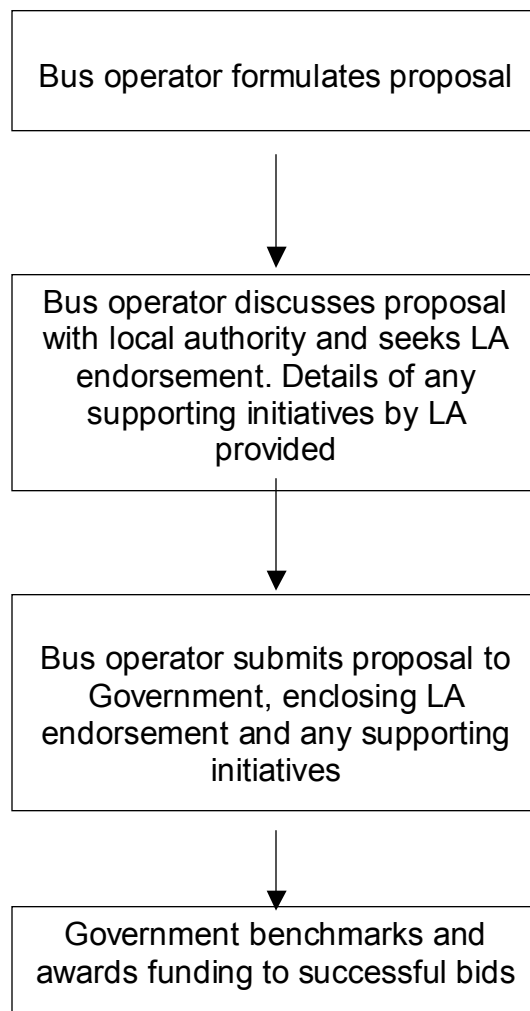
Figure 5: Kick Start – estimated investment in new Euro III Buses in the UK

2001 Total Fleet	36,104 ^a
Less London Fleet	<u>(6,500)^b</u>
	<u>29,604</u>
Suitable market = 10% of above figure	2,960
<p>Route 7 experience was an investment in new buses equivalent to 75% of the fleet in operation prior to the service change.</p>	
<p>Non-London figure for the Industry would therefore be investment in 2,220 vehicles (i.e. 2,960 x 75%).</p>	
<p>Total investment, at average of £90,000 per vehicle, would therefore be £200m.</p>	
<p>^a Bus Industry Monitor 2001 Vol.3 ^b Stagecoach estimate</p>	

How Kick Start would operate

The Stagecoach management team recommend that the Government establish a Kick Start Fund, which would be used to finance accepted Kick Start proposals. We envisage that a UK scheme could operate on the same principles as those established in New Zealand. While Kick Start proposals will be operator led initiatives, we believe proposed projects should only be considered if they also have the support of the local transport authority.

The proposed Funding Process may be illustrated as follows:

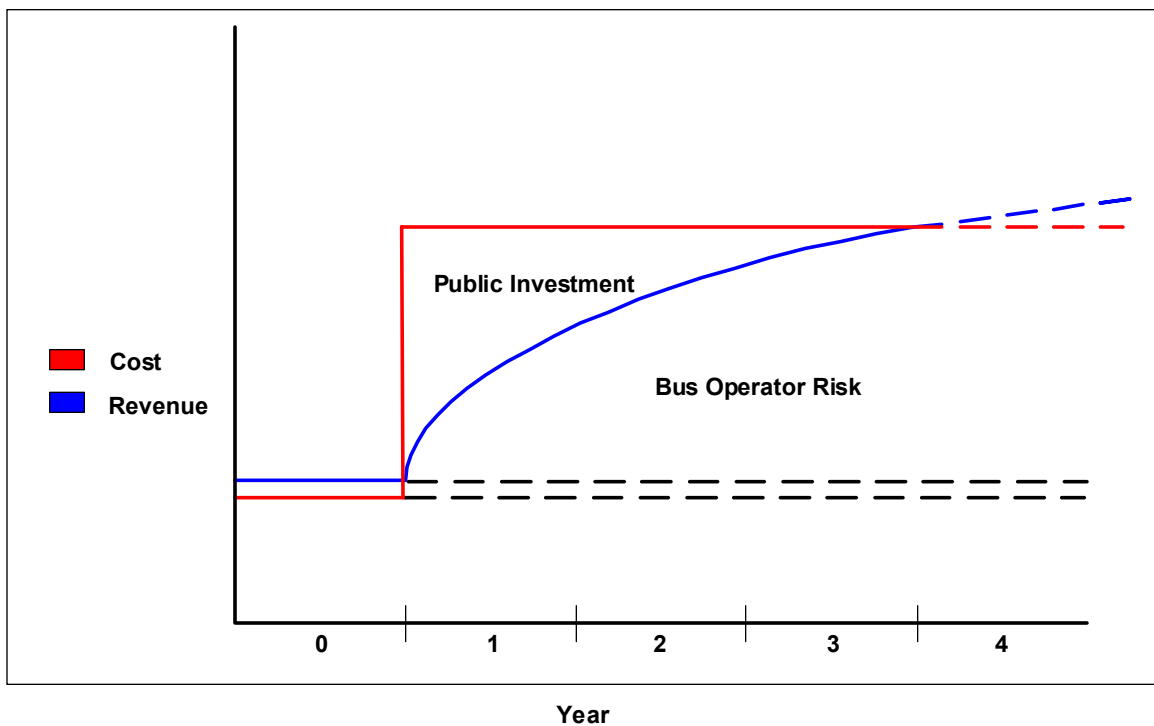


The underpinning principle of Kick Start is that the intervention funding is an incentive to encourage risk and enterprise.

Bus operators would have a contractual agreement with Government to operate a specific level of service over the three-year period. Government would agree a public investment profile based on passenger growth projections as submitted by the bus operator. Public support would fund the difference between the projected revenue and cost of the project. However, the bus operator would bear the risk. In the event that passenger volumes and revenue do not rise in line with projections or costs increase beyond forecast, the bus operator would be contractually bound to absorb the loss.

The risk and public investment profile is illustrated in Figure 6 below. By the start of Year Four, the service has become commercially sustainable and no further public investment is required.

Figure 6: Kick Start: illustrative risk and investment profile



Stagecoach is confident that Kick Start will provide excellent returns for Government and local authorities in meeting bus passenger growth and modal shift targets.

Stagecoach would welcome a dialogue on a detailed model for Kick Start, drawing on the New Zealand experience and statistics from our UK pilot project. Our experience suggests that three years is the optimum period to fully test and refine the improved service, and achieve a reasonable rate of commercial return. At the end of the three-year period, the service would continue on a fully commercial basis without external support funding.

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