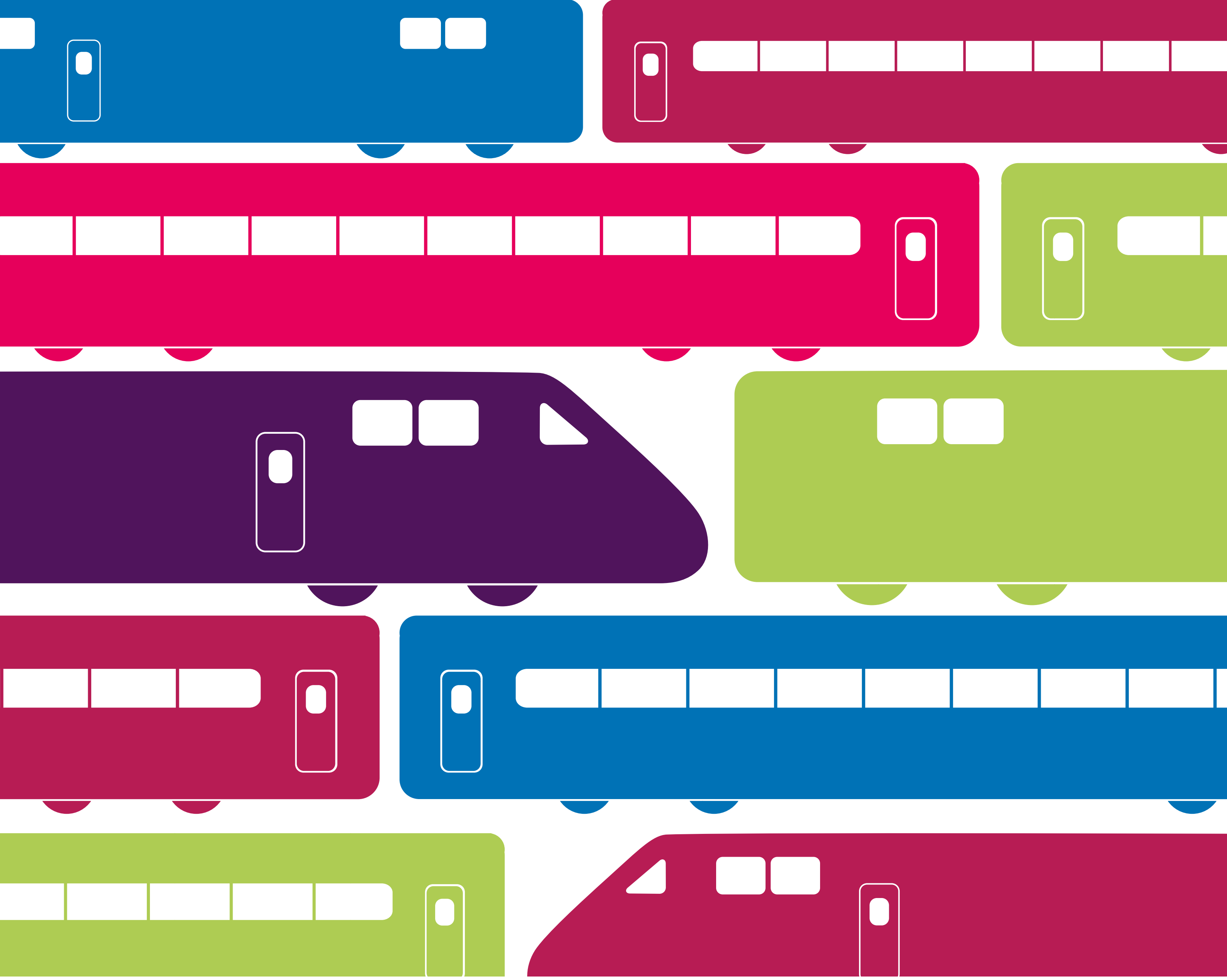


Growth and prosperity
How franchising helped transform the railway into a British success story

ATOC

Association of Train Operating Companies

ATOC.ORG JULY 2013

Foreword by Tim O'Toole

What follows in this report is a straightforward, almost modest, description of the unprecedented growth and stunning improvements in the British rail system since rail franchising was introduced in the mid-1990s.

The facts are beyond dispute:

- Record numbers of passengers, reversing a downward trend, with the longest sustained growth in history
- Significant improvements in performance and punctuality scores, and frequencies between major cities
- Improvements in safety and passenger approval ratings

How did this happen? How do policy makers distinguish causation from correlation?

This report, based on data collated and analysed by KPMG, provides important evidence to demonstrate the essential role franchising and private sector operators have played in the success of the past 20 years. This original research underlines the significant contribution rail franchising has made in reversing the industry's fortunes, delivering exceptional journey growth and substantial passenger benefits.

At the heart of this success story lies a clear determination by train operators to use their skill and creativity – born of the flexibility of the private sector – to innovate and meet passengers' expectations; and by successive Governments, working through Network Rail, to invest unprecedented sums in our national rail infrastructure.

As this research makes clear, neither element would have created this growth without the other. Conservative, Labour and Coalition Governments have believed in the franchising model and our industry partnership; and have chosen to keep investing in rail.

The franchising model in Britain, like the rest of the industry, has evolved since its introduction and the railway's transformation continues, most recently through the creation of the Rail Delivery Group (RDG). Franchising in the context of greater co-ordination among the train operating companies, freight operating companies and Network Rail is the next logical step for the industry as it evolves to the next stage of capability.

Systems, all systems, inevitably become more complex in order to achieve greater capability and productivity. Franchising's diversity of operators has yielded the innovation that has led to growth to which a single state operator would never aspire. The RDG represents the industry's determination to preserve that record of achievement while offsetting the industry's necessary complexity.

Our next stage of development will ensure that the interests of passengers, and not contractual relations, drive everything we do. By working in partnership with Government, Network Rail and the rest of the industry, franchised train companies will continue to strive for a bigger and better railway, not simply because encouraging more people to travel by rail is good for our business, but because it is vital for the future of the economy and the country.

In so doing, operators will help to equip Britain with a railway fit for the decades to come.

Tim O'Toole is CEO of FirstGroup plc and RDG chairman


43165

Foreword by Sir David Higgins

The railway has seen a decade of unprecedented growth. Compared with just 10 years ago, there are a million more trains and half a billion more passengers every year. And this growth is set to continue. We forecast that, by 2020, another 400 million rail journeys will be made.

This phenomenal growth is driven by a multitude of factors. Social and economic changes within Britain have a big role to play. As more jobs are located in city centres but people's homes are in suburbs, or even different towns, commuting has increased markedly.

The growing role of communications technology in our everyday lives also means that people have wider social networks and are more likely to travel to visit friends and family who don't live nearby. Alongside these changes to the way people live and work, the cost of fuel, running a car and road congestion all impact on the number of people who travel by rail.

There is no question that train operators have also played a key role in making rail an attractive way to travel. The industry's separation of infrastructure provider and train operator has allowed operators to focus on passenger needs and preferences, to make significant strides forward in understanding their markets and to tailor the services they offer.

This research makes an important contribution in highlighting the passenger benefits that operators have delivered and the role they have played in attracting passengers to the railway.

As an industry, it is our responsibility to understand this wide range of different drivers of growth and how they all interact with one another. This understanding is vital to inform our strategic planning of how the rail network and rail services need to grow and evolve in the future.

What is clear is that maintaining a strong focus on whole-life, whole-system management and development of the network is critical to ensuring the continued success of the railway. Whether we are working alongside franchise operators, concessionaires, open access operators or freight operators isn't the key issue. The key issue is that we work collaboratively with all operators to deliver outstanding value for rail users and taxpayers.

The industry has come a long way in recent years but we need to build on what we have achieved. 2020 and its 400 million extra journeys is only seven years away. This is a time for us to work together, to consolidate the understanding and experience we have gained and build a better railway for a better Britain.

Sir David Higgins is Chief Executive of Network Rail and RDG deputy chairman

Executive Summary

The story of the railway in Britain over the past 20 years is a story of success. A strong partnership between the public and private sectors has delivered for passengers, taxpayers and the country as a whole.

Significant investment and an industry focused on attracting more rail users are generating passenger growth unseen for more than 80 years. This is generating record levels of revenue to pay for more and better services, in turn creating a virtuous circle by encouraging greater rail use.

Crucial to this success was the introduction in the mid-1990s of competition between private train companies to win franchises to run passenger services. This report, based on an analysis of rail data by KPMG[1], provides powerful evidence that franchising is a key ingredient in the industry's recent success in three key areas[2].

Operators are generating more revenues, helping to reduce public subsidies and sustain investment while earning modest operating margins:

- Passenger revenue has risen by £3.2 billion, with 96% of the increase coming from passenger growth and 4% from fares changes *(see Fig A)*
- Passenger journeys per train operator employee have increased by 37%, an improvement in staff productivity that has helped to contain the cost of train operations
- The achievements on revenues and train company-controlled costs has increased the money flowing back to Government to reinvest in rail by £1.3 billion, from £400 million in 1997-98 to £1.7 billion in 2011-12
- Operating margins are on average around 3% of turnover

Passenger growth has outperformed key external demand factors, gaining market share and outstripping other European railways:

- Journey numbers have increased by 73%, with the growth rate more than doubling since the last years of British Rail (BR)
- Train journeys have grown twice as fast as the growth in GDP while rail and car usage costs have broadly mirrored each other
- Passenger growth in Britain has been greater than in France, Germany and the Netherlands

Growing numbers of rail users have been registering record levels of satisfaction, while the network is managed more intensively and the average price per mile paid by passengers has remained almost flat:

- On a railway effectively the same size as 15 years ago, there are now 4,000 more services a day, a 20% increase

[1] Most of the data is publicly available and comes from established industry sources including the Office of Rail Regulation, Passenger Focus and the Rail Industry Monitor

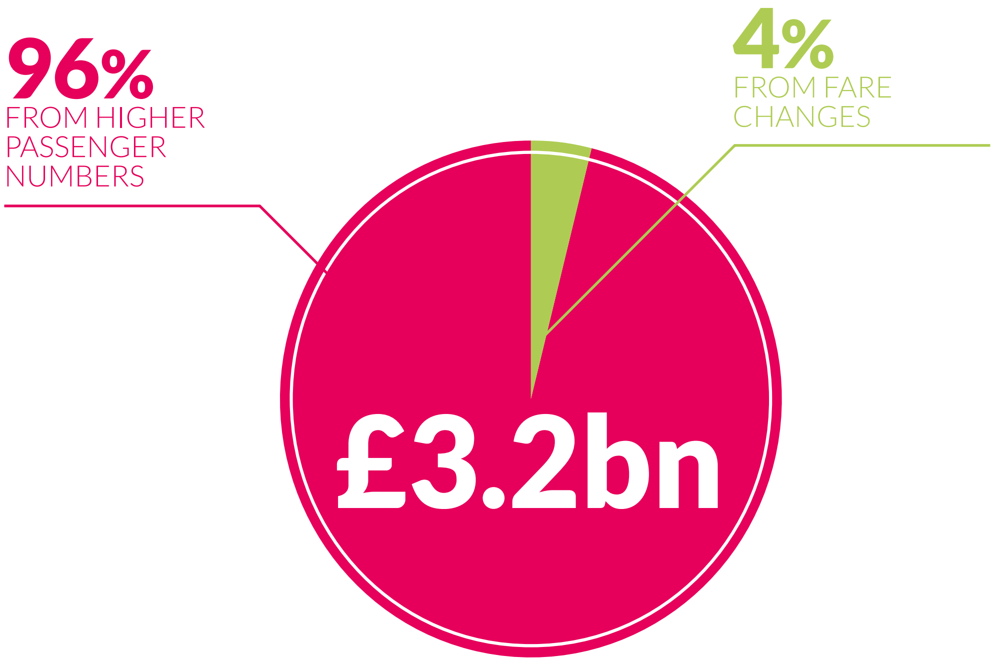
[2] Unless stated, comparisons cited in the Executive Summary refer to the period from 1997-98 to 2011-12 and monetary figures are in 2012 prices

[3] Throughout the report, Government refers in most cases to funders which include the UK Government, the devolved Governments in Scotland and Wales, Transport for London and other devolved bodies

- Over 500 million more journeys are described as satisfactory or good by passengers since the National Passenger Survey was launched in 1999, while punctuality is at a near-record high
- The overall average price paid per passenger mile has risen in real terms from 19.6p to 20.4p[4], with a wide choice of fares, including some of the lowest in Europe

In contracting private companies to operate trains, Government has devised a winning formula where competition injects new ideas and skills to enhance services, attract more passengers and keep costs down. It is a model that will deliver further improvements in rail services, and that other countries are keen to learn from and emulate.

Figure A THE VAST MAJORITY OF THE £3.2BN INCREASE IN PASSENGER REVENUE HAS COME FROM PASSENGER GROWTH



[4] This provides an average indicator of all the different fares bought by passengers, including Season Tickets, Advance and Off-Peak

Passenger rail – a success story

The Railways Act of 1993 resulted in a move away from a nationalised industry to a privately-run and publicly-accountable railway. This allowed the then Government to transfer tracks, signalling, tunnels and stations to Railtrack (privatised in 1996).

The Act also introduced a system whereby private train companies competed to win and run passenger services on that infrastructure, typically for seven years.

Since then, the industry has continued its evolution through many changes and some challenges. When Railtrack collapsed in 2001, with taxpayers picking up a substantial bill, Network Rail (NR), a not-for-dividend company, was created to take responsibility for this infrastructure and has operated successfully since.

Unlike Railtrack, franchising has been a highly successful model that has delivered stability and growth. Franchises have been awarded more than 40 times by Government and other funders since the model was introduced. On just three occasions have operators been unable to continue and the franchise surrendered, resulting in operations ceasing. For the companies involved, this was far from costless, both financially and in terms of reputation, although on each occasion services were maintained without disruption to passengers.

Sixteen franchised train companies, two concessions and two main open-access operators now run passenger rail services in Britain, along with direct operation of East Coast mainline services by the Government (which are due to return to private operation in 2015).

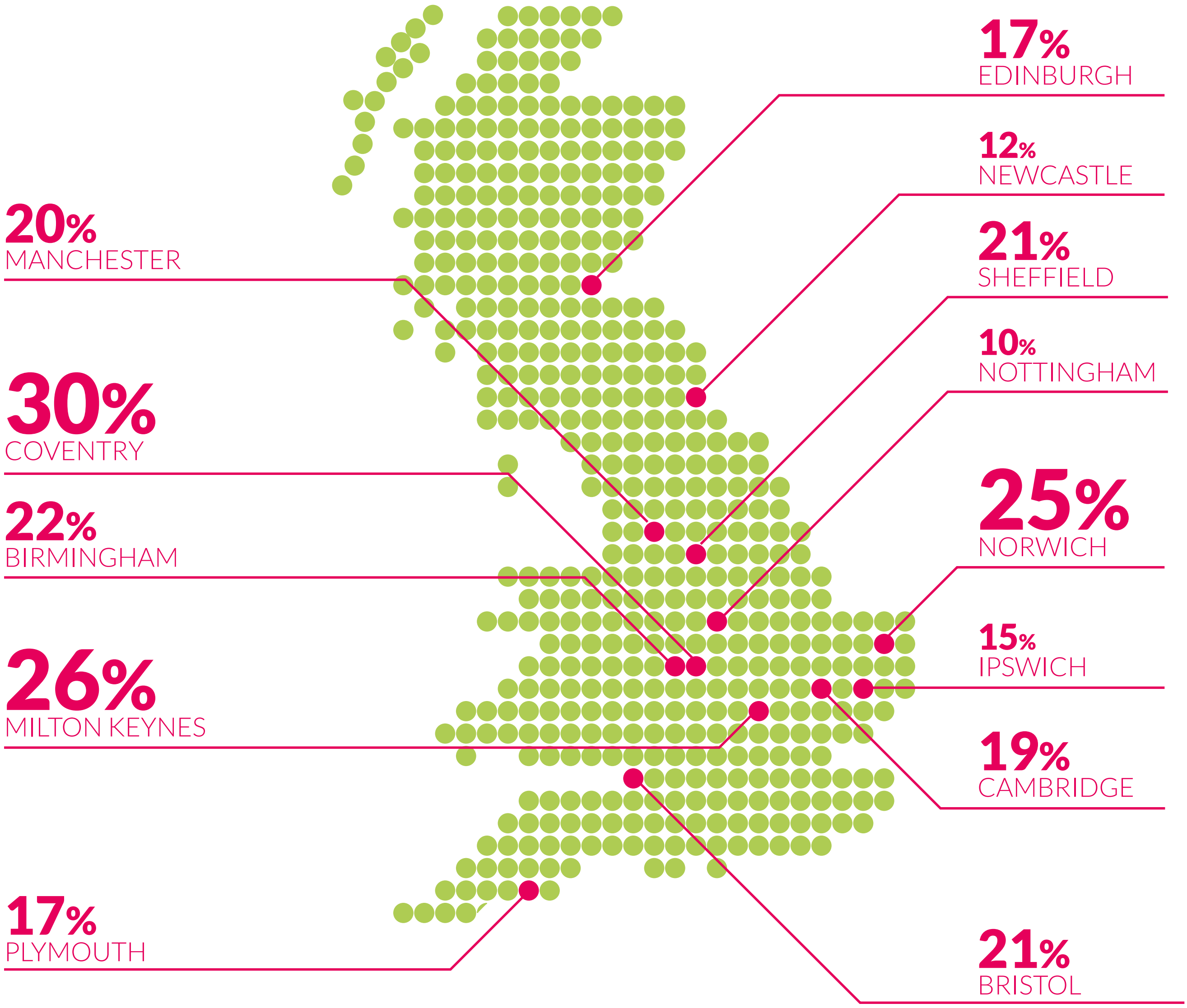
In a sector where private train companies work in partnership with Government, NR, freight operators, the industry supply chain and key stakeholders, the structure has allowed each party to focus more clearly on securing improvements in their areas of responsibility. As the culture of the industry has matured, collaborative working has become more commonplace, enabling improved efficiency and better services for passengers.

ATOC asked KPMG to collate and analyse rail data, particularly on passenger rail operations[5] and how they have fared in recent years against a range of important indicators. The analysis[6] underpinning this report includes comparisons of passenger operations in Britain since the first full year of private passenger rail operations in 1997-98 with the last 15 years of BR, and with railways in a selection of other European countries. The most important aspects of the analysis divide into three key areas, which this report now focuses on in detail.

[5] Franchises and concessions

[6] Passenger rail: dataset on financial performance, growth and passenger benefits, 1997-98 to 2011-12, ATOC, July 2013

Figure B DOUBLE-DIGIT RAIL GROWTH THROUGH RECESSION



AN ATOC ANALYSIS PUBLISHED IN MARCH 2013 SHOWED SOME OF BRITAIN'S BIGGEST TOWNS AND CITIES, EXCLUDING LONDON, SAW DOUBLE-DIGIT GROWTH IN RAIL JOURNEYS DESPITE THE 2008-12 ECONOMIC DOWNTURN

Source: Lennon Database

Financial success

In the decade and a half since franchised train operating companies (TOCs) started running services, they have significantly increased revenue while containing the growth in the operating costs they can control (that is, excluding infrastructure-related costs). This has created a growing financial surplus[7], the vast majority of which is ploughed back into the upkeep and enhancement of the network, to the benefit of passengers and taxpayers *(see Fig C)*.

Figure C SURPLUS GENERATED BY TRAIN OPERATORS HAS RISEN FROM £600M TO £2BN

Aggregate costs TOCs control and revenue – 2012 prices

£BN REAL	1997-98	2011-12	Change
PASSENGER REVENUE	4.0	7.2	+3.2
OTHER TOC REVENUE	0.6	0.7	+0.1
TOTAL TOC REVENUE	**4.6**	**7.9**	**+3.3**
STAFF COSTS	(1.3)	(2.2)	(0.9)
ROSCOS	(1.2)	(1.5)	(0.3)
OTHER OPERATING COSTS	(1.5)	(2.2)	(0.7)
TOTAL TOC-OWNED COSTS	**(4.0)**	**(5.9)**	**(1.9)**
SURPLUS GENERATED BY TRAIN OPERATIONS	**0.6**	**2.0**	**+1.4**

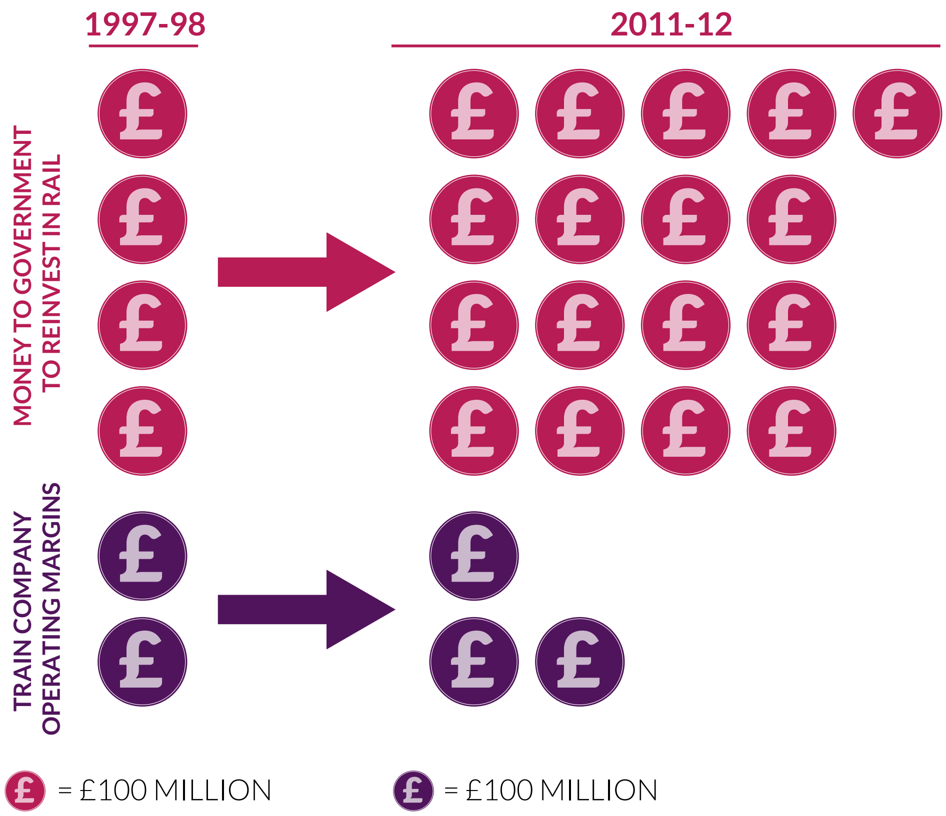
[7] This has been calculated to show the surplus generated by train companies before payments are made towards the network's infrastructure costs, their own shareholders, or to/from Government

The main driver behind the increased revenue is the rise in rail usage: 96% of the real-terms growth in passenger revenue of £3.2 billion since 1997 results from journey growth, with 4% coming from fare changes over the same period.

Leaving aside access charges paid to NR[8], over which train companies have no control, the surplus generated by train operations has increased by £1.4 billion in the 15 years up to 2011-12. Almost £19 out of every £20 of this increase has gone back to Government. It in turn has chosen to reinvest this money in NR.

In 1997-98, train operations generated £600 million, of which £400 million went back to Government. Fifteen years later, the equivalent figures had risen to £2 billion and £1.7 billion – an increase of £1.3 billion going back to Government *(see Fig D)*.

Figure D SURPLUS GENERATED BY TRAIN OPERATORS



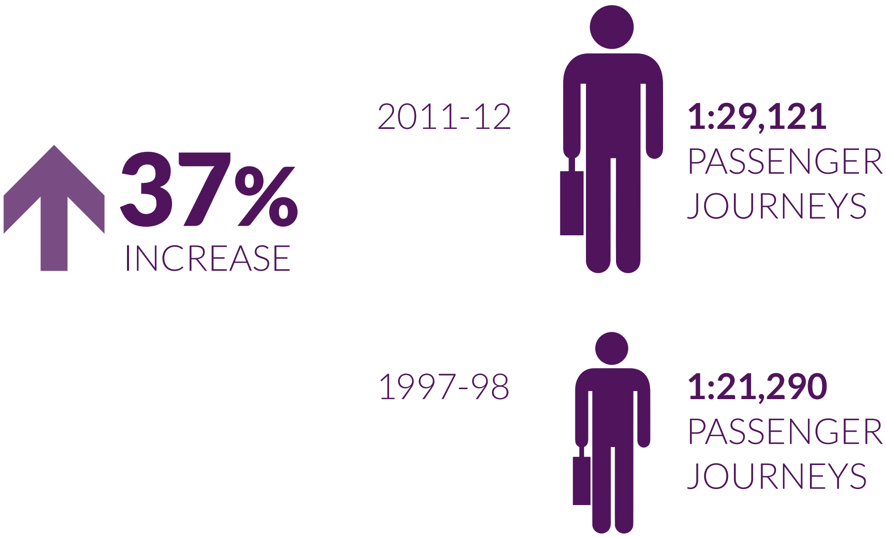
The other factor behind the growth in financial surplus is that operating costs have not risen as fast as revenue because productivity has improved. Train operators now employ over 10,000 more people than in 1997-98, a 26% increase, yet over the same period, passenger journeys per train operator employee have grown by 37%[9] *(see Fig E)*.

[8] See also the section below on investment on this issue

[9] In 1997-98, there were 21,290 passenger journeys per train operator employee; by 2011-12, this had increased to 29,121

Figure E IMPROVED PRODUCTIVITY

RATIO OF EMPLOYEE TO PASSENGER JOURNEYS INCREASED BY 37%

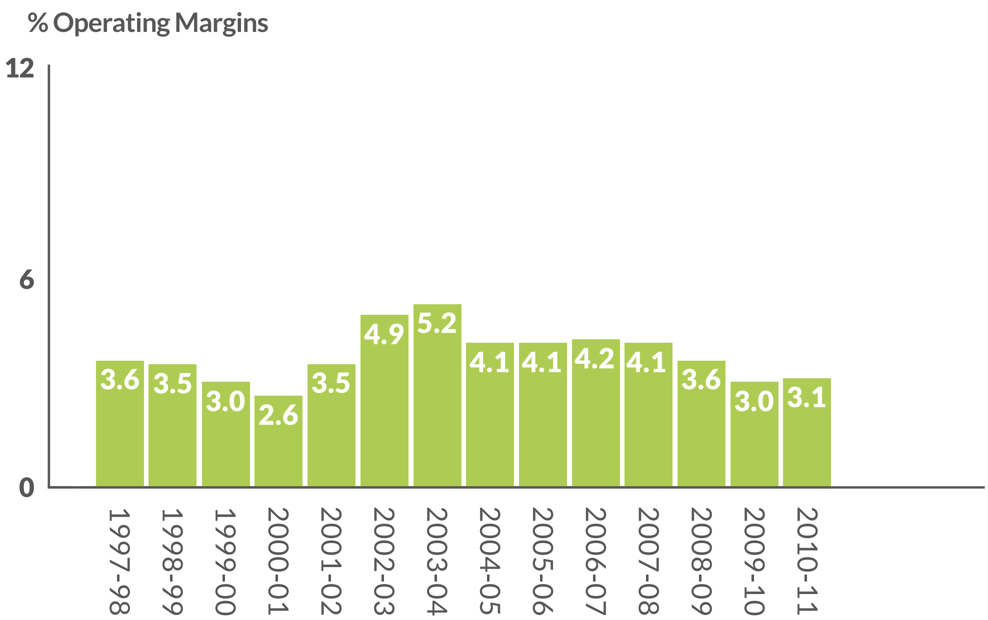


As well as improving efficiency, train operators have invested heavily in improving the skills of their workforce and achieved a record of positive industrial relations, with a dramatic reduction in the number of days lost to strike action since the mid-1990s.

The efforts of train companies, incentivised under franchising to contain costs, are also reflected in the most recent international comparison. European benchmarking analysis undertaken for the Office of Rail Regulation (ORR)[10] stated that "GB [train operating companies'] normalised total costs per train km are at the lower end in commuter and long-distance services."

[10] European Benchmarking of the costs, performance and revenues of GB TOCs, Civity, November 2012

Figure F AVERAGE TOC OPERATING MARGINS



The analysis undertaken for the ORR provides a far more accurate picture than the 2011 McNulty report, which sought to show how Britain compared with other countries but which was hampered by data limitations. This was because, in the time available, the McNulty team were unable to separate train company costs from those of infrastructure in the way that the more recent European comparison has done.

The competitive nature of franchising has also been a key factor in ensuring that the growth in passenger revenue and the money from train operations flowing back to Government have far outpaced operating margins of train companies in absolute and relative terms.

In 2010-11, the operating margins were on average around 3% of turnover, 15% lower than in 1997-98 *(see Fig F)*. Indeed, some franchises have made losses in recent years, as the Transport Select Committee showed in a recent report[11]. By comparison, the profits made by Britain's supermarkets are currently around 5% in a notably low-margin, high-volume business.

[11] Rail 2020, House of Commons Transport Committee, January 2013

Of huge significance to the railway has been the massive investment made during the past decade and a half by successive Governments in the country's railway infrastructure. A major factor in making possible this commitment to invest has been the growth in the surpluses generated by train operators.

The surplus has enabled major investment by NR to address the maintenance backlog inherited from BR and Railtrack, and to enhance the network through the biggest investment programme in decades *(see Fig G)*. Even with this expenditure, the net effect of cost efficiency in the whole industry and passenger growth in train operations has meant overall Government support for the railway has been falling since 2006-07 and is set to fall further.

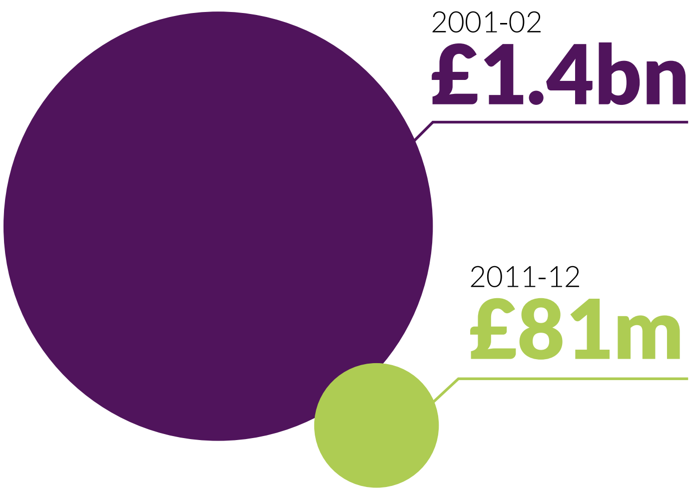
Figure G RAIL EXPENDITURE TACKLING BACKLOG INHERITED FROM BRITISH RAIL AND RAILTRACK SINCE 1997-98

2011-12 prices	£bn	%
OPERATIONS, MAINTENANCE, RENEWALS	83.8	85%
ENHANCEMENTS	15.0	15%

A key component of this is that net direct Government subsidy to train companies through franchise agreements has fallen in real terms from £1.4 billion in 2001-02 to £81 million in 2011-12 – a 94% reduction over the last decade[12]. This drop in Government support has come about because of the large increase in passenger revenue driven by journey growth *(see Fig H)*. It has been achieved largely independently of the Government's decision to change the rules in 2001-02 and pay some of Railtrack/NR's costs directly rather than via access charges paid by train companies.

[12] This period has been chosen because network grant was paid to Network Rail every year in this decade, unlike the previous years when Railtrack's access costs were paid entirely by train operators

Figure H NET DIRECT GOVERNMENT SUPPORT TO TOCS DOWN FROM £1.4BN TO £81M IN A DECADE



The access charge framework put in place by Government ensures that any changes are revenue-neutral to train companies – i.e. any benefits due to a reduction of the charge are clawed back pound for pound by Government as part of the contractual arrangements set out in each franchise agreement.

Although the total subsidy to the industry at around £4 billion is higher than in the last years of BR in absolute terms, such a comparison fails to take into account the vast increase in passenger numbers since the 1990s. While 2006-07 remains the high watermark of subsidy per journey at £6.52, the equivalent figure five years later was £2.67, 18% lower than in 1997-98[13]. The 2011-12 subsidy per journey figure is also lower than or the same as that for six of the 12 years leading up to privatisation.

This is a considerable achievement given that BR had not been able to invest adequately in track and fleet renewal over many years because its subsidy was squeezed, whereas today's rail industry is able both to renew and expand while reducing subsidy.

[13] All in 2012 prices

Unprecedented growth

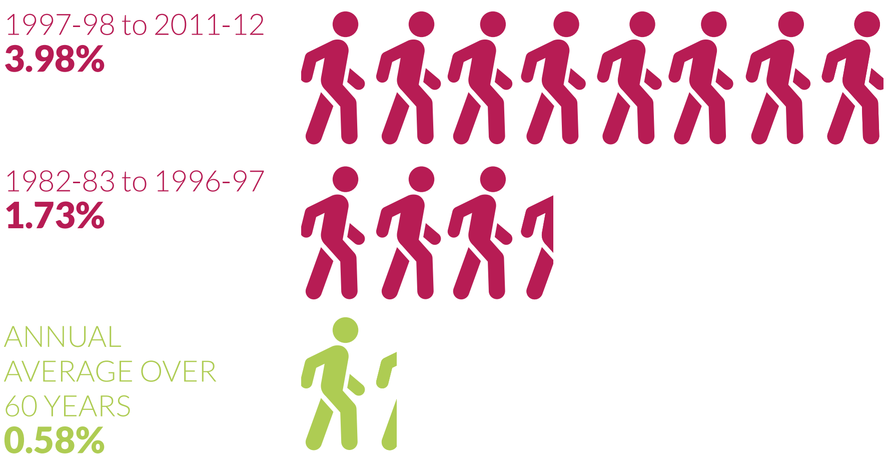
The increasingly large amount of money generated by train operations that plays a significant role in underpinning the industry's finances is driven by unprecedented growth in rail travel. The data collated by KPMG demonstrates that this growth has outperformed key external demand drivers.

Between 1997-98 and 2011-12, passenger journeys increased by 73%, from 845 million to 1,460 million.

Passenger numbers were picking up in the decade or so before privatisation but the rate of growth has increased significantly since the mid-1990s.

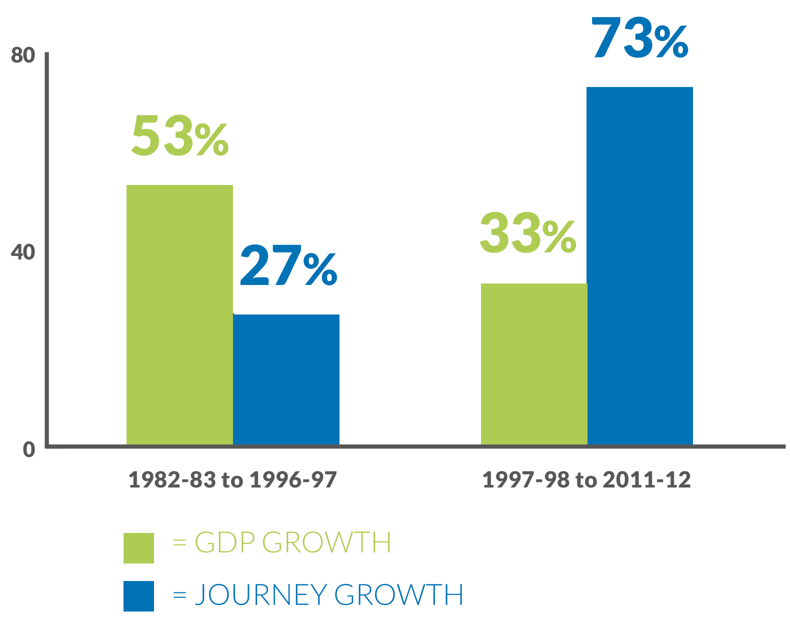
In the 15 years before 1997-98, annual passenger journey growth was 1.73%; thereafter, this more than doubled to 3.98% a year. The rate of growth in recent years is striking when compared with an equivalent figure of 0.58% for the past 60 years *(see Fig I)*.

Figure I ANNUAL PASSENGER JOURNEY GROWTH



Some commentators argue greater rail use is a product of Britain's economic growth over this period. However, the data shows that the correlation between the two is far from complete. Since 1997-98, rail journeys have grown at a rate twice as fast as the growth in GDP, while in the previous 15 years journey growth was around half that of GDP growth. Economic growth has helped to increase journey numbers but it cannot alone explain the unprecedented increase in rail travel *(see Figs B and J)*.

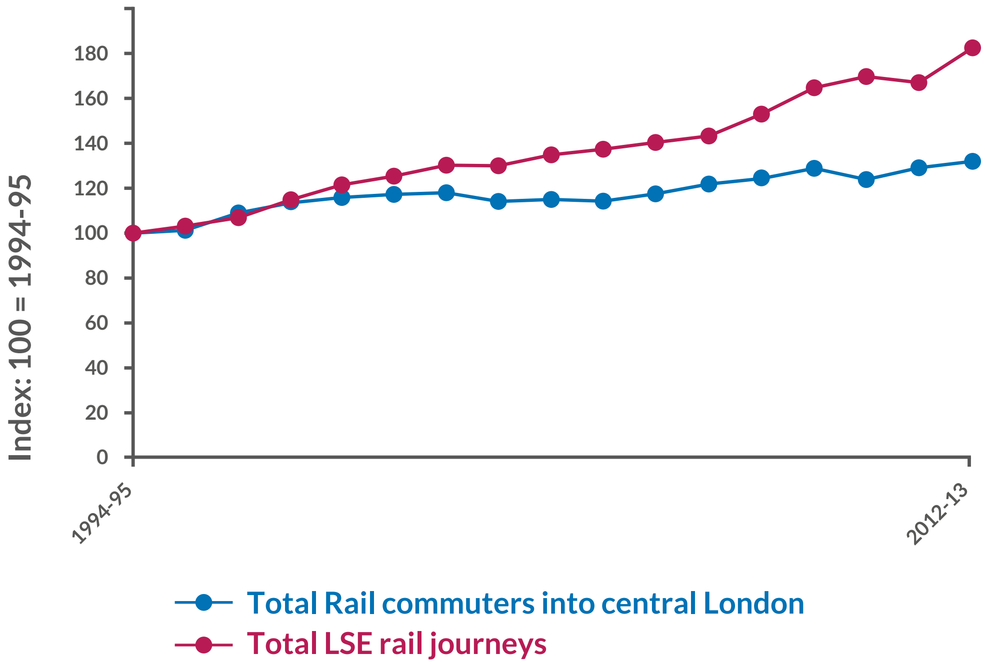
Figure J ECONOMIC GROWTH CANNOT ALONE EXPLAIN RISE IN RAIL TRAVEL



The analysis also looked at whether another factor has been the increase in morning and evening peak travel into and out of London and in particular whether there is a 'London effect', where rail use has grown because the London and South East economy has a growing and captive commuter market.

The mainline rail network does indeed play a major role in London, carrying more than half a million commuters into the capital each working day. But peak journeys have grown by just 17% in the past 15 years, whereas total travel in London and the South East (including peaks) has grown by 73%, almost exactly in line with the national average. This indicates that the major growth in travel has not been on the back of a captive commuter market *(see Fig K)*.

Figure K RAIL GROWTH NOT ON BACK OF 'LONDON EFFECT'

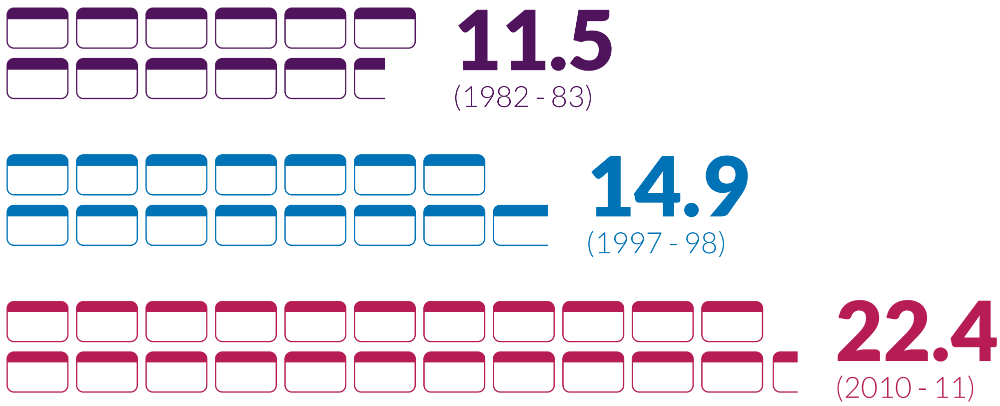


Nor is the increase in journeys at a national level purely a reflection of population growth. Annual rail journeys per head of population rose *(see Fig L)* during the years leading up to franchising from 11.5 in 1982-83 but accelerated significantly thereafter to 22.4 in 2010-11[14]. Rail's market share[15] was 5.8% in 1982-83, and dropped to 4.7% in 1997-98 before rising again to 6.9% in 2010-11.

[14] Journeys per head of population were 14.9 in 1997-98

[15] Compared with other modes of transport

Figure L RAIL JOURNEYS PER PERSON OUTSTRIPPING POPULATION GROWTH NATIONALLY

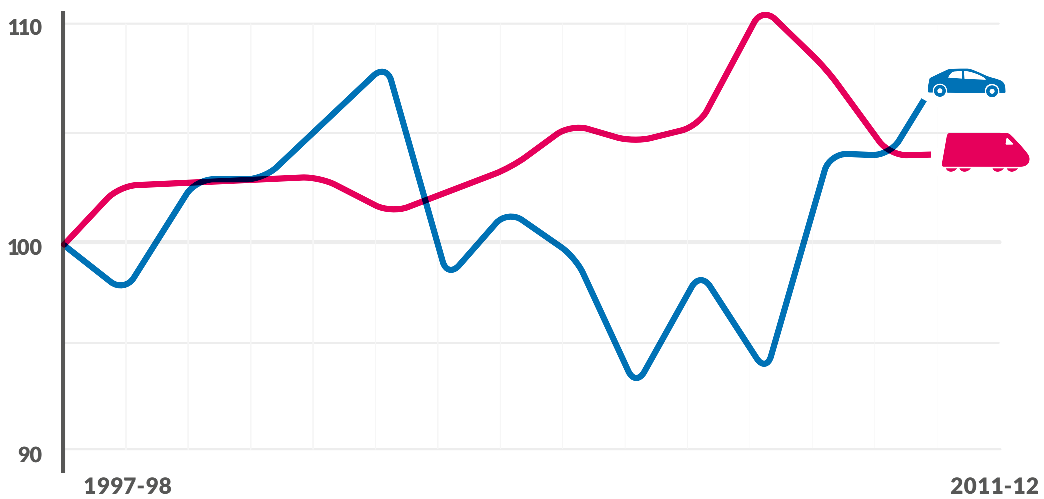


As the RAC Foundation noted in On the Move, its report[16] published last year, this growth in rail travel, compared to car use, is remarkably evenly spread across the country and has resulted from a larger proportion of the population using rail services over time, rather than existing passengers travelling more often.

"The main conclusion concerning the increase in National Rail travel between 1995-97 and 2005-07 is that the growth in passenger kilometres of 50% per person is almost entirely explained by an expanding market base," the report said. Rail's market has continued to expand since the data was evaluated in the RAC report.

Rail's growth also cannot be explained by car usage becoming more expensive. Although there have been year-by-year fluctuations in the respective price of travelling by train and by car, across the period since 1997 as a whole they have broadly mirrored each other *(see Fig M)*.

Figure M RAIL AND MOTORING COSTS HAVE BROADLY MIRRORED EACH OTHER

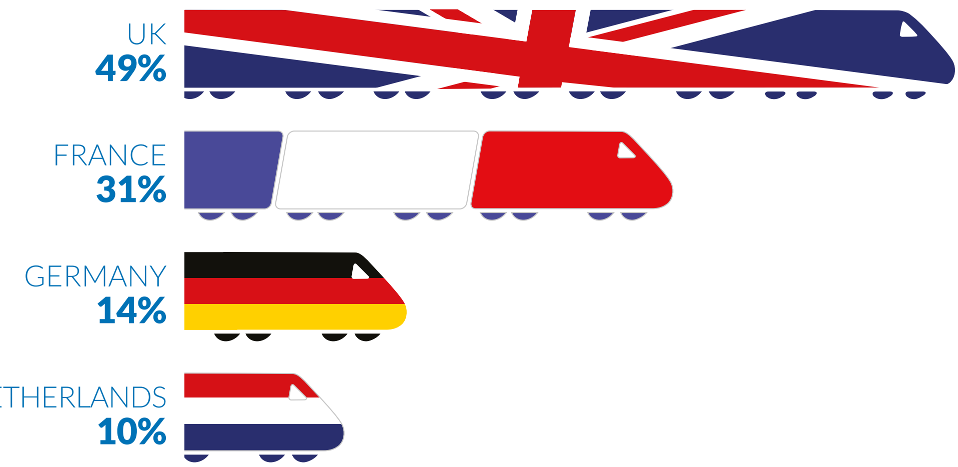


[16] On the Move: Making sense of car and train travel trends in Britain, Scott Le Vine and Peter Jones, RAC Foundations, December 2012

Growth on Britain's train operations has also significantly outperformed publicly-run railways at home and abroad. Passenger journeys on National Rail services in London and the South East have risen by 73%, as previously stated: for the publicly-run London Underground, the increase was 41% between 1997-98 and 2011-12. The growth of UK rail also far exceeds that of the state-owned railways in France, Germany and the Netherlands *(see Fig N)*.[17]

Figure N JOURNEY GROWTH IN BRITAIN HAS OUTSTRIPPED EUROPEAN COMPARATORS (1998 TO 2010)

UIC Railisa data only available until 2010. UK journey growth over longer 1997-98 – 20011-12 period is 73% (see page 16)



While it is the case that significant investment in new trains, faster services and better stations has helped to drive growth, it is important to note that most of the expenditure by Railtrack and NR between 1997-98 and 2011-12 has been spent on maintaining the railway. This cleared the backlog in maintenance and renewals that happened under BR.

There is no doubt that this expenditure has been important in restoring the reliability of the railway, helping to make rail travel more attractive and generate passenger growth. Yet only 15% of the money spent on the infrastructure has been available for enhancements to the network as opposed to maintenance and renewal work, much of which has been invested in recent years. This expenditure is vital to serving the growth in demand, but it too does not alone account for the higher passenger numbers over the period.

[17] UK also increased rail journeys per head of population between 1998 and 2010 from 15.3 to 21.5. Over same period France increased from 14.1 to 17.2, Netherlands from 18.7 to 19.5 and Germany from 20.2 to 23.2.

Consumer success

If external demand drivers and other factors cannot alone explain rail's success, what part has been played by franchising where train operations are focused on delivering what customers want? Franchises are strongly incentivised to deliver and, where possible, exceed the revenue targets set out in their bids: the key to this is finding out what customers want and delivering in a cost-efficient way.

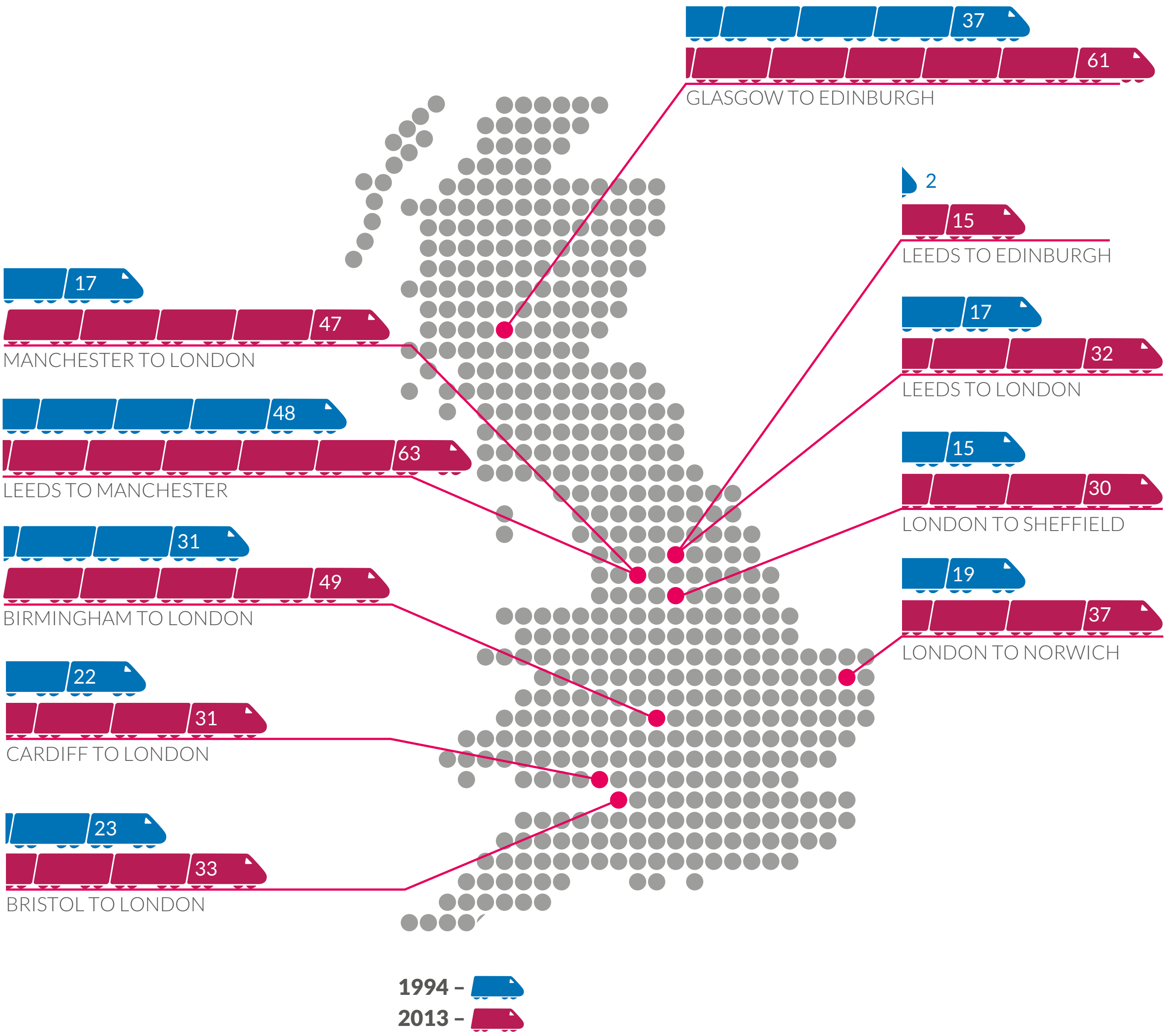
The National Passenger Survey (NPS), produced twice a year by Passenger Focus, the independent passenger watchdog, shows that train operators have been delivering greater satisfaction with services. Overall satisfaction levels were 76% in 1999 and 82% by spring 2013[18].

The NPS shows that passengers want a more punctual railway. Partnership working between NR and train companies has helped the recovery from the huge drop in performance after the Hatfield crash of 2000. Performance has now overtaken the level in 1997-98 to stand at a near record high of 91.6% of short and long-distance services arriving respectively within five or 10 minutes of their scheduled arrival time in 2011-12.

Steps to improve the comfort of passengers and provide more services have also helped to transform the railway beyond recognition in the past 15 years. There are now 4,000 more services a day than in the mid-1990s – a 20% increase. Frequencies on many mainline routes across the country have been doubled since 1997-98, with most large cities now connected by intercity train services running at least every 30 minutes and some every 20 minutes *(see Fig O)*.

18 Passenger Focus's findings echo those of the 2011 Eurobarometer survey which also shows the UK in the top quartile of European comparators for satisfaction with punctuality, journeys and frequencies

Figure O MORE INTERCITY TRAINS
NUMBER OF TRAINS PER DAY



Private operators working with leasing companies have financed almost £5 billion of investment in new trains, replacing about half of the fleet inherited from BR. Almost all of the rest of the fleet has been refurbished with more comfortable interiors and improved accessibility, transforming the railway from the days of widespread use of slam-door trains before franchising.

Nearly all new trains ordered in the past two decades have had air-conditioning as standard as operators have recognised the need to provide a journey experience that offers the same, or better, comfort than car travel. Wi-fi is being rolled out across the network by operators, recognising that passengers want to be online for work or leisure throughout a journey.

Compared with other transport modes in this country and railways in Europe, Britain's railway has led the way in providing information and data to passengers, helping them to find the right service at the right price and access up-to-the-minute travel news. Set up and run by train companies, National Rail Enquiries is the most popular travel information service in the country and has won multiple awards.

At the same time, improvements are being made in the provision for passengers who need assistance in travelling on the railway. Passenger Assist, launched by operators in 2012, is a free service for disabled passengers and others who require assistance with any part of their train journey.

On a network effectively the same size as 15 years ago, train companies are carrying 73% more passengers with a fifth more vehicles, and they have achieved this with only a marginal increase in rush-hour crowding levels in London, as measured by the Department for Transport. Claims that privatising train companies would undermine safety have proved wrong as fatalities and injuries on the railway have declined to levels that make Britain's railway the safest compared with major European networks.

Passengers have also benefited from train companies offering a wider choice of attractive deals including Off-Peak, airline-style discounting, and value for money packages for specific groups through offers and Railcards *(see Fig P)*.

Despite UK Government policy since 2004 favouring above-inflation increases in regulated fares, including Season Tickets, the overall average price paid per passenger mile has largely remained flat in real terms since 1997-98.

While research published by Passenger Focus in 2009 showed that Britain had some of the highest fares in Europe, it also demonstrated that this country had the lowest ticket prices for long-distance journeys[19].

Figure P PASSENGERS BENEFIT FROM DISCOUNTED FARES

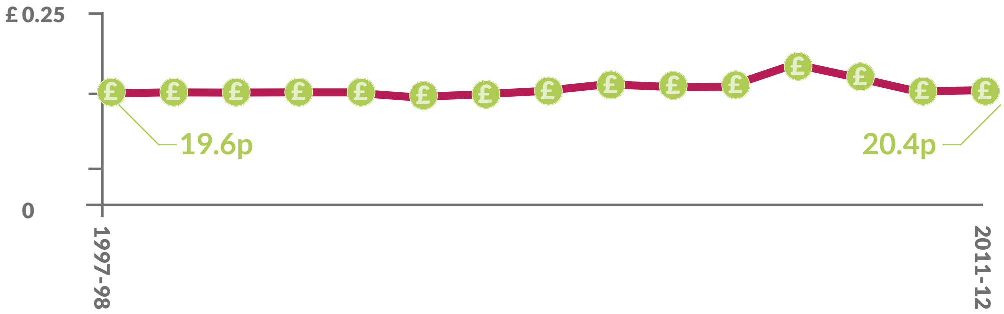
75% OF PASSENGERS TRAVEL FOR LESS THAN:
£49 LONDON TO MANCHESTER
£38 LIVERPOOL TO NORWICH
£32 BIRMINGHAM TO CARDIFF
£30 LONDON TO BRISTOL
£24 LONDON TO BIRMINGHAM

Source: Lennon Database

[19] Fares and Ticketing Study: Final report – Passenger Focus, February 2009

More than a million journeys are now made each week using these cheaper Advance fares, four times more than in 2005-06[20]. As well as Advance fares, increasing numbers of journeys are made with Off-Peak and other discounted fares[21] *(see Fig S)*. This has contributed to the average price paid per passenger mile across all journeys rising from 19.6p 15 years ago to 20.4p in 2011-12 in real terms *(see Fig Q)*.

Figure Q AVERAGE PRICE PER PASSENGER MILE



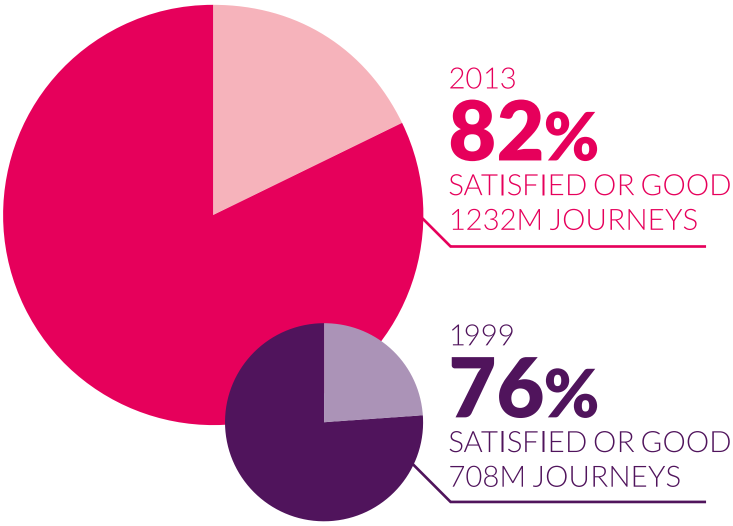
While some commentators group rail travel in with utilities when looking at prices, the comparison does not stand up to scrutiny. The average price paid per passenger mile has risen by 4% in 2012 prices, while over the same period gas prices have increased by 98% and electricity by 34%, using the same real-terms prices.

Working with industry partners, train companies have delivered on a range of key indicators, from frequency and punctuality to safety. They have also shown their skill in marketing the railway, offering a range of discounted tickets. Passenger satisfaction has risen in response: when combined with growth in network usage, this is equivalent to more than 500 million more journeys rated as 'satisfactory' or 'good' each year by passengers, as reported by Passenger Focus *(see Fig R)*.

[20] In 2005-06, 13.4 million Advance journeys were made; in 2012-13 that figure had risen to 53.5 million

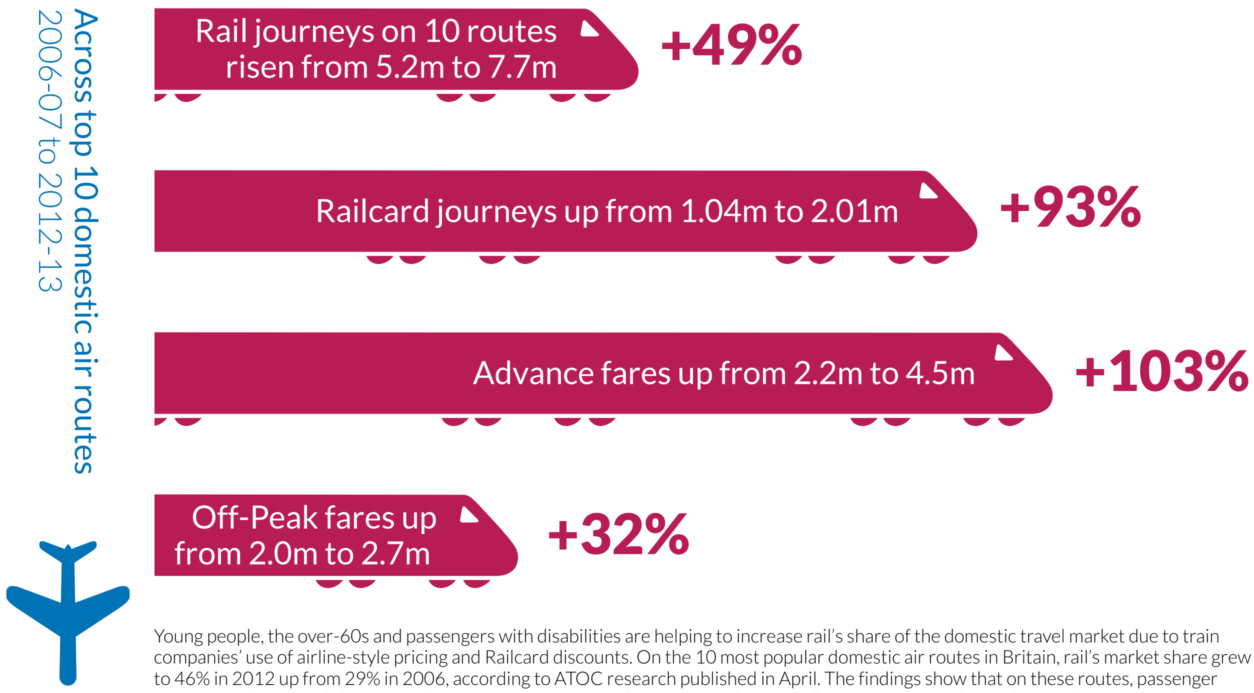
[21] In 2005-06, 346.4 million journeys were made using Off-Peak and Super Off-Peak tickets, rising to 430.2 million in 2012-13; Railcard journeys over the same period rose from 74.8 million to 113.3 million

Figure R MORE PASSENGERS ARE MORE SATISFIED WITH THEIR JOURNEYS



Source: National Passenger Survey

Figure S DISCOUNTED TOC FARES HAVE GROWN RAIL MARKET



Young people, the over-60s and passengers with disabilities are helping to increase rail's share of the domestic travel market due to train companies' use of airline-style pricing and Railcard discounts. On the 10 most popular domestic air routes in Britain, rail's market share grew to 46% in 2012 up from 29% in 2006, according to ATOC research published in April. The findings show that on these routes, passenger journeys with Railcards have risen by 93%, far outstripping the 49% growth in overall train journeys. Sales of cheap Advance fares have grown even faster, rising by 103%. Advance fares are now used by around four out of every seven rail passengers on these routes. Use of Off-Peak fares has also seen 32% growth.

Franchising works

The transformation of the railway is a uniquely British success. With the highest sustained growth in passenger numbers of any major railway in Western Europe, Britain's network now serves more than 1.5 billion journeys a year, more than at any time since the 1920s.

This achievement is due to many factors and reflects the contribution of organisations across the railway industry. But central to this success is franchising.

In contracting private companies to operate trains, Government has devised a winning formula which gives operators effective commercial incentives to attract more passengers and contain costs. If they can do this successfully, train companies can earn profits, although even then many contracts ensure that revenues or operating margins in excess of pre-agreed levels are shared with Government.

In a franchise, bidders must identify ways of generating increased revenue either to pay Government or reduce subsidy, through innovation in areas such as customer service and pricing, or through better timetables and, where funders permit, investment. A winning operator will then want to deliver on the specifics of its contract to improve the prospect that it will retain the business when it is next let or to be invited to bid for another franchise.

The result has been that passengers have benefited from the competitive nature of franchising driving up the quality of passenger services while, measured across all franchises together, train companies' operating margins have been modest for a decade and a half.

Each time a franchise is let, it is open to any interested party to tender to operate it, whether a specialist in transport or not. This allows an injection of new ideas and skills that is hard to replicate in the structure found in many other European countries in which the state retains the monopoly to operate all or the majority of services.

In this country, franchising has attracted a range of companies and organisations as well as those with established records operating bus and other transport services, all eager to improve the passenger experience. This model has also encouraged other major European and international operators to participate: currently companies established by the railways of France, Germany and the Netherlands, as well as the private rail transport operator in Hong Kong, participate either directly or through part-owned subsidiaries.

It is little wonder that many other national railways are seeking to replicate our success by adopting the British model. Franchising is also being applied in the Czech Republic, Denmark, Germany, the Netherlands and Poland, as well as in the US where a number of heavy rail commuter services into major cities are now tendered out, and in commuter networks in Australia.

Indeed, key elements of this approach are now being proposed by the European Commission for application across all member states. In new legislation put forward this January, the Commission has recommended that tendering be applied to all public rail services in Europe, citing in support the positive outcomes in Britain, particularly in customer satisfaction.

The next 20 years

Private train companies have worked in partnership with Government, NR and other partners to transform Britain's railway into a modern, competitive, forward-looking public service. They are determined to improve still further, ensuring that rail services carry on growing and improving despite the need to reduce public funding.

This means working with Government and industry partners to generate more revenue by attracting more passengers while improving efficiency to deliver better value for money for rail users and taxpayers. With more than 70% of the passenger market – measured in terms of revenue – coming up for tendering over the next four years, the opportunities for further improvement are considerable.

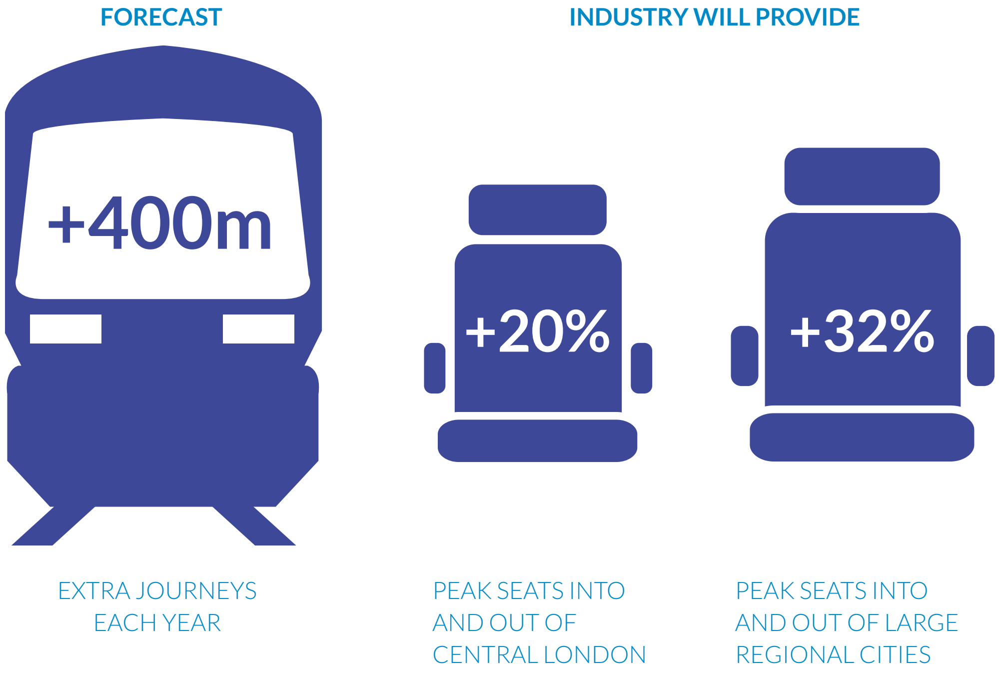
To attract passengers, train companies want to push punctuality and customer satisfaction levels still higher. Achieving the industry's goal of a passenger satisfaction level of 90% will come from a combination of improving performance still further, measures to reduce crowding, and better information. It is challenging but, based on the improvements of the past 10 years, achievable.

Also key are enhancements to how tickets are sold and marketed, including the introduction of smart ticketing technology. Operators want to work with Government to produce a stable, long-term plan for fares and retailing that would provide greater confidence and certainty for passengers, helping to remove anxiety that they might end up with the wrong ticket. In the meantime, train companies are delivering a programme of improvements to how they sell tickets.

Train companies are already working closely with NR and freight operators through the RDG. They want to improve that co-operation to develop and expand rail services – and to address the challenge of doing so within the finite resources of the network and the need to improve efficiency.

By 2019-20, train operators and NR are planning for the network to accommodate a further 400 million journeys a year. The industry's business plan is for 20% more seats into and out of central London at peak times, and a 32% increase in seats into and out of large regional cities *(see FigT)*.

Figure T **MORE PASSENGERS, MORE SEATS TO 2019-20**



Train companies will build on their record of success. They have demonstrated their expertise in delivering commercial results and have delivered through a difficult period, and seek the freedom to make further improvements to meet their customers' needs.

To help train companies go further, Government should continue its rail reforms, stepping back from the current level of tight prescription and detailed control, and instead adopt a more focussed approach to regulation – one that is appropriate to a flexible franchise system with strong incentives for the train companies and NR to work together.

Such an approach would leave Government to decide how it funds the railway, allowing the industry – train and freight operators, NR and suppliers – to run it, delivering what Government and passengers want, developing technology, creating greater capacity to respond to growing demand, and improving workforce skills.

Conclusion

The franchising model has enabled train companies to generate significant financial returns for the Government, played a crucial role in delivering unprecedented growth in journey numbers, and provided passengers with improved services and better value.

Key to this success has been the competition to win and run franchises which has focused passenger rail operations on encouraging more travel by train through improved services and offering good deals. This approach has been crucial to transforming the railway, ensuring it continues to act as a social good for the nation.

Train operators will continue to help drive a more prosperous economy, in particular if the railway remains open to greater enterprise and innovation. Above all, train companies want to devote their energies to providing passengers with what they want because it is good for business and the country. In that way, the railway will continue to drive growth, improve services and deliver the biggest benefits to Britain.

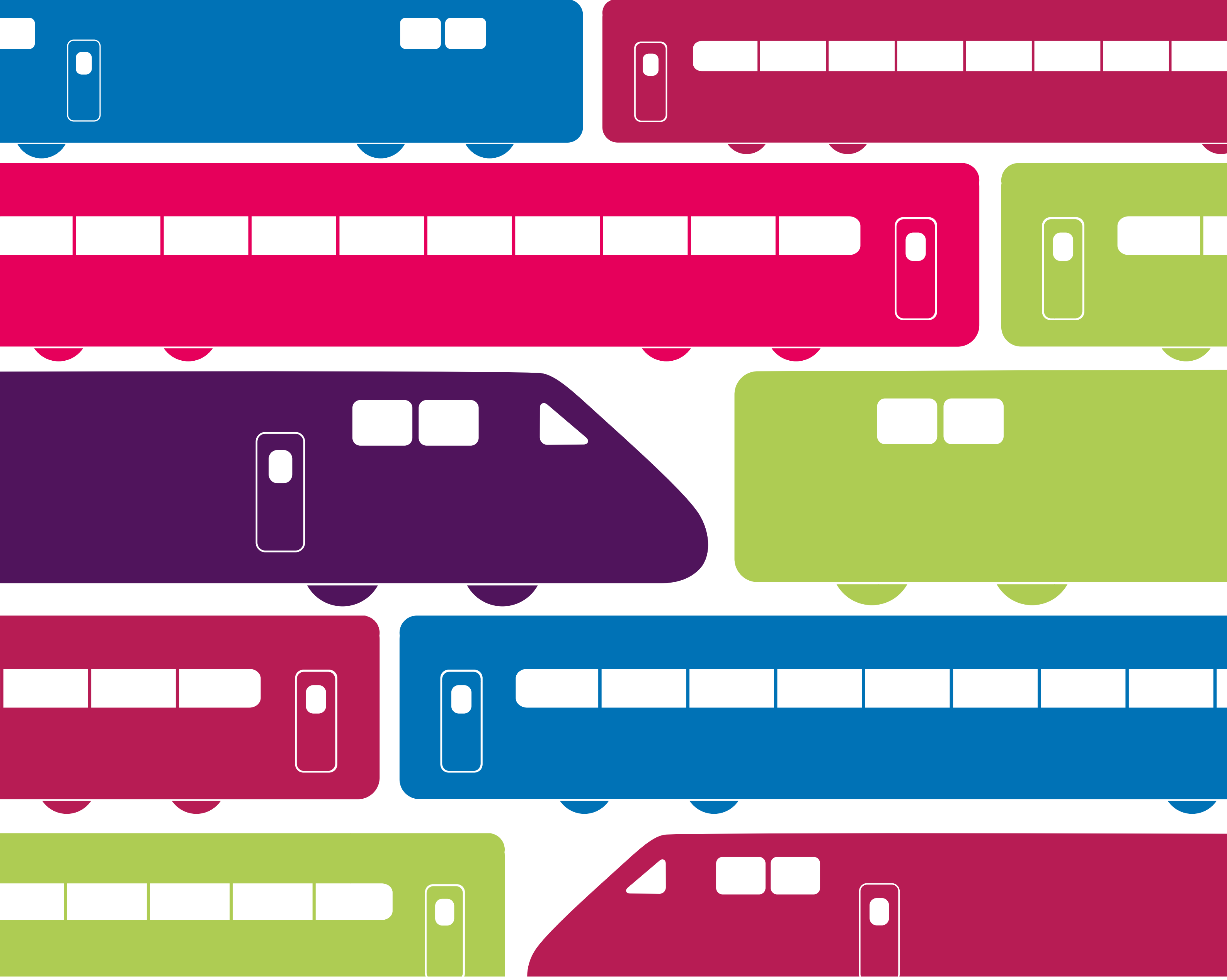
Acknowledgements

This report has been based upon data analysed and collated by KPMG. The dataset is published on www.atoc.org to accompany this report.

ATOC would like to thank KPMG for its work, and in particular Dr Ashley Steel and Ed Thomas.

In addition, ATOC is also grateful to those who provided feedback, advice and/or input as we assembled the data and drafted Growth and Prosperity, including members of the Rail Delivery Group and specifically:

- Rt Hon Lord Adonis
- Sir John Armitt
- Hala Audi, HM Treasury
- Norman Baker MP, Parliamentary Under Secretary of State for Transport
- Nick Bisson, Department for Transport
- Rt Hon Simon Burns MP, Minister of State for Transport
- Stephen Clark, Rail North
- Maria Eagle MP, Shadow Secretary of State for Transport
- Professor Stephen Glaister, RAC Foundation
- Julian Glover, Special Adviser to the Transport Secretary
- Lilian Greenwood MP, Shadow Rail Minister
- Mike Hewitson, Passenger Focus
- Rt Hon Margaret Hodge MP, Chair, Public Accounts Committee
- Veena Hudson, Special Adviser to the Deputy Prime Minister (CLG, DfT and Defra)
- Stephen Joseph, Campaign for Better Transport
- David Leam, London First
- Rt Hon Patrick McLoughlin MP, Secretary of State for Transport
- Douglas McNeill, Charles Stanley
- Anthony Smith, Passenger Focus
- Jim Steer, Steer Davies Gleave
- Christian Wolmar
- Ian Wright, Passenger Focus



Association of Train Operating Companies