1. Introduction

On order of instruction by a group of leading railway magazine TransEcon has been commissioned to conduct a research study into the strategic issues facing the passenger railway industry in Britain.

1.1. Objectives

The report consists of the following points:

- The structure of the railway industry in Britain
- Train Operating Companies, ownership patterns, and length of franchise
- Trends in passenger numbers
- Main external factors affecting the TOC's
- Analysis of TOC's according to Porters 5 forces
- Trends in profitability of Virgin Rail Group LTD
- Recommendation of strategies that could be adopted by Virgin Rail Group LTD

1.2. Literature search

The main sources of information used were researched from a number of websites and reports, which are listed in the bibliography.

2. Introduction to Britain's rail industry

In the period between the second world war and 1996, rail services in the UK were provided by a single sector public company – British Rail. Despite the Conservative Governments enthusiasm for privatization, the strength of public feeling regarding the importance of rail transport prevented it from acting sooner. The pivotal moment occurred with the publication, in 1992, of the Conservative Government's white Paper, New Opportunities for the Railways. The paper contained the following key features for the privatization of the railway industry:

- The track and infrastructure would become the responsibility of a new track authority, Railtrack PLC

- The operation of passenger services would become managed and operated through the private sector via a series of franchises

- Rights of access to the railway would be available to private operators without a franchise, with a rail regulator appointed to oversee access rights

- Rail freight and parcel operations would be transferred entirely to the private sector

- The private sector would have the right to purchase or lease stations.[1]

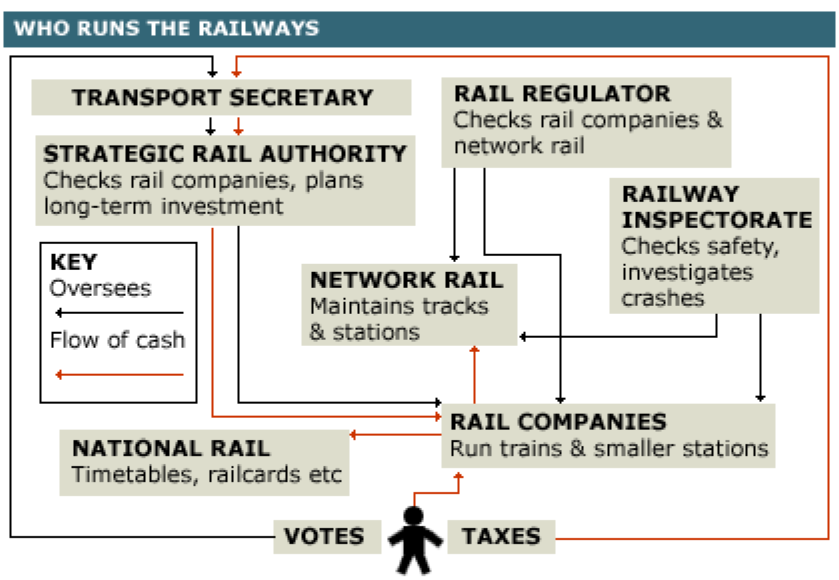
British Rail was privatised in 1996. The track and infrastructure was devolved to a company called Railtrack, whilst ticketing and passenger and freight operations were

[1] Key Note market report 1999, Rail Travel, 3.Industry Background, Recent History

franchised to individual private sector operators (originally 25 passenger and 4 freight operators). The government claimed that privatisation would see an improvement in passenger services: this outcome has yet been realised, although passenger levels initially increased to the level they had been at in the late-1980s. A series of major rail accidents after privatisation - at Ladbroke Grove, Hatfield, Potters Bar, and Selby - caused widespread loss of confidence in the safety of rail travel.

After the Hatfield crash, speed limits were drastically reduced throughout Britain and train travel was seriously disrupted for months. Railtrack came close to bankruptcy due to the enormous cost of additional safety measures and was effectively re-nationalised, when ownership of the railway system was transferred to the newly-created "not for profit" company limited by guarantee, Network Rail on October 3, 2002. The private rail companies are heavily subsidised but much of the investment has not gone into regeneration or modernisation. However, the government has resisted public pressure to return the network to the public sector.[2]

3. Structure of the rail industry



[2] http://en.wikipedia.org/wiki/Rail_transport_in_the_United_Kingdom

The UK rail industry is made up of a number of market sectors and trade associations, which have to work together to ensure the smooth running of the industry. Below is a diagram showing the structure of the rail industry and a brief description of the organizations that make up the industry.

Association of Train Operating Companies (ATOC): Unifying body that represents the interests of all 26 train operators. It is responsible for "through-ticketing" (i.e. buying a single ticket which operates for several lines), railcards, and the National Rail Inquiries phone line. Its public face is "National Rail", and it uses the familiar "double arrow" British Rail logo.

British Rail Board (BRB): This remnant of British Rail still exists, now as part of the SRA. It is responsible for non-operational railway land and the British Transport Police. It also provides advice on rail policy. Also uses the familiar "double arrow" British Rail logo.

Department of Transport and Regions (DTR): The DTR sets the national strategy and framework for Britain's rail system. The public money which goes to subsidise the rail companies - an amount which should decrease year on year - comes from this department to the SRA which then passes it on. The department also appoints the SRA and the Rail Regulator.

HM Railways Inspectorate: Part of the Health and Safety Executive, the Railways Inspectorate is responsible for ensuring that new track and trains meet safety standards, and for investigating crashes, particularly serious ones.

Network Rail: The not-for-profit company founded to maintain track and stations after the collapse of Railtrack.

Office of the Rail Regulator (ORR): Headed by the government-appointed "industry watchdog" Tom Winsor, the ORR can impose heavy penalties on train operating companies and Railtrack should they fail to reach the required standards. It also sets out the minimum service levels which customers can expect from their train lines.

Passenger Transport Executives (PTEs): In seven metropolitan areas - West Midlands, Greater Manchester, Merseyside, Tyne and Wear, South Yorkshire and Strathclyde - PTEs specify the minimum level of service, administer subsidy and are co-signatories to the relevant franchise agreements.

Rail Passengers Council (RPC): The RPC is charged with taking care of passenger concerns. Funded by the government, the RPC is a statutory consumer organisation that monitors and investigates the policies and performances of train and station operators. It has the legal right to make recommendations for changes and investigates passenger complaints that have not been satisfactorily resolved. It was formerly the Central Rail Users Consultative Committee (CRUCC).

Rolling Stock Leasing Companies (Roscos): The British train fleet is owned by three leasing companies: HSBC Rail UK (parent Hong Kong Shanghai Banking Corporation), Angel Train Contracts Ltd (parent Royal Bank of Scotland Group), Porterbrook (parent Abbey National). These companies lease the rolling stock out to the train operating companies.

Strategic Rail Authority (SRA): Responsible for promoting rail use and strategically developing the rail network, the SRA was behind the newly announced Strategic Plan.

The SRA:
• awards franchises to the train companies
• gives loans, grants and guarantees for the development of railways
• filters the government's subsidy for train operating companies
• can ask the rail regulator to require train companies to make specific investments
• draws up blueprints for expanding railways as part of an integrated transport network

The SRA came into existence in February 2001. It was formerly the Shadow Strategic Rail Authority (SSRA) and before that the Office of Passenger Rail Franchising (OPRAF).[3]

4. Train Operating Companies

The industry is made up of 25 Train Operating Companies, which are divided into 3 sectors:

- Long Distance operators
    1. Anglia (Intercity)
    2. First Great Western
    3. Great North Eastern Railway
    4. Midland Mainline
    5. Virgin West coast
    6. Virgin Cross Country

Long Distance operators

Virgin Cross Country has the longest franchise of 15 years and 3 months, due to terminate in April 2012. Virgin Cross Country operates long distance services from Scotland, the north west and north east through Birmingham to the south coast and south west of England.

Anglia Railways had the shortest franchise length of 7 years and 3 months with the franchise terminated in April 2004. Anglia operated its mainline trains between London, Colchester, Ipswich and Norwich.

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[3] http://news.bbc.co.uk/1/hi/uk/1760638.stm -Who runs the railways?

- London and SE operators
    1. c2c
    2. Chiltern Railways
    3. Connex South Eastern
    4. First Great Eastern
    5. Silverlink
    6. South central
    7. South West Trains
    8. Thames Trains
    9. Thameslink
    10. West Anglia Great Nothern

London and SE operators

Connex South Eastern holds the longest franchise length of 20 years, due to end in December 2021 and operates commuter services between central London and the south east London suburbs, the whole of Kent and part of Sussex.

Thameslink holds the shortest franchise term of 7 years and 1 month terminated in april 2004. The routes operated by this company are between Bedford and Brighton via central London and also between Luton and Sutton via Wimbledon. Its north/south routes serve 5 major stations in central London, and two airports – Gatwick and Luton.

- Regional operators

    1. Anglia Locals
    2. Arriva Trains Merseyside
    3. Arriva Trains Nothern
    4. Central Trains
    5. First North Western
    6. Gatwick Express
    7. Island Line
    8. ScotRail

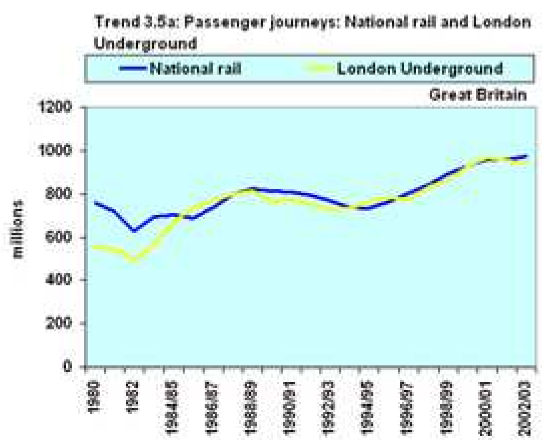
9. Wales and Border Trains
10. Wessex Trains

Regional operators

Arriva Trains Merseyside has the longest franchise time of 25 years terminating in July 2028. It operates rail services between Liverpool and Southport, Ormskirk, Kirby, Hunts Cross, New Brighton, West Kirby, Chester and Ellesmere Port.

Scotrail holds the shortest term of 7 years terminating in September 2003 providing the vast majority of services in Scotland extending to Newcastle via Carlisle and Hexham. It also provides the Caledonian sleeper services between London Euston and Glasgow.[4]

5. Passenger numbers



Since 1980, the number of journeys made by national rail has gone up by 28 per cent, from 760 to 976 million. It fluctuated, largely with the economic cycle, during the 1980s

[4] Appendix 1, franchise lengths and franchisee, Appendix 2, individual operators and routes

and early 1990s, but has risen sharply since 1995/96. Distance travelled by national rail has increased by 31 per cent since 1980, from 30 to 40 billion passenger kilometres. Again, most of the increase has occurred since 1995/96. The Hatfield crash in October 2000 briefly interrupted the previous trend, but usage has increased since.[5]

6. Pest analysis of external factors affecting the industry

Political

- The Conservative government was largely responsible for the privatization in 1996 of the rail industry in Britain
- there are many guidelines and laws made by the government which affect and regulate the rail industry, such as the transport act 2000, which is related to railway licence modification[6]
- Currently schemes such as congestion charging introduced by the government are encouraging people to use trains to commute, therefore increasing revenue for the rail industry
- Strikes organized by the RMT mean that trains are often delayed or even cancelled which causes great losses to the TOC's in terms of revenue and passenger confidence.

Economical

- research reveals that higher fares or increased government subsidies will be needed to support the rail network in the next decade amid an investment shortfall of £17bn.

  The cash crisis comes in the face of increasing passenger numbers, which have

[5] http://www.dft.gov.uk/stellent/groups/dft_transstats/documents/page/dft_transstats_026295.hcsp

[6] http://www.jrtr.net/jrtr08/f15_bra.html, Feature: Restructuring Railways (part 2)
The Privatization of Railways in Britain, Bill Bradshaw

risen by 6% in each of the past three years. And that growth is expected to continue as the economy expands and road congestion worsens.[7]

- fluctuation in the economy affects passenger numbers[8]

social

- state of trains - Toilet waste from trains is building up on parts of the rail network, affecting track inspections and raising fears about health risks to staff.
- One track worker told BBC News Online the problem meant some maintenance work was not being carried out and platforms may have to close within weeks, if a major fault was detected. [9]

- events such as the Madrid bombing and the crashes at Hatfield and Potters Bar are a great cause of concern for passenger safety, as rail travel is the only mode of commuting for many passengers.

Technological

- Compared to Europe, the rail industry in the UK has not been able to acquire and make use of many essential technologies which may create a difference in terms of passenger safety. 'In Brussels, the European Rail Research Advisory Council (ERRAC) presented a comprehensive Strategic Rail Research Agenda (SRRA), which identifies key scientific and technological priorities for both passenger and freight rail transport over the next 20 years.'[10] This is due to years of under-funding and under invest in the UK rail industry.

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[7] http://news.bbc.co.uk/1/hi/uk/540440.stm, Rail network 'needs £41bn investment'
[8] http://www.dft.gov.uk/stellent/groups/dft_transstats/documents/page/dft_transstats_026295.hcsp

[9] http://news.bbc.co.uk/1/hi/uk/3020938.stm, toilet waste 'hampers rail repairs'
[10] http://www.innovations-report.com/html/reports/logistics/report-15326.html

- signalling technology has attained considerable importance in recent years. While new train orders and technical developments tend to attract the headlines, the contribution which modern systems can make to increase capacity of networks and improve safety is often overlooked.[11]

7. Porters five forces affecting TOC's

There are 5 forces:-

1. Level of Competition
2. Threat of new Entrants
3. Bargaining power of suppliers
4. Bargaining Power of buyers
5. Threat of Substitutes

Competition

- There are 25 TOC's grouped into 3 sectors- Long distance, London & SE, and Regional operators. The operators within each sector are in competition with each other, although not all of them operate along the same routes.

- The SRA awards franchises based on the bids and performance of the TOC's.

- The Rail Regulator monitors TOC's and ensures that monopoly is controlled to protect users and deliver benefits to them. Within the framework of the existing policy which moderates competition between passenger operators, the year has seen a number of innovative developments in rail services and products.

[11] Key Note market report 1999, Rail Travel

New entrants

- The threat of new entrants is high as the SRA awards the franchises, and the companies which cannot perform will not be awarded franchises, which in turn leaves the path open for new entrants

- It is very difficult for new entrants to enter the industry as there are many rules, regulations, and barriers in the way.

Suppliers

- The bargaining power is high as there are only a handful of companies which supply the TOC's

- There are three main companies that supply the TOC's with rolling stock
  1. Angel trains
  2. HSBC Rail
  3. Porterbrook Leasing company

- Two new companies have entered into this market
  1. GL Railease
  2. Halifax Asset Finance

Buyers

- The buyers are the passengers, who buy the tickets to travel on the trains

- The passengers have low buying power as the TOC's do not all operate the same routes, therefore, reducing the competition in ticket fares

Substitutes

- Cars - although the government has introduced schemes such as congestion charging, many people still prefer to travel by car.

- Buses – another form of public transport, the government also encourages commuters to travel on London's bus service

- Long distance coaches – there are long distance coach services provided by several companies

8. Profitability of Virgin Rail Group LTD

- In 2002 the turnover was £520,090,000 whilst in 2003 it increased to £556,044,000
- Although the turnover increased in 2003, the company has made a loss of £8,496,000 (a profit margin of -1.54%) compared to a profit of £37,732,000 (profit margin of 7.25%) in 2002
- The return on capital employed in 203 is -8.53% compared to 30.92 in 2002[12]

- The increase of ticket prices has meant that the turnover has increased, but the train delays, and other problems have contributed to the company making a loss.

8.1. Recommendations

- Virgin Rail Group Ltd should try to cut down on the amount of capital spent so that they do not over spend.
- The operating profit could also be increased by the company making use of all the resources they have, and also ensuring that the resources are used to the best of their ability.
- The company could also decrease their operation costs allowing them to increase their operating profit margin and gross profit margins.

[12] http://fame.bvdep.com/cgi/template.dll?product=1&checkathens=1&user=uow0307977&pw=%3CQKmn6gPANE2pn%2B5U%2Fg%3E

- The company should try to improve passenger services i.e. reduce the number of delays etc., as it is the passengers who are the main source of revenue

9. Conclusion

To date, the passenger rail industry has been going through great difficulty, with years of under funding and under investment, not to mention the accidents that have also taken place. But there are a number of reasons as to why the passenger rail transport may improve in the near future.

- The Government has shown that it is committed to the public transport.
- The private Sector operators are starting to make significant improvements in a new rolling stock, which will allow them to improve the quality of service that they offer.
- Rail track have announced a 27bn investment programme aimed at reducing delay, as well as expanding the network
- Finally as road congestion charges worsens, the public perception of rail travel as an alternative to the private motor will change, as a result, the railways share of the overall passenger market may begin to increase.

APPENDIX 1

Franchise lengths and Franchisee[13]

[13] On Track Rail performance trends Oct 2002 – Mar 2003, page 52