Rail Partners

Revitalising Rail: How private operators can accelerate recovery

September 2022

Introduction

A reformed public-private partnership can once again deliver for Britain

A public-private partnership delivered a huge amount since privatisation in the 1990s

Thirty years ago, consistently declining passenger numbers under British Rail left the Government with a choice – continue to manage decline, or harness private sector operators to reinvigorate the railway. A public-private partnership was developed, with government contracting to the private sector to run services, placing commercial incentives on operators to attract more passengers and revenue while containing costs – with the main beneficiaries being the taxpayer and travelling public.

Through commercial acumen and a focus on the customer, private sector operators delivered more than a doubling of passenger journeys, revenue growth at twice the rate of GDP, and the overturning of a £2 billion annual industry operating loss. At the same time, freight operators leveraged significant private investment to grow the rail freight market and take more polluting HGVs off our roads.

As we emerge from the pandemic, recovery is fastest among operators with more commercial freedom

Post-pandemic, a similar choice faces policy makers – how best to avoid decline and enable economic recovery. Currently passenger operators are largely on post-pandemic contracts that do not afford much commercial freedom – but we believe the private sector again has a critical role to play.

While the private rail freight sector has largely recovered and in some places is exceeding pre-pandemic levels, the passenger sector is facing a cumulative shortfall of around £20 billion in fares revenue by 2025, with the gap currently being plugged by taxpayers. This is unsustainable, the rail industry cannot take more than its fair share of public funds. Yet our analysis shows that operators with more commercial freedom and revenue incentives are recovering revenue much more quickly than those not afforded the same flexibilities. Activating existing revenue incentive mechanisms in current National Rail Contracts for the majority of operators will harness their commercial expertise and bring back revenue faster.

With the right reforms we can again meet the railway's challenges in the 2020s and 2030s

The private sector has previously restored the industry's finances to good health and can do the same in the coming years. To achieve this, it is crucial that new legislation establishes Great British Railways (GBR) to harness the commercial and operational expertise of operators, rather than be a top-down specifier of inputs. Current National Rail Contracts and future Passenger Service Contracts must provide operators with the commercial freedom within that new framework to chase revenue, reduce costs and return passengers to rail. Establishing long-term structures and maintaining legislative safeguards is equally important for freight. And through the rail transformation process an ambitious freight growth target to treble freight by 2050 can act as a catalyst by unlocking continued private sector investment and securing modal shift to meet net-zero goals.

Rail Partners and its members want to co-create this new system. If the reforms we are calling for are implemented, we believe we can set the railway on track to a sustainable future, supporting the wider economic and environmental outcomes that a vibrant railway supports.

The track record

1

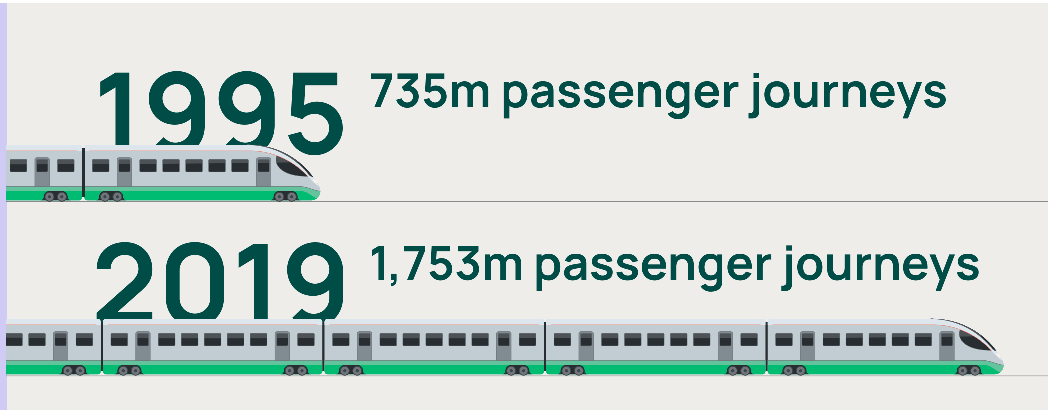
A public-private partnership has delivered a huge amount since privatisation in the 1990s

The private sector, in collaboration with public partners, delivered significant value to the railways since the 1990s. Operators used their operational expertise to innovate in areas like timetabling, customer service and fares, generating more revenue to pay back to government or reduce subsidy. At the same time freight operators leveraged significant private investment to increase freight movements and take more polluting HGVs off our roads.

Private passenger owning groups, and their train operating companies, more than doubled passenger journeys and grew revenue at twice the rate of GDP, while overturning a £2 billion annual operating loss. Commercial incentives placed on both passenger and freight operators have helped to regenerate the railways since the mid-90s through...

More than a doubling of passenger journeys

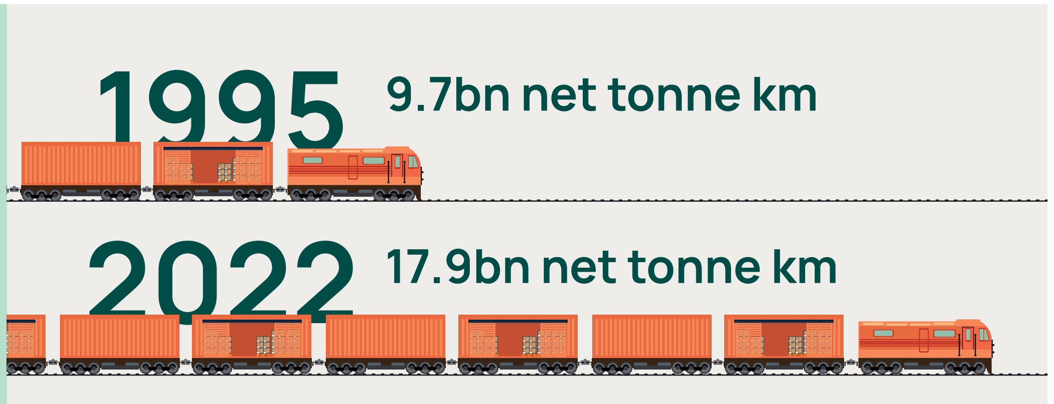
A 138% increase outpacing growth in European countries such as France and Germany pre-pandemic



ORR Passenger Journeys

A freight renaissance

An 84% increase in volumes (excluding coal) in the two decades following privatisation and private investment of over £2.8 billion



ORR Rail Freight Usage (excluding coal) & Performance and KPMG research

Passenger services up by a third

On the eve of the pandemic the railways ran over 21,000 services on an average day – nearly a third more than before privatisation

1/3 more
services since 1997

RDG analysis

Transformed industry finances

From a £2bn operating deficit to an operating surplus in many of the years before the pandemic.

RDG analysis

Private investment

£6bn
since 2015

Private investment totalled nearly £6 billion since 2015 to bring in new rolling stock and improve the customer experience

ORR Rail Industry Finance

More jobs

27% increase in rail jobs when compared to 2011

approx. **50k** approx. **63k**

ORR FTE employees by operator

The safest in Europe

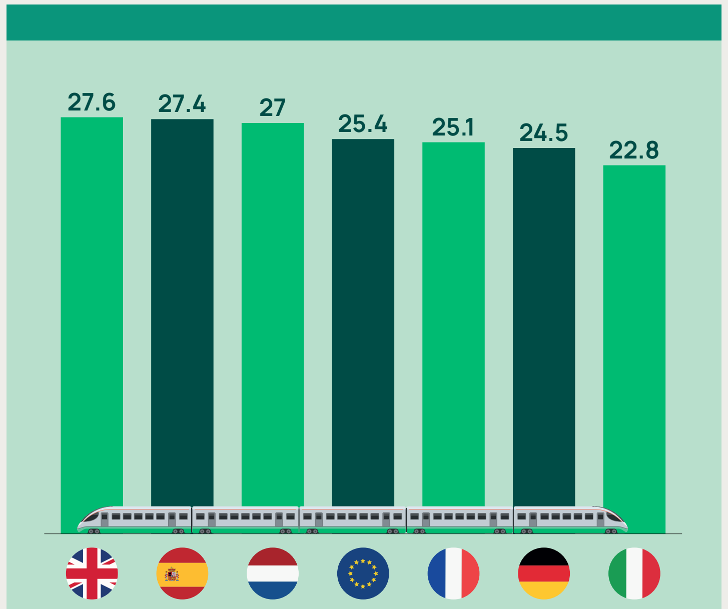
Compared to other EU countries, GB rail ranks highest across 5 combined safety criteria

Safest in Europe

ORR Common Safety Statistics

Improved satisfaction

Our railway outperforms other major European railways on overall satisfaction



Average respondent scores

Flash Eurobarometer 463 Report: Europeans' satisfaction with passenger rail services

Pre-pandemic, operators more than doubled passenger journeys, improved the customer experience, grew revenues at twice the rate of GDP, and overturned a £2bn operating industry deficit

It is widely recognised that franchising had run its course prior to the pandemic, leading to operators themselves calling for reform, and the pandemic compounded the need for change. However, these case studies demonstrate that the private sector played a significant role in improving the railway in the years to 2019.

These improvements are largely driven by the commercial incentives placed on operators through the profit motive and a deep understanding of the customer, which must continue to be harnessed during the reform process. With the right reforms to contracts and structures, the private sector can again help set the railway up for recovery and growth for the next decade.

c2c (Trenitalia) enhancing the customer experience through digital retailing

Trenitalia has invested heavily (approx. £30m) to deliver an award-winning retail hub for use on c2c – drawing on its use in the Italian market and strategic partnerships with IBM and other suppliers new to the UK market. The app makes it easier for customers to buy tickets and manage their account, whilst reducing operational costs by removing old legacy systems.

When implemented this was GB rail's first integrated retailing platform, bringing together separate systems for ticket offices, vending machines and online purchases onto one platform. Trenitalia made several investments to improve the service by integrating Paypal and Apple/Google pay – increasing uptake and ease of ticket purchase.

This type of investment and innovation highlights how the private sector seeks to make it easier for passengers to purchase tickets and thus grow passenger numbers. Trenitalia's innovation is now being made available to other UK train operators, given it provides a significantly improved customer experience and opportunities to advance paperless ticketing.

Greater Anglia (Abellio/Mitsui) investing to overhaul old fleets

Since taking over the Greater Anglia franchise, Abellio has been replacing the old, inherited fleets of trains with new, modern, passenger-friendly fleets. Despite a 4% increase in the number of vehicles on lease once full replacement has occurred, lease charges will significantly decrease due to Abellio's effective procurement from both the manufacturers and the financiers.

The most recent Greater Anglia commuter trains, built by Alstom, come with fast Wi-Fi, air conditioning, underfloor heating and a wheelchair area and accessible toilet on every train. The trains also come with space for bikes and new improved passenger information screens. Earlier introductions by Abellio comprised of regional bi-mode, intercity electric and Stansted Express electric trains – further helping to achieve net-zero goals.

The streamlining of fleets led to more efficient maintenance regimes out of Norwich Crown Point and Ilford depots, which have been specifically invested in to bring down long term costs. Rolling stock maintenance costs continue to decrease and there are also opportunities in other business areas through the digitisation of fleets. The new fleets significantly improved journey times, punctuality, reliability and allowed for more services. It is this type of investment and improvement, secured by owning groups under franchising, that led to more services on the network, increased patronage and greater revenue.

Govia Thameslink Railway (Go-Ahead Group/Keolis) launches first co-operative energy project on the UK rail network

GTR launched a new innovative co-operative energy project with climate action group, Energy Garden. The project saw London's Streatham Hill depot turned into a local source of renewable eco-friendly energy generation. The scheme, in partnership with Community Benefit Society Energy Garden, installed 526 solar panels installed on the depot's roof. The solar panels are projected to save 884 tonnes of carbon and generate 4,165,000kW/h of electricity over a 20-year period.

The scheme harnesses GTR's commitment to financially supporting innovative programmes that benefit the wider community. Profits are used to support community development amongst the 50 community groups supported by CBSEG. Over the next 20 years, the combined income is set to generate more than £100,000, which will fund Energy Garden's delivery of schools' education, youth training programmes, and community gardens on the rail network.

The present day

2

As we emerge from the pandemic recovery is fastest among operators with more commercial freedom

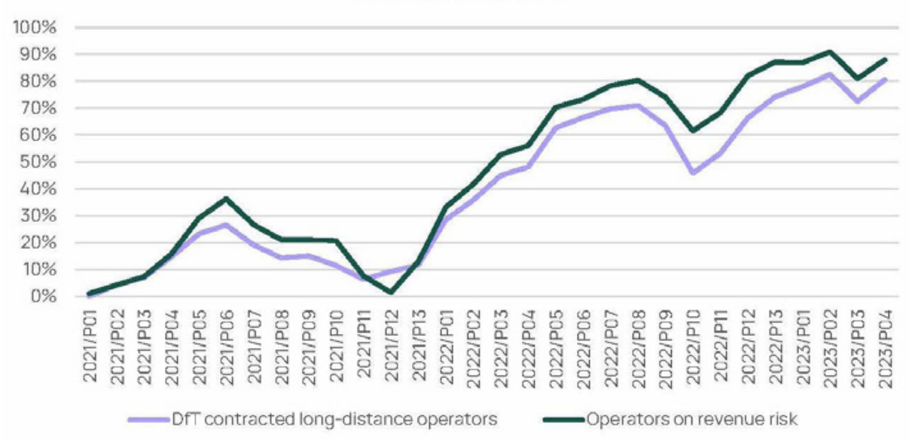
Our research shows that as we emerge from the pandemic, passenger operators with more commercial freedom and strong revenue incentives have increased revenues faster when compared to DfT contracted long-distance operators with limited or no commercial freedom. Similarly freight operators have responded to commercial drivers and capitalised on spare capacity by running innovative trains during the pandemic.

In March 2020 most DfT operators were placed onto emergency contracts and are now being transferred onto National Rail Contracts. Under these contracts, operators have limited freedoms to drive recovery because most cost risk and all revenue risk is transferred to government and revenue growth incentives are currently not activated. The whole premise of private sector involvement in rail is to harness its commercial expertise and foster innovation to deliver better outcomes for customers and taxpayers.

Figure 1 highlights by July 2022, three operators on revenue risk (Grand Central, Merseyrail, Hull Trains) had grown collective revenues to 88% of pre-pandemic levels compared with DfT contracted long-distance operators at 81% of pre-pandemic revenues. This shortfall equates to over £200m of lost revenue per year. That is why we believe it is vital to activate dormant revenue growth incentives in National Rail Contracts to accelerate financial recovery. There are many examples of commercial freedom driving better outcomes post-pandemic:

- **Targeted fares and localised campaigns:** Agile campaigns and tailored fares allowed Hull Trains and Merseyrail to accelerate the return of leisure and commuter passengers.
- **Adapting the offer to compete with air and road:** A low fare, standard class only service from London to Edinburgh operated by Lumo has encouraged significant modal shift from more carbon heavy forms of transport such as air and road.
- **Differentiating the service during times of uncertainty:** Grand Central extended booking horizons ahead of other operators to attract customers back post-pandemic.
- **Rail freight making use of capacity:** Rail freight operators ran longer, heavier and more direct services to maximise free capacity on the rail network, taking HGVs off the road, improving productivity, carbon efficiency and supporting local economies.

Figure 1: Revenue risk operators vs long distance ERMA/NRC operators revenue as % of 2019



Merseyrail (Abellio/Serco) working with local partners to market rail

Merseyrail were able to optimise revenue recovery with agile campaigns that aligned spend and activity with national trends.

For example, after each lockdown, Merseyrail promoted outdoor days to encourage leisure journeys when restrictions limited indoor activity – working with local partners to promote outdoor venues and events. For returning commuters, a 'flexi-ticket' was developed consisting of 3 return tickets for use within 7 days. In addition, from May 2022, in response to the high levels of demand, Merseyrail operated a 15-minute frequency service to capitalise on revenue potential.

For all marketing campaigns, Merseyrail has adopted a commercially flexible approach with a 'base budget', which is committed, with an upper spend limit agreed which can be used via adjustable channels (i.e. digital or radio). The strength of this approach was highlighted by benchmarking in late 2021 which showed that Merseyrail leisure revenue was 7% above similar operators.

Grand Central (Arriva) extended booking horizon

Driven by the fact it had received no government support and needed to recover as fast as possible, Grand Central worked on extending advance booking horizons from the standard of 12 weeks before departure (T-12) to 6 months (T-26).

This change went live in March 2021, 23 days before Grand Central resumed passenger services. This enabled Grand Central to double the amount of its inventory available for sale and along with the industry's 'Book with Confidence' policy, customers were able to confidently book advance purchase fares and make reservations up to 6 months in advance.

This commercially-driven change came at a time when the industry was struggling to maintain T-8 on most routes – with CrossCountry at T-6 and LNER at T-8 (although LNER have subsequently extended to T-26). Grand Central bookings beyond T-12 now typically making up 8% of all bookings. While Network Rail goes live with its 'Personalised Journey Information programme', which will enable all operators to potentially extend to T-12, Grand Central achieved that milestone 15 months ago.

Innovative freight trains during the pandemic making best use of capacity

During the pandemic freight operators, working in collaboration with their customers and Network Rail, innovated and adapted to keep the economy moving during an economically challenging period.

For example, Freightliner teamed up with Tarmac to operate record breaking jumbo trains that made use of spare capacity, carrying over 3,600 tonnes of aggregates used to build major infrastructure projects in the South East, such as HS2 and housing developments.

Likewise, DB Cargo introduced new freight services transporting fresh fruit and vegetables from Valencia over 1,800km into the UK in less than 50 hours for distribution to Tesco supermarkets to help keep supply chains moving during the pandemic. While Colas rail re-introduced timber services between Devon and South Wales for Kronospan – transporting 800 tonnes of logs on a 100 mile trip to Chirk helping to decongest roads in the South West.

Not only have these services benefitted customers by reducing costs and journey times, they have supported environmental objectives by reducing HGV movements and lowering carbon emissions to achieve net-zero.

Lumo (First) a new offering competing with air travel

Lumo started in the difficult post-pandemic market, offering good quality, high speed services at low fares, designed to attract new customers to rail from other modes. The standard class only model is just one of several innovations which would be unlikely to be developed through a centrally specified contract procurement.

Lumo had a phased ramp up to its full 10 trains a day service which started on 1 April 2022. In the first 2 periods of operating it captured a 25% rail revenue market share on its main London – Edinburgh flow, much higher than its 15% share of the timetabled services. However, there is emerging evidence that this is a result of providing an attractive new proposition to compete with the dominant air market on this flow.

In March 2022 there was a clear improvement in the rail vs air market share on the London Edinburgh flow, with rail improving from 25% in March 2019 to 39% in March 2022. In contrast the rail vs air market share on the comparable London Glasgow flow remains virtually unchanged with rail at 23% (2019 24%).

Looking ahead

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With the right reforms private sector operators can meet the railway's challenges in the 2020s and 2030s

When given commercial freedom in the past, operators have demonstrated their ability to double passengers numbers and enhance the customer experience. Where they have commercial freedom and revenue incentives now, operators are driving faster recovery when compared to those with limited ability. Looking ahead, operators can again drive a railway renaissance if we get the framework right – namely the establishment of Great British Railways (GBR) as a guiding not controlling mind, new contracts that create an effective public-private partnership, and an ambitious freight target to treble rail freight.

The coming legislation to create GBR must establish a body that enables its contracted operators to deliver better outcomes, rather than be simply a specifier of the inputs it requires. Alongside calling for GBR's functions and duties to be included in primary legislation, we believe a specific duty should be placed on GBR to promote private sector innovation and investment. Right now, it is unclear how a commercial mindset is being baked into GBR, or how structures will be built which will encourage GBR to leverage the experience and knowledge within operators. By leaving too much unspecified, there is a risk that GBR becomes too centralised and prescriptive, rather than using operators to help solve shared problems.

To once again enable private operators do to what they do best – attract passengers and reduce costs – dormant revenue growth incentives in National Rail Contracts should be switched on and operators given the ability to discharge their responsibilities to chase every potential passenger. Looking ahead to new Passenger Service Contracts (PSCs), we believe revenue growth incentives (and in some cases transfer of revenue risk) and the commercial freedom to respond to those incentives is a must – allowing operators to input on timetabling to drive performance and patronage, shape yield managed fares to grow revenue, and deliver local marketing campaigns to boost promotions.

Rail freight contributes £2.45 billion to UK plc every year, with over 90% of the economic benefits occurring outside of London and the South East, and each freight train removing up to 76 lorries from our roads. The economic and environmental rationale for developing a rail system that enables rail freight to flourish is compelling. There was much that was positive for rail freight in the Plan for Rail, most obviously the proposed introduction of a rail freight growth target. That must be set with a high level of ambition – trebling freight by 2050 and should be supported by policies, incentives and investments that create the conditions for freight to grow. If that target is set and met, that is worth £7.35 billion to UK plc and equates to 21 million fewer HGV movements annually, supporting the economy and the environment.

Getting reforms right by creating a renewed public-private partnership that delivers for customers and the railway will mean we can face the coming decades with confidence. We believe there is a clear way forward by:

- **Getting the design of GBR right** to ensure it is a guiding not controlling mind;
- **Ensuring PSCs that are fit for purpose** and harness the commercial expertise of the private sector; and
- **Establishing an ambitious freight growth target** to treble rail freight by 2050and encourage freight modal shift.

Rail freight securing investment to decarbonise the railway and increase modal shift

Rail freight already plays a critical part within a low-carbon freight and logistics sector, with each tonne of freight transported by rail producing 76% less CO_2 than the equivalent transported by road. However freight operators are pushing to do more to help realise the UK government's legal commitment to decarbonise the UK economy by 2050.

In 2016 Direct Rail Services unveiled their new Class 88 bi-mode locomotives, in total 10 trains were ordered requiring significant investment from the operator. The trains marked a significant step forward for rail freight's environmental credentials as they can operate across the GB rail network using both diesel and electric traction. More recently, GB Railfreight announced an order of 30 Class 99 bi-mode locomotives which will enter service in 2025. These trains will provide improved tractive effort and power which are estimated to reduce the operator's carbon footprint by 428 tonnes per working day.

Operators are now facing decisions on the next generation of low-carbon freight locomotive. Greater clarity on what the future network will look like including the scale of ambition of a freight growth target, and the timescales for delivery of electrification and other infrastructure schemes will help the private sector to make substantial complementary investments in trains to support the transition to a decarbonised economy.

Chiltern (Arriva) and Porterbrook delivering innovative rolling stock to achieve net-zero

Chiltern Railways and Porterbrook rolling stock company teamed up with engineering giant, Rolls-Royce, to develop a hybrid diesel-electric power pack that could be retrofitted to existing Turbostar trains. When in battery mode, the train emits no diesel fumes and is virtually silent, thus creating a cleaner and quieter environment.

The initial project secured investment for the conversion of two of more than 500 vehicles. To date, £7m has been invested, which will benefit the wider industry as a whole. Early evidence suggests that the HybridFLEX unit can deliver: 25% less fuel consumption; 75% less noise; 40% less friction braking energy usage; 75% less nitrous oxide; and 90% less particulate emissions. It has also been shown that journey times can be reduced by combining diesel and electric power for increased acceleration, and lower maintenance costs of key components, such as the braking systems, of nearly 20% over the life of the fleet.

Looking ahead, reform must allow private sector owning groups, operators, and rolling stock companies to commercially collaborate to provide a more environmentally conscious public with low carbon travel options. Coupled with the ability to develop investment and finance strategies that lead to improved rolling stock to better the customer experience.

SWR (First/MTR) partnering to rollout superfast 5G for passengers

Evo-rail, a UK-based rail technology company formed out of FirstGroup, has developed rail-5G, the first multi-gigabit internet connectivity solution built for the railways. This new technology would transform customer journeys in the UK by significantly boosting connectivity on trains.

This innovative and original approach would have the ability to provide an unrivalled service offering and attract new customers by creating an environment for increasing productivity and improving the customer on-board experience. Superfast onboard Wi-Fi would make rail more competitive and attractive - online polling commissioned by evo-rail found that more than 40% of people would be more likely to consider taking the train than another mode of transport if there was fast, reliable on-board Wi-Fi provided by the train company.

The new technology was trialled on Island Line trains on the Isle of Wight with a wider roll out currently being deployed on the mainland SWR network as well as in Northern Spain with additional UK contracts under negotiation. Any new contractual framework introduced by GBR must give operators the commercial freedom to allow for innovative relationships with partners and suppliers like evo-rail which can radically improve the customer offer and make rail more attractive.

About Rail Partners

Rail Partners exists to make the railway better by harnessing the expertise and creativity of private sector operators for the benefit of those who use the railway, passengers and freight customers, and those who pay for it, including taxpayers.

Rail Partners plays a key role in representing its members' interests in the national debate about the future of the rail industry and its role in supporting the wider economy, environment and prosperity of the nation as we transition to the end state, as imagined in the Plan for Rail.

Rail Partners

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