Australian Government | Infrastructure Australia

Improving Public Transport

Customer Focused Franchising

May 2017

REFORM SERIES

Infrastructure Australia is an independent statutory body that is the key source of research and advice for governments, industry and the community on nationally significant infrastructure needs.

It leads reform on key issues including means of financing, delivering and operating infrastructure and how to better plan and utilise infrastructure networks.

Infrastructure Australia has responsibility to strategically audit Australia's nationally significant infrastructure, and develop 15 year rolling infrastructure plans that specify national and state level priorities.

Hardcopy

ISBN: 978-1-925352-14-6

Online

ISBN: 978-1-925352-15-3

Contents

Executive Summary

Public transport plays a critical role in the lives of all Australians.

Each year Australians make nearly 1.6 billion public transport trips. For those who regularly catch a bus, a train, a ferry or a tram, public transport is an important part of getting to work or leisure. Those who do not use it regularly also benefit because public transport is an important factor in reducing congestion, improving liveability and increasing productivity.

But our public transport is facing a number of challenges. The combination of increasing demand and capacity constrained networks poses a risk to service quality and means significant investment is needed. Without action, Australians are set to experience worsening services alongside increasing costs.

Reform is required to maintain and enhance the quality of our public transport

From 2011 to 2030, the urban public transport task in Australia is expected to increase by nearly 30%, to 25 billion passenger kilometres per annum.[1] Growth on this scale will transform our cities and deliver a substantial increase in demand for already constrained infrastructure.

Left unaddressed, this means people are going to face increasing levels of crowding and delays, reducing their productivity and negatively impacting their quality of life.

The situation is made worse by the growing budgetary constraints facing Australian governments. The growing need for government expenditure on public transport is unsustainable in the face of an ageing and growing population, and associated pressure to fund welfare and health services. Governments can no longer afford to fund the increasing public transport needs of our cities in the same way it has in the past.

Meeting these challenges will require a rethink of how we plan, operate and fund infrastructure. Action across a number of fronts will be required. We must reform the way we plan and pay for infrastructure, while also ensuring we extract the maximum value from the infrastructure we already have. Enhancing the efficiency of public transport services is a key component of this reform program.

Franchising is an opportunity to deliver service improvements and reduce costs

Public transport franchising (franchising) refers to a process where governments expose public transport services to contestable supply, so that the best operator delivers the services. This approach has been shown, both domestically and internationally, to deliver:

1. Improved services for users.
2. Substantial savings for taxpayers.

Franchising should not be confused with the sale of infrastructure assets. Instead, it is a competitive process where government transfers operational responsibilities for the delivery of services for an agreed period of time. Ownership of the infrastructure and strategic decisions, which generally includes network planning, investment in new infrastructure, fare prices and timetabling, remains with the public sector or independent regulators.[2]

Under a franchise agreement, governments are able to hold a private operator to account via an enforceable contract with clear performance targets and penalties for poor service. Domestic and international experience shows that this combination of competition and incentives delivers tangible improvements for customers.

Franchising also provides substantial savings to government. Infrastructure Australia commissioned international consulting firm PricewaterhouseCoopers (PwC) to analyse potential savings from franchising major government operated rail and bus networks in Australia's largest cities. This study projected total operational cost savings in the range of $11.6 billion to $15.5 billion (real 2016 dollars) at a 7% discount rate and $28.6 billion to $38.4 billion undiscounted.

This range was developed by modelling two scenarios:

1. **High savings scenario ($15.5 billion):** where the state achieves high levels of savings while, at a minimum, maintaining existing service standards. Under this scenario, the franchisee is able to find significant operating efficiencies.
2. **Conservative savings scenario ($11.6 billion):** where franchisees still improve efficiency, but are more constrained in doing so. This could be for numerous reasons such as broader economic conditions, government policy decisions and relatively efficient operation prior to franchising.

Table 1 provides a summary of the modelling results.

It is important to note the estimates show what is possible and are intended to illustrate the quantum of savings available – so there are some important caveats to keep in mind:

- The timeframe is indicative only. This report does not suggest any of the modelled networks should be franchised immediately, without the necessary preparation, or at the same time.
- The data is based on percentage rail and bus cost savings that are applied uniformly across networks. In reality, savings would depend on context and there would likely be variations across cities.
- The estimates do not take into account changes to farebox recovery, which could potentially further reduce government subsidies.
- The estimates do not take into account cost escalation over time. Operating costs often increase due to growth in population and demand. Increases in patronage may lead to growing expenditure which absorbs savings from franchising. When this occurs, provided due diligence is carried out on all investments, costs per passenger should decline.

Table 1: Estimated costs savings from franchising Australian public transport operations, undiscounted and discounted, 2017-2040

$M 2016	**Total** (undiscounted)	**Total** (discounted 4%)	**Total** (discounted 7%)	**Total** (discounted 10%)
High Savings Scenario	38,443	22,229	15,544	11,331
Conservative Savings Scenario	28,616	16,510	11,551	8,438

Customer Focused Franchising is a practical pathway to introduce reform

This paper provides a roadmap for state and territory governments to capitalise on the opportunities of franchising to enhance service quality, increase capital investment and improve cost efficiency across public transport. The paper argues that by reinvesting the proceeds of reform – that is the reduced subsidy required to run services more efficiently – back into the public transport system, policy makers can use franchising reform as a service improvement tool.

We call the approach Customer Focused Franchising and we are recommending that all state and territory governments adopt the model when introducing contestable supply to public transport. It would see a proportion of the savings from franchising used to deliver new rolling stock, station upgrades, greater capacity and new additions to the network. It also provides governments with a useful tool to communicate the benefits of franchising to the public.

The approach borrows from the Asset Recycling model, where proceeds from the sale or lease of mature publicly owned infrastructure assets are directly invested into new, productivity enhancing infrastructure. A key difference with the asset recycling initiative is the savings from franchising would not be additional revenue, but instead would be a reduction in expenditure.

This means that the introduction of franchising would improve the budget bottom line but would not necessarily result in additional expenditure on public transport. In order to ensure some of the savings from franchising are re-invested into the transport network, under the model governments would:

1. **Identify the extent of the savings.** Governments could do this by creating a public operator benchmark – which would be based on operating and maintenance expenditure prior to franchising. Expenditure following franchising could then be compared to the benchmark and any savings identified.
2. **Decide the proportion of savings to be re-invested and where.** This would be a decision for governments based on their competing priorities. Governments could consider directing savings to specific capital projects or to investments required for improved operating practices. The identification of investments should be informed by existing infrastructure and land use planning processes.
3. **Publish information about the extent of savings and where the money is being directed.** Publication would help to improve transparency and could also help publicise the benefits of franchising.

The savings delivered by franchising could be directed to funding valuable infrastructure upgrades

Customer Focused Franchising represents a tangible opportunity for state and territory governments to improve the quality of their public transport systems.

Total (discounted and undiscounted) savings available to each state, over the 24 year modelled period, are shown in **Table 2.**

Table 2: Savings available to jurisdictions from franchising, 2017–2040, in 2016 dollars

Jurisdiction	**High scenario** (7% discounted) $M	**Conservative scenario** (7% discounted) $M	**High scenario** (undiscounted) $M	**Conservative scenario** (undiscounted) $M
New South Wales	8,973	6,663	22,145	16,460
Queensland	3,350	2,484	8,295	6,163
Victoria	1,085	841	2,644	2,045
South Australia	890	644	2,240	1,634
Western Australia	786	568	1,983	1,445
Australian Capital Territory	345	265	848	652
Tasmania	114	86	287	218
Total	**15,544**	**11,551**	**38,443**	**28,616**

Savings of this magnitude could be used to make a substantial contribution to network improvements. For example:

- In New South Wales, franchising could contribute to paying for the Sydney Metro City and Southwest.
- In Queensland, the savings could help pay for Cross River Rail.
- In Victoria, the available savings are greater than the cost of their Tram procurement program.
- In South Australia, the savings are significantly greater than the Torrens junction project.
- In Western Australia, the savings available could make a substantial contribution to funding the Forrestfield to Airport rail line.
- In the Australian Capital Territory, the savings available could significantly contribute to stage one of the ACT light rail.
- In Tasmania, available savings exceed the existing funding commitment for updating Metro Tasmania's bus fleet.

Australia's governments are well placed to learn from domestic and international experiences

Introducing franchising is a complex and multi-faceted process. Fortunately, Australia's governments are in a good position to learn from past experiences and ensure the successful implementation of reform.

This paper uses case studies to advise governments on how to structure the finer details of individual franchises. There is now a long track record of competition reforms in passenger transport, both in domestic and global jurisdictions. Governments can learn from the reform history of others, capturing best practice and avoiding pitfalls to drive improved efficiency and enhance outcomes for customers.

The case studies explored in this paper will draw on the experiences of the Victorian reform of rail and tram services in the 1990s and 2000s, and the reform of the United Kingdom's rail sector in the 1990s. The case studies represent different approaches that are nonetheless united by driving contestability, accountability and efficiency in the delivery of public transport.

National leadership is required

Finally, the paper looks at how to make a complex reform like franchising happen. In particular, the report establishes a role for the Australian Government.

While public transport services are traditionally operated by state, territory and some municipal governments, this paper argues that national government has a direct interest in more efficient transport service delivery. This direct interest creates a strong case for the Australian Government to incentivise the states and territories to embark upon reform under the Customer Focused Franchising model.

This paper builds on our recommendation in the *Australian Infrastructure Plan*

In the context of a growing population, particularly in our largest cities, the delivery of effective and efficient public transport will be key to ensuring Australia continues to provide a world class standard of living. Franchising public transport services provides government with a proven pathway to deliver an enhanced customer experience at a lower cost to taxpayers. However, with some notable exceptions, the majority of public transport operators are government owned, meaning there is significant scope to reform public transport in Australia.

Infrastructure Australia recognised this opportunity in the *Australian Infrastructure Plan*, which called on all governments to adopt the default position of exposing public transport services to contestable supply.[3] The Australian Government supported this recommendation, noting a potential role for the Council of Australian Government (COAG) Transport and Infrastructure Council.[4]

This paper will build on the recommendation in the *Australian Infrastructure Plan* by providing advice to governments about how to action franchising in their jurisdiction. The paper makes further recommendations to governments on how to carry out reform. These are included throughout the paper and summarised at the end of the report.

Recommendation 6.14

Governments should adopt a default option of exposing public transport services to contestable supply through franchising.

The focus of reform should be to improve customers' experience by exposing delivery to contestable supply and selecting the best operator to provide services. Private operation of public transport through time limited, exclusive franchises – where providers compete to deliver services – is a proven model both in Australia and overseas in raising service quality and value for money for customers. It should be the default option for public transport provision, with capital city bus and rail services as immediate candidates for franchising.

The Case for Reform

At a glance

- Our public transport networks are facing a number of challenges which, if left unaddressed, will result in a decline in service quality and increasing costs.
- Franchising – the provision of rail, bus, ferry or other public transport services by an operator under an agreement with government – is an opportunity to deliver higher quality services to users at a better value to the taxpayer.
- Managed effectively, franchising can generate considerable cost savings. Modelling by PwC estimates that franchising could deliver discounted savings of between $11.6 billion and $15.5 billion ($28.6 billion to $38.4 billion undiscounted) nation-wide between 2017 and 2040 which could then be re-invested into the public transport network.
- Franchising can be a complicated reform, but by enabling governments to contract for specific outcomes, it provides a platform to drive service improvements and encourage innovation, all to the benefit of public transport users.

1.1 The case for reforming public transport in Australia

Getting public transport right is one of the central pillars to ensuring Australia's long term liveability and productivity. Public transport plays a key role in the day to day lives of most Australians, particularly in our cities. It makes it easier for people to get to jobs and services, ensures businesses can operate efficiently and enables the creation of dynamic communities with strong social ties.

Our public transport systems face a number of challenges. Australia has one of the highest population growth rates in the developed world. Over the last decade, our growth was more than twice the average of the countries that make up the Organisation for Economic Cooperation and Development (OECD).[5] This growth is set to continue. Over the next 24 years to 2040, Australia's population is projected to increase by nine and a half million people.[6] About 80% of this growth will be in our capital cities.

Growth on this scale will transform our cities and deliver a generational increase in demand for already constrained transport infrastructure and services. From 2011 to 2030, the urban public transport task in Australia is expected to increase by nearly 30%, to 25 billion passenger kilometres.[7]

For public transport networks in our largest cities, projected demand is often beyond the system's current capacity. In Sydney, trains on average are already filled to 126% of seated capacity in the morning peak, but demand is projected to increase a further 36% by 2031.[8] Similarly, for Brisbane, rail boardings in the morning peak are projected to increase by 90% from 2011 to 2031. Under current service levels, this would lead to significant overcrowding, with demand in some parts of the network more than three times the number of available seats.[9] **Box 1** summarises projected growth in demand for public transport in our four largest cities.

In addition to growing demand, Australian governments face significant fiscal pressures. The *Australian Infrastructure Audit* found the current level of public sector expenditure on transport is unsustainable in the face of an ageing and growing population, and increasing pressure to fund welfare and health services.[11]

The experience of customers can also be varied. In 2015, L.E.K Consulting released the *Public Transport Barometer*, which reviewed the key performance indicators for major metropolitan transport networks in Australia. The report found that while public transport patronage across Australian cities is increasing, the performance of services in terms of punctuality and reliability varies across different services and between different cities.[12]

Box 1: Projected growth in public transport demand in our largest cities

Demand for public transport will grow significantly in the coming years. The *Australian Infrastructure Audit* projected the following growth in demand from 2011 to 2031:

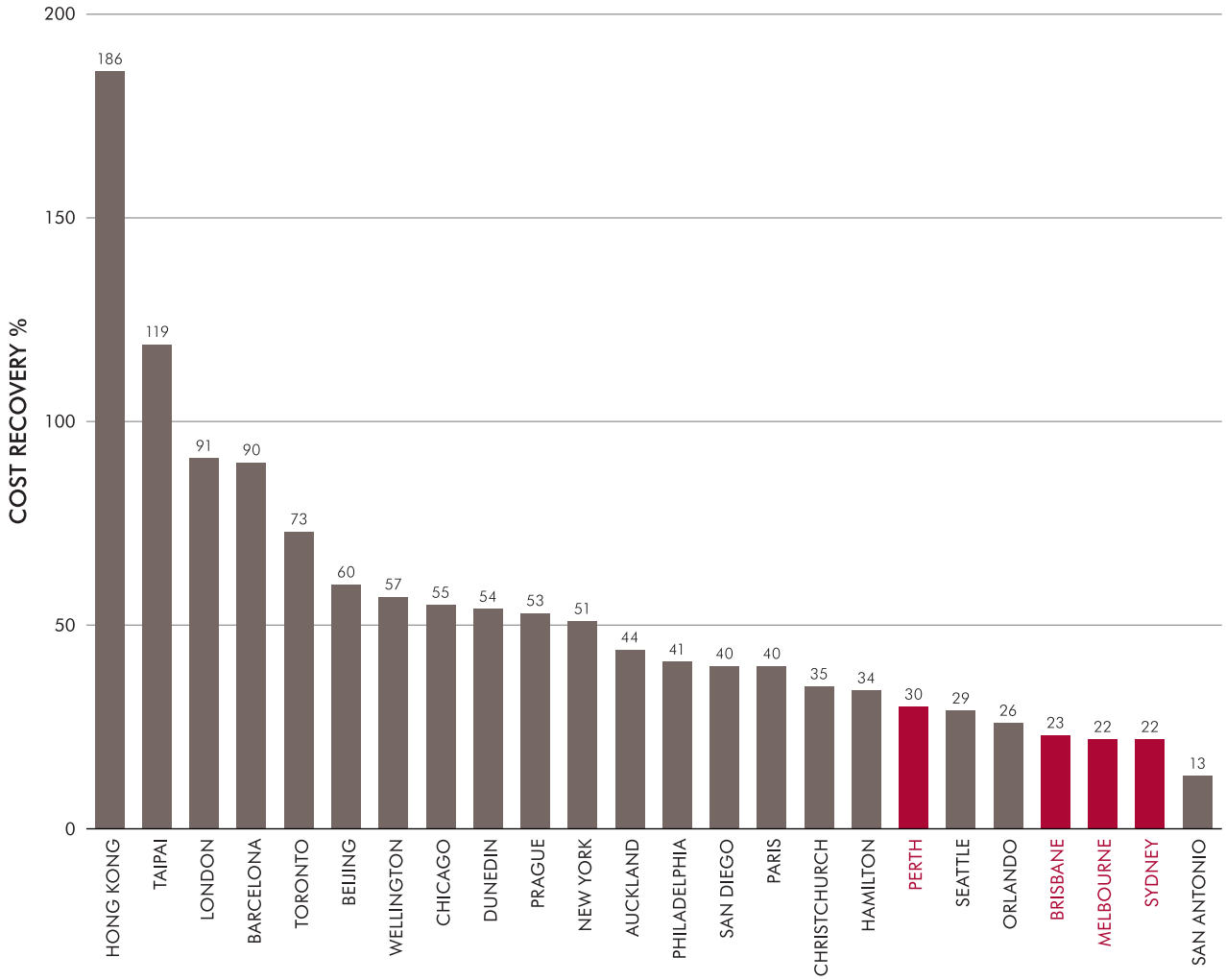
- Sydney: About 1.3 million extra public transport boardings each day, representing 48% growth.
- Melbourne: Almost two million extra public transport boardings each day, growing by 95%.
- South East Queensland: About 460,000 additional public transport boardings daily, representing growth of 67%.
- Perth: More than 450,000 extra public transport boardings per day, representing 99% growth.
- Adelaide: An increase of almost 90,000 daily public transport boardings, or 38%.
- Canberra: Growth of about 50,000 daily boardings, representing 69%.[10]

There is considerable scope to reform our public transport services. With a small number of notable exceptions, Australia's public transport networks are largely government operated. Excluding Melbourne, all major metropolitan heavy passenger rail services are publicly run. In contrast bus, light rail, regional passenger rail and ferry networks in most states are a mixture of private and public operation.[13]

Cost recovery[14] in the sector is low, around 20 to 30%.[15] **Figure 1** compares public transport cost recovery in selected Australian cities with international networks. It is important to note these figures are for public transport across entire cities. In reality cost recovery varies significantly between individual networks and routes.[16]

Public transport in Australia is unlikely to operate at full cost recovery. However, there is considerable scope for the current, relatively low levels of recovery to be improved. This is particularly important in the context of rising demand for services and the increasing budgetary constraints facing governments. Measures that increase cost recovery would improve the financial sustainability of services, ensuring they are in a better position to meet the long term challenges facing the sector.

Figure 1: Cost recovery of public transport across global cities[17]



1.2 Franchising is an opportunity to deliver service improvements and reduce costs

Franchising refers to a process where governments contract an operator, usually though a competitive tender, to provide public transport services for a time-limited period.

This should not be confused with the sale of public transport assets. Instead, it is a competitive process where government transfers operational responsibilities for the delivery of services, and in some cases the responsibility for the maintenance of the network and rolling stock, to an operator for an agreed period of time. Ownership of the infrastructure and strategic decisions, including network development, investment in new infrastructure, fares and timetabling, usually remains with the public sector or independent regulators.

Public transport, in particular rail networks, are generally seen as natural monopolies because it is not usually feasible or economically desirable to duplicate services. Whether the monopoly transport operator is public or private, a lack of competitive forces can result in inefficiencies that drive up costs and reduce the quality of service.[18]

Through franchising, governments are able to introduce competitive pressures to the provision of services. These pressures come through a tendering process where multiple operators bid for rights to operate a service over a given period. A government contracts an individual operator for a set period and allows the state to periodically retest the market at the end of a franchise term, while holding the provider to account through an enforceable contract and performance regime.[19]

Through this process governments will generally define the operational and performance requirements that operators must meet. A carrot and stick approach is adopted to ensure the provider delivers. Payment is usually made under a fee-for-service model. Contractual and financial incentives may be set up to drive intended behaviours.

1.3 There are a number of ways to deliver franchising

There are numerous ways in which franchising can be undertaken. Ultimately the model selected needs to suit individual context. Franchising may be put in place for the operation of an entire (single mode) network, or for a sector/route within the broader public transport system.

For rail networks, franchising can be vertically integrated or separated. An example of a vertically integrated franchise is Metro Trains Melbourne, which is responsible for running trains but also for infrastructure management and maintenance. In contrast, the United Kingdom's rail franchising system is vertically separated, whereby franchisees are responsible for operating trains but the infrastructure is managed by Network Rail – an 'arms-length central government body'.[20]

Beyond the structure of the franchised network, there are four broad contract structures typically used. In practice, some features of these contract types may overlap and so individual franchises can be a mixture of the following:[21]

1. **Management or cost plus contract:** this is where the operational and revenue risk (risk associated with train operation, such as punctuality, and the revenue earned through ticket sales) is retained by the government. Generally, the government will pay a base fee to the successful bidder and subsidise operating costs. Franchisees normally don't keep any of the service revenue under this arrangement.

2. **Gross cost or gross cost with incentives contract:** under this arrangement the government transfers operational risk to the service provider but retains revenue risk. This means the operator will be directly impacted for poor performance (often in the form of penalty payments) but the state will still bear the risk of decreases in ticketing revenue. The government will generally collect fare revenue, therefore reducing the operator's incentive to increase patronage. However, the use of innovative contract incentives can mitigate this risk. Under the gross cost with incentives approach, the franchisee is paid at a contracted rate based on measured output in order to incentivise performance improvements.
3. **Net cost contract:** the government will transfer a proportion of operational and revenue performance risk to the private sector, with the level of transfer dependent on individual contracts. Performance under net cost contracts is generally managed through regularly monitored indicators and may lead to incentive payments to franchisees and profit sharing with government for over performance, as well as penalties for under performance. Net cost contracts have been used in rail franchising in Victoria and the United Kingdom.
4. **Commercialised service:** the franchisee will pay a lump sum to government for the right to operate a service and retain related revenue. This arrangement relinquishes the government's ongoing budgetary burden and transfers revenue and cost risk to the franchisee. This approach is generally not suitable in the Australian context for major public transport services because they require operating subsidies from government.

There is no 'correct' model for franchising, rather, it depends on context. There is significant evidence in Australia and internationally to suggest that, so long as an appropriate model is selected, franchising public transport can simultaneously improve service quality, generate considerable cost savings for taxpayers, encourage innovation and ensure our public transport is well placed to meet the demands of population growth.

1.4 Franchising can deliver significant cost savings

Franchising is not an easy fix, but, done well, it could generate significant cost savings for Australian governments and in turn taxpayers.

PwC, at the request of Infrastructure Australia, has modelled high level estimates of operating cost savings from franchising Sydney Trains, Queensland Rail, Transperth, Adelaide Metro, State Transit (NSW), Brisbane Transport, numerous non-franchised Melbourne bus operators, ACTION Buses (ACT) and Metro Tasmania. It's important to note that in February 2017, the Victorian Government announced it would phase out exclusive bus contracts over the next decade.[22]

The modelling indicates that, in contrast to a business as usual public sector delivery model, franchising would likely deliver operational cost savings in the range of $11.6 billion to $15.5 billion (2016 dollars, 7% discount rate) over a 24-year period from 2017 to 2040. This timeframe is indicative only and there is no suggestion any of the networks will be franchised in 2017 or at the same time.

Two approaches to franchising were modelled:

1. **High savings scenario ($15.5 billion):** where the state achieves high levels of savings while, at a minimum, maintaining existing service standards. Under this scenario, the franchisee is able to find significant operating efficiencies.
2. **Conservative savings scenario ($11.6 billion):** where franchisees still improve efficiency, but are more constrained in doing so. This could be for numerous reasons such as broader economic conditions, government policy decisions and relatively efficient operation prior to franchising.

The estimates are shown in **Table 3** and **Table 4** for each scenario and operator at different discount rates. The savings available in Sydney are significantly higher than other cities, with its train and bus networks accounting for about 60% of the national total. In addition, savings from rail networks are greater than from buses, reflecting the significantly higher operating costs associated with that mode of transport.

It is important to note some key caveats to the data below. Firstly, it does not take into account operating cost escalation. An increase in operating costs over time is common as networks expand to meet growing populations and demand. Strong patronage growth may require increases in expenditure, thus absorbing the savings from franchising. When this occurs, the overall cost savings may be reduced or absorbed entirely, but the cost per passenger will still decline. The rate of cost escalation is far from uniform across networks and in large part is dependent on government policy, such as decisions to expand the network. Due to the complexities in estimating cost escalation, the below data are based on estimates of current operating costs that remain constant over time.

Secondly, the estimates are based on high and conservative percentage cost savings scenarios for rail and bus. In reality cost savings would likely differ more between networks. For example, it is likely Transperth would have lower percentage cost savings than some of the other rail networks, because a significant proportion of its business is already outsourced to the private sector.

Table 3: High savings scenario, by operator at different discount rates, from 2017-2040 (2016 dollars)

Operator	Undiscounted $M	Discounted (4%) $M	Discounted (7%) $M	Discounted (10%) $M
Rail				
Sydney Trains	17,768	10,263	7,173	5,228
Queensland Rail	6,374	3,674	2,563	1,864
Adelaide Metro (heavy and light rail)	2,240	1,283	890	643
Transperth	1,983	1,135	786	567
Total rail	28,364	16,354	11,412	8,301
Buses				
State Transit (NSW)	4,378	2,555	1,800	1,321
Melbourne non-franchised operations[23]	2,644	1,542	1,085	796
Brisbane Transport	1,921	1,120	788	577
ACTION Buses (ACT)	848	492	345	252
Metro Tasmania	287	165	114	82
Total buses	**10,078**	**5,874**	**4,132**	**3,029**
Total (rail and buses)	**38,443**	**22,229**	**15,544**	**11,331**

Table 4: Conservative savings scenario, by operator at different discount rates, from 2017-2040 (2016 dollars)

Operator	Undiscounted $M	Discounted (4%) $M	Discounted (7%) $M	Discounted (10%) $M
Rail				
Sydney Trains	13,071	7,537	5,268	3,842
Queensland Rail	4,679	2,690	1,875	1,364
Adelaide Metro (heavy and light rail)	1,634	931	644	464
Transperth	1,445	822	568	408
Total rail	**20,829**	**11,981**	**8,355**	**6,079**
Buses				
State Transit (NSW)	3,388	1,975	1,396	1,032
Melbourne non-franchised operations	2,045	1,190	841	621
Brisbane Transport	1,484	863	609	450
ACTION Buses (ACT)	652	377	265	195
Metro Tasmania	218	124	86	62
Total buses	**7,787**	**4,529**	**3,196**	**2,360**
Total (rail and buses)	**28,616**	**16,510**	**11,551**	**8,438**

Finally, the potential savings do not take into account any changes to farebox recovery. If the franchise contracts are well-structured and result in improvements to services, farebox recovery could improve, therefore increasing operating cost savings. A more detailed discussion of the model and methodology is available in PricewaterhouseCooper's supplementary technical paper, *Infrastructure Australia: potential cost savings from rail and bus franchising technical report.*

The model is based on assumed percentage savings of existing costs over a 24-year period. Two 12-year rail franchising terms and three 8-year bus terms were modelled.

For rail networks, cumulative savings begin at 5% in the first year and escalate over the two 12-year terms to between 25% and 32.5%. For buses, more significant savings are found in the first year (10%) and this escalates over three eight-year terms to between 30% and 35%.

Although savings accumulate over time, the most significant gains are made in the first franchise term, where there is generally more opportunity to improve efficiency. There are also increases in savings at the beginning of each new term, reflecting that lessons are normally learned and contracts as well as operator behaviour change accordingly.

Figure 2 and **Figure 3** show savings over time, expressed as a percentage of current operating costs for the modelled rail and bus networks.

These estimates are supported by local and international experience that shows cost savings, particularly following the first round of franchising, are generally between 20% and 30% and sometimes as high as 50%. **Table 5** shows percentage cost savings achieved by competitive tender processes in Australia and internationally.

Governments often undertake reform of transport networks in preparation for franchising, which can also result in cost savings. For example, evidence from Victoria shows that reform of the Public Transport Commission prior to franchising in the 1990s resulted in a 43% cost savings to the Victorian Government.[24] For a more detailed discussion of rail franchising in Victoria see **Chapter 3** (p.23) of this report.

1.5 Franchising can deliver cost savings from a range of sources

The sources of cost savings from franchising will in large part depend on the structure and operations of the specific transport network. When a network has identified areas of operational inefficiency, such as poor labour productivity, rolling stock utilisation or maintenance regimes, it is likely to benefit from the competitive pressures that franchising introduces.

However, where a network has already undertaken significant reform, or already outsources some operations, savings may be smaller. This does not necessarily mean franchising has no benefits. The introduction of competition can help to ensure efficiencies are maintained, but it is important to keep in mind that context plays a key role when discussing the source and extent of cost savings.

Figure 2: Cumulative operating costs savings for rail under franchising

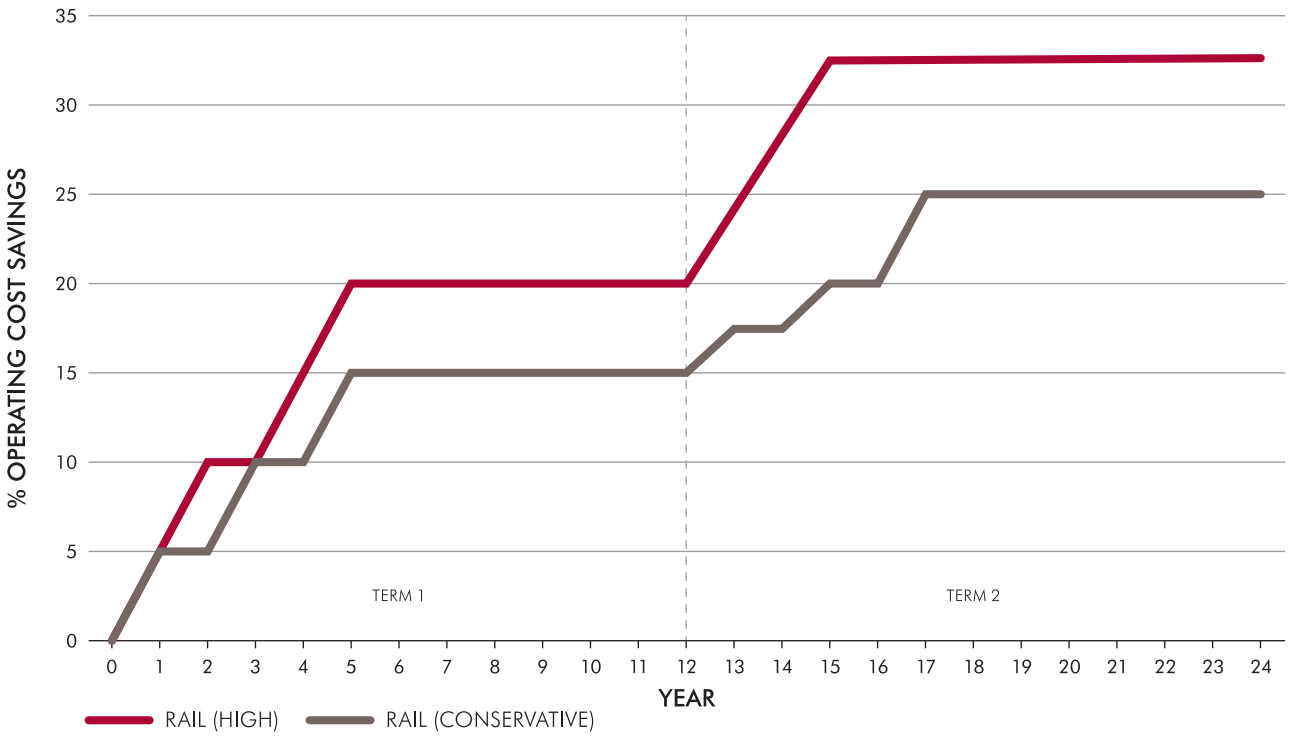


Figure 3: Cumulative operating cost savings for bus under franchising

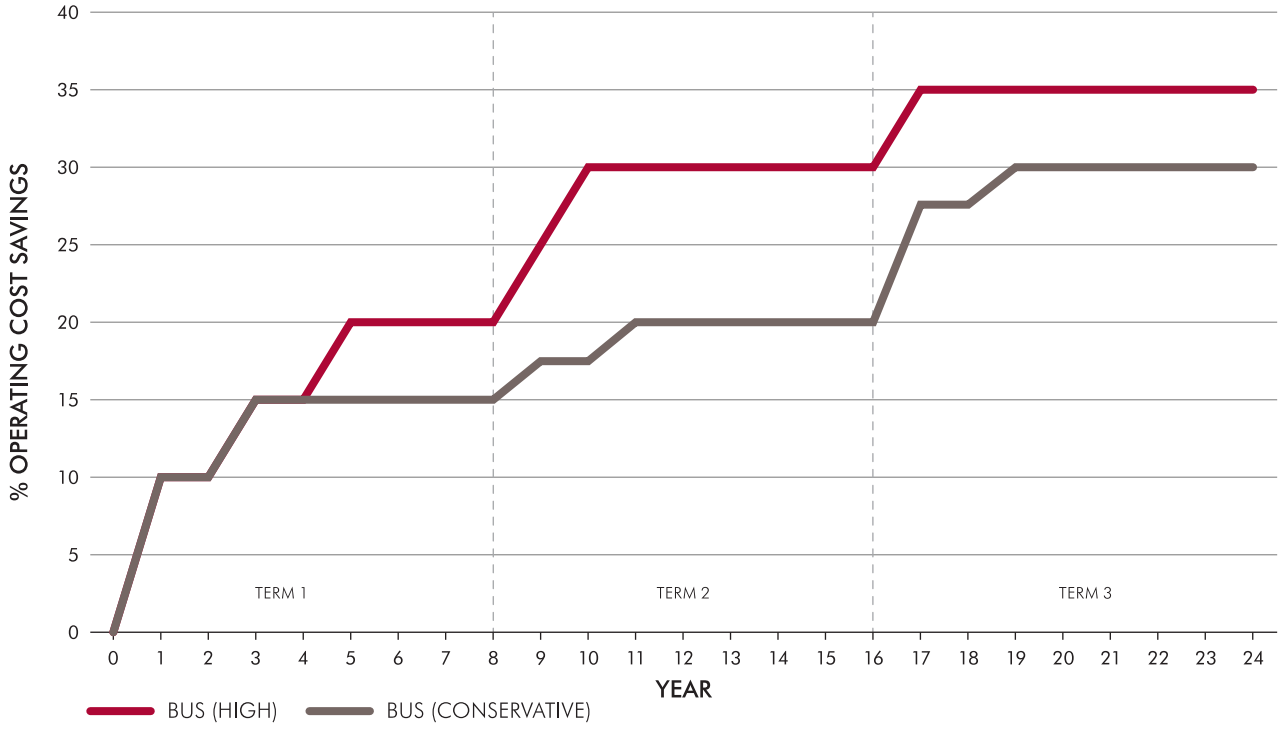


Table 5: Cost savings following franchising, per cent[25]

Country/City	Mode	Timing	Cost reduction range (%)
Unit cost reduction[26]			
Britain, London	Bus	1985–2000	51
Britain (outside London)	Bus	1986–1999	54
Sweden (Stockholm)	Bus	1989–1992	20–32
Sweden (National)	Bus	1987–1993	5–6
United States (8 cities)	Bus	Not available	30-46
New Zealand (Auckland, Wellington, Christchurch)	Bus	Not available	40
Australia (Adelaide)	Bus	1994–2001	38
Australia (Perth)	Bus	1996–2001	22
Operating cost and/or contract cost			
Sweden (regional/interregional)	Rail	Numerous contracts from 1990. Contract length generally 3–5 years	18–30
Germany	Rail	Numerous contracts from 1996, contract length about 10 years	20
Netherlands	Rail	Numerous contracts since 1998, contract length generally between 10 and 15 years.	20–50
Australia (Sydney)	Ferries	2012–2016	12
Australia (Melbourne)	Bus	2013–2014	18

There are generally three broad areas where cost savings can be realised from franchising:

1. **Staff productivity and costs:** labour costs normally represent a significant proportion of operating costs. A recent review by the NSW Independent Pricing and Regulatory Tribunal (IPART) showed that for Sydney Trains, labour costs (primarily crewing and cleaning) made up about 60% of train operating costs (a subset of total network operating costs). Furthermore, customer interface costs almost entirely consist of labour.[27]

   The savings from labour costs may come from improving productivity. There are numerous ways to do this, such as staff training and greater multitasking, improved hiring practices, contracted performance incentives or greater workforce flexibility.

   Savings may also be realised from managing staff numbers. This can be one of the more challenging and controversial aspects of franchising, with many decisions about staffing being subject to government policy regarding staffing of railway stations and crewing of rolling stock.

   Although staff costs can be a challenging topic it is important to note there is no evidence to suggest franchising results in poorer pay; indeed, IPART's review found that wages and hours of railway staff in Sydney, Melbourne and Brisbane were comparable (see **Table 6**).

2. **Better asset management and utilisation:** asset management is a significant driver of operating costs. This cost component includes maintenance of assets (such as rolling stock), and how efficiently those assets are used. Franchising introduces competitive pressures which incentivise more efficient asset management. Common ways to improve efficiency include: optimising vehicle and carriage configurations, improved scheduling of maintenance, ensuring maintenance facilities and depots are strategically located to avoid empty vehicle running, and improved network design which optimises routes and fleet utilisation.

3. **Efficient procurement:** Under the right contract settings, franchising has been shown to incentivise more efficient approaches to procurement than traditional public sector delivery models.

   For example, with the franchising of railways in Sweden in the 1990s, one operator significantly reduced rolling stock costs by procuring standardised 'off the shelf' stock that was suited to the local environment but also significantly cheaper to buy and maintain than bespoke stock.[28]

Another approach to delivering cost savings is to increase cost recovery (thereby reducing the subsidy) by increasing fares. This approach seeks to address the 'recovery' side of the cost-recovery ledger. Beyond the obvious discomfort of raising fares without improved services, this approach could also be considered as wasteful. It gathers new money from users, but continues to spend that money as inefficiently as every other dollar it collects, and can lead to reduced patronage, which has other economic costs, such as increased congestion.

In contrast, franchising addresses the costs side of the ledger. While maintaining and improving service levels, appropriately structured incentives in a franchising contract, coupled with competition to supply services, can place substantial downward pressure on operating costs.

1.6 Franchising enables government to incentivise service improvements

Franchising provides an opportunity to incentivise service improvements by contracting for specific performance outcomes. Key performance indicators are monitored and generally published, which also helps to improve transparency.

Under franchise agreements, governments are able to set the expected outcomes in areas of importance and to define contractual regimes for monitoring, incentivising and enforcing good operator performance. Financial penalties may be applied for poor performance while sometimes bonuses can be paid for exceeding agreed standards. Performance incentives are generally applied to measurable service aspects including punctuality, cancellations, ticket machine availability and customer satisfaction.[29] These financial incentives are difficult to effectively implement under public sector operation as a result of government simultaneously being the owner, operator and regulator of services.

Table 6: Wage comparison of people employed in Australian passenger rail transport sector, ($) 2011[30]

City	Operation	Average wage/week ($)	Average hours	Wage per hour ($)
Sydney	Public	1,555	37.6	41.3
Melbourne	Private	1,517	37.2	40.8
Brisbane	Public	1,539	37.8	40.8

This combination of contracted benchmarks, rewards and financial penalties creates a powerful incentive for the operator to improve the performance and efficiency of its service. Evidence suggests that this structure delivers better outcomes for users. There are numerous examples in Australia and overseas where franchising has resulted in service standard improvements or innovations. These include:

1. **Melbourne rail on-time running:** the franchising of rail and tram services in Melbourne in the late 1990s provided financial rewards for improved punctuality. On-time running improved by 2.6 percentage points in the first few years of corporatisation and franchising.[31]
2. **Harbour City Ferry service standard improvements:** Sydney's iconic ferry services were franchised in 2012. The winning bidder, Harbour City Ferries, has improved on-time running, consistently achieving 99% of services on-time since taking over the contract. Customer complaints have also declined. In 2014–15 the complaint rate was about 2.2 per 100,000 boardings, which was about 30% lower than the final year of public sector operation in 2011–12.[32] These improvements were made while also reducing the contract price to government by 12% per annum.[33]
3. **France multimodal planning and operation:** Between 1998 and 2009, the respective transport agencies in the French cities of Lyon, Bordeaux and Rennes each contracted a single operator to run their city's entire public transport network.[34] Through the operation of an entire network rather than a single service, the various operators have been able to optimise each city's public transport network to drive better outcomes for passengers.
   - In Lyon, the operator re-designed the operation of the city's public transport network to enable passengers to make 90% of their journeys within the city with two or less transfers between the network's different modes.[35]
   - In Rennes, the operator was the first public transport operator in France to publish open multimodal data sets, enabling the creation of digital applications. This meant passengers could access updated schedules, real time traffic information, journey planning and the availability of bicycle and car spaces through their smart-phones and tablets.[36] The New South Wales Government has adopted a similar approach to the delivery of public transport in Newcastle. From July 2017, a single operator will run the city's existing bus and ferry services, with light rail to be added in 2019 when it is completed. The new operating model is expected to deliver multi-modal benefits to the city's transport network, including increased patronage, integrated user friendly timetabling and more services.[37]

1.7 The success of franchising is contingent on a number of conditions being in place

Introducing franchising is a complex and multi-faceted process. While the potential benefits of reform are well established, a poorly executed franchising arrangement can result in unnecessary cost and a decline in service quality.

Getting franchising right is contingent on the structure and delivery of each franchising arrangement. Domestic and international experience indicates that getting these settings right is not a simple undertaking. There are several examples where governments have been required to undertake a number of franchising rounds before settling on an optimal model. Fortunately, Australia's governments are in a good position to learn from past experiences and ensure the successful implementation of franchising.

Chapter 3 closely examines two franchising case studies (the United Kingdom and Victoria) and identifies a set of principles which aim to avoid the risk of a poorly structured franchise through encouraging competition, encouraging contracted incentives and reducing risk. With these settings in place, governments can ensure that the pitfalls of this reform are avoided and maximum value is delivered for the passenger and taxpayer.

Recommendation 1

Where practical, the operation of new additions to the transport network should be franchised. This should occur where additions are stand-alone operations rather than small extensions to existing networks.

Customer Focused Franchising

At a glance

- Franchising can be a contentious issue for the community. However, evidence shows that the community is supportive of the reform when it is properly explained and their concerns regarding changes to the quality of services adequately addressed.
- The Customer Focused Franchising model would see government use a portion of the ongoing cost savings of franchising for investment in public transport. The approach provides governments with a practical pathway to alleviate community concerns regarding franchising.
- Customer Focused Franchising provides governments with a tool to deliver substantial network improvement. Modelling completed by PwC shows that franchising could create a sizeable pool of revenue for investment back into public transport, such as new rolling stock, station upgrades, greater capacity and new additions to the network.

2.1 Addressing community concerns about franchising should be the first step of reform

The franchising of public transport services is a contentious policy issue for the community. Public transport plays a central role in the lives of many Australians. As a result, the public has understandable concerns regarding how changes to the management and administration of these services could impact their day-to-day lives.

Market research by GA Research[38] has found that community concerns regarding franchising generally fall into one of four categories:

1. **Adverse impacts on the quality and frequency of services:** the perception that the profit-maximising motive of a private sector operator may result in a reduction in the frequency of services, the cancellation of unprofitable services or a decline in service quality.
2. **Increases in fares:** concern that a private operator will increase fares in pursuit of increasing profit.
3. **Potential disruption if the private operator defaults:** uncertainty regarding who has responsibility to provide services if an operator goes bankrupt.
4. **The 'off-shoring' of profits:** concern that by transferring services to a multinational company any profits would flow offshore.

Community anxiety regarding franchising has created a perception in some jurisdictions that the introduction of the reform will be a complex process. As a result, governments have been reticent to use their political capital to advocate for franchising, believing it could adversely impact their standing with the public.

In practice the community is more supportive of franchising when it is properly explained and concerns

regarding impacts on service are addressed. The research by GA Research concluded that, once people understood the principles of franchising, they were much more supportive of the policy. In addition, most respondents understood there were benefits to involving the private sector, including greater efficiency and access to international expertise.[39]

The study found that the public has a limited understanding of what franchising actually is. The policy is often confused with reforms such as privatisation and deregulation. But when the policy was explained, the majority were supportive of the reform.[40] Engagement tools, like Campaign for Better Transport's *Passenger's Guide to Franchising* (see **Box 2**) are useful resources for improving the general public's understanding of this process.

This alternative analysis of the public and political perception of franchising suggests that with the right approach it is possible to create a fertile environment to introduce reform.

2.2 Governments should draw lessons from the Asset Recycling model

Australia's recent reform history provides useful insights into how to create a fertile environment for the introduction of complex policies, like franchising.

The recent successful use of the Asset Recycling model, where state/territory governments used the proceeds from the sale or lease of mature publicly owned infrastructure assets to invest in new, productivity enhancing infrastructure has demonstrated the value of linking complex reforms to the creation of wider public benefit.

Box 2: The Passenger's Guide to Franchising

Campaign for Better Transport is an independent think tank in the United Kingdom, which advocates for more effective, affordable and sustainable public transport.[42] In 2015 the organisation, in partnership with the Department of Transport, released the *Passenger's Guide to Franchising*, which aimed to provide accessible insights into the planning, procurement and operation of rail franchises.

The guide is based on the premise that the process of rail franchising is complex and large sections of the general public do not have a good understanding of what it entails. The guide looks to address this by using jargon-free language to answer a range of commonly asked questions,[43] including:

- What does a rail franchise include?
- Who decides the cost of my train fare?
- Who is responsible for what on the railway?
- How does a franchise get awarded?
- What happens if a franchise is terminated?
- How can I find out how my train is performing?

The guide demystifies the process of rail franchising, reducing the likelihood of public opposition based on misunderstanding. It also provides the general public with the necessary tools to more effectively engage in the franchising process.

The $5 billion scheme saw the Australian Government provide a 15% top up payment of the proceeds of an asset sale or long term lease, provided the proceeds of the sale/lease were allocated to new infrastructure investments.[41]

By linking the sale of assets with investment in new infrastructure, governments have been able to effectively communicate the value of transferring publicly owned assets into private ownership – a traditionally complex and politically challenging reform.

Box 3 outlines the positive role the Asset Recycling model played in addressing community concerns regarding the partial sale of the New South Wales electricity network assets.

The success of the Asset Recycling model demonstrates that it is incorrect to assume that the community will automatically oppose contentious reform. Instead the model shows that if the change is explained in the right way and the wider benefits clearly demonstrated, public support is much more likely to occur.

2.3 The Customer Focused Franchising model is a practical pathway to introduce reform

Building on the success of the Asset Recycling model, there is an opportunity for state and territory governments to adopt a similar method for the franchising of major public transport services.

Publicly run networks in Australia are largely funded through state government general revenue. There are only relatively small contributions made by operator revenue (which largely consists of ticket and advertising revenue), grants for specific capital projects from the Australian Government, and in some jurisdictions, hypothecated revenue raised from parking levies.

This means that the publicly operated networks rely on substantial state government budget allocations for capital projects, and operating expenditure for the relevant government departments and transport operators. Franchising typically delivers a reduction in government funding for transport operations as efficiencies are realised by appropriately incentivising operators under a contestable model. There is an opportunity for governments to re-invest these savings back into public infrastructure, thereby ensuring the benefits of the reform are shared across the community.

Box 3: The role of asset recycling in the partial lease of electricity network assets by the NSW Government

In June 2014, the NSW Government announced its intention to lease 49% of the state's electricity network. The sale of electricity assets has traditionally been highly contentious in New South Wales with previous rounds of reform being unpopular with the general public.

As part of the sale, the NSW Government committed to recycle the proceeds of the sale to help fund a $20 billion investment in the state's infrastructure under the Rebuilding NSW initiative.[44] The Australian Government recognised the sale under the Asset Recycling Initiative and the NSW Government also received a 15% top up payment for investment in infrastructure.[45] The proceeds of the sale, in addition to the 15% top up, have helped to fund a number of key projects including Sydney Metro, WestConnex and Sydney Light Rail.[46]

By creating a link between the sale of assets and investment in infrastructure, the NSW Government was able to generate support for the reform. Market research undertaken by Infrastructure Partnerships Australia found that about 60% of the sample surveyed supported the lease or sale of these assets if the proceeds were re-invested into new infrastructure.[47]

This experience suggests that if governments effectively explain the need for reform and the benefits it will deliver, the community is much more likely to offer its support.

This approach, titled the Customer Focused Franchising model, would see a proportion of the ongoing cost savings delivered by the introduction of contestable operation re-invested into the delivery of new or upgraded public infrastructure.

A key difference from the Asset Recycling model is the savings from franchising would not be additional revenue, but instead would be a reduction in expenditure. This means that the introduction of franchising would improve the budget bottom line but would not necessarily result in additional expenditure on public transport.

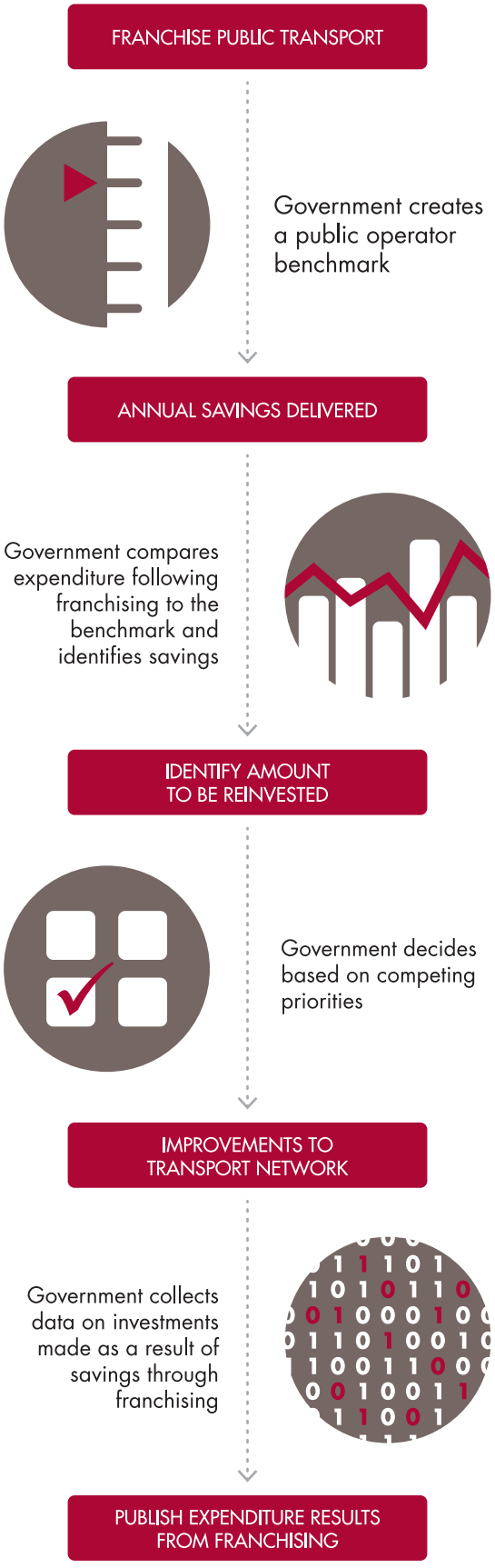
In order to ensure some of the savings from franchising are re-invested into the transport network, under the Customer Focused Franchising model, government would:

1. **Identify the extent of the savings.** A government could do this by creating a public operator benchmark – which would be based on operating and maintenance expenditure prior to franchising. Expenditure following franchising could then be compared to the benchmark and any savings identified.
2. **Decide the proportion of savings to be re-invested and where.** This would be a decision for government based on their competing priorities. Governments could consider directing savings to specific capital projects or to investments required for improved operating practices. Any investments should be directed towards initiatives identified as part of government's long term infrastructure and land-use planning processes.
3. **Publish information about the extent of savings and where the money is being directed.** Publication would help to improve transparency and could also help publicise the benefits of franchising.

Figure 4 provides an overview of how the model would be structured.

The Customer Focused Franchising approach presents state and territory governments with a practical pathway to implement a typically contentious reform. By linking ongoing cost savings to infrastructure investment, the reform, which will deliver benefits in its own right, will also allow governments to increase the available funding for infrastructure. This will in turn alleviate one of the community's most pressing concerns about franchising – that the transition to contestable supply will contribute to a decline in the quality of services.

Figure 4: Overview of the Customer Focused Franchising model



2.4 Franchising can create a significant pool of funding for investment in the transport network

In addition to establishing a vehicle through which governments can communicate the benefits of reform, the Customer Focused Model could also realise a sizable pool of funding for investment in infrastructure.

As discussed in **Chapter 3**, modelling undertaken by PwC for Infrastructure Australia calculated that franchising would deliver savings in the range of $11.6 billion to $15.5 billion (2016 dollars, 7% discount rate) by 2040. The 24-year time period is indicative only and was developed so two 12-year rail and three 8-year bus terms could be modelled. There is no suggestion the modelled networks will be franchised in 2017 or at the same time.

Table 7 provides a summary of the modelling results by jurisdiction.

While these numbers are only an estimate, they do indicate that the magnitude of potential investment is large and could make a material impact on addressing the infrastructure challenges facing Australia.

The revenue could be used to make targeted investments to improve the ongoing operation of transport networks, such as station and bus stop upgrades, new rolling stock, improvements to wayfinding or technology upgrades aimed at enhancing the experience of public transport users. For example, the total (7% discounted high scenario) savings available in Victoria would more than cover the costs of their $800 million tram procurement program and similarly in Tasmania the savings are significantly greater than the metro bus fleet initiative.

Alternatively, the cost savings could be directed to fund network additions which increase the capacity and reach of the services. For example, savings in New South Wales could contribute to paying for the Sydney Metro City and Southwest. In Queensland, the savings could help pay for Cross River Rail. In Western Australia, the savings available could make a substantial contribution to funding the Forrestfield to Airport rail line. In the Australian Capital Territory there could be a substantial contribution to the cost of light rail and finally, in South Australia, the available savings easily exceed the cost of the Torrens junction project.

Table 7: Estimated cost savings from franchising Australian public transport, by jurisdiction, undiscounted and discounted 2016 dollars

Jurisdiction	High scenario (7% discounted) $M	Conservative scenario (7% discounted) $M	High scenario (undiscounted) $M	Conservative scenario (undiscounted) $M
Average annual savings (2017-2040)				
New South Wales	374	278	923	686
Queensland	140	104	346	257
Victoria[48]	45	35	110	85
South Australia	37	27	93	68
Western Australia	33	24	83	60
Australian Capital Territory	14	11	35	27
Tasmania	5	4	12	9
Total savings (2017-2040)				
New South Wales	8,973	6,663	22,145	16,460
Queensland	3,350	2,484	8,295	6,163
Victoria[49]	1,085	841	2,644	2,045
South Australia	890	644	2,240	1,634
Western Australia	786	568	1,983	1,445
Australian Capital Territory	345	265	848	652
Tasmania	114	86	287	218
Total	**15,544**	**11,551**	**38,443**	**28,616**

Ultimately decisions regarding the allocation of funding are the responsibility of the relevant government and its Treasury. The analysis above simply demonstrates that in addition to improved services the Customer Focused Franchising model could also deliver substantial additional budget capacity and improve the quality of public transport services through the reinvestment of savings.

Recommendation 2

State and territory governments should adopt the Customer Focused Franchising model. Under the approach governments would re-invest a proportion of the cost savings of franchising back into public infrastructure. The model provides governments with a practical pathway to alleviate community concerns regarding reform and creates a significant pool of revenue which can be used to deliver infrastructure and service improvements.

Case Studies

Where has franchising been done and what have we learned?

At a glance

- Introducing franchising is a complex and multi-faceted process. Fortunately, Australian governments are well placed to learn from the knowledge and experience of other jurisdictions. This chapter uses the case studies of the Victorian reform of rail and tram services in the 1990s and 2000s, and the reform of the United Kingdom's rail sector in the 1990s, to identify key learnings and best practice.

- While the Victorian and United Kingdom case studies each adopted a different approach to franchising, there are common findings:
  - Franchising brings challenges, but done well, it can improve operational efficiency, customer experience and increase patronage.
  - Franchisees will respond to appropriate incentives. The key for government is to ensure operating conditions allow franchisees to perform well.
  - Getting franchising right is contingent on the structure and delivery of each individual arrangement.

- The Victorian and United Kingdom experiences show there are key principles that Australian governments should consider when franchising:
  - Ensure contractors are incentivised to continually improve service quality.
  - Allocate risk to those best able to manage it.
  - Periodically re-franchise and choose an appropriate contract length.
  - Ensure the assessing agency is appropriately informed and skilled.
  - Ensure selection criteria is transparent.

3

3.1 Learning from international and domestic experience

Implementing franchising can be a complicated undertaking and the success of the reform, in large part, is determined by how well the government can align market and contracted incentives with the interest of customers and taxpayers. Franchising requires a deep understanding of the local context and the suitability of different contract designs. Most importantly, governments need to understand how they can create the right conditions for franchisees to respond to incentives.

Fortunately, there is significant experience and knowledge both domestically and internationally of franchising.

Competitive tendering in the rail sector was first introduced in the United Kingdom in the mid-1990s and Victoria followed later that decade. Rail franchising has also been introduced in a number of other jurisdictions including New Zealand, Germany, the Netherlands and Sweden.

Bus franchising, internationally and in Australia, is more widespread than rail. This is likely because franchising bus services is less complicated than rail operations. Some ferry services have also been franchised in Australia. For example, Sydney's iconic ferry network was franchised in 2012.

It's also important to note most significant, standalone projects currently being constructed in Australia will be franchised or at least privately operated.

Nevertheless, despite the growth in franchising, the majority of public transport in Australia is still delivered by the public sector. **Figure 5** illustrates which existing and future public transport networks are franchised in Australia.

Australian governments should take advantage of the experience gained and lessons learned from previous franchising processes. Analysing past experience is crucial to avoiding common pitfalls and ensuring contracts are appropriately designed. This chapter looks at the rail franchising experience in Victoria and the United Kingdom and draws out some key principles for Australian governments to follow.

3.2 Franchising in Victoria: background

Victorian passenger rail and tram operations were franchised in 1999. Three areas of operations were franchised: the regional passenger services (V/Line Passenger), Melbourne's tram network, and its heavy rail system.

Figure 6 illustrates the history of rail franchising in Victoria.

The reform process in Victoria can broadly be split into five periods: pre-franchising, the first franchises (1999–2002), non-tendered private operation (2003–2009), re-franchised operation (2009–2016), and renegotiation of contracts (2016–ongoing).

1. **Pre-franchising:** from 1989 the publicly owned Public Transport Commission managed Melbourne's tram and heavy rail services, as well as V/Line's regional passenger trains. From the early 1990s the Victorian Government began a period of significant public transport reform, designed to improve the performance of the public transport workforce and bureaucracy.[50] Between 1992 and 1997 staffing levels at the Public Transport Commission were reduced from 18,000 to 8,400, with an annual cost saving of $245 million. During this period, some modest improvements in service levels and ridership were achieved.[51] In 1998, in preparation for franchising, the Public Transport Commission was disbanded and split into five separate corporatised entities: Bayside Trains, Hillside Trains, Swanston Trams, Yarra Trams and V/Line Passenger.

Figure 5: Status of Australian public transport operations, as of February 2017

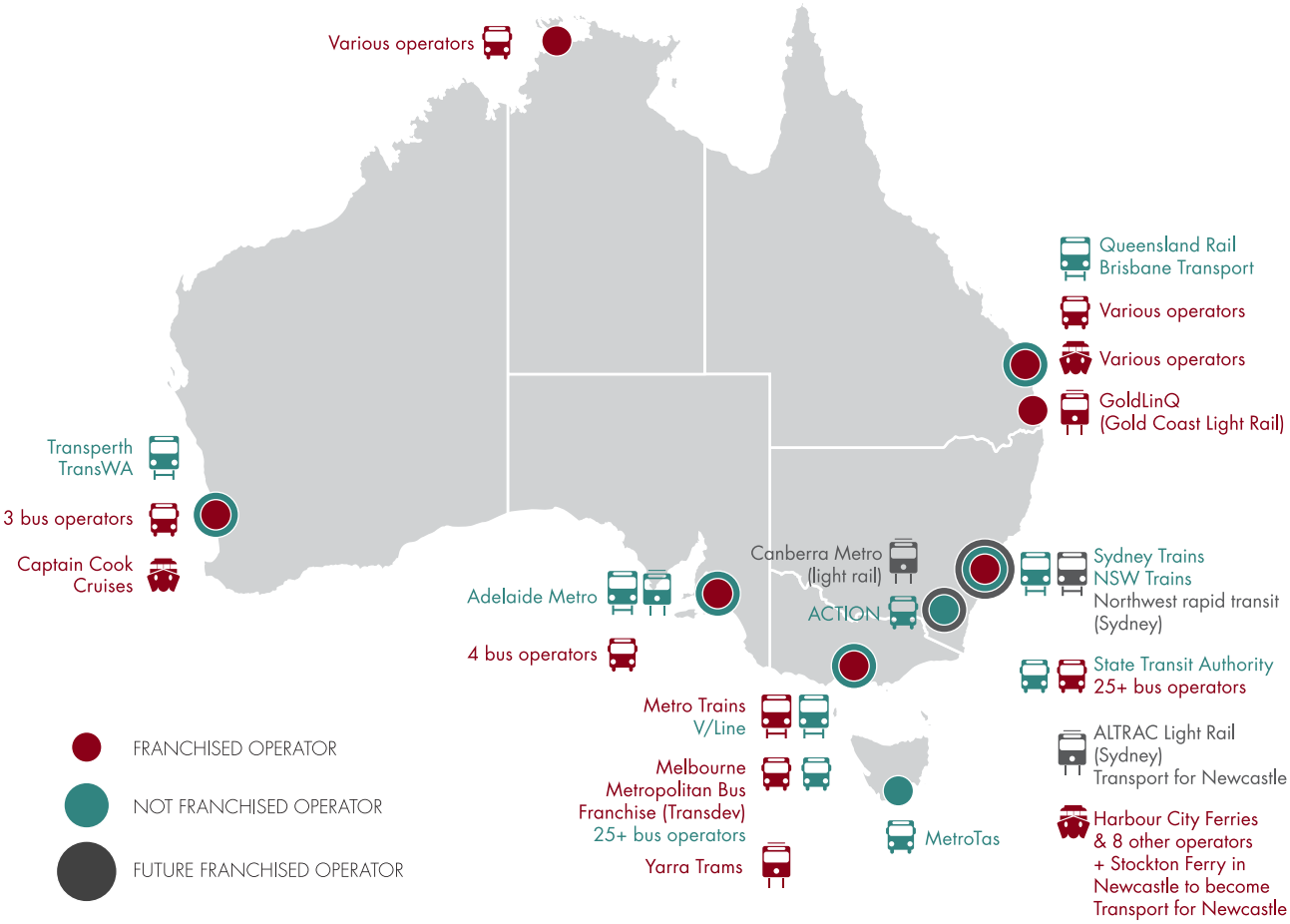
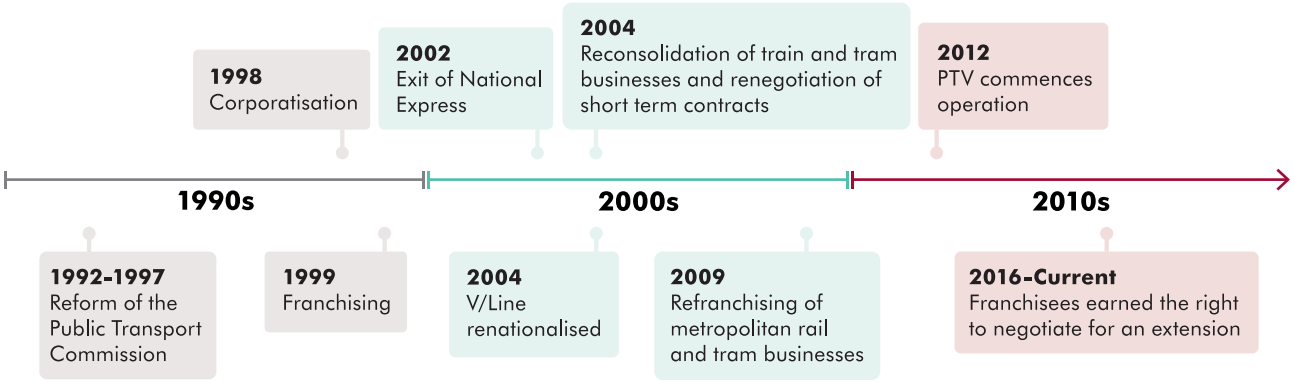


Figure 6: Timeline of franchising in Victoria[52]



2. **First franchise (1999–2003):** in June 1999, successful bidders for the five contracts were announced. National Express won the contracts for Bayside Trains, Swanston Trams and V/Line Passenger. Connex won the contract for Hillside Trains and a joint venture between Transdev and Transfield Services won Yarra Trams. The franchise models were vertically integrated, with the franchisee managing the infrastructure and train operations. Despite some significant success in improving service levels, by 2002 the franchisees were experiencing financial difficulties. In response, the government called a review of the franchising process and implemented interim operating arrangements. In December 2002 National Express withdrew from its three contracts. The government appointed receivers to run the former National Express franchises and announced the restructuring of the network into single metropolitan train and tram companies. It was also decided that V/Line Passenger would return to public operation, where it remains today.

3. **Non-tendered private operation (2004–2009):** in 2003-2004 contracts were renegotiated with the remaining franchisees, with Connex taking over heavy rail and Transdev/Transfield Services contracted to the tram network. The contracts were relatively short (four years).[53] This recognised that they were renegotiated rather than re-franchised, and in the near future the market should be tested again. Some key contract amendments were made, including revenue risk sharing with government, which ensured the operators were financially stable for the duration of their contracts.
4. **Re-franchised operation (2009–2016):** in 2009 a competitive tender process was undertaken, with Metro Trains Melbourne winning the heavy rail contract and Keolis Downer EDI Rail (KDR) operating the tram network. The contracts were set to run to 2017, with the franchisees able to negotiate for a seven-year extension if they meet performance criteria.
5. **Renegotiation of contracts (2016–ongoing):** in February 2016 the government announced the franchisees had met the necessary performance criteria to begin negotiating exclusively for a contract extension. A Request for Proposal has been issued to the franchisees and negotiations are ongoing. If negotiations fail, the state could extend the existing agreements at a fixed price for three years while a new tender process is undertaken.

3.3 Franchising in Victoria: patronage and service quality

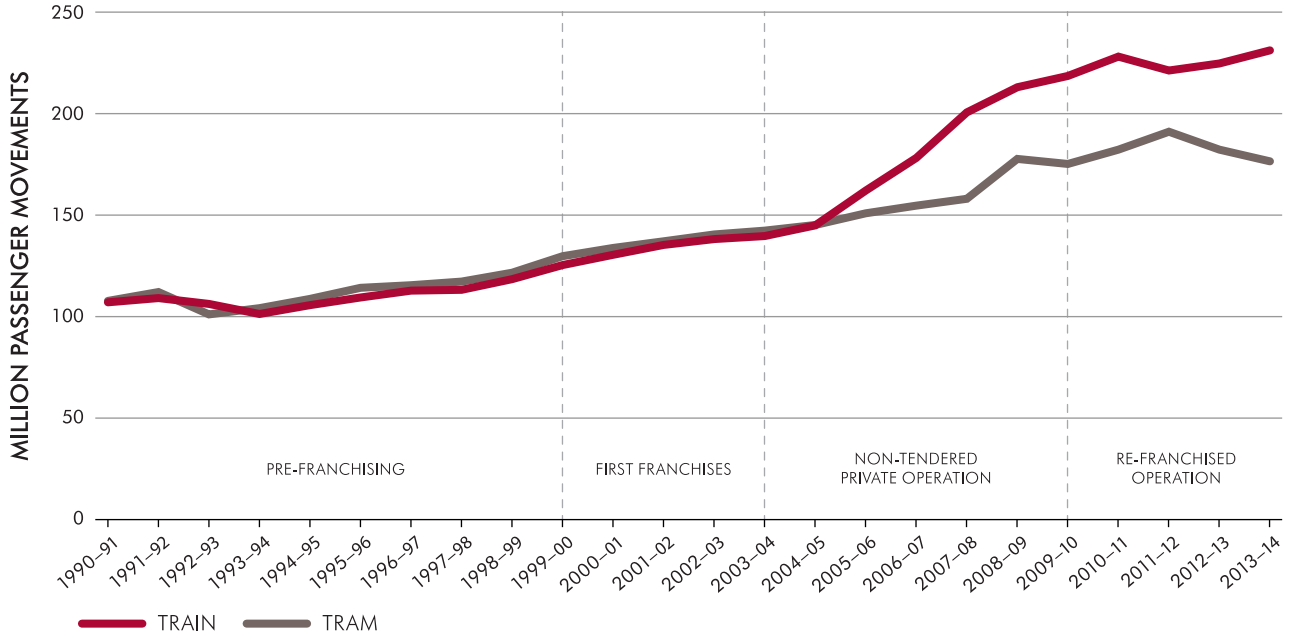
Patronage has grown significantly since the early 1990s and delivered tangible improvements in service quality. Operators responded to contracted punctuality incentives in the first few years of franchising but, due to strong patronage growth, on-time running deteriorated from 2003–04. Metro Trains Melbourne, have significantly improved punctuality since 2009–10.

Patronage has grown strongly

One of the key aims of franchising for the Victorian Government was to encourage public transport use. Train and tram patronage has grown strongly since the early 1990s, corresponding with the government's reform of the Public Transport Commission and eventual franchising in 1999. Train patronage is now almost double its level when services were first franchised. Tram patronage has grown by about 45% in the same period. **Figure 7** shows patronage growth since 1990.

Patronage growth cannot be attributed to a single cause, rather it is likely a result of various factors. The period of growth from the early 1990s to mid-2000s corresponds with improvements to punctuality and reliability during the Victorian Government's reform program and the first franchise period.[54] The Victorian economy was also growing strongly in this period, which encourages greater commuter and leisure trips.[55]

Figure 7: Train and tram patronage in Melbourne, by franchise period[56]



The strongest period of growth occurred between 2003–04 and 2009–10, when patronage grew by almost 60% for trains and 25% for trams. The Bureau of Infrastructure, Transport and Regional Economics[57] attributes the increase in patronage to strong growth in Melbourne's CBD. Between 2006 and 2008, Melbourne City local government area (LGA) gained 50,400 new jobs, an annual employment growth rate of 7%. Melbourne's public transport, in particular its rail network, is designed to provide radial, commuting trips to the CBD. Job growth in this area would therefore increase train patronage. Melbourne's population also grew strongly in this period, with an increase of 13% between 2004 and 2010.

The Victorian Government has clearly succeeded in its goal to increase public transport patronage. Like many areas of public policy, this success is a combination of macro-economic factors and government reform.

Punctuality performance has improved in recent years – it relies on underlying conditions and contracted incentives

Melbourne's train and tram network contracts include incentive payments to improve punctuality and reliability performance as well as penalties if the operators do not reach agreed standards. The punctuality data for Melbourne shows that operators have responded to incentives when they are able to. Punctuality improved markedly during the two periods of franchised operation (from 1999 and from 2009). This is because the underlying conditions – infrastructure and rolling stock capacity relative to patronage – allowed the private operators to improve service standards. Performance declined from 2003–04 to 2009–10 because patronage grew at a rate that was beyond the capacity of the network.

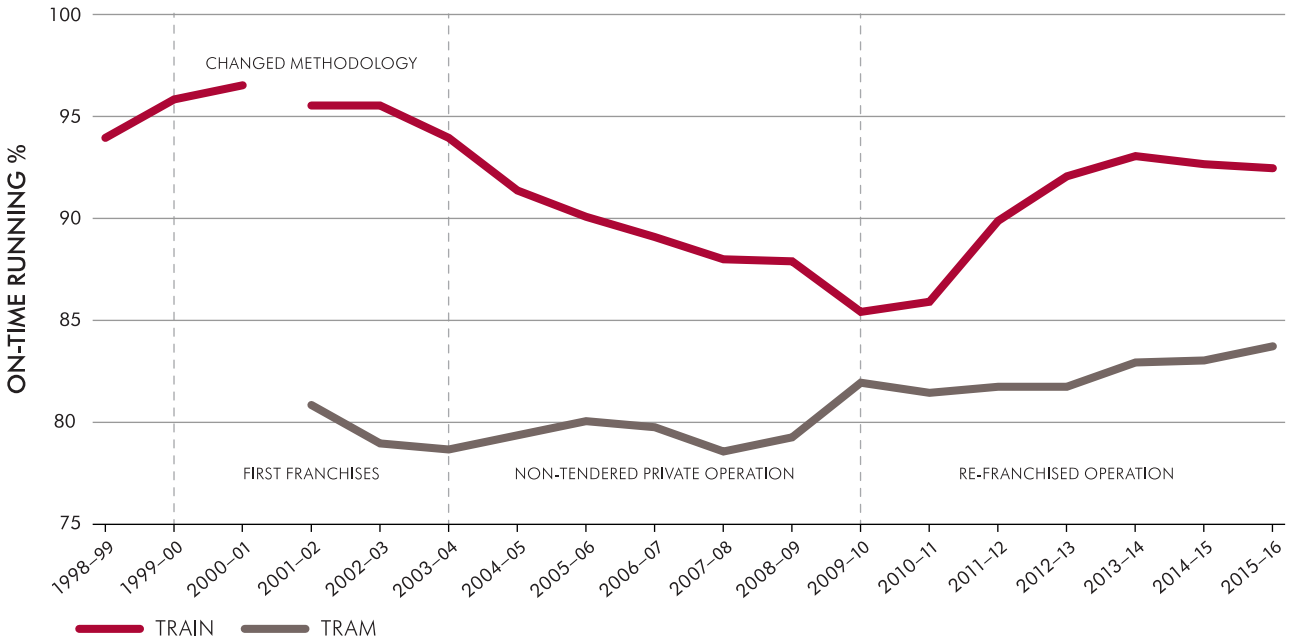
Figure 8 shows punctuality performance for trains and trams over the three periods of private operation.

The inclusion of punctuality incentives in the first franchise agreement is widely credited with improving performance over this period.[58] It was one of the key areas of success from the original agreements and, as a result, the incentives have been retained and further developed in subsequent contracts.

However, despite these incentives, from 2003–04 punctuality began a downward trend, particularly for train services. The Victorian Auditor General[59] notes this was due to a combination of strong patronage growth[60] and underlying system constraints. Both of these issues are largely beyond the control of franchisees, highlighting the importance of governments working closely with operators to identify and address emerging strategic issues and capital requirements.

Under the most recent franchise agreements, operators again are responding to punctuality incentives. This has been enabled by government investment in rolling stock and infrastructure. The Victorian Auditor General notes the main factors behind improvements to train performance since 2009 have been more taxpayer investment in the network, new rolling stock, franchisee performance initiatives and stable patronage growth.[61]

Figure 8: Punctuality – trains and trams that run on time as a percentage of total services[62,63]



Reliability has remained stable, with the vast majority of scheduled services being delivered

Reliability of services has remained mostly stable since franchising, with targets being largely met by operators. Reliability is measured by the percentage of scheduled (timetabled) services that are delivered. In other words, it measures the number of service cancellations. **Figure 9** shows reliability since 2001–02 for trams and 2004–05 for trains.

Customer satisfaction correlates with punctuality – it is currently at a 15-year high

Customer satisfaction is monitored and reported quarterly by Public Transport Victoria. There are numerous elements in measuring overall satisfaction, however the primary drivers are on-time performance, frequency and time taken to travel.[64] The customer satisfaction index is shown in **Figure 10.**

Figure 9: Reliability of train and tram services, percentage of scheduled services delivered[65]

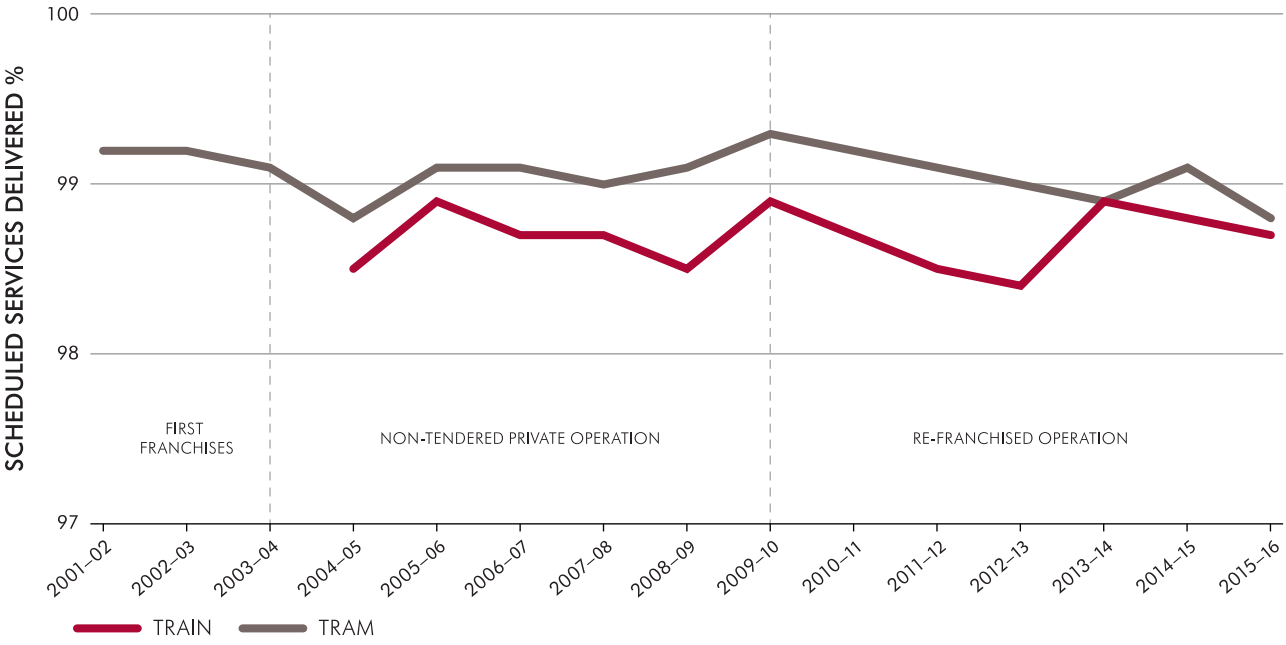


Figure 10: Customer satisfaction index, train and tram[66]

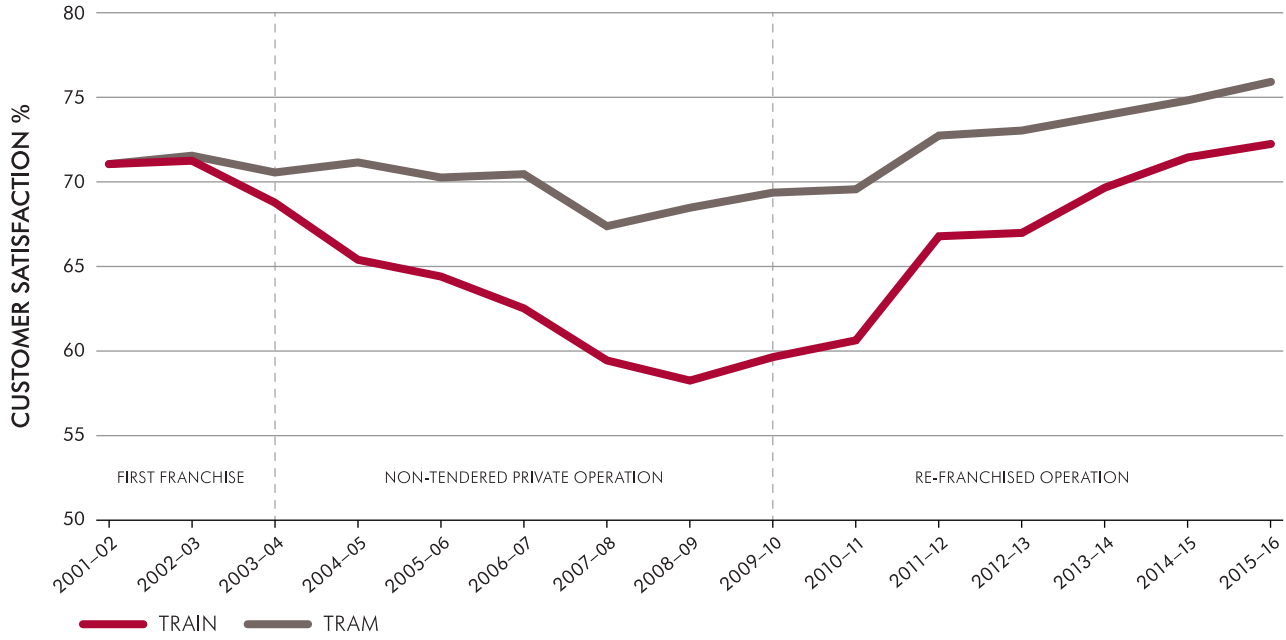
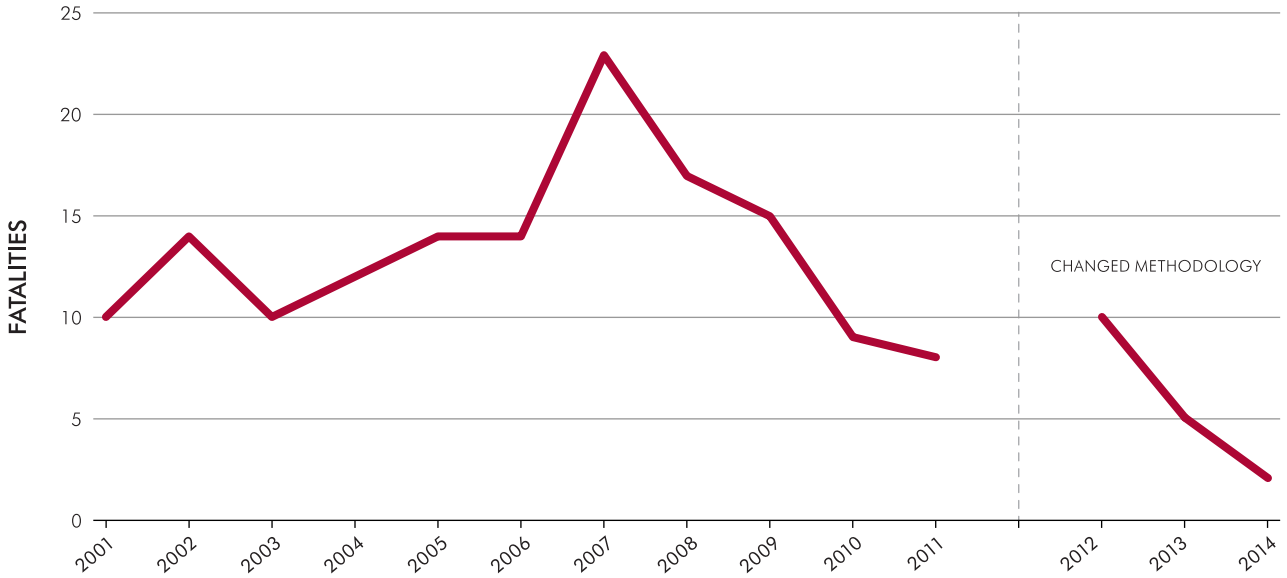


Figure 11: Heavy rail fatalities, Victoria[67,68]



The index correlates closely with the punctuality data shown in **Figure 8.** Satisfaction with services declined as the system experienced overcrowding and delays between 2003–04 and 2009–10. However, with the improvement in franchisee performance since 2009–10, customer satisfaction has increased and is at its highest level in over 15 years.

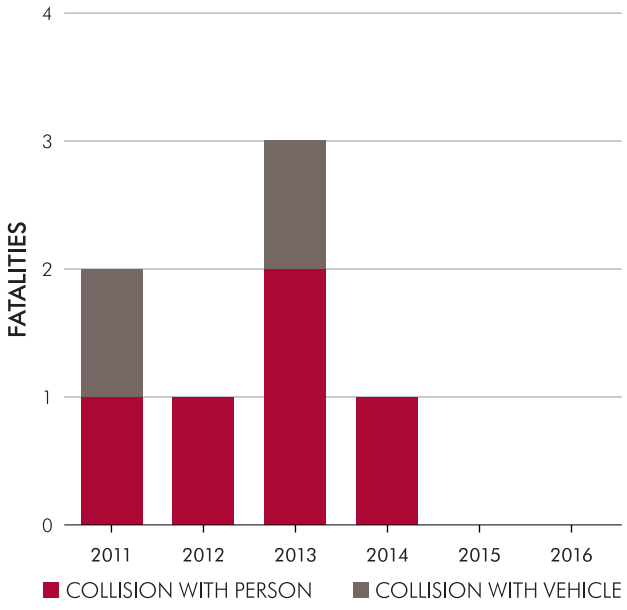
Safety – rail safety has remained stable under private operators

Figure 11 presents the heavy rail fatalities data for Victoria between 2001 and 2014. Heavy rail safety data is only available from 2001, meaning comparisons cannot be made with the period prior to franchising. In addition, heavy rail data is for all of Victoria, which includes the urban private operator as well as the publicly operated V/line and freight operations. It is also important to note the data presented in this section are high level fatality statistics only. Safety in the rail industry is about more than fatalities and includes injuries to passengers, pedestrian and workers, collisions, and line derailments.

Heavy rail fatalities in Victoria have declined since 2007, when fatalities peaked because of the Kerang accident, in which a truck ran into a V/Line Passenger train, killing 11 passengers. The majority of railway fatalities in Australia are caused by level crossing accidents, trespass and suicides.

Tram safety statistics are available dating back to 2011 (see **Figure 12**). A significant proportion of Melbourne's tram network is shared space with cars, presenting obvious safety risks. In addition, there is a greater pedestrian interface for trams than heavy rail. Fatalities on Melbourne's tram network have remained stable, with no discernible trend in the past five years.

Figure 12: Tram fatalities, by cause[69]



In recognition of the importance of passenger awareness for rail safety, both the rail and tram operators in Melbourne have developed well publicised safety campaigns. The campaigns encourage passengers, drivers and pedestrians to take care in the rail environment. In 2013 Metro Trains Melbourne released its well-known 'Dumb Ways to Die' campaign, which won numerous advertising industry awards. Similarly, Yarra Trams have run a well-recognised safety campaign called 'Beware the Rhino', which highlights the weight of trams (30 times the weight of a Rhino) and the dangers of not being careful nearby tram tracks.

3.4 Financial performance and operating efficiency

Reform produced significant operating cost savings – although growing demand from improved services generates new funding pressure

The reform of Melbourne's public transport system included the restructuring of the publicly owned Public Transport Commission in the mid-1990s and the eventual franchising of operations in 1999.

At the beginning of the 1990s, the operating deficit of Victoria's public transport was the highest in the country. The reform of the Public Transport Commission produced annual savings of about $245 million. An Auditor General comparison with 1991-92 costs[70] showed this saving was equivalent to about 43%.[71] The efficiencies achieved by reform were so significant that there was limited opportunity for franchising to produce additional savings.[72] While the bulk of costs savings were delivered under public operation, these were achieved as part of a reform program to prepare the networks for franchising.

Public Transport Victoria publish quarterly payments made to train and tram franchisees. The payments are made up of numerous components:

- the base contract (a fixed subsidy plus operator margin).
- payments for agreed maintenance works.
- ticket revenue payments.
- project payments; incentive/penalty payments.
- payments for an array of operations/systems requirements.

Figure 13 shows payments to train and tram operators since 2004–05.

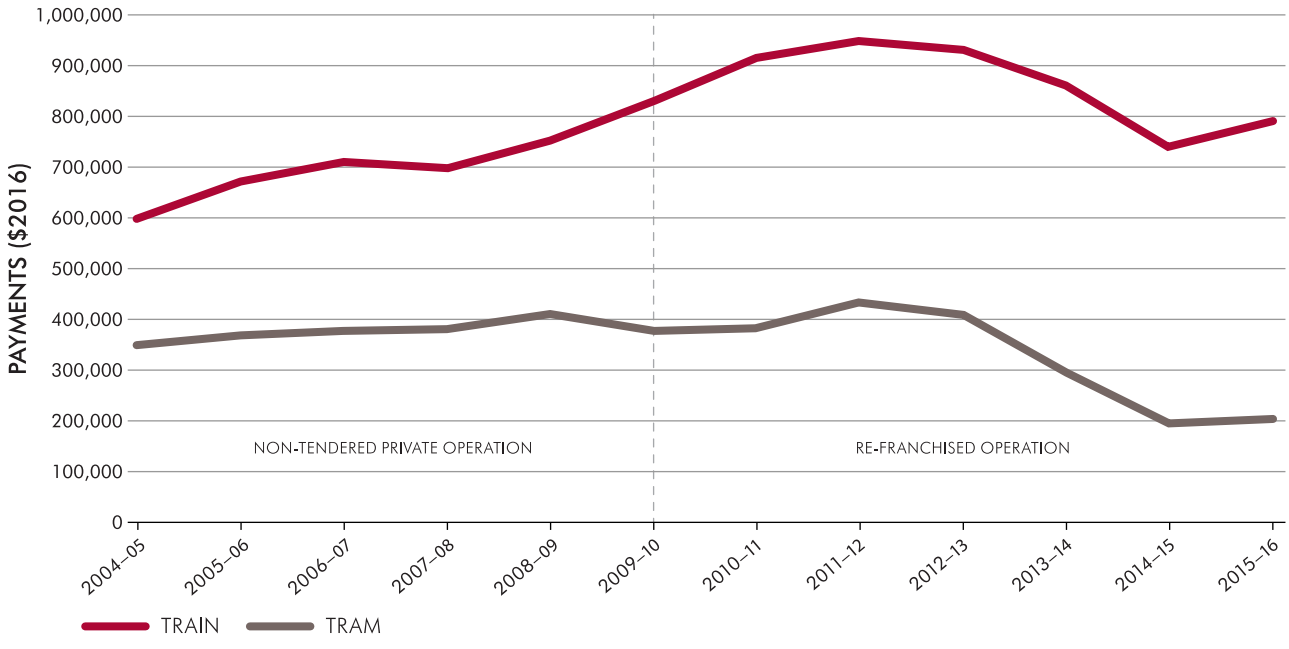
Payments for the operation of heavy rail have gradually increased since 2004-05, while tram payments have remained relatively stable. Since 2014, PTV has not included ticket revenue payments in its *Track Record* publication, hence the decrease in payments shown in **Figure 13** for both trains and trams.[73]

The increase in costs for trains can largely be attributed to an increase in the scale of the operation, which is in response to growing patronage. The key reasons for increased costs are:

- increase in the number of kilometres travelled by trains and trams.
- additional 'premium' railway stations, line extensions, network facilities and associated maintenance costs.
- increases in the costs of infrastructure.
- increases in wages and the introduction of new staff to support service improvements.

The Victorian Auditor General notes these increased costs have been absorbed by both the franchisees and government.[74]

Figure 13: Payments to train and tram operators, 2016 dollars[75,76]



Melbourne is comparatively efficient, with lower operating costs than Sydney

The result of Melbourne's reforms is a network that is considerably more efficient than comparable systems. In 2015 the NSW Independent Pricing and Regulatory Tribunal (IPART) undertook a benchmarking study in which the operating efficiency of Melbourne's heavy rail network was compared with Sydney's. The study is instructive because the size and service requirements of the two systems are similar and they are subject to the same business frameworks, such as industrial relations laws. The main difference between the systems is that Melbourne is privately operated while Sydney's is operated by the public sector.

The study found Melbourne's costs per passenger trip and per car kilometre are significantly lower than Sydney's. IPART also adjusted for differences between the two networks by applying Sydney's unit costs to Melbourne. With the adjustment, they found Melbourne operates at 37% below Sydney's costs (see **Figure 14**).

3.5 Difficulties encountered through franchising

The most significant problems encountered in Victoria were during the first phase of franchising (1998–99 to 2003–04). During this period the franchisees were financially unsustainable, with National Express withdrawing from its contracts for Bayside Trains, Swanston Trams and V/Line Passenger.

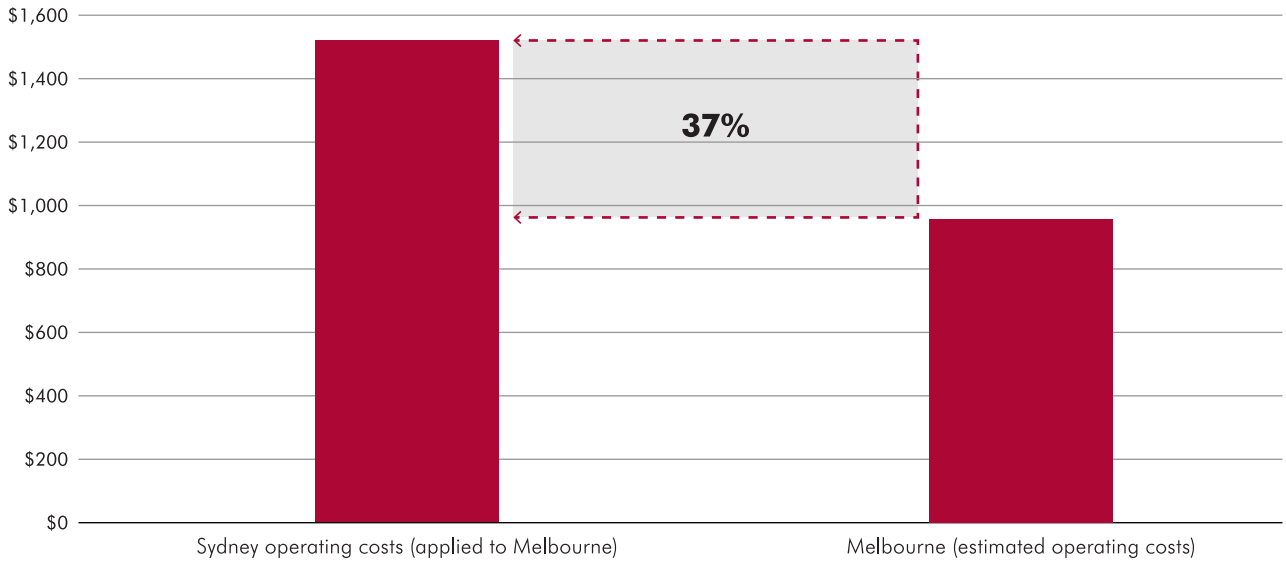
The instability came at a cost to taxpayers, with an additional $110 million in subsidies paid to the operators.

Additionally, because of the need for stability, the subsequent contracts with Connex and Transdev/ Transfield Services were renegotiated rather than re-franchised and V/Line Passenger was returned to public operation, where it remains today.

The main reasons for the financial problems were:

1. **Most revenue risk was transferred to the private sector:** the viability of the franchisees was dependent on revenue from patronage projections. This became a problem when projected patronage increases were not realised.
2. **Overbidding of franchisees:** the business models of the franchisees were based on unrealistic patronage and revenue projections. In its winning bid National Express predicted patronage growth of 84% by 2014. The figure itself is not unrealistic (growth on Melbourne's network has actually exceeded this amount), but the predicted ramp-up in patronage was incorrect. Revenue was projected to increase by 15.5% in the first year of operation and then a further 64% between 2000–05.[77] Additionally, the patronage growth on which these projections were based was expected to occur outside of the peak periods, meaning there would be little need for commensurate increases in service levels and costs.[78] The bids also predicted significant cost reductions, with savings to the taxpayer between $1.1 billion and $1.8 billion over the life of the agreements.[79] There appeared to be little

Figure 14: Operating costs – Sydney unit costs[81] applied to Melbourne ($M, 2014-15)[82]



acknowledgement of the significant cost reductions already achieved from the government's reform of the Public Transport Commission.[80]

3. **Public sector bid assessment:** with the benefit of hindsight, the unrealistic nature of bids should have been identified during the bid assessment process. There appears to be little evidence supporting the optimistic bids of the franchisees. In the five years prior to franchising, patronage had grown by an average of 3.2% per annum for both train and tram. National Express' projection of 15.5% growth in revenue in its first year, and then 10.4% per annum until 2005 therefore appears unrealistic. In regard to cost reductions, the Auditor General noted in 1998, following the reform of the Public Transport Commission, 'after 6 years of cost-cutting and rationalisation of operations, there appears to be limited scope for further large savings'.[83]

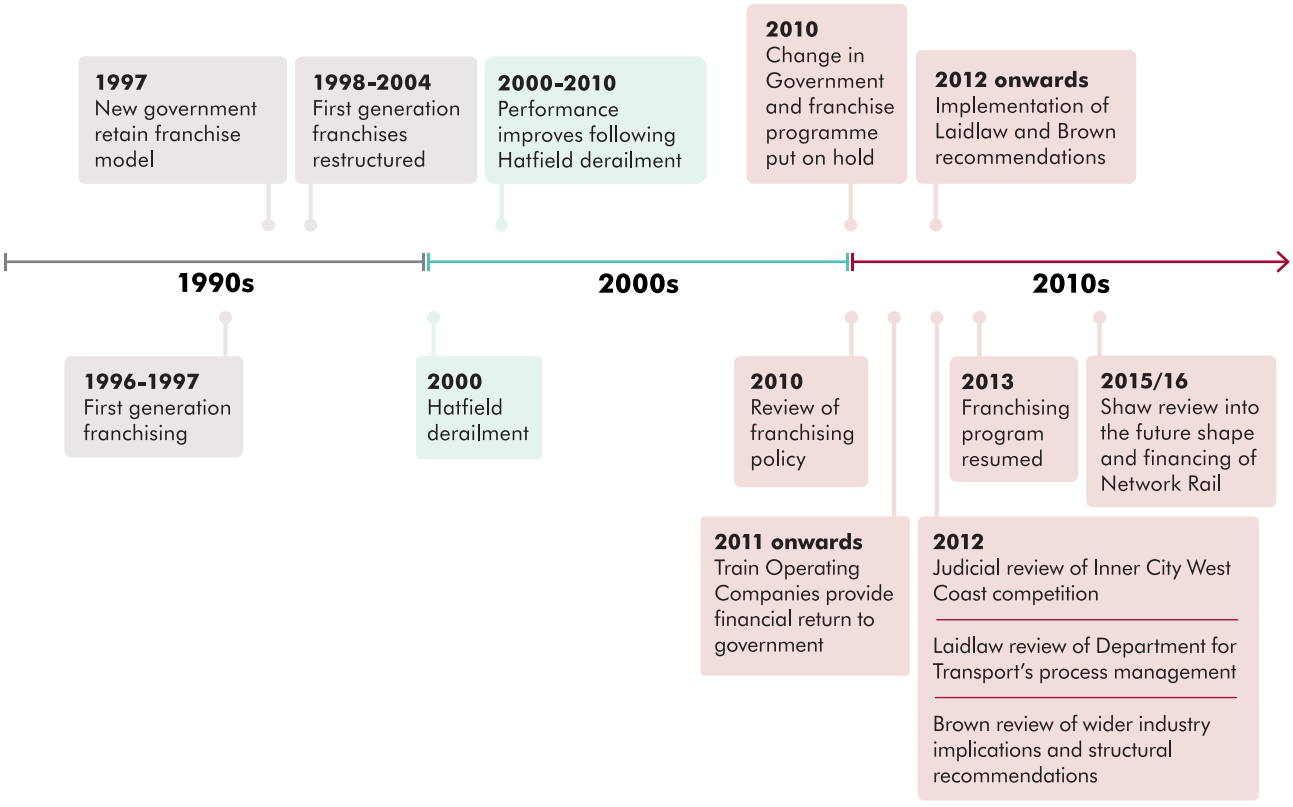
Subsequent operators have been significantly more stable, indicating important lessons were learned from the initial franchising process. Most importantly, contracts now share revenue risk between the public and private sectors, with government providing financial assistance if revenue drops below an agreed level.

3.6 Franchising in the United Kingdom: background

Franchising developed in the United Kingdom following the privatisation of British Rail, with the first franchisees commencing operation in 1996. In contrast to Victoria, the model was vertically separated – franchised train operators paid the infrastructure manager for track access. This system remains in place today.

Figure 15 provides a timeline of rail franchising in the United Kingdom, followed by a brief description.

Figure 15: Timeline of franchising in the United Kingdom[84]



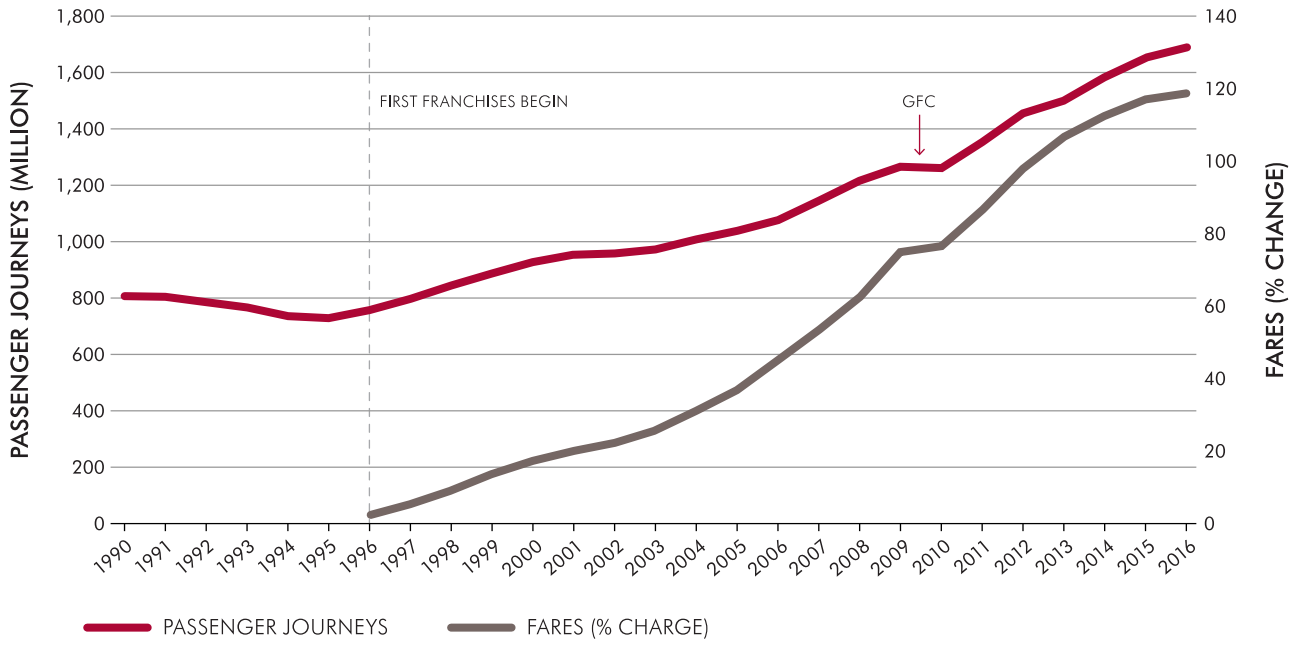
Franchising in the United Kingdom can be split into three periods: first generation franchises (1996–2004), second generation franchises (2004–2010) and 2010 onwards.

1. **First generation franchises (1996–2004):** the franchise agreements included relatively few service incentives beyond contracted minimum service levels (set to the former British Rail timetable) and an agreed subsidy payment profile. Revenue risk was transferred to franchisees, as was responsibility for cost reductions. Many of the first generation franchisees eventually ran into financial difficulties and were restructured. There were also concerns about the operational performance of numerous franchisees in this period. Poor levels of punctuality and reliability can be largely attributed to the imposition of speed restrictions and changes in operating practices following the Hatfield derailment in 2000.
2. **Second generation franchises (2004–2010):** the second generation of contracts were designed to address the financial instability and operational performance of the original franchisees. The contracts included a cap and collar revenue guarantee, where the government would provide support if revenue fell below agreed levels. The contracts were also characterised by much more tightly defined service levels.[85] This period was characterised by gradual but significant improvements in franchisees' operating performance.
3. **Review of franchising – 2010 onwards:** in 2010 the re-franchising program was put on hold, pending review. Franchising began again in 2012, with the Intercity West Coast franchise. The process saw the incumbent (Virgin) instigate legal proceedings against the decision to award the franchise to the preferred bidder (First Group). The proceedings uncovered significant flaws in the way the Department of Transport had managed the competition, resulting in a temporary management contract being handed to Virgin and the announcement of the *Laidlaw Inquiry* into the tendering process. A further report, the *Brown Review*, looked at the implications of the West Coast franchise controversy for the industry as a whole. Franchising was suspended during the review process.

The franchising program again resumed in 2013, with the *Brown Review* recommending: the Department for Transport should strengthen its ability to manage tender competitions; franchise contracts should be between seven and ten years; mechanisms should exist to remove exogenous risk; and profit sharing mechanisms should be used.[86]

Despite the difficulties, the financial and operational performance of franchisees has continued to improve. Since 2010, train operators have provided a financial return to government, reliability has remained stable and safety incidences and fatalities have decreased.

Figure 16: Passenger journeys and rail fares, United Kingdom[87]



3.7 Franchising in the United Kingdom: patronage and service quality

Patronage has grown strongly

One of the key objectives of franchising in the United Kingdom was to increase patronage growth. The country has seen a significant and sustained increase in railway passenger numbers following franchising. The growth in patronage has come despite increases in rail fares (in contrast to Victoria, rail fares were unregulated for numerous operators). **Figure 16** shows passenger journeys and fare changes on United Kingdom railways.

Passenger journeys reached 1.69 billion in 2015-16, the highest level on record. Patronage has increased by 111% since franchised operations began in 1996. In the same period, fares have increased by 118%.

The strong growth in patronage, despite fare increases, is a significant achievement for the railways. Economic growth normally has a significant impact on rail patronage and the United Kingdom is no exception, with Gross Domestic Product (GDP) per capita almost doubling since 1996.[88] However, to a certain extent this increase in wealth will have been offset by the 118% growth in fares.

If customers are not being attracted by lower relative costs, there must be other causes for patronage growth. It is likely some of the patronage increases can be attributed to improvements to rail services.

Punctuality and reliability performance has improved over the last decade

Much like the Victorian case study, punctuality, reliability and customer satisfaction data show that franchisees will respond to contracted incentives when the circumstances allow.

In the period immediately following franchising, punctuality declined sharply and the number of service cancellations increased. This has largely been attributed to the Hatfield derailment in October 2000, which resulted in widespread speed restrictions and changes to operating and maintenance practices.[89] Following the Hatfield derailment, government expenditure increased on maintenance and renewal works, eventually easing speed restrictions. **Figure 17** shows punctuality and **Figure 18** shows service cancellations on the United Kingdom's rail network.

Figure 17: Percentage of trains arriving on time, moving national average[90,91]

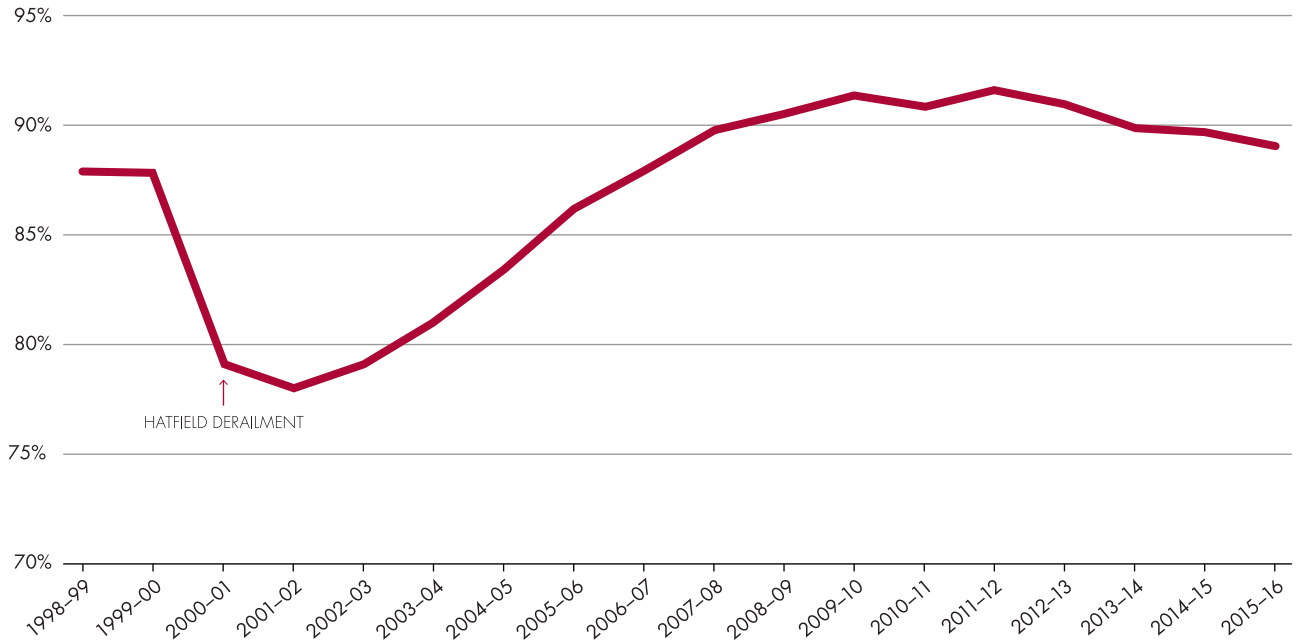
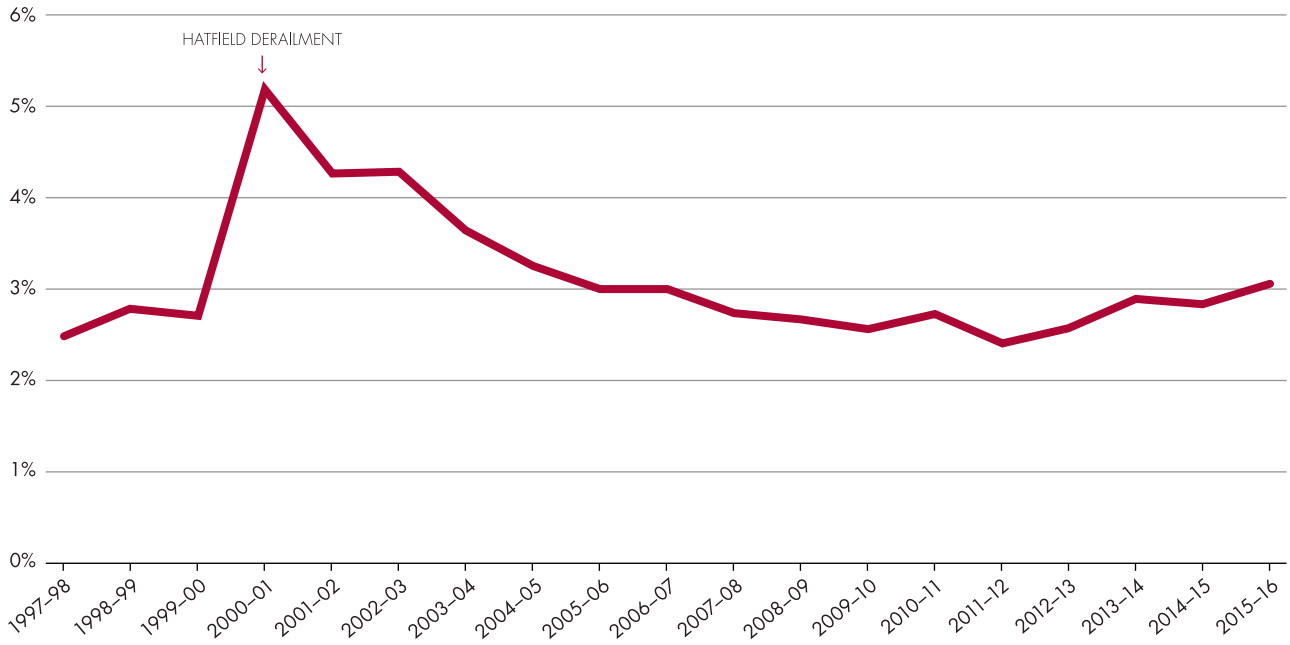


Figure 18: Percentage of trains that are cancelled or significantly late[92]



The first franchising contracts in the United Kingdom contained minimum service levels, but these were based largely on the former British Rail timetables and included few incentives, such as financial bonuses, for achieving punctuality targets. In response to the deterioration of punctuality during the first franchise period, the second generation of franchise contracts, from 2004 onwards, included much more tightly defined service characteristics.[93] The combination of contracted service requirements and progressive lifting of speed restrictions has resulted in a gradual improvement in punctuality and reliability.

Customer satisfaction has improved with punctuality and reliability

Punctuality and reliability are the most important drivers of customer satisfaction and the rate of complaints.[94] It is no surprise that customer satisfaction has largely followed trends in these key areas of service, with satisfaction reaching its lowest level in 2001 and gradually improving since that time. The rate of complaints is consistent with customer satisfaction survey results, with complaints highest between 2000 and 2003 before declining sharply. **Figure 19** shows customer satisfaction and **Figure 20** shows the rate of complaints per 100,000 passengers.

Figure 19: Percentage of satisfied customers[95]

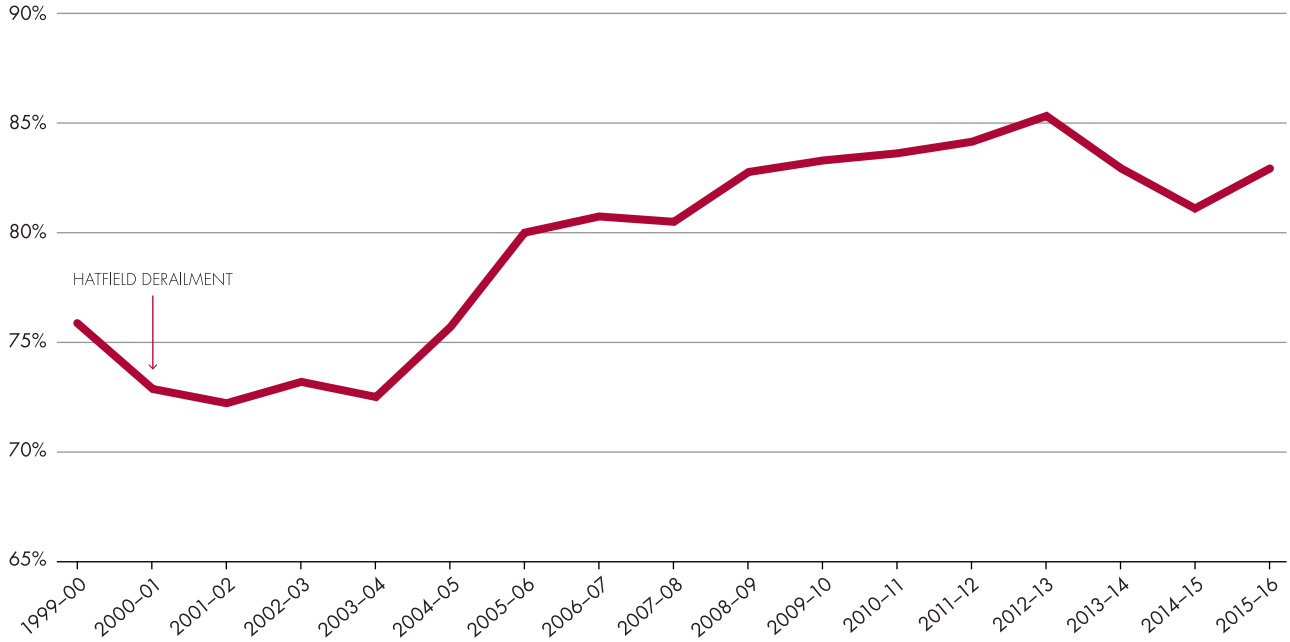
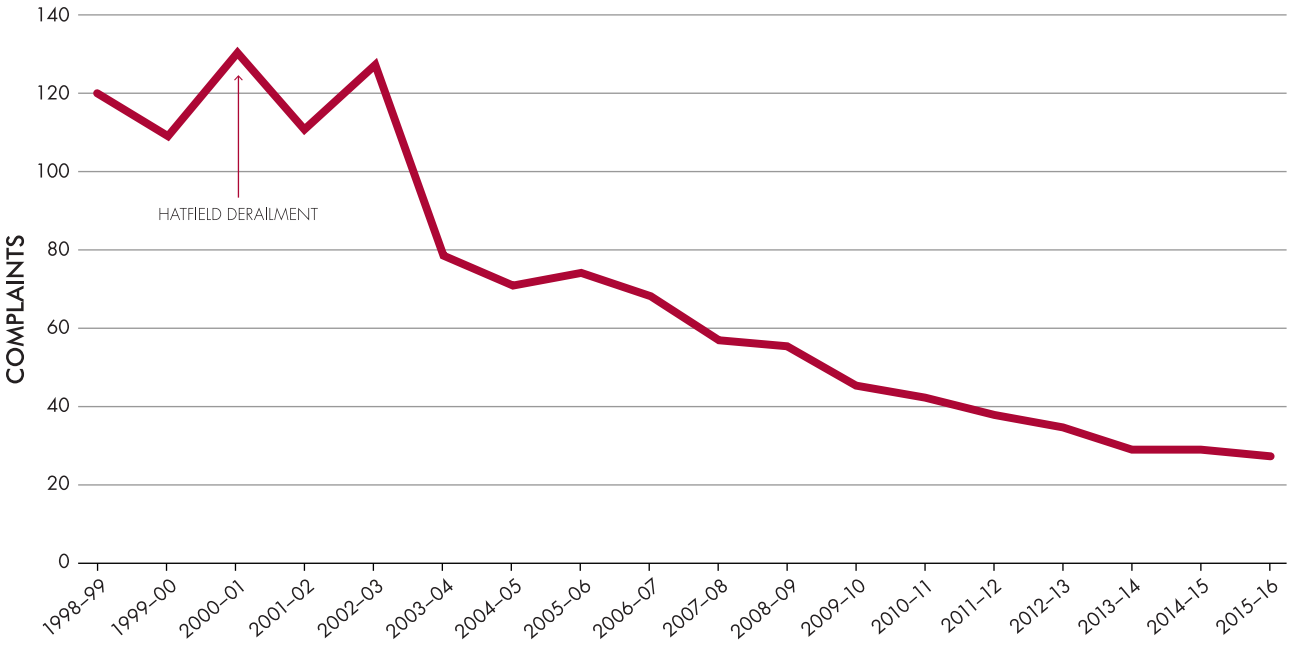


Figure 20: Complaints per 100,000 passengers[96]



Safety – fatal accidents have decreased since franchising, with no accidents for nine years

Franchised operators have a strong safety record in the United Kingdom. Fatal train accidents have been trending downwards for decades, with improved safety practices and technologies across the network. Under franchised operation, there has not been a fatal train accident for nine years (see **Figure 21**). The 10-year rate of fatal train accidents is now at 0.1 per year, the lowest ever achieved.

The frequency of fatal train accidents only tells part of the safety story. Passenger fatalities can be caused by a range of events such as falls, assaults and general health issues. Workforce fatalities are another important aspect of railway safety, and one that is directly influenced by the practices of train operators and infrastructure managers. **Figure 22** shows that both passenger and workforce fatalities have decreased substantially in the last 50 years. Under franchised operation, the trend in safety improvements has continued – reflecting improved work practices and technological developments such as better signalling and more crashworthy rolling stock.

An area which has not improved significantly is fatalities to the public. This category largely consists of deaths resulting from trespass, suicide and level crossing accidents. While significant public policy issues, they are largely beyond the control of train operators.

Figure 21: Fatal train accidents in the United Kingdom[97]

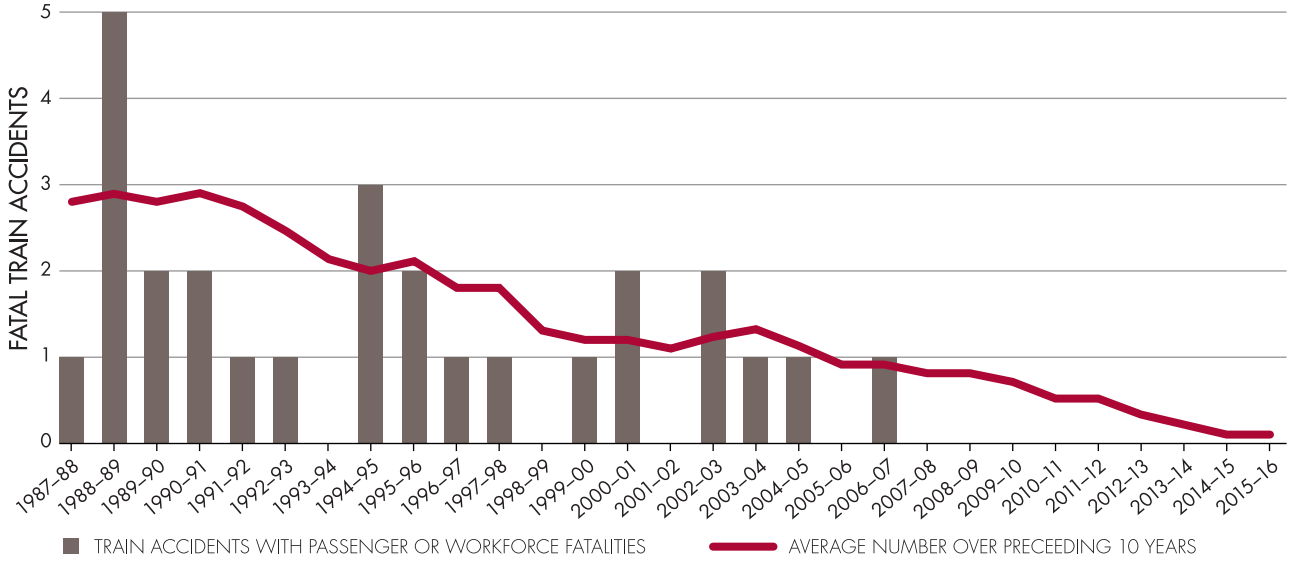
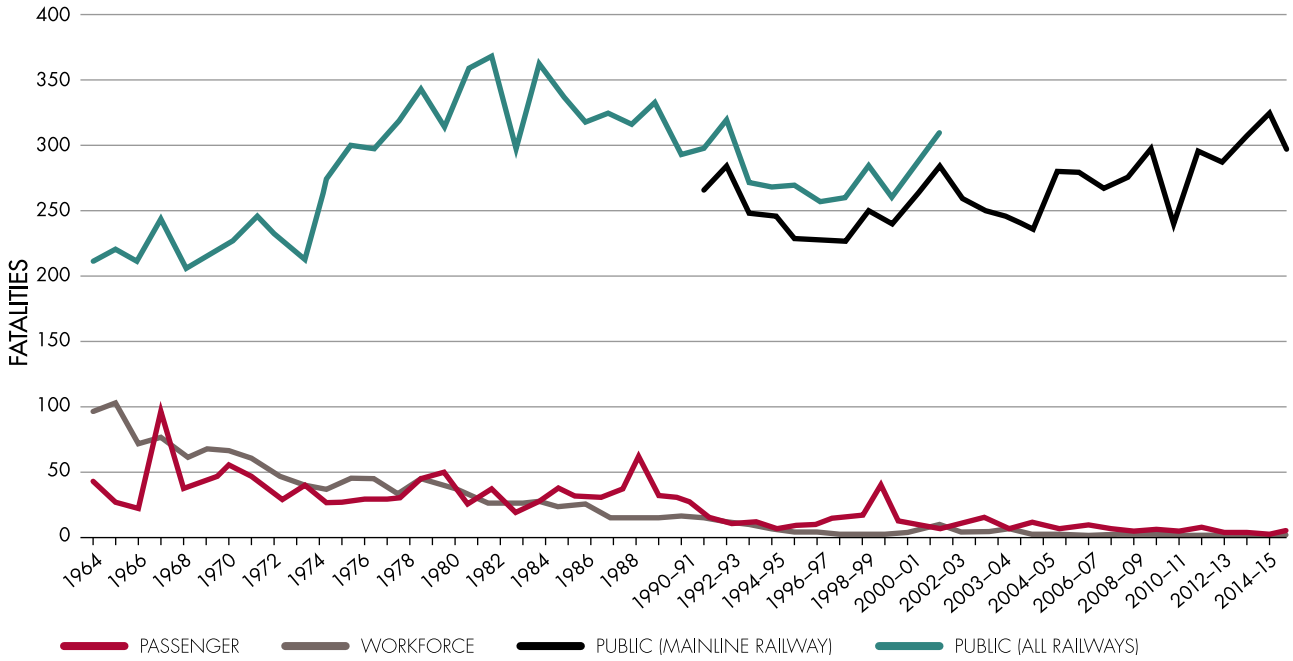


Figure 22: Railway fatalities, passengers, workforce and public[98]



3.8 Financial performance and operating efficiency

Government funding of the rail network increased following the Hatfield derailment but has since declined

Franchising has contributed to a substantial improvement in the financial performance of train operations in the United Kingdom. Since the late 1990s, government support for operators has gradually decreased, with franchisees providing a financial return to government since 2010–11. This has helped to counter the significant increase in government support to Network Rail for infrastructure maintenance and renewal.

Funding decreased immediately after franchising, although the downward trend had begun three years beforehand. Following the Hatfield derailment, public funding increased substantially due to expenditure on infrastructure renewal and maintenance. Since 2006-07, government funding has again decreased and is currently about £4 billion. **Figure 23** shows government funding for train operations and infrastructure management and maintenance.

Train company costs per passenger mile have decreased

Operating costs of the train operating companies show that franchisees have gradually improved their efficiency. Since franchising in 1996–97, operating costs have increased but at a slower rate than patronage. Operating costs per passenger mile have decreased by 20% since franchising.[99] **Figure 24** shows the decline in train company operating costs per passenger mile.

Train operating companies now provide a net financial return to government

Government support to train operators has decreased substantially since franchising. Support reached a peak in the mid-1990s at about £1.8 billion but has since trended downward. Government has received a net payment from the train operating companies since 2010–11. This means franchisees have been operating without a net subsidy; though this differs depending on the line and service, with some franchisees requiring a subsidy while others deliver a return to government. In 2014–15, franchisees provided a return to government of £802.2 million. The financial performance of individual franchisees varies significantly depending on where the company operates and what type of service it offers. Regional operators generally receive a subsidy from government while operators in the long distance market and London and the South East sectors pay a premium back to government.[100] Net subsidies to train operators since 1985–86 are shown in **Figure 25**.

Figure 23: Government funding to train operating companies (TOCS) and network rail[101,102]

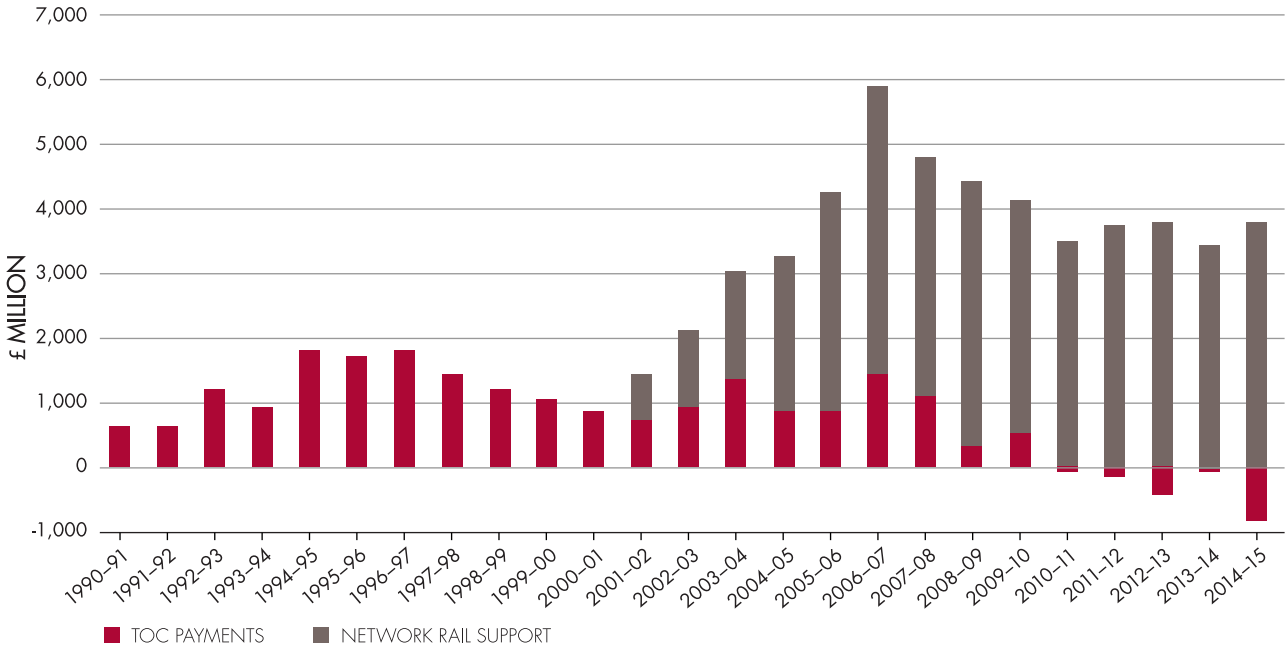
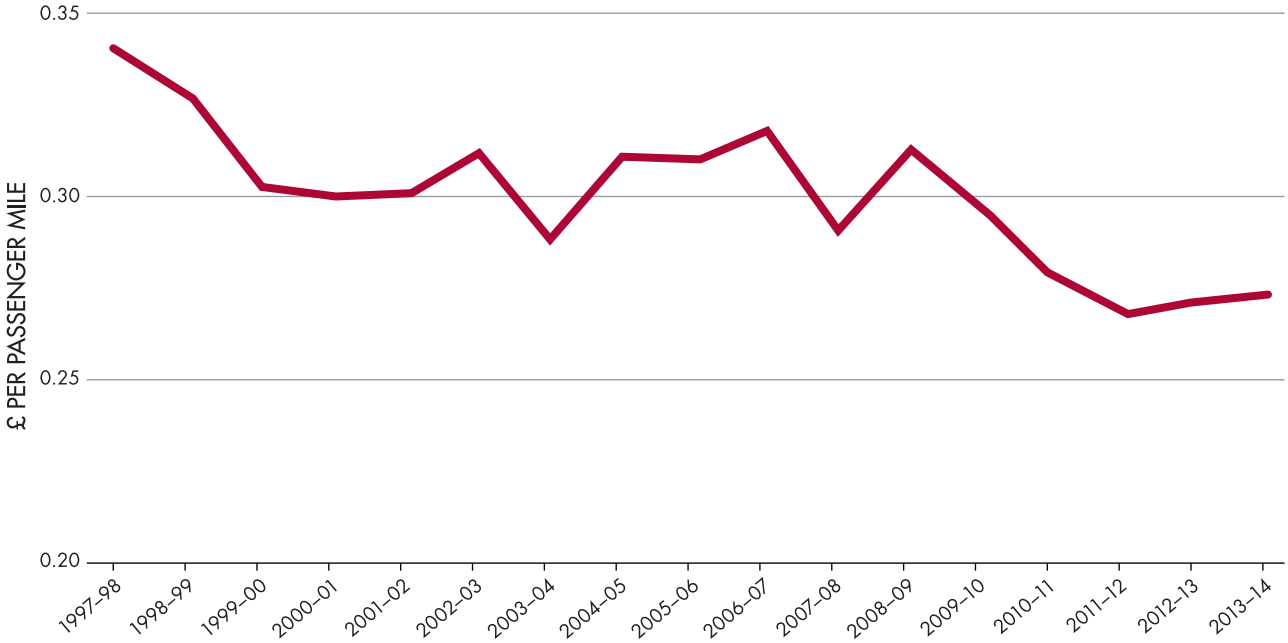


Figure 24: Train company operating cost, per passenger mile (2013-14 prices)[103]

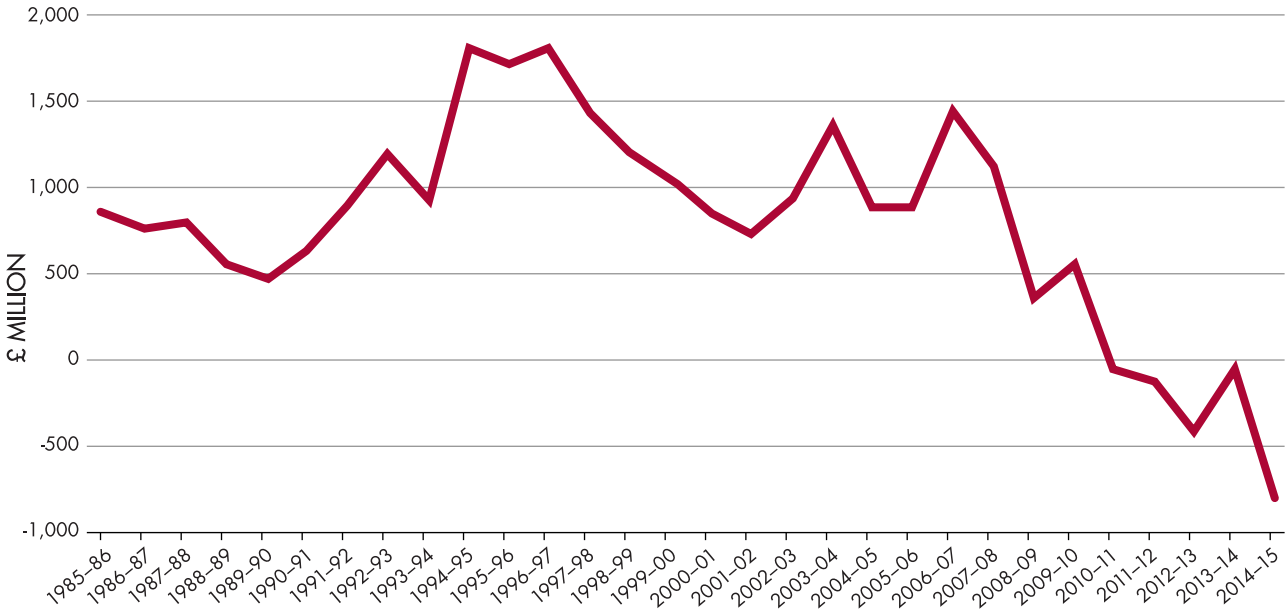


3.9 Difficulties encountered from franchising

Although there have clearly been benefits from franchising, some difficulties have also been encountered. Numerous franchisees have experienced financial problems, due to a combination of contract design and external factors. There have also been problems with the public sector assessment of bids, with the 2012 West Coast bid controversy leading to a review into how the competition was held.[104] The main problems encountered during franchising are discussed below.

1. **Franchisees have experienced financial difficulties.** Towards the end of the first franchising agreements (2003-04), over one-third of TOCs had been moved to management contracts because they were struggling financially. A feature of the first contracts was an assumption that operators would rely on significantly reduced subsidies over time. Numerous operators were unable to achieve their optimistic efficiency improvements and, with the Hatfield derailment in 2000 leading to service disruption and revenue loss, the contracted decline in subsidies began to impact the franchisees' finances.[105]

Figure 25: Net subsidies for train operating companies, £M[106]



2. **Cap and collar revenue guarantees resulted in perverse incentives and created difficulties for government expenditure forecasts.** In response to the financial difficulties experienced in the first round of franchising, it was decided revenue risk should be shared between the operators and government. The cap and collar mechanism meant government would support operators if revenue fell below agreed levels. Revenue would also be shared with government if revenue was higher than a set level. Although the mechanism resulted in more financially stable operators, it also led to significant government payments to operators when revenue fell during the 2009 recession. The mechanism was not only problematic for government expenditure, it also led to operators bidding aggressive revenue forecasts in the knowledge they would be supported by government should they fail.[107]

3. **Bid assessment processes have sometimes failed to identify unrealistic bids and their governance structures have been criticised.** As discussed above, some of the initial franchise agreements (from 1996-97) included overly optimistic projections about cost savings which allowed for reduced subsidies over time.[108] The failure of the bid assessors to identify unsustainable bids arguably contributed to the financial difficulties encountered in 2002-03.

In 2012, the re-franchising program was temporarily put on hold when the incumbent of the InterCity West Coast franchise (Virgin) began legal proceedings against the decision to award the franchise to the preferred bidder (First Group). The process uncovered significant flaws in the way the Department for Transport had managed the bids. The subsequent Laidlaw inquiry recommended improvements to accountability and governance structures at the Department.[109]

3.10 Lessons learned from franchising in Victoria and the United Kingdom – principles in competitive tendering

The Victorian and United Kingdom's experiences show that franchising involves a number of complexities and risks. Nevertheless, when done correctly, franchising can significantly improve services and provide substantial operating efficiencies. There are some key principles that governments should consider when franchising. These principles aim to maximise competition, encourage contracted incentives and reduce risk.

1. **Design a contract with appropriate incentives.** Good contract design is essential to the success of a franchise. The contract should incentivise the goals and priorities of the state. If a key goal of the government is to improve service standards, for example, performance based payments and/or penalties should be included in the contract. This has been a key factor in improving service standards in Victoria.

2. **Allocate risk to those best able to manage it.** The allocation of revenue risk to operators in the first round of franchising in Victoria and in the United Kingdom was an important element in the financial difficulties of operators. Public transport patronage can be impacted by a broad range of factors

outside the franchisees' control, such as economic conditions, public policy settings and the quality of infrastructure. The difficulty in predicting some of these factors means allocating revenue risk entirely to the franchisee can result in instability. In Victoria and the United Kingdom revenue risk is now shared between operators and the government. This has ensured greater financial stability and the retention of performance incentives.

3. **Periodically re-franchise and choose an appropriate contract length.** The competitive bidding process introduces incentives for operators to consider cost savings and service quality improvements, however, these incentives will decline over time. Periodic re-franchising is intended to ensure that competitive pressures are maintained. There are a number of trade-offs to be aware of when choosing between long and short contracts. Factors in favour of longer contracts include:

   – franchise efficiency: operators have greater opportunity to learn and deepen their skill base, thereby becoming more efficient.

   – investment incentives: longer contracts encourage investment as they provide more time to gain a return.

   – competition costs: there is more time to recoup bidding and management costs for both the franchisee and franchisor.

   There are also numerous factors that encourage shorter contract lengths including:

   – incumbent advantage: the longer an operator holds a contract, the more that business is advantaged in future competitive tenders. Any real or perceived advantage can reduce competition.

   – incumbent performance: frequent re-franchising creates greater competitive pressures, therefore encouraging immediate and sustained high performance.

   – franchisor and bidder uncertainty: unforeseen circumstances can alter the government's and operators' preferred service delivery. Shorter contracts, and the incentives they contain, are more likely to remain up to date.[110]

   The appropriate length of a franchise term depends on local context and the type of service being franchised. In the United Kingdom the Brown Review recently recommended contract lengths between seven and ten years. In Victoria the current operator's contract is for seven years, with an opportunity for renegotiation based on performance.

4. **Ensure the assessing and management agency is appropriately informed and skilled:** a risk in the competitive tender process is over-bidding. Franchising generally adopts a sealed-bid auctioning approach, where details of each bid are not disclosed to other participants. This means bidders are more likely to exaggerate what they are able to achieve, simply to ensure they are not trumped by their competitors.[111] Although this poses a potential financial risk to the operator, in reality, the risk is shared because the public sector bears ultimate responsibility for ensuring the transport system runs smoothly. The risk of over-bidding is particularly strong when the public sector takes on some revenue risk. The assessing agency should have the necessary information, expertise and time at its disposal to ensure it can judge the operators' financial robustness, track record, skill base and the plausibility of its bid.[112]

5. **Ensure selection criteria are transparent.** The process for selection, its criteria and weighting should be made as transparent as possible. This is to ensure consistent advice is provided to bidders and to avoid perceptions of favouritism. The West Coast franchise controversy in the United Kingdom may have been avoided had advice to bidders regarding their risk capital been clearer and more consistent.

These principles provide Australian governments with guidance on how to maximise the benefits and avoid the pitfalls of franchising.

Recommendation 3

Australian governments should draw lessons from jurisdictions where services have been franchised, including Victoria and the United Kingdom. Governments should consider the following five principles when franchising: ensure contractors are incentivised to improve service quality; allocate risk to those best able to manage it; periodically re-franchise and choose an appropriate contract length; ensure the assessing agency is appropriately informed and skilled; and ensure selection criteria is transparent.

Next Steps

How to make reform happen

At a glance

- The franchising of major public transport services will deliver productivity benefits across the Australian economy. Given the national benefits of the reform, the Australian Government should provide incentives for state and territory governments to introduce public transport franchising.
- Australia's reform history, in particular the National Competition Policy, provide the Australian Government with a valuable blueprint for how they can encourage state and territory governments to introduce politically challenging, but nationally significant reform.
- The incentives could be structured using a range of mechanisms including, the City Deals framework, COAG's Competition and Reform Agreements or Infrastructure Reform Incentives.

4.1 Delivering complex reform

Micro-economic reforms, like franchising, are complex by their nature. However, we should remind ourselves that Australia has faced – and overcome – these reform challenges before.

During the 1980s and 1990s, Australia underwent a series of major micro-economic reforms. These included the floating of the dollar, deregulation and privatisation of key industries and a suite of tax reforms including the introduction of the Goods and Services Tax. The result was a transformation of the economy, followed by the strongest period of productivity growth in Australia's history.

This period and the government processes that underpinned reform, provide critical learning for how to enable the delivery of complex policy change. In particular, the period highlights the important role that the Australian Government can play.

The National Competition Policy, a national micro-economic reform process, was a critical element in the delivery of many of the major micro-economic reforms from the 1990s onwards. An important element of the program's success was its underpinning incentive structure, National Competition Payments. Under the scheme, payments were made by the Australian Government to the state and territories according to progress against agreed reform priorities.

The incentive structure, which rewarded jurisdictions that met difficult but nationally significant reform milestones, provides a valuable blueprint for how the Australian Government can encourage state and territory governments to introduce politically challenging, but nationally valuable reforms, like public transport franchising.

Infrastructure Australia has sought to build on the legacy of the National Competition Payments in the *Australian Infrastructure Plan*, through proposing the creation of *Infrastructure Reform Incentives*. The proposal recommended the provision of additional Australian Government investment in state and territory infrastructure – over and above existing and projected allocations – in return for delivery of agreed infrastructure reforms.

The Australian Government, in formally responding to the *Australian Infrastructure Plan*, supported this recommendation to establish a system of incentive based payments. The support was contingent on identification of an appropriate program of reform and the capacity to provide the necessary funding.[113]

The Australian Government already makes a series of payments to state, territory and local governments in the form of grant funding to contribute to the delivery of nationally significant infrastructure projects. These payments are tied to projects, but varying levels of conditionality are applied to the payments. Through a system of reform incentives, additional payments would be tied to the delivery of reforms that are the responsibility of individual state, territory and local governments but which contribute to national productivity objectives.

4.2 Franchising would create national benefits

While public transport has historically been operated by state, territory and some local governments, the Australian Government also has a direct interest in the more efficient delivery of these services.

This is particularly pronounced within our cities. Most Australians live and work in cities and in coming decades our cities are expected to be home to the majority of Australia's population growth. The success of our cities in accommodating this growth will be materially impacted by the efficiency and effectiveness of their public transport.

The health of the Australian economy is therefore fundamentally linked to how successful these cities and their transport networks are. Reforms focused on improving the efficiency of public transport within our cities is therefore a clear focus of the Australian Government, given the wider national productivity benefits they will create.

Infrastructure Australia undertook modelling as part of the *Australian Infrastructure Plan* to measure the potential economy-wide impacts of the prospective policy reforms, covering the energy, telecommunications, water and transport sectors, identified within the document.

The modelling found that, if implemented in full, the package of reforms would deliver an annual increase in Gross Domestic Product (GDP) of $27.2 billion by 2031 and $39 billion by 2040.[114]

Reforms to the transport sector which included the franchising of major publicly operated bus and rail services in New South Wales, Victoria, Queensland and Western Australia, was the major contributor to the increase in GDP. The suite of transport reforms, if implemented in full, could result in an annual increase of GDP, growing to $34.8 billion per annum in 2040.[115]

While it is not possible to disaggregate these figures to identify the specific impact of franchising, it is reasonable to assume that these reforms would make a material contribution to the overall potential increase in GDP in the period to 2040, demonstrating the wider national value that franchising would create beyond the immediate day to day service improvements for users and operational cost savings for the taxpayer.

4.3 The role of the Australian Government

While the introduction of franchising will deliver benefits across the economy, the responsibility for implementing the reform will be carried by individual state and territory governments. Given this disparity, the Australian Government has an important role to play in enabling these reforms.

Building on the success of the National Competition Payments and more recently the Asset Recycling Initiative, the Australian Government should use direct incentives to drive the implementation of key reforms, such as franchising.

There are a number of different mechanisms that could be used.

1. ***Infrastructure Reform Incentives:*** The *Australian Infrastructure Plan* called on the Australian Government to use its funding role for infrastructure to drive the implementation of reforms to the infrastructure sector by other jurisdictions.[116] The structure is particularly well-suited to the introduction of contestable supply on public transport, because it links Australian Government infrastructure investment with the delivery of wider reforms across the infrastructure sector.
2. **City Deals:** The Australian Government's *Smart Cities Plan* identified City Deals as a potential mechanism to drive reform within Australia's cities.[117] City Deals are agreements with state, territory and local governments for the future development of cities or parts of cities. The agreements are to be structured around nationally and locally informed objectives with Australian Government funding linked to meeting objectives.
3. **New competition and reform agreement for the Council of Australian Governments**: In response to the Competition Policy Review led by Professor Ian Harper, the Australian Government committed to negotiate a new competition principles and reform agreement for the Council of Australian Governments' (COAG) consideration.[118] Australia's governments, through COAG, will be responsible for agreeing on the details of the reform agenda and implementing it. The COAG agreement could provide a national framework for governments to commit to relevant reforms and a suitable incentive package.

The now completed Asset Recycling Initiative provided the Australian Government with tangible evidence of the positive impact it can have on the reform trajectory of state and territory governments. The Australian Government should maintain the momentum of that initiative and use the mechanisms outlined above to drive the introduction of other nationally significant reforms, like franchising.

Recommendation 4

The Australian Government should provide incentives to encourage state and territory governments to expose public transport services to contestable supply through franchising.
The franchising of major public transport services will deliver productivity benefits across the Australian economy. For this reason, the Australian Government has a clear role to play in encouraging reform. The incentives could be structured using a range of mechanisms including, the City Deals framework, COAG's Competition and Reform Agreements or *Infrastructure Reform Incentives*.


SUNCORP
235 C 1846
Introducing
Foxtel Broadband
Powered by Entertainment
LAUNCH
FOXTEL
922 MVG

List of Recommendations

Recommendation from the *Australian Infrastructure Plan* and Australian Government Response

Recommendation 6.14: Governments should adopt a default option of exposing public transport services to contestable supply through franchising. The focus of reform should be to improve customers' experience by exposing delivery to contestable supply and selecting the best operator to provide services. Private operation of public transport through time limited, exclusive franchises – where providers compete to deliver services – is a proven model both in Australia and overseas in raising service quality and value for money for customers. It should be the default option for public transport provision, with capital city bus and rail services as immediate candidates for franchising.

Australian Government Response: The Australian Government supports this recommendation, noting this is primarily a matter for state and territory governments. The Australian Government supports private sector involvement in infrastructure delivery where cost-effective, noting that the provision of public transport services is primarily a matter for state, territory and local governments. Where appropriate, franchising should be used to support the delivery of public transport services. This is a potential role for the COAG Transport and Infrastructure Council.

Supporting recommendations identified within this paper

1. **Where practical, the operation of new additions to the transport network should be franchised.** This should occur where additions are stand-alone operations rather than small extensions to existing networks.
2. **State and Territory governments should adopt the Customer Focused Franchising model.** Under the approach governments would re-invest a proportion of the cost savings of franchising back into transport infrastructure. The model provides governments with a practical pathway to alleviate community concerns regarding reform and creates a significant pool of revenue that can be used to deliver infrastructure and service improvements.
3. **Australian governments should draw lessons from jurisdictions where services have been franchised, including Victoria and the United Kingdom.** Governments should consider the following five principles when franchising: ensure contractors are incentivised to improve service quality; allocate risk to those best able to manage it; periodically re-franchise and choose an appropriate contract length; ensure the assessing agency is appropriately informed and skilled; and ensure selection criteria are transparent.
4. **The Australian Government should provide incentives to encourage state and territory governments to expose public transport services to contestable supply through franchising.** The franchising of major public transport services will deliver productivity benefits across the Australian economy. For this reason, the Australian Government has a clear role to play in encouraging reform. The incentives could be structured using a range of mechanisms including, the City Deals framework, COAG's Competition and Reform Agreements or Infrastructure Reform Incentives.


Wharf 3
Manly Ferry

References

1. National Transport Commission, (2016). *Who moves what where*. Melbourne: National Transport Commission, p.109

2. Specific responsibilities of the government and private operator will vary by contract. For example, in Australia fares have been set by government while in the United Kingdom there is a mixture of regulated and unregulated fares.

3. Infrastructure Australia. (2016). *Australian infrastructure plan*. Sydney: Infrastructure Australia, p.122

4. Australian Government. (2016). *Response to the Australian infrastructure plan*. Retrieved from https://infrastructure.gov.au/infrastructure/publications/files/Australian-Government-Response-to-Australian-Infrastructure-Plan_Nov-2016.pdf

5. Infrastructure Australia. (2015). *Australian infrastructure audit background paper: population estimates and projections*. Sydney: Infrastructure Australia, p.15

6. ABS. (2016). *ABS population projections*. Retrieved from http://stat.data.abs.gov.au/Index.aspx?Queryid=294

7. National Transport Commission, (2016). *Who moves what where*. Melbourne: National Transport Commission, p.109

8. This means all seats are taken, with passenger numbers being 26% more than the number of available seats. Existing load factor data refers to an average AM peak for suburban trains between 8:00am-8:59am. Demand growth refers to increase in demand for rail/light rail/ferry between 2016 and 2031 over a two hour morning peak.

9. Per cent growth rates for Brisbane measured from 2011; Transport Performance and Analytics. (2016). Train load statistics. Retrieved from http://www.bts.nsw.gov.au/Statistics/Train/default.aspx; Infrastructure Australia. (2016). *Australian infrastructure plan*. Sydney: Infrastructure Australia.

10. Projected change from 2011; Infrastructure Australia. (2015). *Australian infrastructure audit: supplementary reports by Veitch Lister Consulting for each city*. Retrieved from http://infrastructureaustralia.gov.au/policy-publications/publications/Australian-Infrastructure-Audit-Supplementary.aspx. Sydney: Infrastructure Australia.

11. Infrastructure Australia. (2015). *Australian infrastructure audit*. Sydney: Infrastructure Australia.

12. L.E.K Consulting. (2015). *Public transport Barometer: A review of key public transport indicators for Australia*. Sydney, pp.3-18

13. Tourism and Transport Forum and L.E.K Consulting. (2012). *Public transport, private operators*. Sydney, p.12

14. Cost recovery refers to the recuperation of some or all of the costs to government of providing a service that at least in part provides private benefits to individuals. Cost recovery on public transport can be improved through increasing revenue or reducing costs. Department of Treasury and Finance. (2013). *Cost recovery guideline*. Sydney: Victorian Government, p.5

15. Infrastructure Australia. (2016). *Australian infrastructure plan*. Sydney: Infrastructure Australia, p.121

16. For example, Sydney's metropolitan buses generally recover about 30% of their costs while its outer metropolitan buses (serving mostly low density, peri urban areas) recover about 10%. Bureau of Infrastructure, Transport and Regional Economics. (2014). *Urban public transport: updated trends*. Canberra: BITRE, p.10

17. L.E.K Consulting. (2015). *Public transport Barometer: A review of key public transport indicators for Australia*. Sydney.

18. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics, p.3

19. There are some cases where competition between operators on the same route is desirable. In the United Kingdom, for example, some parts of the rail network are open access and allow multiple operators to compete for customers.

20. Network Rail. (2016). *About us*. Retrieved from http://www.networkrail.co.uk/about-us/governance/

21. Infrastructure Partnerships Australia. (2011). *Franchising passenger rail services in NSW*. Sydney: IPA, p.43; Productivity Commission. (2009). *Public infrastructure financing*. Sydney: Australian Government, p.200

22. To assist operators during the transition period, operators will be able to choose between short and long term agreements that best suit the needs of their business. Premier of Victoria (2017), *Major overhaul of bus contracts to put passengers first*. Retrieved from http://www.premier.vic.gov.au/major-overhaul-of-bus-contracts-to-put-passengers-first/

23. In February 2017, the Victorian Government announced it would phase out exclusive bus contracts over the next decade. Premier of Victoria (2017), *Major overhaul of bus contracts to put passengers first*. Retrieved from http://www.premier.vic.gov.au/major-overhaul-of-bus-contracts-to-put-passengers-first/

24. Auditor General (Victoria). (1998). *Public transport reforms: moving from a system to a service*. Melbourne: Victorian Government, p.29-35

25. Tourism and Transport Forum and L.E.K Consulting. (2012). Public transport, private operators. Sydney; Hensher, D., & Wallis, I. (2005). Competitive tendering as a contracting mechanism for subsidising transport: the bus experience. *Journal of Transport Economics and Policy*, 39(3), 295-321; PwC Australia. (2016). *Modelling of potential policy reforms*. Sydney: Infrastructure Australia; Office of Rail and Road. (2011). *Realising the potential of GB Rail*. London: Department of Transport, p.34; Auditor General (NSW). (2016). *Franchising of Sydney's ferry network services*. Sydney: NSW Government, p.2. Auditor General (Victoria). 2015. *Tendering of metropolitan bus contracts*. Melbourne. Victorian Government, p.13

26. Unit costs divide total costs by specific units of measurement. For example, costs per bus kilometre is total costs divided by the number of bus kilometres travelled. Unit costs differ from total costs or net subsidy levels because the later can be affected by external factors such as changes in service provision.

27. IPART categorises total network operating costs into Infrastructure (20.1%), rolling stock (15.3%), overhead and marketing (22.9%),Train operation costs (27.4%) and Customer interface (14.4%).

28. Gunnar Alexandersson, Staffan Hulten (2000), *Competitive tendering of railway services in Sweden*, Stockholm School of Economics, p.12

29. Tourism and Transport Forum and L.E.K Consulting. (2012). *Public transport, private operators*. Sydney, p.20

30. Independent Pricing and Regulatory Tribunal. (2015). *Efficiency of NSW public transport services*. Sydney: NSW Government.

31. Compares punctuality from 1998-99 to 2000-01. Data was not compared to the last year of franchised operation (2002) due to a change in definition of on-time running. Public Transport Victoria. (2010). *Track record 45*. Melbourne: Public Transport Victoria; Public Transport Victoria.

32. Auditor General (NSW). (2016). *Franchising of Sydney's ferry network services*. Sydney: NSW Government; Transport for NSW (2015), *Annual Report 2014-15*, Sydney: NSW Government.

33. Auditor General (NSW). (2016). *Franchising of Sydney's ferry network services*. Sydney: NSW Government, p.2

34. Keolis. (2016). *Emblematic networks*. Retrieved from http://www.keolis.com/en/our-group/emblematic-networks

35. Keolis. (2016). *Emblematic networks*. Retrieved from http://www.keolis.com/en/our-group/emblematic-networks

36. Keolis. (2016). *Emblematic networks*. Retrieved from http://www.keolis.com/en/our-group/emblematic-networks

37. Transport for NSW. (2016, December 16). *Integrating services*. Retrieved from Revitalising Newcastle: http://ourtransport.revitalisingnewcastle.com.au/integrated-services

38. Tourism and Transport Forum and L.E.K Consulting. (2012). *Public transport, private operators*. Sydney, pp.43-44

39. Tourism and Transport Forum and L.E.K Consulting. (2012). *Public transport, private operators*. Sydney, p.44

40. Tourism and Transport Forum and L.E.K Consulting. (2012). *Public transport, private operators*. Sydney, p.48

41. Australian Government. (2015). *The asset recycling initiative: helping states unlock their balance sheets*. Retrieved from Budget 2014-15: http://www.budget.gov.au/2014-15/content/glossy/infrastructure/html/infrastructure_04.htm

42. Campaign for better transport. (2015). *New guide will demystify rail franchising for passengers*. Retrieved from http://www.bettertransport.org.uk/media/07-July-2015-passenger-guide-to-franchising

43. Campaign for better transport. (2015). *New guide will demystify rail franchising for passengers*. Retrieved from http://www.bettertransport.org.uk/media/07-July-2015-passenger-guide-to-franchising

44. NSW treasury. (2016). *Electricity network transactions*. Retrieved from http://www.treasury.nsw.gov.au/electricity_network_transactions

45. Australian Government. (2015, March 18). *$2 billion Asset Recycling deal to rebuild NSW*. Retrieved from The Treasury: http://jbh.ministers.treasury.gov.au/media-release/016-2015/

46. Infrastructure NSW. (2016). *Infrastructure NSW update to the 20 year state infrastructure plan*. Retrieved from http://www.infrastructure.nsw.gov.au/expert-advice/state-infrastructure-strategy-update-2014.aspx

47. Infrastructure Partnerships Australia. (2015). *84 per cent of Sydney residents hate congestion, majority support asset recycling*. Sydney.

48. In February 2017, the Victorian Government announced it would phase out exclusive bus contracts over the next decade. Premier of Victoria (2017), *Major overhaul of bus contracts to put passengers first*. Retrieved from http://www.premier.vic.gov.au/major-overhaul-of-bus-contracts-to-put-passengers-first/

49. In February 2017, the Victorian Government announced it would phase out exclusive bus contracts over the next decade. Premier of Victoria (2017), *Major overhaul of bus contracts to put passengers first*. Retrieved from http://www.premier.vic.gov.au/major-overhaul-of-bus-contracts-to-put-passengers-first/

50. Currie, G. (2009). A review of Melbourne's rail franchising reforms. *Journey's*, 36-43, .p.36

51. Currie, G. (2009). A review of Melbourne's rail franchising reforms. *Journey's*, 36-43, .p.36

52. KPMG (2016).

53. The contracts were subsequently extended to November 2009.

54. Auditor General (Victoria). (1998). *Public transport reforms: moving from a system to a service*. Melbourne: Victorian Government, pp.3-4

55. Average annual growth rates between 1992-93 and 1997-98 was close to 4 per cent. Department of Treasury and Finance, Victoria. (2013-14). *Strategy and outlook*. Melbourne: Victorian Government.

56. Bureau of Infrastructure, Transport and Regional Economics. (2015). *Australian infrastructure statistics yearbook 2015*. Canberra: Department of Infrastructure and Regional Development.

57. Bureau of Infrastructure, Transport and Regional Economics. (2012). *Understanding Australia's urban railways*. Canberra: Department of Infrastructure and Regional Development, p.18

58. Tourism and Transport Forum and L.E.K Consulting. (2012). *Public transport, private operators*. Sydney, p.21; Currie, G. (2009). A review of Melbourne's rail franchising reforms. Journey's, 36-43, .p.39; Greig, D. (2002). Rail privatisation in Victoria. Agenda, 9(3), 237-251, p.247

59. Auditor General (Victoria). (2012). *Public transport performance*. Melbourne: Victorian Government.

60. Overcrowding at peak periods became particularly problematic for on-time running, as trains were forced to dwell at stations to allow for boarding and alighting.

61. Auditor General (Victoria). (2016). *Managing the performance of rail franchisees*. Melbourne: Victorian Government, p.4

62. In 2009 the definition of on-time running for both modes changed from "no earlier than 59 seconds before and no more than 5 minutes 59 seconds after the time in the timetable" to ""no earlier than 59 seconds before and no more than 4 minutes 59 seconds after the time in the timetable". The data, with its new definition, was backdated to 2001-02 – this is represented by a gap in the chart. Train punctuality is measured at its destination. Tram punctuality is an average of several points along the route. The indicator was not collected for trams prior to 2001-02.

63. Public Transport Victoria. (2010). *Track record 45*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2011). *Track record 47*. Melbourne: Public Transport Victoria; Department of Transport Victoria. (2012). *Annual report 2011-12*. Melbourne: Victorian Government; Public Transport Victoria. (2013). *Annual report 2012-13*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2014). *Annual report 2013-14*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2015). *Annual report 2014-15*. Melbourne: Public Transport Victoria. Public Transport Victoria. (2016). *Annual report 2015-16*. Melbourne: Public Transport Victoria.

64. Public Transport Victoria's customer service surveys group these into a single category named "running of services". Public Transport Victoria. (2016). *Customer satisfaction monitor – January-March 2016*. Melbourne: Public Transport Victoria, p.8

65. Public Transport Victoria. (2011). *Track record 47.* Melbourne: Public Transport Victoria; Department of Transport Victoria. (2012). *Annual report 2011-12*. Melbourne: Victorian Government; Public Transport Victoria. (2013). *Annual report 2012-13*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2014). *Annual report 2013-14*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2015). *Annual report 2014-15*. Melbourne: Public Transport Victoria. Public Transport Victoria. (2016). *Annual report 2015-16*. Melbourne: Public Transport Victoria.

66. Public Transport Victoria, Track Record 2010-11 cited in Parliament of Victoria. (2011). *Transport legislation amendment bill 2011.* Retrieved 2016, from http://www.parliament.vic.gov.au/publications/research-papers/2216-transport-legislation-amendment-public-transport-development-authority-bill-2011; Department of Transport Victoria. (2012). *Annual report 2011-12*. Melbourne: Victorian Government; Public Transport Victoria. (2013). *Annual report 2012-13*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2014). *Annual report 2013-14*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2015). *Annual report 2014-15*. Melbourne: Public Transport Victoria. Public Transport Victoria. (2016). *Annual report 2015-16*. Melbourne: Public Transport Victoria.

67. Data from 2012 excludes level crossing, suspected suicide and trespass fatalities and therefore should not be compared to previous years.

68. Bureau of Infrastructure, Transport and Regional Economics. (2015). *Australian infrastructure statistics yearbook 2015.* Canberra: Department of Infrastructure and Regional Development.

69. Transport Safety Victoria. (2015). *Tram safety statistics*. Melbourne: Victorian Government.

70. Specific reforms and their savings ($ million) in the program include: rationalisation of workshops ($75.8), reduction in revenue staff numbers ($22.8), Infrastructure rationalisation ($22.5), freight rationalisation ($20.7), outsourcing ($17.4), removal of guards on trains ($15.3), inventory management ($14.6), corporate overhead staff ($12.2), contracting of Metbus services ($10), replacement of some country rail services with coaches ($6.6), private bus contracts ($4 million), trading and catering ($3.5), driver roster changes ($2 million), rationalisation of trains services ($1.3), cessation of dedicated city loop train service ($0.6), 10 per cent fare increase ($14.8).

71. Auditor General (Victoria). (1998). *Public transport reforms: moving from a system to a service*. Melbourne: Victorian Government, pp.29-35

72. Auditor General (Victoria). (1998). *Public transport reforms: moving from a system to a service*. Melbourne: Victorian Government, p.12

73. The reason for this change in reporting is an adjustment in the ticket revenue payment arrangements. Since re-franchising in 2009 until 2014, the government guaranteed ticket revenue due to uncertainties associated with the implementation of the myki ticketing system – this guarantee was included in publically available data. Since 2014 franchisees have been exposed to the risk of variable ticketing, which is offset through an upper and lower limit risk sharing regime. This means ticketing revenue is no longer received in the form of a government guarantee and is therefore not published in Track Record. Auditor General (Victoria). (2016). *Managing the performance of rail franchisees.* Melbourne: Victorian Government, p.7

74. Auditor General (Victoria). (2016). *Managing the performance of rail franchisees*. Melbourne: Victorian Government, p.36

75. Public Transport Victoria disaggregate the total payments into components however these have changed over time, so only totals are published here. Prior to 2004-05 data for maintenance and ticket revenue payments were not published.

76. Public Transport Victoria. (2004). *Track record 20*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2005). *Track record 24*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2006). *Track record 28*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2007). *Track record 33*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2008). *Track record 37*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2009). *Track record 41*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2010). *Track record 45*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2011). *Track record 47*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2014). *Track record 59*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2015). *Track record 64*. Melbourne: Public Transport Victoria; Public Transport Victoria. (2016). *Track record 67*. Melbourne: Public Transport Victoria.

77. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics, p.71

78. Greig, D. (2002). Rail privatisation in Victoria. *Agenda*, 9(3), 237-251, p.245

79. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics, p.45

80. Currie, G. (2009). A review of Melbourne's rail franchising reforms. *Journey's*, 36-43, p.37

81. Unit costs divide total costs by specific units of measurement. For example, costs per passenger trip is total costs divided by the number of passenger trips. It is a way of measuring the efficiency and allowing for comparison across networks of different sizes.

82. Independent Pricing and Regulatory Tribunal. (2015). *Efficiency of NSW public transport services*. Sydney: NSW Government.

83. Auditor General (Victoria). (1998). *Public transport reforms: moving from a system to a service*. Melbourne: Victorian Government, p.12

84. KPMG. (2016). *Franchising reform pathways*. unpublished work for Infrastructure Australia.

85. Nash, C. (2006). Passenger rail franchising: British experience. Paris: University of Leeds, p.13

86. KPMG. (2016). *Franchising reform pathways*. unpublished work for Infrastructure Australia.

87. Office of Rail and Road. (2016). *Passenger rail use 2015-16 Q4 statistical release*. London: UK Government.

88. The World Bank. (2015). *GDP per capita*. Retrieved from http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=GB

89. Rail Executive. (2015). *Rail trends fact sheet 2014/2015*. London: UK Government, p.2

90. Office of Rail and Road. (2016). *Public performance measure*. London.

91. Trains are on-time if they arrive within 5 minutes of their scheduled destination, or for long distance services, within 10 minutes.

92. Office of Rail and Road. (2016). *Cancelled and significantly late moving annual average*. London: Office of Rail and Road.

93. Nash, C. (2006). *Passenger rail franchising: British experience. Paris: University of Leeds*, p.13

94. Rail Executive. (2014). *Rail trends, Great Britain 2013/14*. London: UK Government, p.13

95. Office of Rail and Road. (2016). *Complaints rate*. Retrieved from http://orr.gov.uk/statistics/published-stats/complaints-data

96. Office of Rail and Road. (2016). *Complaints rate*. Retrieved from http://orr.gov.uk/statistics/published-stats/complaints-data

97. Rail Safety and Standards Board. (2016). Annual rail safety report. London, p.14

98. Rail Safety and Standards Board. (2016). Annual rail safety report. London, p.16

99. Rail Delivery Group. (2014). *GB rail: better services, better journeys and better value*. London.

100. Office of Rail and Road. (2015). *Government support to the rail industry*. Retrieved from https://dataportal.orr.gov.uk/displayreport/html/html/a830de20-83bf-408d-9c22-7f3ec23999f9; Office of Rail and Road. (2015). *Rail finance annual statistical release 2015-16*. London: UK Government.

101. Excludes government payments to strategic transport bodies and major infrastructure projects such as Crossrail.

102. Office of Rail and Road. (2015). *Government support to the rail industry*. Retrieved from https://dataportal.orr.gov.uk/displayreport/html/html/a830de20-83bf-408d-9c22-7f3ec23999f9

103. Rail Delivery Group. (2014). *GB rail: better services, better journeys and better value*. London, p.10

104. KPMG. (2016). *Franchising reform pathways*. unpublished work for Infrastructure Australia, p.6

105. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics.

106. Office of Rail and Road. (2015). Government support to the rail industry. Retrieved from https://dataportal.orr.gov.uk/displayreport/html/html/a830de20-83bf-408d-9c22-7f3ec23999f9

107. Hayford, O., & Klimt, S. (2016). *Clayton Utz: achieving better public transport outcomes through contestable franchising*. Retrieved 2016, from https://www.claytonutz.com/knowledge/2016/march/achieving-better-public-transport-outcomes-through-contestable-franchising

108. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics.

109. The inquiry found the Department had used flawed and inconsistent methodology when guiding bidders on the amount of risk capital they would need to guarantee against. UK Government. (2012). *Final report of the Laidlaw inquiry released*. Retrieved 2016, from https://www.gov.uk/government/news/west-coast-main-line-final-report-of-the-laidlaw-inquiry

110. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics, p.9

111. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics, p.9

112. Bureau of Infrastructure, Transport and Regional Economics. (2009). BTRE staff paper. *The pitfalls in competitive tendering: addressing the risks revealed by experience in Australia and Britain*. Canberra: Bureau of Transport and Regional Economics, p.9

113. Australian Government. (2016). *Response to the Australian infrastructure plan*. Retrieved from https://infrastructure.gov.au/infrastructure/publications/files/Australian-Government-Response-to-Australian-Infrastructure-Plan_Nov-2016.pdf

114. PwC Australia. (2016). *Modelling of potential policy reforms*. Sydney: Infrastructure Australia, p.44

115. PwC Australia. (2016). *Modelling of potential policy reforms*. Sydney: Infrastructure Australia, p.47

116. Infrastructure Australia. (2016). *Australian infrastructure plan*. Sydney: Infrastructure Australia, pp.16-17

117. Department of Prime Minister and Cabinet. (2016). *Smart cities plan*. Canberra: Australian Government, pp.21-22

118. Australian Government. (2015). *Australian government response to the competition policy review*. Canberra: Australian Government, p.3

Accessible longform charts and graphics

Figure 1: Cost recovery of public transport across global cities

City	Cost recovery (%)
Hong Kong	186
Taipai	119
London	91
Barcelona	90
Toronto	73
Beijing	60
Wellington	57
Chicago	55
Dunedin	54
Prague	53
New York	51
Auckland	44
Philadelphia	41
San Diego	40
Paris	40
Christchurch	35
Hamilton	34
Perth	30
Seattle	29
Orlando	26
Brisbane	23
Melbourne	22
Sydney	22
San Antonio	13

Figure 2: Cumulative operating costs savings for rail under franchising

Year	Rail (high) (%)	Rail (conservative) (%)
0	0	0
1	5	5
2	10	5
3	10	10
4	15	10
5	20	15
6	20	15
7	20	15
8	20	15
9	20	15
10	20	15
11	20	15
12	20	15
13	24	18
14	28	18
15	33	20
16	33	20
17	33	25
18	33	25
19	33	25
20	33	25
21	33	25
22	33	25
23	33	25
24	33	25

Figure 3: Cumulative operating cost savings for bus under franchising

Year	Bus (high) (%)	Bus (conservative) (%)
0	0	0
1	10	10
2	10	10
3	15	15
4	15	15
5	20	15
6	20	15
7	20	15
8	20	15
9	25	18
10	30	18
11	30	20
12	30	20
13	30	20
14	30	20
15	30	20
16	30	20
17	35	28
18	35	28
19	35	30
20	35	30
21	35	30
22	35	30
23	35	30
24	35	30

Figure 4: Overview of the Customer Focused Franchising model

Graphic showing the overview of the Customer Focused Franchising Model.

1. Franchise Public Transport: Government creates a public operator benchmark.
2. Annual Savings delivered: Government compares expenditure following franchising to the benchmark and identifies savings
3. Identify amount to be invested: Government decides based on competing priorities
4. Improvements to transport network: Government collects data on investments made as a result of savings through franchising
5. Publish expenditure results from franchising.

Figure 5: Status of Australian public transport operations, as of February 2017

Jurisdiction	Operator	Status
Queensland	Queensland Rail	Not Franchised
	Brisbane Transport	Not Franchised
	Various bus operators	Franchised
	Various ferry operators	Franchised and not franchised
	GoldLinQ	Franchised
NSW	Sydney Trains	Not Franchised
	NSW Trains	Not Franchised
	Northwest rapid transit	Future franchised operator
	State Transit Authority	Not Franchised
	25+ bus operators	Franchised
	ALTRAC light rail	Future franchised operator
	Transport for Newcastle	Future franchised operator
	Harbour city ferries, 8 other operators and Stockton ferry in Newcastle (to become Transport for Newcastle)	Franchised
ACT	Canberra light rail	Future franchised operator
	ACTION buses	Not Franchised
Victoria	Metro Trains	Franchised
	V/Line	Not Franchised
	Melbourne metropolitan bus franchise (Transdev)	Franchised
	25+ bus operators	Not Franchised
	Yarra Trams	Franchised
Tasmania	Metro Tasmania	Not Franchised
South Australia	4 bus operators	Franchised
	Adelaide Metro	Not Franchised
Western Australia	Captain Cook Cruises	Franchised
	3 bus operators	Franchised
	Transperth	Not Franchised
	TransWA	Not Franchised
Northern Territory	Various bus operators	Franchised

Figure 6: Timeline of franchising in Victoria

Decade	Event		
1990s	**1992-1997** Reform of the Public transport Commission	**1998** Corporatisation	**1999** Franchising
2000s	**2002** Exit of National Express	**2004** • V/Line renationalised • Reconsolidation of train and tram businesses and renegotiation of short term contracts	**2009** Refranchising of metropolitan rail and tram businesses
2010s	**2012** PTV commences operation	**2016 – Current** Franchisees earned the right to negotiate for an extension	

Figure 7: Train and tram patronage in Melbourne, by franchise period

Period	Year	Train passenger movements (million)	Tram passenger movements (million)
Pre-franchising	1990–91	106.9	107.6
	1991–92	109.0	112.0
	1992–93	106.1	100.9
	1993–94	101.1	104.0
	1994–95	105.5	108.6
	1995–96	109.3	114.1
	1996–97	112.7	115.4
	1997–98	113.1	117.2
	1998–99	118.4	121.6
	1999–00	125.4	129.8
First franchises	2000–01	130.5	133.9
	2001–02	135.4	137.2
	2002–03	138.3	140.6
Non tendered private operation	2003–04	139.8	142.5
	2004–05	145.1	145.3
	2005–06	162.4	151.1
	2006–07	178.6	154.9
	2007–08	201.2	158.3
	2008–09	213.7	178.1
	2009–10	219.3	175.6
Re-franchised operation	2010–11	228.9	182.7
	2011–12	222.0	191.6
	2012–13	225.5	182.7
	2013–14	232.0	176.9

Figure 8: Punctuality – trains and trams that run on time as a percentage of total services

Period	Year	Train (% on-time running)	Tram (% on-time running)
First franchises	1998–99	94	
	1999–00	95.9	
	2000–01	96.6	
	Methodology changed		
	2001–02	95.6	80.8
	2002–03	95.6	78.9
	2003–04	94	78.6
Non tendered private operation	2004–05	91.4	79.3
	2005–06	90.1	80
	2006–07	89.1	79.7
	2007–08	88	78.5
	2008–09	87.9	79.2
	2009–10	85.4	81.9
Re-franchised operation	2010–11	85.9	81.4
	2011–12	89.9	81.7
	2012–13	92.1	81.7
	2013–14	93.1	82.9
	2014–15	92.7	83

Figure 9: Reliability of train and tram services, percentage of scheduled services delivered

Period	Year	Train (% scheduled services delivered)	Tram (% scheduled services delivered)
First franchises	2001–02		99.2
	2002–03		99.2
	2003–04		99.1
Non tendered private operation	2004–05	98.5	98.8
	2005–06	98.9	99.1
	2006–07	98.7	99.1
	2007–08	98.7	99
	2008–09	98.5	99.1
Re-franchised operation	2009–10	98.9	99.3
	2010–11	98.7	99.2
	2011–12	98.5	99.1
	2012–13	98.4	99
	2013–14	98.9	98.9
	2014–15	98.8	99.1

Figure 10: Customer satisfaction index, train and tram

Period	Year	Train (% customer satisfaction)	Tram (% customer satisfaction)
First franchises	2001–02	71.1	71.1
	2002–03	71.3	71.6
	2003–04	68.8	70.6
Non tendered private operation	2004–05	65.4	71.2
	2005–06	64.4	70.3
	2006–07	62.5	70.5
	2007–08	59.4	67.4
Re-franchised operation	2008–09	58.2	68.5
	2009–10	59.6	69.4
	2010–11	60.6	69.6
	2011–12	66.8	72.8
	2012–13	67.0	73.1
	2013–14	69.7	74
	2014–15	71.5	74.9

Figure 11: Heavy rail fatalities, Victoria

Year	Fatalaties
2001	10
2002	14
2003	10
2004	12
2005	14
2006	14
2007	23
2008	17
2009	15
2010	9
2011	8
Methodology changes	
2012	10
2013	5
2014	2

Figure 12: Tram fatalities, by cause

Year	Collision with person	Collision with vehicle	Total
2011	1	1	**2**
2012	1	0	**1**
2013	2	1	**3**
2014	1	0	**1**
2015	0	0	**0**
2016	0	0	**0**

Figure 13: Payments to train and tram operators, 2016 dollars

Period	Year	Train $2016)	Tram ($2016)
Non tendered private operation	2004–05	601,079	352,302
	2005–06	673,275	369,653
	2006–07	713,858	380,609
	2007–08	700,136	382,807
Re-franchised operation	2008–09	754,656	412,190
	2009–10	829,175	377,448
	2010–11	916,103	383,407
	2011–12	950,353	434,638
	2012–13	935,678	411,802
	2013–14	864,810	297,957
	2014–15	742,471	194,885
	2015–16	792,014	207,675

Figure 14: Operating costs – Sydney unit costs applied to Melbourne ($M, 2014-15)

	Operating costs ($ million)
Sydney operating costs (applied to Melbourne)	1,513
Melbourne (estimated operating costs)	957

There is a 37% difference.

Figure 15: Timeline of franchising in the United Kingdom

Decade	Event					
1990s	**1996 – 1997** First generation franchising	**1997** New government retain franchise model	**1998 – 2004** First generation franchises restructured			
2000s	**2000** Hatfield derailment	**2000 – 2010** Performance improves following Hatfield derailment				
2010s	**2010** • Review of franchising policy • Change in Government and franchise programme put on hold	**2011 onwards** Train Operating Companies provide financial return to government	**2012** • Judicial review of Inner City West Coast competition • Laidlaw review of Department for Transport's process management • Brown review of wider industry implications and structural recommendations	**2012 onwards** Implementation of Laidlaw and Brown recommendations	**2013** Franchising program resumed	**2015/16** Shaw review into the future shape and financing of Network Rail

Figure 16: Passenger journeys and rail fares, United Kingdom

Year	Fares (% change)	Passenger journeys (Million)
1990		812
1991		810
1992		792
1993		770
1994		740
1995		735
1996	2.6	761
1997	5.2	800
1998	9.2	846
1999	13.5	892
2000	17.2	931
2001	20.1	957
2002	22.5	960
2003	26.2	976
2004	31.3	1,012
2005	37.5	1,040
2006	45.5	1,076
2007	53.6	1,145
2008	63	1,218
2009	75.3	1,266
2010	76.5	1,258
2011	87.1	1,354
2012	98.6	1,460
2013	107.1	1,501
2014	112.6	1,586
2015	117.2	1,654
2016	118.7	1,687

Figure 17: Percentage of trains arriving on time, moving national average

Year	Trains arriving on time (%)
1998–99	87.9
1999–00	87.8
2000–01	79.1
2001–02	78.0
2002–03	79.2
2003–04	81.2
2004–05	83.6
2005–06	86.4
2006–07	88.1
2007–08	89.9
2008–09	90.6
2009–10	91.5
2010–11	90.8
2011–12	91.6
2012–13	90.9
2013–14	90.0
2014–15	89.7
2015–16	89.1

Figure 18: Percentage of trains that are cancelled or significantly late

Year	Trains cancelled or significantly late (%)
1997–98	2.5
1998–99	2.8
1999–00	2.7
2000–01	5.2
2001–02	4.3
2002–03	4.3
2003–04	3.6
2004–05	3.2
2005–06	3.0
2006–07	3.0
2007–08	2.7
2008–09	2.7
2009–10	2.6
2010–11	2.8
2011–12	2.4
2012–13	2.6
2013–14	2.9
2014–15	2.8
2015–16	3.1

Figure 19: Percentage of satisfied customers

Year	Satisfied customers (%)
1999–00	76
2000–01	73
2001–02	72
2002–03	73
2003–04	73
2004–05	76
2005–06	80
2006–07	81
2007–08	81
2008–09	83
2009–10	83
2010–11	84
2011–12	84
2012–13	85
2013–14	83
2014–15	81
2015–16	83

Figure 20: Complaints per 100,000 passengers

Year	Complaints (per 100,000 customers)
1998–99	120.0
1999–00	109.0
2000–01	131.0
2001–02	111.0
2002–03	127.8
2003–04	78.8
2004–05	71.4
2005–06	74.4
2006–07	68.5
2007–08	57.3
2008–09	55.8
2009–10	45.0
2010–11	42.3
2011–12	38.2
2012–13	34.3
2013–14	29.0
2014–15	29.1
2015–16	27.9

Figure 21: Fatal train accidents in the United Kingdom

Chart showing train accidents (total and 10-year average) from 1987/88 to 2015/16. Fatal train accidents have trended downward from a ten-year average of about 2.8 in 1987/88 to about 0.1 in 2015/16.

Figure 22: Railway fatalities, passengers, workforce and public

Chart showing railway fatalities classified as passengers, workforce and public from 1964 to 2014/15. Passenger and workforce fatalities have trended downward since 1964 but Public fatalities have remained stable.

Figure 23: Government funding to train operating companies (TOCS) and network rail

Year	TOC payments (£ million)	Network rail support (£ million)
1990–91	637	
1991–92	902	
1992–93	1,194	
1993–94	926	
1994–95	1,815	
1995–96	1,712	
1996–97	1,809	
1997–98	1,429	
1998–99	1,196	
1999–00	1,031	
2000–01	847	
2001–02	731	684
2002–03	935	1,166
2003–04	1,359	1,670
2004–05	878	2,370
2005–06	879	3,367
2006–07	1,456	4,463
2007–08	1,123	3,673
2008–09	347	4,073
2009–10	551	3,564
2010–11	-53	3,492
2011–12	-131	3,745
2012–13	-420	3,780
2013–14	-40	3,453
2014–15	-802	3,802

Figure 24: Train company operating cost, per passenger mile (2013-14 prices)

Chart showing train company operating cost, per passenger mile, from 1997-98 to 2013-14. Costs have trended downward from about £0.34 per passenger mile in 1997-98 to £0.27 per passenger mile in 2013-14.

Figure 25: Net subsidies for train operating companies, £M

Year	Net subsidies (£ million)
1985–86	849
1986–87	755
1987–88	796
1988–89	551
1989–90	479
1990–91	637
1991–92	902
1992–93	1,194
1993–94	926
1994–95	1,815
1995–96	1,712
1996–97	1,809
1997–98	1,429
1998–99	1,196
1999–00	1,031
2000–01	847
2001–02	731
2002–03	935
2003–04	1,359
2004–05	878
2005–06	879
2006–07	1,456
2007–08	1,123
2008–09	347
2009–10	551
2010–11	-53
2011–12	-131
2012–13	-420
2013–14	-40
2014–15	-802


6003
6003

Improving Public Transport
Customer Focused Franchising

May 2017

Infrastructure Australia
GPO Box 5417 Sydney NSW 2001 Australia
T +61 2 8114 1900 **F** +61 2 8114 1932
E mail@infrastructureaustralia.gov.au
W infrastructureaustralia.gov.au