BUS PRIVATISATION AND THE MANAGEMENT LEARNING PROCESS

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INTRODUCTION: THE IMPORTANCE OF PRIVATISATION

For the past ten years, British bus managers have been involved in a learning process - transforming the bus industry from arm of the welfare state to market. Commonly referred to as 'bus deregulation', the 1985 Transport Act was actually a package: deregulation and privatisation. Integration of privatisation with deregulation was a coherent policy to maximise the pressures that market mechanisms could bring to bear to turn the industry around from disastrous stewardship by the State.

The project has suffered from its 'deregulation' label. In contrast to deregulation, privatisation attracted relatively little discussion in the development of the policy, and consequential inconsistencies in the legislation itself, and also in the way it was applied, have had a profound effect on the way the market has evolved. It is now clear that privatisation deserved more attention than it received in the deregulation debate.

It is by focusing on privatisation as an equal part of the 1985 package that the bus market and management learning process can be understood. This paper seeks to realign the debate by approaching these issues. Research by both authors is used - such as that developed by John Hibbs (1991), and doctoral research of managerial approaches to deregulation and privatisation, by Matthew Bradley.

Structure Of The Paper:

Firstly we take a look at how the industry has changed since D-day. We believe it has been transformed. However we recognise a number of weaknesses in post-regulation performance, which we seek to explore. We then look at how privatisation has influenced the management learning process since 1986. Drawing on this analysis we are able to make a number of judgements about how the bus market has evolved, and how it is likely to perform in the future.

SECTION ONE: TEN YEARS OF RESTRUCTURING

When post regulation performance is set against the historical context, a remarkable transformation has taken place: (tables 1, 2 and 3, illustrating progress in mileage, patronage, subsidy).

Underpinning these results are a range of restructuring processes undertaken by managers, which have enabled the industry to break out of the spiral of decline.

Reform Of Cost Structures

During the era of nationalisation and block subsidy, costs escalated In the commercial world, this cannot be tolerated, and managers have taken action to reduce them.
i) Labour
This accounts for some 60% of costs, so staff restructuring has been important. Wage, conditions and bargaining structures are now geared to local markets, while the need to improve the bottom line has tended toward a reduction in administrative functions and a shift toward 'productive' staff directly contributing to 'wheel turn'.

ii) Overheads
Operational efficiencies permitting smaller fleets, the widespread use of mini/midi vehicles, and establishment of low-cost units for commercial expansion or competitive tender, have made traditional structures such as large depots and engineering facilities increasingly redundant. Some companies have invested the proceeds yielded from infrastructure disposal in productive assets such as new vehicles (which permit further engineering cost reductions).

Taken together, these trends have transformed the 'big bus company' into the flexible, lower cost structure of the traditional independent.

Reform Of Revenue Strategy

Complementing cost reductions, managers have sought to maximise revenue.

Identification of losses and profits has enabled appropriate action to devised. Under previous block subsidy arrangements , many managers failed to develop such information.The scandal of wasted subsidy is illustrated by an example of a former PTE company, where following an audit of performance and change of operating procedure, 75% of the pre-deregulation was registered as commercial in 1986, yet prior to this the best estimate was that only 5% of routes were profitable (Bradley, 1997).

The minibus has been an important tool. Helping to reduce costs, it has also been the key to revenue generation in many locations. In Exeter, for example, the high frequency city-wide network yielded threefold passenger growth and eliminated the need for subsidy (Blundred 1995).

The potential for competition has inspired many operators to register 'watertight' networks to minimise opportunity for competitive entry. This has helped to reduce subsidy and keep mileage up. Where competition has broken out, most have sought to control it, but with the post competition service often better than that provided previously. Oxford is an example where quality competition along the lines of that anticipated by the 1985 Act has been sustained over a ten year period, yielding passenger growth of 70% (Blundred, 1995).

Marketing is increasingly important. In Derby, Trent Buses used market research to design products to appeal to new customers - yielding substantial patronage growth (Jarosz, 1997a)

Reform Of Managerial Structures

To respond effectively to the market 'busman' has become 'businessman'. Managers in devolved structures are closer to the market and better able to respond to it. A recognition that the customer can no longer be taken for granted has tended to replace the damaging 'take it or leave it' culture of the regulated era.

To sum up, the industry:

* has successfully reduced its cost base without compromising standards;
* has dramatically reduced its dependence on subsidy;
* is better managed by being increasingly customer rather than product orientated.

These results account for the transformation of key indicators of the health of the industry: patronage is increasing, mileage is increasing, subsidy has decreased, profitability has been secured and is increasing.

But other aspects of the original vision have tended not to be delivered:

* widespread competition and diversity of ownership has not been sustained;
* the growth of mileage has not yielded corresponding patronage growth.

Rather than indicating market failure or managerial incompetence, we would suggest that these disappointments are accounted for by inconsistencies in the structure and handling of the privatisation process. Our analysis now turns to the White Paper "Buses" (the government's case for reform) to find out why.

SECTION TWO: PRIVATISATION AND DEREGULATION - A COHERENT PACKAGE

The vision set out by the White Paper and encapsulated by the 1985 Act was a theoretically coherent approach to harnessing the market as a tool to halt the damage caused by regulation and subsidy, and to give the industry a new and better future. There can be no doubt that the period of increasing public ownership after 1947, and increasing local authority control after 1968, failed to halt the secular fall in bus usage; nor that this was a result of a policy of 'managed decline', combined with the absence of sophisticated costing processes. The almost complete lack of pro-active marketing management over the forty-year period stands in stark contrast to the successes being reported today.

The 1985 Act introduced a significant potential for competition by combining privatisation with deregulation. A myriad of operators spurred on by competition, and an entrepreneurial climate, would expand the market and reverse decline. The vision for change was inspired by the idea of a free and competitive market economy for the industry, such as seems to have been lacking where other privatisations during the 1980s were concerned.

In order to facilitate competition by abolishing quantity controls, the industry was fragmented. Deregulation allows competition, while privatisation (involving fragmentation) establishes the variety of actors in the market available to engage in competition. The removal of "obstacles to enterprise, initiative and efficiency" (p.3), referred not only to the regulatory framework, but also to the structure of the bus industry. A lesson from the 'Trial Area' experiments under the 1980 Transport Act was that "under present conditions" (NBC), " deregulation itself may not be sufficient to allow small operators, however efficient, to compete successfully with established operators with greater resources" (p.79).

Thus structural reform and privatisation became an enabling component of the deregulation project. The White Paper noted that "the structure of the public sector bus operations is an obstacle to the provision, through competition, of the bus services which the community needs" (p.16). And so "the structure of the industry must be allowed to change to meet these needs."

By enabling competition, structural changes to the industry would allow the full benefits of market liberalisation to be yielded. Fragmentation would also increase the efficiency of an industry displaying few economies of scale, while privatisation itself would further deepen market benefits, as the experience of the National Freight Corporation (NFC) had demonstrated - transfer "to the private sector leads to better performance by management and staff" (p.17).

Theoretically, the vision of deregulation and privatisation should have created a largely self-regulating and sustainable competitive market order. Specific protection against predatory behaviour was therefore considered unnecessary; a structure that had the principle of fair competition built into it would be the safeguard. The government was happy that once the legislation had been put in place, "the market can set the pattern of operation and ownership" (p.18) - a remark illustrating the confidence it had in the package approach selected to sustain diversity of ownership beyond privatisation.

SECTION THREE: PROBLEMS WITH PRIVATISATION - A POLITICAL LEARNING PROCESS

Analysis of the policy making process and closer examination of the White Paper reveals that while the project was theoretically coherent, in reality there were a number of weaknesses with the privatisation aspect. After all, the 1985 Act was not an academic product, but part of a political story.

Our analysis demonstrates that privatisation was incorporated into the policy proposals at a late stage and that there were tensions within government about both its value and how it should be applied to the industry. By contrast, deregulation had featured in debate as early as the 1960s (Hibbs 1963). Over that period removal of quantity controls was developed as a concept, and widely accepted as sufficient to reform the industry. Thus by the late 1970s when free market thought gained political ascendancy, deregulation as a policy prescription had been thoroughly thought through.

It is only when reform of the bus industry entered the policy process that attention was given to the issue of the *structure* of the bus industry - the part that structure had played in contributing to decline, and the part it might play in any solution. It is only by accident that the issue of structure became one of ownership, thus introducing privatisation at a late stage.

It is clear from the text of the White Paper that structure (primarily meaning size) rather than ownership was considered the primary area of reform if deregulation was to work, and the industry to require less subsidy. Thus the White Paper argued that "it is generally agreed that this industry does not show economies of scale;" (p.15) and that large organisations are not "necessary or efficient" (p15). Reform of large organisations by separating out functions and devolving responsibility "is not enough in itself to produce organisations which will seek out market changes and adapt to them." (p15). Large organisations are "an obstacle" (p16) to competition.

Given this interpretation, industry fragmentation should have been sufficient to underpin the competitive potential. However, appearing almost as an afterthought, the issue of privatisation was introduced. The White Paper noted that in Scotland, it was the *private sector* that "has risen effectively to the challenge of partial deregulation in 1980 and has contributed significantly to the substantial increase in long distance express services which in turn have provided major benefits for less well-off travellers." (p21), while the "sale of the NFC to the private sector has shown that freedom from control by government leads to better performance by management and staff. Transfer to the private sector also removed any potential future liability on the taxpayer to provide capital or make good the losses. Managers and employees have the chance to gain from their own success." (p17).

The rationale for privatisation therefore seems to have developed not entirely as a consequence of ideology, but also for pragmatic reasons - in that the results of coach deregulation and NFC demonstrated it to be a good idea. Indeed the emergence of bus privatisation mirrors the evolution of privatisation in Conservative policy - a political learning process. Rather than there being a privatisation blueprint for Britain, privatisation was an idea that was stumbled upon and then only later, after it had been demonstrated to 'work', did it become a centrepiece of policy. Bus reform coincided with privatisation in its formative phase and might have been handled differently, had it been dealt with later on. Debate within the Conservative Party was also important. The "chance arrival" (Mackie & Preston, 1996) of free-marketeer Nicholas Ridley at the Department of Transport was crucial to the switch away from the "step by step approach of previous ministers," (and the notion that NBC might be privatised as a single unit, and competition restricted to area tendering), to the combination of full deregulation with privatisation of a broken up bus industry. Thus when the White Paper was published in 1984, it advanced the case for privatisation connected with deregulation in order to deepen market benefits.

However, inconsistencies in the structure and application of privatisation suggests that by the time the 1985 Transport Act reached the statute book, the issue of privatisation and its implementation had not been fully thought through, or debate within government concluded.

SECTION FOUR: PRIVATISATION PROLONGING THE RESTRUCTURING PROCESS

The White Paper gave the impression that it had mapped out a viable future. The onus was on managers to "use their freedom to manage and compete" (p25) in the new market. As we have already seen in Section One, managers have made substantial progress in restructuring the industry so that it is in a good position to exploit the opportunities of the market.

However our research demonstrates progress in restructuring to be a function of privatisation. Since privatisation was one of the key objectives of the 1985 Act, it can be argued that only when the hurdles of restructuring due to both deregulation *and* privatisation have been surmounted, can companies be considered to be trading up to full potential in the market.

The problem is that the extension of privatisation over a ten year period, combined with a series of changes to methods of organisation and implementation, have both dominated events (arguably more so than deregulation) and delayed the day when managers are able to progress beyond the transitional period of change and focus on the task of building patronage.

Phases Of Restructuring

The research reveals that the restructuring processes which have transformed the industry have involved three phases:

1) Making changes in preparation for D-day, to prepare for privatisation in the case of NBC and SBG and the change to company status in the case of PTE and municipal undertakings. This process typically began as soon as the 1985 Act became law, tending to continue through the first year of deregulation.

2) Learning from experience and the comercial results of one to two years trading, many managers embarked upon a secondary phase of adjustment. Typically this process involved a deepening of earlier changes, with managers discovering further ways of reducing costs. The emergence of widespread competition during this period exerted further pressure to become 'lean and fit'.

The sum of these restructuring phases has delivered the structural transformation of the industry described earlier. With the exception of 'problem' companies, 1989/1990 was for most managers a watershed period - in that they perceived the bulk of restructuring to be complete, with the future one of minor adjustments to keep pace with a maturing market. However beyond 1989/90, a third phase of restructuring may be identified, involving the selling-on of many former NBC companies privatised earlier to growing bus groups such as Stagecoach , and coinciding with the privatisation of some municipal and PTE companies.

The context of higher values attached to companies mean that selling-on necessitated a further round of restructuring to pay for take-over. In addition, the Stock Market flotation of the bus groups has not only created the necessary capital to fund acquisition programmes, but has required profit and turnover targets levels of between 15% and 20% (to satisfy City investors), requiring further restructuring to deliver these results. Economies of scope yielded through merger, and access to cheaper centralised purchasing of vehicles, spare parts, fuel and insurance, have enabled costs to be driven down.

The structure of privatisation by giving some companies a head start, created a momentum toward agglomeration, undermining the sustainability of independent ownership in the 'big bus company' sector (distinct from the traditional independent sector). Thus companies even considered by management to have successfully made the transition to deregulation and privatisation, and restructured toward profitability have not completed the journey through the restructuring process, until they have become integrated into a large bus group, and 'adjusted' to yield profit levels demanded by the City.

Evidence To Support The Theory Of A Loaded Market

Clearly a loaded market has arisen - a function of a number of problems with the privatisation process:

Early privatisers were able to clear purchase debts at an early stage, so as to restructure in order to be better able to compete in the market. Others continued to trade as public sector undertakings (recognised by the White Paper as less efficient), joining the private sector later on, but inevitably lagging behind in the restructuring process, and thus vulnerable to competition.

Rising Company Values

Linked to the staggered process of privatisation, and compounding the difficulties of restructuring, is the issue of rising company values. Those privatised early on tended to be sold at modest prices, or were even undersold, compared with asset value, whereas later sales have involved significantly higher prices. For example, West Midlands Travel was sold in 1991 for more than the proceeds of the whole NBC privatisation. Such companies have faced the disadvantage of both delay and the need to undertake deep restructuring in order to deal with a large burden of debt.

Changes To The Rules

Privatisation has not followed consistent guidelines. For example, in the early stages of privatisation, management and employee bids attracted discounts. In the case of some PTE and municipal companies 'closed bidding' was allowed. The combination of lower prices and restricted bidding in some cases allowed in-house buyouts to be viable. But with later sales there has been open bidding, and early privatisers have tended to do well, thus reinforcing the emerging groups.

The subsequent government decision to actively encourage the sale of PTE and municipal undertakings (already restructured as arms-length companies) caused further structural change in this sector. The manager of a former PTE company reported that continual restructuring, first to arms-length status, then in response to competition in the market, and finally in response to privatisation (within the context of higher prices) had diverted managerial efforts from the important tasks of developing the market and modernising the fleet (Bradley 1997).

Mismanaged Fragmentation

Even the break-up of NBC was compromised by inconsistencies. Some companies made the transition to deregulation without change (e.g. Go-Ahead Northern) or were reorganised into profitable urban areas (e.g. Brighton & Hove). Such companies had an advantage in the race to restructure, whereas some were saddled with poor operating areas (e.g. Southdown), or were created from scratch (e.g. North Western). The latter examples have had to trade within artificially created territories, or with no previous track record, and became vulnerable to competition and take-over.

Increasing Concentration Of Ownership

All of these factors have conspired to create a momentum toward concentration of ownership. The founders of the large bus groups were involved in privatisation from an early stage, and have capitalised on this advantage ever since.

In parallel with concentration has gone diminution of competition. It has been a process whereby the large groups have developed commercial strength so as to engage in predatory behaviour, to negotiate non-competitive agreements, and by thus reducing the number of actors in the market (through acquisition and predation) to correspondingly reduce the opportunities for competition - the cornerstone of the deregulation project.

SECTION FIVE: IMPLICATIONS FOR THE MARKET

The bus market has therefore tended to develop not as the myriad of competing companies envisaged by the legislation, but as an industry characterised by large groupings and a declining competitive potential between operators. It is in this context that the management learning process has developed. Rather than engaging in the kind of managerial behaviour associated with a freely competing market, managerial effort has tended to be inward looking, focused on the extended process of restructuring, involving strategies of continued cost cutting and on examining the scope for acquisitive expansion.

With the exception of a minority of companies such as Thames Transit (Oxford) and Trent (Derby), (which have resisted pressure to sell to large groups), managers have tended to be distracted from the important issue of expanding patronage - the only viable long term strategy for the industry. This interpretation accounts for why the pattern of increased mileage post regulation has not yielded a corresponding growth in patronage.

But there are encouraging signs. As the process of agglomeration draws to a close, there is evidence that managers are focusing efforts on developing the market. For example:

* emergence of partnerships between private companies and local authorities to increase the attractiveness of public transport;
* increasing use of low entry vehicles;
* greater awareness of the value of marketing;
* development of quality regional express lines - such as Stagecoach Express;
* plans by Stagecoach to found in Glasgow a network of quality routes to compete head-on with the car (Jorosz, 1997b).

The industry facing pressure from the City to deliver long term profitability, now faces an urgent need to focus primarily on market development. While costs can never be reduced by 100%, market growth can increase by 100% and more. It seems that managers are learning this lesson.

The scope for market led growth has been amply demonstrated by quality competition in Oxford and marketing advances in Derby. Now that the industry has both the time and incentive to learn from these examples, we anticipate that great strides will be made over the next few years as managers respond to this challenge.

The 1985 Transport Act, has delivered many benefits. But as a consequence of structural inconsistencies has provided only a partial testing of the potential benefit of markets in public transport. Although the industry today is a world away from the White Paper vision, important elements of the market - such as private sector management with the incentive to expand the market, are in place. We anticipate that provided the market is left unfettered, in the next few years, the outcome of 'deregulation' will be even more impressive, especially on the key test of patronage. We will look with interest as quality partnerships and the Stagecoach project in Glasgow deliver results.

The lesson is, that markets can and do work in public transport, and that managers perform far better to the benefit of consumers in the commercial context. But if governments want to unleash the full benefits of the market and for private sector managerial flair to transform public services, they should deregulate and privatise quickly and consistently, - and then stand well back and let the market do its work without political interference.

CONSIDERABLE MANAGERIAL PROGRESS

The achievements of the radical reform of the bus industry by the 1985 Transport Act have been substantial, as our analysis shows. This is even more remarkable when it is set against the previous five decades of protectionist legislation, to which the industry owes so much to its post-war decline. For the inescapable conclusion is that managers who believed that the regulatory system gave them a monopoly failed to realise what market they were in, and that their true competitor after 1950 was the private car.

Our research has identified the learning process whereby a radical change has taken place, albeit over a ten-year period, which has replaced the managed decline with vigorous marketing management in the most progressive companies. It has also shown that this process was hampered throughout the period by weaknesses in the provisions of the 1985 Act for privatisation, and in the way it was carried through. We form no conclusions as to the agglomeration process itself, if only because the lead companies in developing a management ethos of positive marketing are to be found in all groups, and outside them. But we conclude that the objectives of the legislation seem to have been achieved in ways that were not foreseen, and despite problems that, with hindsight, we consider could have been minimised.

We have in the course of our research discussed these issues, and the learning process they have involved, with a wide range of managers throughout the bus industry, and our final conclusion must be to congratulate them on their success in adapting to the consequences of so radical a change.

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Table 1: Local Bus Mileage: vehicle kilometres (millions): Great Britain

1931/32	2,507
1950	3,390
1955	3,387
1960	3,179
1965	3,023
1970	2,620
1975	2,447
1980	2,263
1985/86	**2,077**
1990/91	2,448
1995/96	2,623

Average % per annum change

1965-1975	-2.1
1975-1985/86	-1.6
1985/86-1995/96	2.9

Source: Bus & Coach Statistics 1995/96

Table 2: Local Bus Passenger Journeys (millions): Great Britain

1931/32	9,486
1950	16,445
1955	15,592
1960	13,313
1965	11,239
1970	8,687
1975	7,533
1980	6,224
1985/86	**5,641**
1990/91	4,850
1995/96	4,383

Average % per annum change

1965-1975	-3.9
1975-1985/86	-2.8
1985-1995/6	-2.7

Source: Bus & Coach Statistics 1995/96

Table 3: Public Transport Support For Local Bus Services (£million at 1994/95 prices): Great Britain

1980/81	772
1985/86	751
1986/87	619
1987/88	473
1988/89	443
1989/90	364
1990/91	374
1991/92	431
1992/93	418
1993/94	281
1994/95	279
1995/96*	268

** At 1995/96 prices*