HOW CAN WE PLUG THE £8BN HOLE IN UK RAIL FINANCES

VIEWS FROM A CROSS-INDUSTRY DISCUSSION

Introduction

We were recently fortunate enough to bring together 20 board members and senior leaders from across the industry for a robust discussion on the future of UK Rail.

Hosted by our Partner, Phil Bulman, and the Transport & Infrastructure team at Vendigital, the session was hugely insightful, highlighting many challenges and opportunities which will be key to driving the change that the industry needs.

The event was run under the Chatham House Rule, so individuals cannot be named, however attendees included leaders from Network Rail, Train Operating Companies (TOCs) and owning groups, equipment manufacturers (OEMs), members of Rail Delivery Group (RDG) and infrastructure providers.

Fundamentally, the overarching topic of conversation was the most significant challenge to UK Rail since war time – financial sustainability.

This is illustrated by Figure 1 (below), showing the historical £4bn gap between the finances covered by Government support, growing to £16bn during COVID and equating to an additional ~£1bn per month, and the total cost of the industry itself. There have been periods of improvement in the past year. yet even if and when revenues return to 75% of pre-COVID levels, a long-term £8bn p.a. hole remains in the finances of the industry – assuming the continuation of the £4bn Government support.

The challenge given for discussion was simply 'what can we do differently to plug this £8bn hole?' Clearly, the answer cannot be to 'continue with a few minor adjustments' and instead calls for major cross-industry action and a new mindset to deliver a step-change in outcomes.

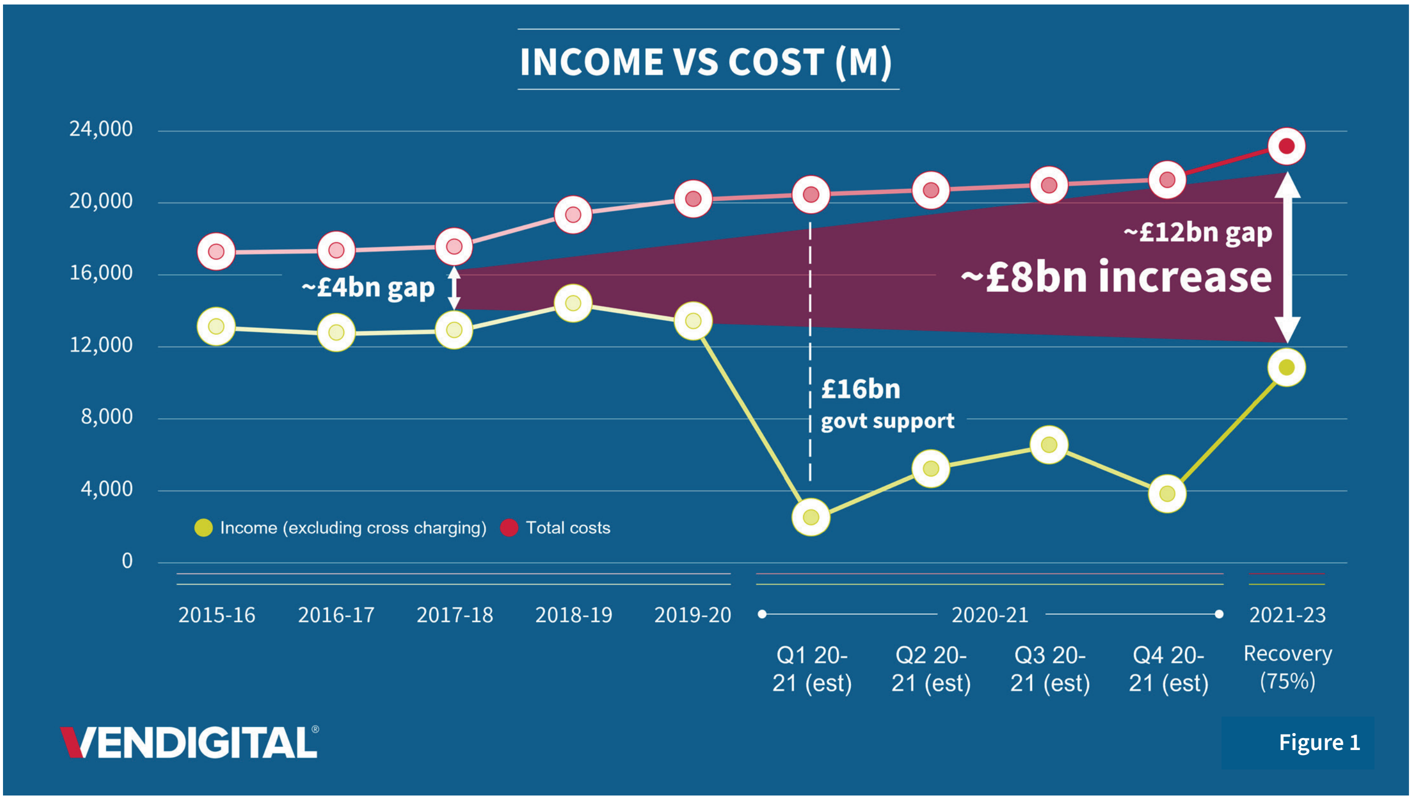

Figure 1

What was clear from the discussions was that this would only be possible with some significant changes to current ways of working and in particular in the way that the different rail organisations interact, with some significant barriers to change to be overcome.

To make the most of having such a senior and influential group in attendance, we asked what the improvements might be and how these could be tackled. We provided an infographic (Figure 2, below) to support the discussion and summarise the breakdown of current combined industry costs (~£20bn p.a.). What came out of the ensuing discussion were ten key opportunities, which we have summarised below. It was clear from the discussion that these were not without challenge – else they would have been done already! But do offer hope that Financial sustainability can be achieved

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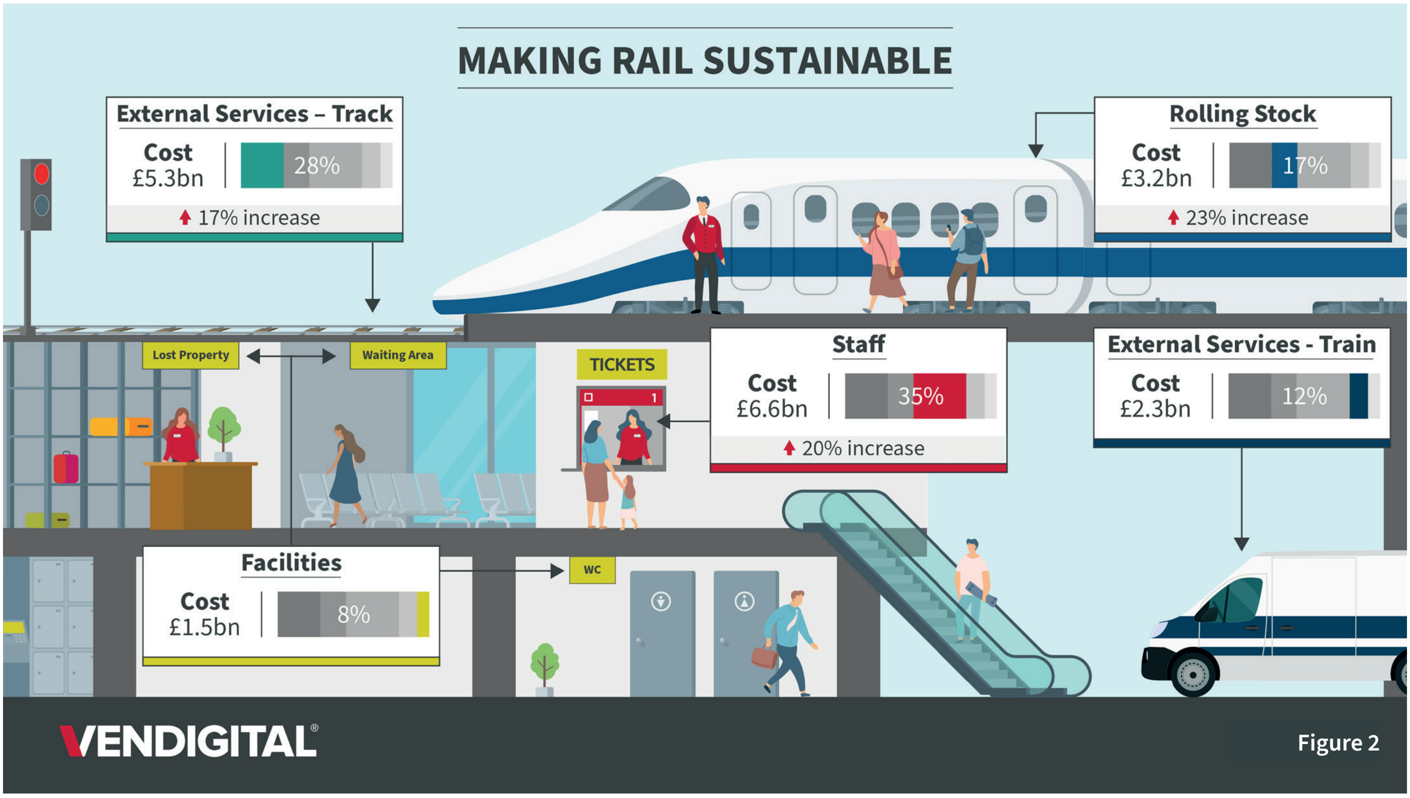

Figure 2

Ten key opportunities

1. Creating a burning platform to act differently

As we saw during the COVID crisis and have seen many times in the past, when needs must, people get inventive and find ways. A good example of this being the fast pace of time-table changes, typically taking 12-24 months pre-COVID, but implemented in weeks during the crisis. In order to create momentum for change sometimes a burning platform is needed. One individual described a sense of 'entitlement' which pervades the industry and is a barrier to real change.

What if the industry was simply given less money, or, as TfL experienced, had to evidence significant efficiency improvements before being given funding to continue?

Would this enable a new mind-set and support the cultural changes that are needed for the industry to create a railway for its customers that is financially sustainable? It seems that the recently published Integrated Rail Plan is to some extent taking this tone, cutting back on investments, partly it seems because of a lack of trust that the industry can deliver on cost efficiency.

Another key point made was that we should 'Not waste a good crisis', that whilst the industry is still on uneasy footing it will be easier to convince people and organisations of the need for change and new approaches, before reverting to business as usual.

The question is not IF this approach is needed, but more HOW it could be employed within the structures of the railway, which leads to the second point.

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2. Aligned objectives and the right incentives

It is not news to anyone in the industry that the different organisations that make up the industry work to very different objectives and priorities. The question is how could they be incentivised to deliver safety, performance AND the change needed to be more cost effective?

With the industry moving away from franchises to simpler TOC rail operating contracts, comes a great opportunity to provide clear incentives in new contracts. Aligning objectives with Network Rail routes and regions could incentivise all involved to work together to find new and innovative ways to increase rider levels and strip out significant cost.

But (and it is a big but) are we in danger of letting this opportunity pass us by? It was clear from the discussion that despite some efforts from operating companies/TOCs, the latest National Rail Contracts (NRCs) do not include any mechanisms for this.

Although there are some good examples of improvement projects, in order to drive the significant change needed, stronger incentives will be key. These could easily be implemented alongside current performance requirements to provide the mechanisms to drive the focus on cost efficiency, alongside all the other expectations of safety, performance and customer service.

The concept of one-P&L between TOCs and Network Rail regions was also discussed and IF implemented correctly, could be a great mechanism to drive changes of attitude, behaviour and decision-making.

3. Matching supply and demand

Based on data from the Department for Transport (DfT), on average pre-Covid services ran with 25-50% of passenger seats used, which over the past year dropped to just 11%. This compares with the airline sector that strictly measures and manages Passenger Seat Utilisation and typically operates at 80% utilisation (passenger load factor) – with Ryanair typically operating at 95%, reducing to 71% during COVID. Whilst some may argue it is unfair to compare, the difference is stark and should challenge us.

To further compound the challenge, with significant new rolling stock procured in recent years coming on-line (and contracted for service), the gap between supply and demand has never been greater.

If we are to offer value for money and encourage passengers (old and new) to utilise rail services, finding ways to map this new demand and match supply will be critical, and will require new approaches to gathering passenger data, assessing fleet usage and timetables, as well as some tough decisions and negotiations.

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4. Joined up Output focussed Decarbonisation plan

One of the greatest strengths of Rail is its green credentials, which should be a great draw to potential passengers seeking to travel without the negative impact of individual car journeys or air travel, and a great long term low-carbon solution for large freight movements.

In support of this ideal, many organisations are working on zero carbon rolling stock solutions, including light rail solutions, Hydrogen and Battery technology, often in small initial pilots to demonstrate what is possible. The most significant solution is of course Electrification which (assuming powered by green electricity) is universally agreed by all in the industry to be the best solution for low cost, low carbon travel on regularly used routes.

Sadly due to historical programmes like the Great Western Electrification which ultimately cost nearly 3x its original budget, the Government has pulled back from further investments, looking to the industry to industrialise alternative solutions (Hydrogen and Battery) that could avoid infrastructure spending.

This approach will however likely lead to short term thinking and lack of proper investment in the optimal long term solutions and could lead to wasted money and investment.

Developing, agreeing and committing to the best long term solution will require bringing together the technology experts, both in Rolling stock and Infrastructure, with local Train operators, Network Rail with Local and national Government, as with other large investment programmes, to evaluate a wide range of options, to then assess and develop the optimal solution. One approach to achieve this could be for Government (local and national) to set the outputs it desires and funding available (ideally over a 10+ yr timescale), giving GBR the role to coordinate a cross-industry groups and alliances to develop the potential solutions. This could be run in such a way as to provide space for innovation, but also competition between alternative providers and solutions leading to preferred solutions and funding approval. Depending on timing, the process could also be linked to the award of PSC contracts and CP7 funding approval.

The devil in this is of course in the detail, but many of the solutions are already well known and would allow for some early progress to be made and critically for the solutions to be optimised and developed based on national scale roll-out, which would include the rolling programme of electrification that is a key part of the solution.

5. REAL focus on Passenger needs

Since Network Rail's launch of 'Putting Passengers First', more importance has been placed on what customers and passengers need. However, according to a recent survey by Transport Focus, the key barriers to passengers using the railway more, beyond the well known challenge of reliability, are convenience (compared with other forms of transport) and ticket price (cost). The industry has clearly focussed on reliability with Network Rail and the TOCs being clearly measured and to some extent incentivised to deliver on this.

The issue of convenience will require a wider assessment of the entire journey, not just on the train. Considering how to make it easy for people to plan, access and hopefully enjoy the full journey from door to door. This means broader but probably more local thinking around the journeys that people make, not just the train routes on offer, and in our new hybrid working and connected world, the thorny issues of wifi and telephone signal on trains.

The most challenging topic however, which further highlights the importance of delivering on the cost efficiencies and improvements highlighted, is passenger views of ticket price (cost). For this it is worth considering what we can learn from other industries.

6. Learning from other sectors – the value of Disruptors

Rail has frequently looked to learning from other sectors and the airlines sector chief among them, given the main review being completed by Keith Williams, ex CEO of British Airways, and Andrew Haines, coming from the Civil Aviation Authority (CAA).

In the 1970s and 80s the airline sector had a lot more in common with rail, with services run by largely government owned/controlled organisations, categorised as having high fares and low productivity. Having undergone large and sometime painful change the industry is unrecognisable from what it was then both in terms of structure, productivity, and passenger experience.

Many of the drivers for change and disruption that are common in significant market shifts come from innovative private companies free from much of the historical 'baggage' (pardon the pun) that the traditional carriers had to deal with.

Companies like EasyJet and Ryanair entered the market, operating in new and far more efficient ways, and with prices typically half the cost of traditional carriers. The new carriers targeted their customers priorities and to take Ryanair as an example, grew from 82,000 passengers in 1987 to 130 million in 2020.

Interestingly, a new disruptive service has just been launched in the rail sector, which has very much taken this approach - Lumo, operated by First Group. Free of the constraints and historical staff structures and requirements, Lumo is offering a low-cost solution at prices previously unheard of in rail. In the case of British Airways, it took 10 years or more for the lessons of the disruptor to be learnt and employed. The question will be, what other disruptors will the rail industry allow and how long will it take for the rest of the industry to take on board (pardon the pun again) the learnings?

7. Staff efficiency/productivity

In the discussion, this topic was clearly considered 'the elephant in the room'. Consider for a moment what our railways require - the management of thousands of stations, depots, track and other costly assets, as well as each service making use of a train which would have cost £10m or more. In this context it is difficult to see why 35% (£6.6bn) of the cost of this system is allocated to the people involved in running, maintaining and providing customer services. By comparison a typical low-cost airline, with arguably fewer assets and infrastructure to maintain, typically spends 20% of its cost on its staff.

It is well known that historical structures and union requirements, whilst rightly designed to protect staff, also sadly often protect the status quo, and limit the industry's ability to be agile, flexible and make efficiency improvements. To add to this is the ageing nature of the current workforce and changing skill requirements to support the latest generation of trains and infrastructure.

There is sadly no easy solution to this challenge, but it is clear that it is too big of a cost area to be ignored. The solution must be founded in the whole industry's acceptance of the need for change and take a collaborative approach with staff and union buy-in, that avoids a 'war' as one described it, but allows the industry to implement more effective ways of working that provide safe but cost-effective travel, and ultimately will involve more innovative technology and less staff.

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8. New approach to Procurement

Every year the rail industry spends billions (about 40% of the entire cost of running the railways) within its supply chain with spend ranging from a few pence to many millions. Because of the way the industry is structured however, the selection, development and management of suppliers is far from optimised to drive performance and cost efficiency.

On the buy side, the fragmented nature of the industry drives many inefficiencies, for example there are many individual organisations (TOCs, FOCs, OEMs and individual Network Rail routes) all procuring similar products and services without co-ordination.

On the supplier side there are many single supplier situations created within the industry that limit the ability for competitive procurement and new entrants. With the restructuring of the industry and simplification of TOC rail operating contracts, and the closer alignment with Network Rail, comes a huge opportunity to re-shape how the industry engages the supply chain.

Interestingly, despite the pressure it has put on the rolling stock OEMs, the view shared by many was that the combination of DfT setting expectations and private companies (ROSCOs/TOCs) running effective procurement has led to a very effective series of contract awards driving huge reductions in rolling stock cost (buy, operate and maintain). The same could not be said for other areas, where traditional public procurement methods can lead to onerous, expensive and complex procurement processes, often limiting the ability for new entrants to offer innovative solutions that could support improved total cost of ownership.

There are simple and short term measures the industry can take to address these imbalances, many of which are learnings from good practice inside and outside the industry.

9. The industry needs ‘Freedom within the Frame’

Many of the changes that have been proposed can be managed and implemented with the TOCs and Network Rail, under the guidance of the Great British Railways and Interim Guiding Mind. There are however many topics which have a political element (such as decisions to allow strikes to happen, or change timetables) where traditionally Westminster, DfT and Treasury will (in some cases rightly) make or influence decisions made. It will however be critical that GBR is given some freedom to make tough decisions that balance the needs of passenger and taxpayer, which we might describe as ‘freedom within the frame’. There are many examples where the current structures lead to additional costs or avoiding investment now, leading to much higher costs in later budget cycles or periods.

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In order to deliver, in the most effective way, what the travelling public wants, freedom is required (within bounds set by Treasury and DfT) to set longer term plans and budgets, take decisions on timetables and routes, manage its staff and work with unions, influence the timing of electrification and rolling stock upgrades etc.

This is possibly the most challenging change, and will doubtless take time to resolve, but many would say it is the biggest single change that has the potential to unlock huge cost efficiencies.

10. Get on with it and don’t wait for GBR!

With the legislation required to give GBR the legal powers it needs not due until at least April 2024 it would be easy for the industry to wait to launch widespread improvement strategies.

Should this happen, over the next three years billions of pounds of taxpayer funding, tonnes of carbon emissions, and countless hours of additional time will be wasted. There is much the industry can do today to solve structural issues, reduce costs and improve customer satisfaction.

Many examples of good work were shared and discussed during our dinner, most of which occurred when different organisations came together in collaborative ways, with strong leadership, to successfully deliver a significant change in business as usual. These should be commended and celebrated but could be happening on a vastly bigger scale.

Concluding remarks

It would be easy for this to be another 'good discussion' and allow us to share our frustrations and highlight what others need to do, before going back to our day jobs and carrying on regardless. However, as leaders in our industry, surely it is incumbent upon us to act?

We at Vendigital are committed to UK rail and are planning to share some more detailed thoughts, insights, and ideas on these topics in the coming months. We would welcome inputs from leaders across the industry. Please do comment and come back to us if you are happy to contribute to the debate and critically to action!

To ensure you don't miss any of our future content on these topics, please subscribe to our insights list and follow our Twitter and LinkedIn profiles.

About Vendigital

At Vendigital, we deliver data-led accelerated cost transformation. We achieve this by combining consulting expertise and our proprietary digital platform – through our Insights360 methodology – to achieve measurable and sustainable cost reductions for clients.

An award-winning UK top-20 management consultancy, we work across procurement; supply chain; cost and value engineering; and operating strategy to transform clients' cost bases at pace and deliver benefits to their bottom line.

Core to our approach is our deep operational capability and industry experience, and in-house data science and data analytics expertise – importantly, this is underpinned by our extensive business transformation and implementation experience.

Our consultants are industry specialists with extensive experience of working within the sectors we serve – aerospace and defence; automotive; consumer products; industrial manufacturing; private equity; technology, media and telecoms; and transportation and infrastructure.

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