ORR Retail Market Review

Response of Arriva UK Trains

21st March 2014

Introduction

Arriva Group is the operator of three UK rail franchises, a joint venture partner in London Overground, the operator of the Tyne & Wear Metro and the open access operator of Grand Central. Arriva offers a unique perspective, as the only owning group to operate in the full range of market models that exist in UK rail, including open access, revenue-risk franchise, cap-and-collar franchise, devolved franchise and devolved concession.

As the only UK rail operator with such a wide range of businesses, Arriva Group is uniquely placed to witness the strengths and weaknesses of the current framework. We welcome this consultation, and look forward to engaging directly with ORR to help develop a revised framework that will maximise consumer protection, passenger benefit and operator innovation.

The rail retail market has not been subject to review since privatisation. During that time, there has been considerable technological development and commercial innovation. It is important that the regulatory structures are designed around the railway as it exists today, not the railway that existed under British Rail.

Key changes that have taken place include:

- The introduction of a wide range of new ticketing technologies, including mobile phone purchase and fulfilment and smartcard; and the imminent introduction of EMV “paywave” and NFC-based technologies
- The dramatic expansion of “Advance” fares on medium to long-distance routes, providing more affordable train travel than ever before, entirely outside the scope of fares regulation
- Dramatic growth in rail travel, with the result that capacity has not always kept pace with demand.

For these reasons, we support reviewing this market.

We strongly support the introduction of smart media and innovation. Arriva Group has been a leader in this field, with Chiltern Railways and CrossCountry the two leading operators in the area of mobile ticketing.

Chiltern Railways was the first operator to offer a fully integrated smart ticketing solution, with purchase and fulfilment via mobile app, and gate lines upgraded to validate mobile tickets. Chiltern Railways was the first (and is still the only) operator to offer mobile phone purchase and fulfilment across an entire commuter network.

CrossCountry was the first (and is still the only) operator to offer a ‘10-minutes before departure’ reservation capability which has now merged the separate technologies of smart retailing, ticketing and yield management to offer revenue managed, Advance fares for sale on the day of travel for the first time.

These are commercial adoptions of smart ticketing, and demonstrate that there is a willingness and enthusiasm from TOCs to innovate. However, there are barriers in UK rail that do not exist elsewhere, which this note will describe.

Answers to questions

1) What additional drivers (if any) of the review should be considered?
2) What is your view on the proposed scope of the review? What, if any, additional areas should be considered? What areas, if any, should not be considered?

The driver and scope seem reasonable. We suggest a particular focus on the barriers to innovation engendered by the franchising regime and potential solutions that we can describe.

It is important that TOCs are considered as being at the centre of the rail retail market. TOCs are those with the greatest commercial incentive to sell and have been the drivers of innovation in rail retailing with new fulfilment technologies; added value services such as 'choose your seat', ticket alerts and packaging of non-ticket add-ons such as catering, car parking and WiFi; and consumer marketing approaches to reward regular users, incentivise repeat purchase and identify opportunities for growing revenue. TOCs have the greatest incentive to grow the overall rail market as they earn the resultant revenues. This incentive provides greater passenger benefit than activity simply designed to redistribute rail retail market shares, as this activity can often result in large amounts of cash simply expended on advertising as opposed to service.

While third party retailers can be vocal, it is notable that the period of major passenger growth for the aviation industry coincided with a period of major expansion in airlines' direct sales capabilities.

3) What features of the GB retail market for tickets work well? What features of the retail market for tickets work less well for passengers and industry?

The UK rail retail market has supported an unprecedented period of growth. The market has widened choice and provided a plethora of retailers. Given that the UK rail sector is the fastest growing in Europe, the current model must be seen as the one upon which to build.

However, there are three key issues that need to be resolved:

- Interoperability
- Back office systems and the innovation cycle
- The franchising system and regulatory framework

This response will focus on these areas.

<u>Interoperability:</u>

Most of the innovation that has occurred has been single operator specific. These innovations have resulted in choice for passengers and greater value for money. While inter-operability is important, there needs to be space for operator innovation and different technologies to coexist. The requirement for interoperability between TOCs can sometimes drive standards to the lowest common denominator and reduce the scope for innovation and new entrants.

ORR should consider encouraging DfT to reduce the requirements for fully interoperable ticketing to enable greater TOC-led innovation.

It is also important to note that passengers' interests are not served by a free-for-all in rail ticketing. Research consistently shows that one of the biggest issues that passengers face is one of confusion. One of the reasons for this is that multiple actors in the retail market all present information differently (and sometimes incorrectly), with the result that passengers struggle to understand ticket validities. An objective of ensuring a fully integrated network combined with a very large and independent retail market risks allowing massive confusion if different combinations of tickets are sold for similar journeys.

The benefits of choice of retailer must be balanced against the need for customers to have consistent and simple information.

Back office systems

It is widely believed TOCs could learn from online retailers and airlines in presenting and communicating conditions and restrictions. This is something that TOCs are very keen to achieve. The main reason why progress has been slow in this area is because rail back-office systems are old and complicated, and require significant investment. For too much of the recent past, too few TOCs have been in a position to justify investment as they are close to the end of their franchise terms.

This is a systemic weakness in the franchising system, as central systems that are collectively owned require all to "jump together" but do not create the circumstances in which this is possible.

Providing longer, more commercially driven franchises will unlock the investment necessary to enable TOCs to deliver these improvements, especially if residual value mechanisms can be developed.

Frequently, TOC managers have been frustrated by the fact that too few franchises are simultaneously in a position to invest to enable change to take place. If the franchising structure creates attractive franchises with the ability to earn a return from investment, many of these problems will solve themselves without need for further intervention.

As an owning group that has consistently sought to lead the industry and innovate, we acutely feel the frustration that this causes. While the problem is in the systems collectively owned by TOCs, the solution sits with Government.

Franchising and Regulation

Innovation is best encouraged by creating an operating environment in which operators will gain a commercial return for investing in new technology, and have the freedom to develop solutions to passengers' problems. In many cases, franchises do not offer the ability for operators to gain a return, with the result that Government is forced to take the lead.

The franchising system should be discouraged from being too prescriptive as this results in TOCs delivering their franchise terms through 'tick boxes', as opposed to innovating for growth.

All TOCs are seeing a shift away from booking offices and towards other channels, and this is mirrored by the experiences of all retailers. The same trends are also seen internationally, such as in the main market of our parent company DB.

However, the inflexibility in flexing booking office opening hours as prescribed by the Ticketing & Settlement Agreement (TSA) makes it much more difficult to construct the business case to invest in alternative technologies. In other sectors, retailers are able to gradually migrate passengers to electronic channels with the ability to gradually reduce costs in one channel as they increase them in the other. In rail, booking office costs are mainly fixed and can only be varied through a cumbersome, lengthy and costly consultation process. This makes the business case harder to justify. In effect, there is a vicious circle which can only be unlocked by allowing operators to vary booking office provision much more dynamically.

Moves to migrate booking office opening hours from the TSA to individual franchise agreements are welcome.

It is important to highlight that operators' revenues are entirely dependent on selling tickets. Operators therefore have a very strong commercial incentive to ensure that ticket purchase is easily available for the widest possible group of passengers. Without flexibility on booking office hours, commercial smart ticketing rollouts become almost impossible to deliver.

CrossCountry's initiative to expand its 'ten minute reservations' capability into Advance ticketing on the day, took 18 months to receive approval through the industry's existing regulatory mechanics. Indeed it took the Secretary of State to give CrossCountry specific permission to proceed, given the constraints of the TSA in particular. Such regulatory restrictions stifle innovation and put unnecessary barriers in the way of TOCs developing solutions that benefit customers and TOC revenues.

4) Are there examples of particularly innovative retailing approaches from rail markets elsewhere or other sectors that could be relevant to the GB rail market?

We believe it is not appropriate for an economic regulator to seek to prescribe specific approaches.

The key objective from this review should be to unlock the barriers that exist to TOCs developing innovative approaches. TOCs, being close to the customer and with a clear commercial incentive, will develop these approaches if given the space to do so.

However, it is worth highlighting a number of current live projects within the Arriva UK rail business to highlight that TOCs are already seeking to develop appropriate innovations for their market:

- Chiltern Railways is working on a pilot of contactless payment card ticketing in partnership with DfT and TfL
- CrossCountry has recently integrated revenue management and mobile ticketing through enabling Advance purchase tickets to be purchased on the day with a seat reservation delivered to a moving train up to 10 minutes before the customer boards.

- Arriva Trains Wales is providing flexible ticketing to the Cardiff Valleys through an app-based Carnet product

These are locally-developed projects that emerged from the needs of specific markets. This should be the model for all innovation in all sectors, including UK rail.

5) What are your views on the proposed timetable and approach to the review?

We look forward to engaging closely with ORR to support ORR in building its understanding of this market and developing solutions to unlock the wave of innovation that the UK rail sector has the potential to deliver.