Contracting in Urban Public Transport

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4th Workshop on Transport Economics - Tendering transport services
Institut d’Economia de Barcelona (IEB) & FEDEA
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Content of the presentation

1. What are the alternatives and what do we observe? A quick reminder
2. Network tendering: the process that leads to the contract, or "reality behind utopia"
3. Should the tendered operator be made responsible for the (wider) marketing of whole urban networks?
4. More fundamentally: which regime should we prefer?
What are the alternatives and what do we observe?
A quick reminder

Example of route tendering:
London (UK)

Area
- Greater London Area
- 8 million inhabitants
- 20% of contracts (700) each year, 5+2 year contracts
- Urban bus

Call for tender
- One route = one contract
- Service and vehicle specified
- Assets owned (or leased) by operator

Awarding
- Competitive tendering
- Award on best overall value

Freedom
- Authority responsible for developing the public transport product (routes, frequencies, fares)
- Operator responsible for timing
- Operator has no freedom to change the product on its own

Incentives
- Revenue risk for Authority
- Extension if above targets

Enforcement
- Self-assurance, roadside timing
- Bonus/penalty related to reliability against targets
- Customer satisfaction, mystery traveller, audits, assessments (driving, engineering, environment,...)
Example of network tendering: Lyon (France)

**Area**
- 1.3 million inhabitants
- 2011-2016
- Bus, tram, trolleybus, metro, funicular

**Call for tender**
- One network
- Predefined quantity, quality and fares by authority
- Assets owned by authority

**Awarding**
- Pre-selection
- Negotiation

**Freedom**
- Operator must suggest improvements (incl. calculation of cost & revenue consequence)
- 1½ free
- No new lines or stops

**Incentives**
- Annual production cost payment to operator
- Annual revenue payment to authority + incentives related to revenue growth
- Very complex, but limited, incentives

**Enforcement**
- Operational quality monitoring with bonuses and penalties

**Example**

- **Asset ownership and management**

  **Authority**
  - Delegated management:
    - Operator makes use of public assets to deliver transport services
  - Provision contract:
    - Operator provides assets and operates services (DBOT, "concessions", etc.)

  **Operator**
  - Public management:
    - In-house operator
    - In-house contract with public operator

  **Management and Operations**


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Example of network tendering: the Netherlands (case)

**Area**
- 100,000-500,000 inhabitants
- 2010-2015/2020
- Bus (100-200)

**Call for tender**
- One network
- Functional tendering
- [Super-incentives contract linked to realized passenger revenue
- Mainly: fixed max. yearly subsidy
- Assets owned by operator

**Freedom**
- Operator may sometimes freely change services within functional specifications after receiving advice from passengers council
- Obligation to produce total service quantity in the bid

**Incentives**
- Revenue risk to operator
- [Sometimes: Revenue multiplier paid by authority, based on promised revenue growth in bid]

**Awarding**
- Competitive tendering
- Complex multi-criteria evaluation (for example: 60% supply quality, 15% service quality, 15% revenue growth and MC, 10% realisation of wishes (services, vehicles,...)

**Enforcement**
- Monitoring by customer satisfaction index with bonus/malus
- Monitoring of production and punctuality with penalty

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**Ideally: Contracting for doing the thing right**

**Actor**
- "The People"
- Transport Authority
- Transport operator

**Relation**
- Democracy
- Hierarchy
- Contract

**Strategic**
- Transport pol. (Discussion)
- Social pol. (Discussion)
- Mobility std. (Discussion)
- Access. std

**Tactical**
- Fares
- Routes
- Timetable
- Vehicle type

**Operational**
- Sales
- Information
- Pers. mngt
- Veh. mngt

**"The authority in the driving seat"**


Transport Policy, 6, 147-157.
Ideally: Contracting for doing the right thing

Actor

<table>
<thead>
<tr>
<th>&quot;The People&quot;</th>
<th>Transport Authority</th>
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<td>Political council</td>
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Relation

Democracy → Hierarchy → Contract

Strategic

<table>
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<th>Transport pol.</th>
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Requires politicians that refrain from intervening too much

Requires a clever, well-equipped authority, with a facilitating role

"The operator in the driving seat"

Tactical

<table>
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<tr>
<th>Fares</th>
<th>Routes</th>
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Operational

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<th>Sales</th>
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Danger: Contracting for doing... what?

Actor

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...where keeping the existing becomes a dominant aim...

...making it difficult to write functional requirements...


Tactical

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<td>(Frequencies)</td>
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...leading to a very prescriptive contract...

...where the operator has only little freedom, despite the original intentions.


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...where the operator in the driving seat... after all?"
2

Network tendering: the process that leads to the contract, or “reality behind utopia”

Who does what and when?
Various approaches

<table>
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<th>Service design during tendering procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>By oper. (within bounds)</td>
</tr>
<tr>
<td>- Autonomous</td>
</tr>
<tr>
<td>- After check</td>
</tr>
</tbody>
</table>

| By authority                              |
|  - GB                                     |
|  - S (?)                                  |

| In bid                                    |
|  - (NL Reform aim)                       |
|  - Functional                             |
|  - Intermediate                           |
|  - F (Cities)                             |
|  - S                                     |

| Negotiated or Base case +                 |
|  - GB London Specified DK Copenhagen     |

A non-absolute tendency to over-specify

Service design during tendering procedure

Free market

By authority

By oper. (within bounds)

Service design during contract

Negotiations / Dvlpt team

GB

S (?)

Auto-nomous

After check

In bid

Negotiated or Base case +

By authority

(NL Reform aim)

Functional

Intermediate

S

NL

F (Cities)

NL

S

Negotiated

Base case +

A caricature: The core of the game

Mars, Venus, the Prince and the Cook

The Prince

"Something nice"

"Something new every day"

The Princesses

"I don’t eat what I don’t know"

The Cook

"Many recipes in my Big Cookbook"

Venus

"Something nice and simple"

Mars

"Something spicy (but not too much…)"

The Old Men

"Yesterday’s menu was better"

The Customer

"I want to be pleased (...but I get a very bland dinner)"


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A few observations, based on experiences in the Netherlands and elsewhere: Reasons for over-specification

- Desire for more innovation
  - Authority gives space for innovation to operator
  - Authority gets frustrated
  - Impression that giving freedom does not work
- Tendency to over-specify at next tendering round

There is freedom, but the contract is bad
- No real freedom due to a large amount of requirements
- Focus on social function, forgetting commercial potentials
- Too few effective incentives (MR>MC) in the contract

There is freedom, but there is no market
- Too high expectations (politicians, civil servants)
- There is no market for new services in the first place
- The product is already very good
- Authority cannot use the freedom (bad organisation)
  - Lack of cooperation from the side of the authority
  - Counter-productive transport policies
  - Cultural differences and lack of partnership

Lack of self-reflection on (earlier) process and contract
- Too much focus on ‘preventing fuss’
- No clear goals and choices, too much focus on ‘hobby horses’

Summing up the problem:
The contracting/tendering trap

- If wrong attitude by the local authority, such as:
  - Exaggerated (political) expectations
  - Insufficient expertise and staffing
  - Risk aversion, tendency to over-specify “just to be sure”
  - Conflicting rationalities (public – commercial) and lack of mutual understanding
    - “Profit is bad, especially with public money”
    - Wrong perception of motivations

- Then this results in inadequate contracts (not conscious)
  - Ineffective incentives (revenues lower than the costs)
  - Operator freedom is only facade

- Resulting in cost focus by operator
  - Little (or unwelcome) innovative action by the operator
  - Disappointment by the authority
  - Leading to even more prescription next time round
What is needed, and what can (or does) go wrong?

<table>
<thead>
<tr>
<th>Requirements</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incentivising, well-balanced contracts (risks/freedom)</td>
<td>Contracts excessively based on political rather than economic rationality</td>
</tr>
<tr>
<td>Balanced view between competitive services and social services</td>
<td>Exaggerated focus on social policy, lack of focus on other general aims</td>
</tr>
<tr>
<td>Non-selfish, benevolent politicians, perfect local democracy</td>
<td>Some prestige or hobby-led politicians, lack of democratic control</td>
</tr>
<tr>
<td>Professional, skilful tendering process</td>
<td>Sub-optimal and unduly prescriptive tendering</td>
</tr>
<tr>
<td>Fair contract monitoring</td>
<td>Lack of appropriate contract monitoring</td>
</tr>
<tr>
<td>Forward-looking, open-minded planners</td>
<td>Conservative planners</td>
</tr>
<tr>
<td>Facilitating authority</td>
<td>Inactive authority</td>
</tr>
<tr>
<td>Partnership arrangements</td>
<td>Hostile stance</td>
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A few observations, based on experiences in the Netherlands and elsewhere: Reasons for over-specification

- Desire for more innovation: Authority gives space for innovation to operator.
- Operator does not use the space, or ‘wrongly’ in the eyes of politicians.
- Authority gets frustrated: Impression that giving freedom does not work.
- Tendency to over-specify at next tendering round.
- There is freedom: • but the contract is bad • but there is no market • but the operator cannot use the freedom (bad organisation).
- Lack of self-reflection on (earlier) process and contract.
- Paying attention to process is essential:
  - Good process for good content
  - Venus, the Prince, the Cook and Mars
- Well-balanced steering model (risks and freedom):
  - Clever call-for-tender
  - Determine important issues, leave the rest free
  - Good calibration of incentives
- Put partnership spirit at the centre:
  - Continuous!
  - Mutual obligations

Based on: Eerdmans, D., S.C.E. van Kooij, D.M. van de Velde and H. Westerink (2010), "Are we doing it wrong or do we expect too much? Forces that push authorities to become public transport designers", Research in Transportation Economics, 29, 133-139.
Necessary factors for a successful tendering of urban networks

Assuming the operator is to be responsible for (wide) marketing!

- Adequate tendering and contracting process leading to good contractual content
  - Acknowledge that this is the core of the problem
  - Reconcile Venus and Mars!
  - Restrict political influence at the tactical level!
- Contract with balanced risk and freedom
  - Functional contracts with a proper contractual balance (roles, incentives, freedom)
  - Operator may use relevant instruments (services, branding, fares, promotion,...)
  - Properly calibrated awarding mechanisms and contractual incentives
- A shared trusting partnership spirit
  - Non-collusive partnerships with duties for both/all parties
  - Authorities addressing cooperation failures between operators and/or authorities
  - Proper process agreement for continuous cooperation
- Transport authorities as system stimulators
  - Focus on stimulating the appearance of professional marketing
  - Foster innovation, foster new combinations
  - Coordinate with other transport issues and with land-use planning
  - Develop adequate transport infrastructure (long-term focus)

So should tendered operators be made responsible for the (wider) marketing of whole urban networks?
The challenge of tendering complete urban public transport networks

- **Technically, it can be done, but...**
  - It is not easy and self-evident
  - Experience shows there is a high probability of
    - Non-recognition of problems
    - Failure to solve them
  - Few authorities want to use this regime
- **What are the main issues?**
  - Generating a sufficient level of competition
  - Preventing the "winner’s curse"
  - Knowledge building when tendering every 10 years
  - Sufficient ‘introspection’ and evaluation of past processes
  - Required distance between politics and service definition
  - Authorities’ ability and readiness to become ‘system stimulators’

The challenge of tendering complete urban public transport networks

- **So: should it be done?**
  - Does it deliver better results than route/bundle/area tendering?
    - In terms of innovation and entrepreneurship?
    - In terms of ‘sustainable’ competition?
  - Does it perform better than alternative arrangements?
    - Regulated public operator?
    - Cleverly regulated ‘deregulated’ regime?
Summarising:
Lessons from past experiences of tendering of urban public services

**Route / Bundles**
- London, GB*, DK, S, N, B*, (D)
  - Mostly gross-cost
  - Often organised by (former) public operator
  - Planning flexibility to authority

**Evaluation**
- (+++) Productive and cost efficiency
- (0) Allocative efficiency (marketing)
- (!) Requires prof. planning body
- (?) Incent. & monit. of planner?
- (+) Easy learning
- (+) Stronger competitive pressure
- (7) More suited for large urban areas

**Network / Area**
- Large urban multimodal: F
- Bus: F, NL, S, (I), (E), (D)
- Often net-cost(-ish)
- Mostly organised by authority
- (Some) planning freedom to operator

**Evaluation**
- (+) Productive and cost efficiency
- (0/+) Allocative efficiency (marketing)
- (!) Requires clever authorities and clever contracting
- (?) Incent. & monit. of authority?
- (-) Difficult tool, easily hampered by political logic, slow learning
- (?) Danger of ‘winner’s curse’
- (??) Relevant for smaller urban areas
  - Problematic in larger urban areas

Summarising:
Promoting which efficiency with contracting and competitive tendering?

**Productive efficiency**
- Yes

**Cost efficiency**
- Yes
- But political interferences reduce the potential

**Allocative efficiency**
- If gross cost: ?
  - Who is monitoring the planner?
  - Is the contract good?
  - Is the system ‘in balance’?
  - Any freedom left?
  - Not too much political interferences?

- If net-cost (etc): yes/no
  - (Is there a market?)

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More fundamentally: Which regime should we prefer?

Is contracting and tendering the only way?

- Contracting approach is a traditional, centralistic, administrative approach
- What about free market initiative?
  - The British regime (1986)
  - But this is not the only way to involve the free market
  - The authority as facilitator of (integrated) market initiative = Towards a clever (de)regulation
    - The British regime (2008) is a step towards such a regime
    - See Sweden after January 2012
    - But there are potentially other ways to deregulate

- By the way:
  - 1. Contracting and tendering will also continue to play an additional role in these regimes
  - 2. Look at what is happening in rail and in coach! (free market)
  - 3. Remember: Reduced readiness to subsidise PT
  - 4. Remember: Development of intermediate modes!

Main options: What are they?

- **Competitive tendering by route**
  - 'London'-style ('Scandinavian'-style)
  - The operator has no power to determine the transport services

- **Competitive tendering by network**
  - 'Dutch'-style or 'French'-style
  - The operator has to determine the transport services (NL), or should help to do so (NL, F)

- **Deregulation**
  - Great Britain (outside London)
  - The operator is free to provide whatever services are profitable
  - The authority orders additional (non-profitable) services via competitive tendering

- **Direct award**
  - (Many) municipal operations
  - The operator needs to be incentivised for efficiency by other means than direct competitive pressure

- **A combination of the above?**

Main options: Deciding on an appropriate regime

**Institutional levels**

<table>
<thead>
<tr>
<th>1</th>
<th>Customs traditions</th>
<th>Embeddedness</th>
<th>Informal institutions, customs, traditions, …</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Legal regime</td>
<td>Institutional environment</td>
<td>Formal rules of the game</td>
</tr>
<tr>
<td>2.2</td>
<td>Regulatory regime</td>
<td>Governance</td>
<td>The play of the game</td>
</tr>
<tr>
<td>3</td>
<td>Governance</td>
<td>Resource allocation</td>
<td>Decisions on contracts, etc</td>
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**Ideally**
- Well-informed decision makers
- Welfare maximisation as aim

**More realistically**
- Ill-informed politicians (in the worst case dogmatic or hobbyistic)
- Planners not always inclined to change approaches
- Operators often lobbying for one specific model, or (even more often) for status-quo

---

One utopia against the other?
A few provocative points for the discussion

**Perfect markets**
- Contestable markets
- Effective regulators
- Appropriate regulation addressing market failure (especially network effects)
- Clover authorities
- Innovative operators

**Perfect authorities**
- Optimal contracts
- Professional tendering
- Fair monitoring
- Forward looking, excellent planners
- Balanced view between competitive services and social services
- Non-selfish, benevolent politicians
- Perfect local democracy

**Reality (exaggerated for the purpose of the argumentation!)**
- Dogmatic regulation (no recognition of network effects)
- Ill-equipped regulators
- Barriers to entry
- Regulation not implemented
- Unwilling authorities
- Disappointing operators

**Reality (exaggerated for the purpose of the argumentation!)**
- Contracts based on political rather than economic rationality
- Unduly prescriptive tendering and inadequate contracts
- Lack of contract monitoring
- Conservative planners
- Exaggerated focus on social policy
- Prestige and hobby-led demagogic politicians


Thank you for your attention!

Discussion