CO-OPERATIVES UK

NEW INSIGHT 6

Co-operative rail: a radical solution

Christian Wolmar

“Co-operatives could improve management performance, encourage innovation, and reduce absenteeism.”

Foreword

When I was Minister for Transport I made a point of spending as much time as I could outside Westminster travelling around the country. This meant I spent a great deal of time travelling by train, an activity I've always regarded as a pleasure rather than a chore. Britain's railways are truly something to be proud of and they serve more passengers today than at any point since 1946.

I also believe they have a bright future thanks to projects such as high-speed rail and Crossrail and the increased capacity and reduced journey times they will deliver for millions of passengers.

But we also know that the management and ownership of our railways remains a unsolved conundrum. The privatisation of British Rail created as many problems as it solved and few would defend the status quo as the best long-term solution. On the other hand, few would argue that wholesale renationalisation is the best solution, and there is no doubt that our railways are more efficient, innovative and customer-focused thanks to competition. Pragmatically we need a blend of both competition and co-operation for our railways to succeed.

This is exactly the kind of creative thinking our railways, and more generally, our public services will need in the years ahead.

This is why I believe that Christian Wolmar's paper is a very important and timely contribution to the debate. The co-operative model challenges us to think beyond the old paradigms of the market versus the state; beyond the divisions between owners and customers; and to think creatively about new ownership and management models. This is exactly the kind of creative thinking our railways, and more generally, our public services will need in the years ahead.

I doubt there is anyone better placed than Christian to make the case for reform given his enormous depth of knowledge and would advise anyone with an interest in improving Britain's railways to study his proposals carefully.

Lord Andrew Adonis
Institute for Government

Executive Summary

Trains are more widely used than ever, but, two decades after the privatisation of British Rail, the railways are in a mess.

The rail industry is fragmented, heavily subsidised and confused – the result of the unsatisfactory nature of the structure that was never explicitly designed and arises from a confused set of policies from successive governments, laid one upon another. The railway is currently the subject of a fundamental debate about its future and its structure, driven by the universally-recognised need to cut costs.

A radical solution could be to introduce co-operation alongside competition – harnessing the interests of passengers, staff and providers by opening up to co-operative business models for train and track.

A co-operative approach will be only one element of a wider, long-term transport system and policy, but new research with passengers suggests that there is strong public support for the idea:

- Almost three quarters (73%) of regular rail users in the UK would like to have a greater say in the rail company they use most frequently, rising to 79% for those who use trains at least once a week.
- Almost two thirds of UK adults (63%) believe passengers should have a greater ownership stake in train companies.
- Over half of UK adults (56%) believe that tickets would be cheaper if rail services were co-operatively owned by passengers.
- Almost two thirds of UK adults (58%) believe that customer service on trains would be better if rail services were co-operatively owned.
- On average, regular commuters would be willing to invest over £840 personally in a co-operatively owned train operating company. Even people who are travelling once a week are still willing to invest over £500 per head.

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The current McNulty Review on the structure of the industry, the opportunities offered by devolved transport policy and the grass roots entrepreneurship of small-scale co-operative and community rail add up to a unique opportunity to foster a culture of social responsibility alongside the discipline of commercial enterprise.

However, co-operative models will not emerge from the current arrangements, without action at different levels:

1. Network Rail could be recast on an accountable, co-operative basis and the options open on how to achieve this include models of ownership by staff that the Coalition Government has endorsed for public services more widely.

2. For train operating companies, policy action is required to reduce barriers to entry in franchising, to encourage passenger and employee ownership as a positive criterion in new franchises and to promote a system of more local micro-franchises and open access arrangements for community-based solutions.

3. At a devolved level, Scottish and Welsh rail franchises appear tailor-made for an imaginative co-operative model that not only serves the public but involves them as members too.

4. An integrated rail company, incorporating both operations and infrastructure, which may result from the proposed structural changes, could offer scope for a co-operative model.

Today's railways

There is a remarkable paradox about the state of Britain's railways today. On the one hand, they are fantastically successful, attracting more passengers than at any time in their history and are the subject of a massive investment programme which has for the most survived the worst of the cuts.

Yet, on the other, they are in a state of crisis, as they are sucking up record amounts of government money and are in the throes of various reviews whose outcome may lead to radical changes and a completely different structure.

That paradox is the result of the fact that over the past 15 years, Britain's railways have been the subject of a unique experiment. They have been broken up and privatised through a model that is more radical than anywhere else in the world with every part of a very fragmented industry being sold or passed on to the private sector. Moreover, since the initial privatisation there have been numerous changes to the structure and the government's rail policy, resulting in a state of uncertainty in the industry. While demand for rail has soared, the cost to the taxpayer has mounted as a result of the complexities and inefficiencies resulting from the privatised structure and the mounting debt of Network Rail, the infrastructure provider.

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The huge subsidy bill of around £5bn, more than double the most ever paid to British Rail (in real terms), prompted the government in late 2009 to launch a review of the structure of the industry which is being conducted by Sir Roy McNulty and, after publishing a couple of interim reports during 2010, is expected to produce a comprehensive analysis of the industry with a series of radical recommendations in late 2011. Any attempt to suggest solutions to this crisis – and that is a fair definition of the state of the railways – requires an understanding of the recent history of the railways and, in particular, the thinking behind the fragmentation and privatisation of the industry, and subsequent changes.

The original model

The railways were privatised by John Major's government of 1992-7 with remarkable haste through a model that was developed on the hoof and is widely recognised as 'botched', a word that has been used on all sides of the political divide. The Conservatives, who had not been expected to win the 1992 election, had put rail privatisation in their manifesto, but with no explanation as to how it would be carried out. This was partly because in the run-up to the election there had been sharp differences, albeit in private, over what model to choose, but also because the sheer complexity of the task had proved daunting. Therefore, under great time pressure, within a few weeks of their surprise victory, the government produced a White Paper which reflected the ideological imperatives of the politicians far more than the operational realities of a modern railway.

It came at an unfortunate time for British Rail, which had spent much of its 50 years accommodating to the postwar situation in which the motor car, rather than the railway, ruled supreme. While throughout its history it had shed staff at the remarkable rate of 10,000 per year, greatly improving efficiency, and closed a third of its mileage, it was not until the final few years of its existence that it settled upon a structure that served both commercial and social purposes with the creation of three passenger divisions – InterCity, Provincial (later Regional) Railways and Network SouthEast – and two main freight companies. There is a widespread feeling among experienced railway managers that the last few years of BR were its heyday, especially as demand for rail had begun to increase in the face of growing congestion on the roads and an upturn in the economy. While money was always tight and there were the usual constraints of operating a nationalised industry, the railway was widely considered as the most efficient in Europe.

It was the sudden ending of the Lawson boom in the early 1990s that had led to pressure to privatise BR which, as always happens at a time of economic downturn, had fallen into the red. Railways have high fixed costs and therefore any sudden reduction in income invariably results in substantial losses. The expectation in terms of passenger demand is that passenger numbers would probably decline or, at best, remain fairly steady.

This was seized upon as a reason to privatise the railways because it was felt that the greater efficiency of the private sector would enable subsidy levels to be cut. There was, too, a strong desire in government circles to reduce the role of government in the railways and to promote competition along with a desire to break the strength of the trade unions that was never explicitly stated. Privatisation seemed to press all the right buttons even though it had long been resisted in Tory circles as being too difficult in the face of the industry's popularity and its permanent need for subsidy.

The White Paper set out, broadly, the eventual structure though several significant changes were made along the way. The crucial decision was that the infrastructure would be handed over to a new company, Railtrack, that would remain in public hands while operations would be run by private companies who would obtain franchises lasting, typically, seven years, though up to double that length if new rolling stock was obtained. Other parts of British Rail were to be sold off, such as the rolling stock which was split arbitrarily into three in order to stimulate competition, as were the freight companies, although the latter were ultimately all sold to the same company, Wisconsin Central. Engineering. Maintenance and renewal was to be broken up into thirteen units and also sold quickly into the private sector.

The model was devised by the Treasury, rather than the Department of Transport, in line with its desire to stimulate competition. It was 'a blueprint for a madcap free-for-all on the railways based on a complete lack of understanding that the network was an integrated system with co-ordination and co-operation, rather than competition, as its bedrock'[1]. Even John Major, the Prime Minister, had doubts over the model, favouring an integrated railway based on the inter-war Big Four companies, but he lost the argument with the Treasury. The fundamental decision over the infrastructure was made for ideological reasons in order to encourage on-rail competition between different rail companies. The idea was that by separating infrastructure from operations, a level playing field could be created with all companies paying the same access charges to use the track, thereby allowing new operators to compete against incumbents.

There was, though, a fundamental and irreconcilable contradiction in this notion, which made the new structure unworkable right from the outset. If private companies were to be given franchises which included obligations to run a full service of trains, then no bidders would be attracted into the market if any rival could come along and cherry pick profitable services, while leaving loss making ones to the franchisee. Moreover, railway lines have limited capacity which does not allow, for example, faster services to be provided on busy lines. Therefore, the regulator had to impose 'moderation of competition' rules which effectively limited potential new operators and even today, 15 years after privatisation, there are barely 30 daily open access passenger services as against 20,000 trains operated by franchisees.

The model was hugely controversial, but while it suffered somewhat of a battering through its Parliamentary and public scrutiny process, the fundamental structure devised in the White Paper emerged largely unscathed, with a crucial extra privatisation. Railtrack, instead, of remaining in the public sector, was sold off in what was rail privatisation's only public sale. It became a conventional PLC and, briefly, reached the FTSE 100.

Various safeguards were written into this structure, with initially the creation of two regulators (The Office of Passenger Rail Franchising and the Rail Regulator) covering respectively Railtrack and the franchise operators, a price cap on fares for season and Saver tickets and the creation of a complex process that made it almost impossible to close a line. At first, the old regional consultative committees which represented local passenger interests, along with the umbrella organisation the Transport Users Consultative Committee, were retained, but later the passengers' organisation was streamlined into a new statutory body, Passenger Focus.

The main legacy, however, has been a fragmented industry which, though entirely in the private sector – if the ostensibly private nature of Network Rail is accepted – is subject to considerable government involvement and requires greater amounts of subsidy than ever before. The pressure for change arises from the unsatisfactory nature of the structure that was never explicitly designed and arises from a confused set of policies laid one upon another.

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1 Christian Wolmar, Broken Rails, Aurum, 2001, p 67.

A lack of consensus

Remarkably, the sale of the entire railway, which had been broken up into around 100 businesses, was completed by the time the Tories lost the 1997 election to a Labour landslide. This served only to compound the difficulties for the railways since Labour had little idea of how to manage this complex arrangement.

The 13 years of Labour rule were characterised by a lack of coherence in railway policy. While Tony Blair had at one time before the election suggested that the railways were to be renationalised, there was in fact never any intention to do so. Moreover, with Labour having promised to adhere to Conservative spending plans, there was very little room for the new Secretary of State, John Prescott, who assumed control of a mega department incorporating both transport and environment, to make any significant changes.

He could not, however, entirely leave the railways to their own devices because concern about safety on the railways arose after a series of four major accidents in the space of five years (Southall 1997, Ladbroke Grove 1999, Hatfield 2000, Potters Bar 2002). These accidents were linked to the way that privatisation was introduced and in particular the speed of change[2]. There was also a difficult situation developing on the biggest investment project on the network, the upgrading of the West Coast Main Line being undertaken by Railtrack, whose projected cost soared from less than £2bn to £13bn[3]. The overruns on the West Coast, together with the repercussions of the Hatfield crash, which led to a panic resulting in the widespread imposition of unnecessary speed limits that reduced on time performance on the railway to 65 per cent, spelt the end for Railtrack which collapsed and was put into administration. It took a year to restructure the company as Network Rail, a company limited by guarantee with no shareholders and profits being reinvested in the organisation, and during that time the costs of operating the railway soared as the administrators proved unable to control spending.

In an attempt to impose some order on the railway, Prescott created the Strategic Rail Authority but did not give it sufficient powers to operate as a standalone agency and the SRA barely outlived Prescott's own departure to another department, being abolished after just six years.

The policy on franchises has been equally inconsistent. Initially most franchises were for seven years, except those that involved the leasing of new fleets, but then briefly the SRA sought 20 year franchises with the idea of encouraging investment by the operators. This proved unrealistic, and faced Treasury opposition, though not before the Chiltern franchise, which has resulted in considerable extra investment, was signed. Another long deal, Merseyrail, was agreed under different arrangements but then the SRA reverted to offering seven year franchises, a policy that has continued after its abolition.

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2 See Christian Wolmar, Broken Rails, Aurum, 2001 for an analysis of the relationship between privatisation and these accidents.

3 Eventually the cost settled at around £9bn.

The number of franchises has gradually been reduced from 25 to 19 and there have been several occasions where franchisees have failed to complete their contractual term, most recently and notably, National Express on the East Coast which, temporarily, is currently being operated by a government owned operator. The underlying concept is that franchisees take the revenue risk, while the government, through the bidding process, drives down the cost of running the railways. In practice several franchises have, at various times, being turned into management contracts where the operator is paid a set amount plus a small extra percentage for profit, because they have fallen into financial difficulties. The profits and losses from franchises have been reduced, too, through the Department of Transport's policy of issuing contracts which have cap and collar arrangements which mean that if revenue is much greater or less than expectations, the government takes a sizeable proportion of the risk. Nevertheless, most franchises have proved profitable, and the train operators make around £250m profit per year, in return for little capital spending since they are short term and for the most part not expected to invest. Because of this, they have been called by a one-time government adviser, Shriti (now Lady) Vadera, 'thinly-capitalised equity profiteers of the worst kind'.

The increase in costs has come from a variety of factors, mostly resulting from the fragmentation and privatisation of the industry, together with safety measures introduced with little regard for the cost implications.

As mentioned in the introduction, with safety concerns now greatly reduced, the most pressing issue in the industry is the rapid and seemingly uncontrollable rise in costs. Whereas in most industries new technology and the maturing of management processes leads to a steady increase in efficiency with the concomitant reduction in unit costs, the opposite seems to have been the case in the rail industry. There have been numerous attempts to explain the rise in costs, which has been experienced in all parts of the industry, but there has been no consensus. The increase in costs has come from a variety of factors, mostly resulting from the fragmentation and privatisation of the industry, together with safety measures introduced with little regard for the cost implications.

Some of these cost increases arise from the fact that every player in the structure of the industry has to make a profit. Others come from the interfaces created by the fragmentation and the need to draw up legal agreements for each one. Still more come from the onerous safety requirements, which are drawn up in a climate of analysing every risk, however small, which makes any work on the railway bureaucratic and complex. Then there is the failure to align strategies or incentives which results in perverse outcomes, such as the fact that train operators are paid compensation for disruption caused by trackwork which ultimately benefits them.

The lack of clarity over the direction of the railways during the Labour years has been a contributor to costs. The constant changes have led to expensive reorganisations, heavy reliance on consultants, and managements left confused and unmotivated by the frequent changes. Nothing characterises Labour's period of dithering more than the short life of the Strategic Rail Authority, created in 2001 and abolished within just six years with, at the time, a staff of more than 500.

The abolition of the SRA has left a vacuum at the top of the industry with the result that government has, ironically, been far more involved both in the day to day running of the industry and in strategic thinking on the railways than when they were nationalised. The coalition government has been critical of the present system and has publicly debated the possibility of major changes to Network Rail's governance and the treatment of its debt. As the recent Public Accounts Committee concluded, 'The unique and complex structure of the rail industry makes it inherently cumbersome and expensive'[4].

It is time for change. This is widely recognised. The scoping study of the McNulty review suggests: 'The cost of the railway is high by historic standards and also when compared to European railways and other regulated sectors where comparisons of comparable activities have been made'[5]. Costs per passenger kilometre are 40 per cent higher than at privatisation, despite the huge increase in passenger numbers which would, in normal circumstances, have led to a reduction in unit costs. Even more remarkably, 'since 1996-97, although rail passenger-kms have increased by 59%, there has been little or no improvement in the total cost per passenger-km, which is remarkable in an industry with relatively high fixed costs'[6]. The McNulty interim report published in December 2010 suggests that one of the fundamental problems in the industry is the lack of alignment on objectives among the various players in the industry, which is the result of conflicting profit motives.

The staff and industrial relations

The sense of alienation of staff throughout the industry is palpable. The older hands recognise that when British Rail was a unified organisation, there was a much greater sense of collective ethos which helped the industry through difficult times. Of course it was not perfect, and there were the usual faults of a large organisation. But people who work for the railway are tribal and are proud of their status as railway people. This has been largely lost in the fragmentation and privatisation. Newer staff often see the industry only from their own point of view.

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4 House of Commons Public Accounts Committee, Increasing Passenger Rail Capacity, H471, 27 October 2010.

5 Sir Roy McNulty, Rail Value for Money, Scoping Study Report, DfT website, http://www.dft.gov.uk/pgr/rail/strategyfinance/railvaluemoneystudyscopingreport.pdf

6 Sir Roy McNulty, Interim submission to Secretary of State September 2010, http://www.dft.gov.uk/pgr/rail/strategyfinance/vfminterimreport/pdf/interimreport.pdf

Management/staff relations are by no means disastrous, and are better than on the London Underground. However, apart from the occasional exception such as the rapid construction of a station at Workington North after the disastrous floods, there is not the old spirit of co-operation and 'the train must get through' that characterised the industry in the past. The widespread cancellations at times of bad weather are testimony to that. The bureaucracy and interfaces created by the structure, together with the lack of sense of unity, are a barrier to working coherently together. People in the industry remain in their silos. According to a position statement by the Railway Safety & Standards Board for the McNulty review, 'the frequent changes of direction and policy, on top of an already complex industry structure have led to a situation where arguably no one fully understands how the industry works, and industry managers have had too much on their own plates to invest sufficient time in understanding how to unlock complex cross industry issues. There is no consensus as to the best way forward; with most industry groups promoting models that involve greater power and influence for themselves'[7].

The McNulty review recognises that the people within the industry have not been sufficiently recognised as a key resource: 'Where there are people-related issues in which the industry lags behind other railways and other industries, we need to understand why, and how such issues can be addressed . . . We also need to understand how people can be appropriately rewarded for the work they do, that the work adds value and also provides job satisfaction'[8].

The trade unions in the industry have acted in a traditional employee-management role, and have expressed little interest in being involved in co-operatives, though recently ASLEF, which represents drivers, is considering preparing a bid for the East Coast franchise which would include all employees.

The UK government's promotion of the co-operative idea

There are numerous ways in which the co-operative idea could be adopted in the railway industry, from very large ones such as turning the whole of Network Rail or a whole franchise into an employee partnership with passenger representation, to much smaller ones, such as a microfranchise or simply a station retail business, possibly including ticket sales. Business models such as the Co-operative Group and John Lewis Partnership have captured the mood of the times. Enterprises such as John Lewis have demonstrated that having ethical goals and fairer remuneration policies can be compatible with economic success even in hard times such as those experienced recently. By avoiding the 'them and us' culture that pervades more conventional business models, they foster an approach that brings together the different sides of the industrial divide.

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7 RSSB input to Value for Money review, 30 July 2010.

8 Sir Roy McNulty, Interim submission to Secretary of State September 2010, http://www.dft.gov.uk/pgr/rail/strategyfinance/vfminterimreport/pdf/interimreport.pdf

In November 2010, Cabinet Office minister Francis Maude announced a £10m fund to help with start up costs of mutuals in the public sector and suggested that workers would be given a right to create them. He envisaged the possibility of creating co-operatives for numerous types of government service on everything from Sure Start care centres and probation services, to prisons and even tax collection. He stressed that co-operatives could improve management performance, encourage innovation, and reduce absenteeism: 'John Lewis's staff absence levels are half of the average in the retail sector. Staff turnover is lower when employees feel they can influence the way their organisation works, and productivity can be up to 19 per cent higher in organisations where staff feel they have a stake in success.'

The co-operative idea also fits in with the government's concept of the Big Society. At the small scale end of the idea, such as co-operatively managed station shops, co-operatives could incorporate both paid and voluntary labour. At the larger end, co-operatives help break down barriers between management and staff.

Possible solutions: co-operatives

Network Rail

It is widely recognised that Network Rail is the most dysfunctional part of the railway industry. It was formed out of necessity when Railtrack collapsed but the obvious solution of simply creating a government agency, in effect renationalisation, was ruled out by Gordon Brown, the then Chancellor, even though the idea had the support of the transport secretary Stephen Byers. Instead, Network Rail was created as a company limited by guarantee, with no shareholders but, rather, more than 100 members, some representing elements within the rail industry, others appointed from outside. The regulatory structure, whereby Railtrack was overseen by the Rail Regulator, was largely retained although the organisation's name was changed to the Office of Rail Regulation (ORR).

This is not an appropriate structure because the regulation of a not for profit organisation has to be different from that of a profit maximising PLC. The only sanction of the ORR, apart from the nuclear option of taking away Network Rail's licence, which would result in the rail industry grinding to a halt, is to fine the company for breaches of its licence. This is a meaningless and counterproductive measure which simply results in less money being available for investment in the industry. Moreover, ORR has been a victim of regulatory capture, as most of its pronouncements on the company are weak and couched in the language of appeasement.

The membership scheme, which was supposed to give provide an alternative to shareholders, has failed miserably in providing any additional oversight. Although members are initially chosen through a process that is supposedly independent, the company itself can veto applications and prominent railway analysts such as Roger Ford have repeatedly been blackballed in the process. Instead, members with little knowledge of the industry have been appointed and are, according to one industry member, 'more interested in the tea and sandwiches in swanky hotels than providing any oversight of the company's activities'. As a pamphlet by the Co-operative Party put it succinctly, 'Network Rail's Board get the type of members that it wants, and the type of members that are the easiest to please'[9]. While theoretically the members are supposed to oversee the accounts, appoint the board and approve changes to Network Rail's constitution, in practice they have rubber-stamped all key decisions made by the directors and exerted very little influence on their actions or behaviour.

Network Rail has responded to this lack of oversight in a predictable way. Led by an aggressive chief executive, Iain Coucher, who has now left the company, it seemed to deliberately set itself against government, by suggesting alternative investment plans on, for example, the high speed line and electrification, and continuing to pay extremely high bonuses – doubling the salary of Coucher, for example – despite ministerial injunctions to show restraint. Within the industry, as a result of its uncollaborative attitude, Network Rail is regarded with fear and anger in equal measure.

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Network Rail is therefore an obvious candidate for a co-operative structure. Indeed, it is halfway there as its profits are already reinvested in the company rather than paid out to shareholders. However, it is unaccountable and its governance arrangements are structurally flawed. As recent events have shown, there is very little to stop the board acting with little regard for outside opinion or the needs of their customers. While the ORR has set Network Rail targets to improve efficiency, there is no effective sanction on failure to meet them.

There are numerous ways that a co-operative style Network Rail could be reformed. It would not necessarily require any major change in the structure or indeed any legislation, but, rather, it would be a matter of opening up membership to a wider constituency. In theory, all rail passengers, which potentially means any UK resident, could be invited to join, which would create an enormous membership basis. For practical purposes, it might then be necessary for the members to elect a committee or council to act as the scrutiny body for the board, with powers to appoint and fire directors, determine company strategy, set remuneration levels and so on. Alternatively, there could be a joint committee involving both employees and passengers to balance their needs.

A more radical alternative would be that Network Rail could become fully employee-owned, with a commitment to co-operative values and principles, keeping passenger representation focused on the train operating companies that are closer to their everyday concerns. If there was a more thorough-going restructuring of financial flows, Network Rail could possibly be recast as a secondary co-operative, owned by the operating companies, who are expected

9 Robbie Erbmann and Peter Hunt, The People's Rail, Co-operative Party, June 2008.

to become longer-term players as a result of the franchise review. Just as the Coalition Government is looking at different mutual models for Post Office Limited (with initial work that is being led by Co-operatives UK), there is more than one way for the railway to go co-operative.

The overall advantages of a co-operative structure are clear in terms of both accountability and governance. There would still be a need for independent regulation, but with a mutual structure the decisions of the Network Rail board would be far more in line with wider societal concerns. The abuses over board bonuses under Iain Coucher would no longer be possible, and incidents such as overrunning engineering work would be subject to far closer scrutiny.

Franchises

The franchise system is currently the subject of a review by government which intends to let longer franchises on a different basis, with the idea of attracting investment. There is uncertainty, however, over whether this is compatible with the operators being allocated the revenue risk, as with longer franchises there will be greater uncertainty over estimates of future income.

Six franchises are due to come up for renewal in the next four years, including in Scotland in 2014, offering the potential for bids for co-operative models which could be in partnership with current operators. Passenger rail operation lends itself well to a mutual or co-operative structure, as it is a high volume business with millions of users and a large workforce.

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A senior rail manager, who supports the co-operative concept, feels ‘the public would see a mutual or co-operative train operator as a refreshing and appropriate alternative, particularly if its declared objective was to improve rail services’. Indeed, the public sees the position of the operators as profit maximisers to be rather anomalous. Support from within the industry for a co-operative structure is born of an acceptance that this is unlikely to change.

A co-operative franchise would be a commercially run enterprise, but the profits would be reinvested within the industry. There would, however, be much less of a ‘them and us’ feel to the railways and people could be more sympathetic when the inevitable disruptions occur. The public would like to see the railways run for their benefit rather than, as they see it, for the shareholders of the private operators. As the senior manager put it, ‘the great attraction of a co-op is that it would make people far more understanding of the difficulties faced by operators and shift the debate onto another footing’.

Another potential model has been suggested by Steve James, a driver with East Coast but formerly a finance director, who has put forward the idea of running a franchise as a mutual with all stakeholders – passengers, unions, Network Rail – represented on the board and the staff being allocated a 10 per cent share of the company. He suggests that a set level of profit would be predetermined for reinvestment in the franchise, and anything above that would be distributed to the various shareholders, with 10 per cent going to the staff. The board would be constituted in such a way that no one party would have a controlling interest. The Department of Transport would have 40 per cent of the votes, but would need to convince other stakeholders to obtain a decisive vote at the board. Day to day management would be through a conventional operating board. This arrangement could be applied to any franchise.

Microfranchising and Open access

A more modest proposal has been put forward by Paul Salveson, a long time advocate of community involvement in rail. He suggests that a particular line or a small group of lines could be operated on the basis of a microfranchise, under community and passenger control: 'The operations could either be sub-contracts from existing franchises, or taken out and run as small, discrete, franchises which are managed by a sub-regional body (eg a county council, Passenger Transport Executive, or consortium of local authorities) over a long franchise period (up to 25 years)'. They could even be combined with local bus services and run on a mutual basis. Small franchises work well in Germany, Sweden and Denmark – and the franchising body is usually the regional government or county council – although up to now most franchises have been awarded to the big multi-national groups such as Arriva and Veolia.

Another idea which has been progressed further is the notion of using the open access arrangements to create a new service operated by a co-operative. A plan to run trains between Westbury and Birmingham, using new rolling stock, has been drawn up by Goco, and has obtained £150,000 seed funding to draw up the project and commission demand forecasts. The structure envisaged by Goco is for a 'multi-stakeholder' arrangement under which conventional shareholders would control a maximum of 25 per cent of votes and employees a further 25 per cent. The rest would be in the hands of passengers who, initially, would be defined as anyone living within ten miles of the line. Goco is currently in negotiation with Network Rail and the ORR over access rights, and with a Chinese company over leasing the trains.

The difficulties faced by such open access operations have, however, been highlighted by the demise of the very popular Wrexham and Shropshire services in January 2011. The service which offered three trains per day had very high customer satisfaction but failed as there were insufficient numbers of passengers. Goco, too, may find it difficult to generate sufficient patronage to pay its costs, given that there are no direct subsidies for open access providers.

Goco has another project which involves using a rail car – a Parry Peoplemover – as a feeder service for commuters in Medstead and Four Marks in Hampshire, using the Watercress heritage line to Alton with test services due to start early in 2011. Other preserved railways operate as co-operatives, notably the very successful five mile long Keighley and Worth Valley which carries more than 100,000 passengers per year and is contemplating running a commuter service.

Other options

There are other opportunities for co-operative involvement, ranging from small scale activities such as station shops to providing engineering services and other support services. Indeed several large suppliers to the rail industry such as Mott Macdonald and Arup are employee owned, as are some catering organisations serving the rail industry.

Arguably, the best model for the railways would be one which the artificial separation between operations and infrastructure was ended and the industry operated in a vertically integrated way which, traditionally, has been the norm for railways throughout the world, although in recent years several countries have begun to franchise out some of their operations. There is no reason why such a reconstituted industry would not have a mutual structure, possibly with both passenger and employee interests. There is, though, little likelihood that any government would want to recreate a British Rail type organisation, even though it might be far more efficient than the alternatives. However, the government is currently examining the possibility of breaking up Network Rail on a regional basis, or, less radically, hiving off parts of it to recreate an integrated railway. Indeed, Merseytravel has sought to run its Merseyrail franchise on this basis for some years, but Network Rail has resisted the move. A more decentralised network, with different types of franchise to suit local and operational needs, might well allow for a co-operative structure to be implemented on part of the rail network. Local or regional services may well be easier to fit into a co-operative model than, say, an InterCity business, because it is simpler to identify clear democratically elected stakeholders.

Passenger views on co-operative models

Passengers want the simple things done right when it comes to trains – not least that they run on time. They have, in general, a critical view on the value for money of tickets and they have, perhaps unfairly, relatively low expectations about the helpfulness of staff.[10]

The measure of success for new models is whether a system based on co-operation rather than fragmentation is going to be more effective on these and related fundamentals. To test public views on this, Co-operatives UK commissioned a YouGov survey of passengers in January 2011. The passengers included in the research included people served by every rail operator and with a variety of travel patterns.

What emerges, perhaps not surprisingly, is a good deal of support for the notion of co-operatives among the travelling public. The headline research conclusions are that:

10 Passenger Focus, What Do Passengers Want?, December 2010

- Almost three quarters (73%) of regular rail users in the UK would like to have a greater say in the rail company they use most frequently, rising to 79% for those who use trains at least once a week.
- Almost two thirds of UK adults (63%) believe passengers should have a greater ownership stake in train companies.
- Over half of UK adults (56%) believe that tickets would be cheaper if rail services were co-operatively owned by passengers.
- Almost two thirds of UK adults (58%) believe that customer service on trains would be better if rail services were co-operatively owned.

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The research took this one stage further then, by exploring the willingness of passengers to invest in a co-operative model. The results showed that, although new except at the small scale, this is an entirely practical option. There are, in short, very considerable untapped financial resources that could be open to rail operators if they were able to open up their ownership to the public. On average, regular commuters would be willing to invest over £840 personally in a co-operatively owned train operating company. Even people who are travelling once a week are still willing to invest over £500 per head.

The travelling public has a strong interest in a better train system and are open to the idea in principle that, with their investment or with staff ownership, co-operative models could help to deliver on that.

Obstacles and barriers

So can government – national, devolved or local - create this coalition of interests? Of course there are obstacles. The bureaucracy required to create this structure would be complex and financial backing would be essential.

The cost of a full franchise bid is reckoned to be in the order of £5m, and requires the involvement of 30-40 professional staff, with around half a dozen employed full time for the duration, which is unlikely to be much short of a year.

Setting up a co-operative is not easy and the rail industry itself poses additional difficulties because of its complex nature which involves a myriad of interfaces, its onerous safety requirements and heavy capital requirement. Any potential co-operative would require not only working capital, but also considerable expertise. Specifically, the requirements are, according to the accreditation questionnaire:

- substantial experience of running passenger transport operations;
- detailed balance sheet information in order to demonstrate viability as a business entity;
- the ability to provide a performance bond facility and a season ticket bond (the performance bond for the East Coast mainline, for example, is in the order of £18 million); and the
- provision of a corporate safety policy or occupational health and safety policy.

The capital requirements extend beyond the performance bond, to ensure there is working capital and to meet any investment requirements, which are likely to be more onerous under the new longer franchise arrangements. There is a Catch 22 issue here as the system is designed to accommodate existing companies rather than newcomers, and it would be impossible for an arrangement such as that proposed by Steve James to be realised without considerable government support. The experience of the management buy-out teams at the beginning of the privatisation process is salutary. Although three did win the bids, one fell away when it could not get the bank backing and the other two were quickly subsumed into conventional companies. The kind of obstacle facing this initiative is demonstrated by the Competition Commission's attitude to a recent employee buy-out proposal. The Commission recently discouraged an employee buyout for buses in Preston, as it feared that excluding external investors would limit financing options. If regulators only understand conventional business models, alternative approaches to ownership will be excluded from the start.

For any hope of success – indeed, even to prequalify – a franchise bidder would be required to show that they had secure financial backing, would need to ensure that the government would agree to their selection as a shortlisted bidder and would have to have an experienced team of managers, both to deliver a winning bid and to establish a new operating company.

ASLEF, which has examined this issue in some detail, has decided that for its mutual bid, plans to establish a specially constituted organisational structure for the bid to allow representation for employees and passengers as well as other stakeholders. The union believes the body should be able to issue shares and be able to raise capital.

Then is are a whole host of other issues, such as pension rights and job security – generally pretty tight under present arrangements for most staff – which might deter staff from supporting a scheme. The unions, too, might indeed be a barrier. With the exception of the ASLEF bid mentioned above, they have traditionally been reluctant to become involved in the management of organisations, preferring the 'them and us' stand-offs from which they have profited and the travelling public have lost out.

The bidders would also have to make arrangements for legal clearance, setting up an IT system and creating a sales and marketing team. Overall, there would have to be a long term strategy supported by the right business model. The financial hurdles are another barrier which appear difficult to overcome without seed funding from government or an easy credit line from a sympathetic organisation.

Existing rules of the franchising process would have to be changed too, as currently experienced operators are given preference over newcomers. The difficulties experienced by Goco highlight the obstacles faced by new arrivals in the industry which are classic chicken and egg. According to Goco's founder, Alex Lawrie, ORR and Network Rail require details of financial backing sufficient to cover first year losses – which could amount to £3m - before approving access arrangements, but that is impossible to obtain without a business case setting out the precise service proposal: 'The rules are clearly drawn up with existing operators in mind, rather than new entrants.'

Unfortunately, the government's response to the franchise reform consultation does not seem to offer any concessions to new entrants based on a co-operative structure. Specifically, it maintains the requirement for franchise bidders to provide a substantial performance bond of between £10m and £15m, and also retains the complex prequalification requirements that stress previous experience in the industry. Most disappointingly, there is no mention in the document of alternative approaches, despite the government's wider emphasis on Big Society and co-operative structures.

In fact, though far bigger than the franchises, Network Rail offers an easier model because of the onerous requirements of the bidding process for franchises and their capital requirement which are likely to become greater if the plan for longer franchise terms, with greater expectations of investment, materialises. The experience of Glas Cymru in Wales demonstrates that mutuals can raise large-scale infrastructure finance – although being a co-operative is clearly not in itself a solution to wider issues of subsidy and sustainability faced by Network Rail.

A radical solution

Despite these obstacles, the various suggestions above for co-operatives in the rail industry are both feasible and desirable.

The rail industry is ill-suited to profit maximising models because of the large subsidy it receives, a situation that is bound to continue. Creating a co-operative structure in the industry would do much to repair the often negative view of the industry among passengers.

As the senior train operator puts it 'Train operating companies are seen as siphoning money away from the railway for the benefit of avaricious shareholders and adopting a short term agenda in pursuit of profit. This is not a view based on objective assessment so much as strong feeling about what is still seen as fundamentally a public service'.

By ensuring that any surplus from the railways is re-invested in the industry, the co-operative model changes the relationship between the various stakeholders. It ticks other boxes, too, such as ensuring that staff feel involved in the railway, creates an ethos of co-operation that is essential in such a complex industry and will lead to greater efficiency.

This will not happen, though, without an open-minded view from within the industry and, crucially, strong and open support from government, whether UK or devolved.

The initial practical steps that could help are:

1. Explicit ministerial encouragement for the principle of a co-operative for a national train operating company franchise with passenger and public membership.
2. A rapid investigation by ORR on how to reduce barriers to new co-operative entrants and on how alternative models of ownership and finance should be recognised in the franchise process, such as making the encouragement of passenger and employee ownership a positive criterion in new franchises.
3. Introducing a system to allow for the letting of local micro-franchises working through existing Passenger Transport Executives, Local Enterprise Partnerships or their equivalent.
4. Facilitating the entry of co-operative ventures as open access operator, by reducing the bureaucratic and financial hurdles they face.
5. Encouraging Network Rail to explore and consult on different mutual options for its membership, with the goal of opening up to a full co-operative membership structure within three years.
6. Promoting a co-operative model for any integrated rail companies covering both operations and infrastructure that emerge from the current review of structural changes.

Co-operatives UK

Co-operatives UK works to promote, develop and unite co-operative enterprises. It has a unique role as a trade association for co-operatives and its campaigns for co-operation, such as Co-operatives Fortnight, bring together all those with a passion and interest in co-operative action.

Any organisation supportive of co-operation and mutuality can join and there are many opportunities online for individuals to connect to the latest co-operative news, innovations and campaigns. All members benefit from specialist services and the chance to network with other co-operatives.

www.uk.coop

THE AUTHOR

Christian Wolmar is a journalist and broadcaster specialising who has written extensively on the railways since 1993 for a variety of newspapers and magazines. His books include *The Great British Railway Disaster* (1997), *Stagecoach* (1999), *On the Wrong Line* (2001), *Fire and Steam, A new history of the railways in Britain and Engines of War, how wars were won and lost on the railways*. He writes regular columns for *Rail*, *Transport Times* and *TSSA* magazines and has had articles published in virtually every national newspaper from the *Financial Times* to the *Daily Mirror*.

Rod Liddle, writing in the *Spectator* (2007), has referred to “our most eminent transport journalist, Christian Wolmar” while Simon Hoggart, in *the Guardian* (2008) has described him as “the greatest expert on British trains.” He is a member of the board of Cycling England and a trustee of the Railway Children.

The rail industry is fragmented, heavily subsidised and confused – the result of the unsatisfactory nature of the structure that was never explicitly designed and arises from a confused set of policies from successive governments, laid one upon another. *Co-operative rail: a radical approach* makes suggestion for how the co-operative model could help rectify this problem.

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