

6 Views of Cowie Group plc

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Introduction

6.1. This chapter presents a summary of some of the views of Cowie on the merger and its implications, as expressed in its written submissions and in hearings.

Background

History of Cowie

6.2. Cowie described the development of the company from before the Second World War when it began as a retailer and repairer of second-hand motor cycles. After the war it entered into car dealing and later developed vehicle leasing and finance. In 1964 the company was floated on the London Stock Exchange.

Organization and structure of Cowie

6.3. Cowie's current group structure consisted of four divisions: motor retailing, motor car lease finance, bus distribution and bus operations. Each division operated through wholly-owned subsidiary companies and Cowie told us that trading between the divisions was on a strictly commercial basis. It had a philosophy of encouraging competition between subsidiaries within the group, rather than taking a corporate view as to which subsidiary might be the most suitable to pursue particular business opportunities. The co-ordination of the operations of the Cowie Group was conducted by the Board of Directors, which was responsible for the quality of services to the group's customers. The group saw its profits as resulting from a policy of increasing sales volumes rather than from increasing prices. It was prepared to develop further both organically and by acquisition.

Cowie's previous involvement in the bus industry

6.4. Cowie explained that its entry into the bus industry had begun in London with the purchase of Grey Green in 1980 and the first invitations from LT to tender for bus routes in London in 1985. Although it had been a coach operator Grey Green had been one of the first companies to be awarded contracts to operate scheduled bus services under contract to LTB. In 1994, on the privatization of LBL's subsidiaries, Cowie's tender for Leaside was accepted and in November of the same year it was approached as the preferred purchaser of SLT, the last of the LBL subsidiaries to be sold, which it acquired in January 1995.

6.5. Outside London, Cowie had acquired, in February 1996, County Bus, which had operated both tendered services for LTB and commercial and tendered services in Hertfordshire, Essex and London. Immediately prior to the acquisition of British Bus, Cowie had been offered the opportunity to purchase Drymona Ltd, the holding company of North East Bus, which had operated commercial services primarily in Cleveland, south-west Durham and on the North Yorkshire coast.

Steps leading to the acquisition of British Bus

Cowie's views on British Bus

6.6. Cowie said that it had been known for some time in the bus industry that the owners of British Bus had been looking for a purchaser. Cowie had considered that such an acquisition would have given it an opportunity to compete in the bus industry on a national, regional and local scale.

Initial invitation to purchase

6.7. Consequently, it had been interested in acquiring British Bus when an initial approach had been made to it in early 1996. However, it had been unable to pursue the opportunity to purchase British Bus at that time as it had been preoccupied with another potential acquisition in a different sector (see paragraph 3.63).

The purchase

6.8. When a second opportunity to purchase British Bus occurred later in 1996 Cowie had been free to follow up its interest. Heads of Agreement were reached in May, a revised offer from Cowie was accepted in early June, negotiations were completed in mid-June and the acquisition came into force on 1 August 1996.

Dealings with the OFT over the purchase

6.9. Cowie described its pre-merger discussions with the OFT on the proposed acquisition of British Bus. These had begun in mid-May 1996 and during further discussions in June the OFT had expressed competition concerns arising from Cowie's ownership of SLT. In July 1996 the OFT had raised further enquiries in relation to the acquisition and asked Cowie to consider the possibility of various divestments in south London in lieu of a reference. Cowie had been unwilling to consider divesting SLT as it was not convinced that the acquisition had raised competition problems. Furthermore, at the time of its discussions with the OFT, Cowie had not had the opportunity to discuss fully, with the company's management, British Bus's operations in south London. Cowie had not been prepared to take a decision quickly on divestment under what it regarded as duress. On the contrary, Cowie concluded that competition in the regulated London market was extremely tough, based as it was on competition for individual routes as LRT offered them for tender on a five-year basis.

Cowie's views on British Bus after acquisition

Benefits of the acquisition

6.10. Cowie regarded its acquisition of British Bus as providing a number of benefits to the travelling public:

- the acquisition had resulted in the creation of an effective, national competitor to the two existing market leaders, FirstBus and Stagecoach, as had been pointed out by the OFT;
- the independent survival of British Bus as an effective, well-resourced competitor had not been an option;
- the acquisition had ensured the survival of British Bus's operations to the benefit of the bus travelling public, which could otherwise have lost access to a comprehensive bus network;
- Cowie's high maintenance standards, exemplified by Cowie's Grey Green and Leaside subsidiaries, would be extended to British Bus;
- both Cowie and British Bus were involved in innovative improvements to buses, such as emission control, catalytic converters, electronic passenger information systems and the introduction of 'kneeling buses';
- Cowie considered that it had a group reputation for acquiring businesses and investing in acquisitions to provide a good-quality service to the public;
- British Bus had a philosophy of investing in its employees, undertaking marketing initiatives and forging quality partnerships throughout the UK, particularly with local authorities;
- the merged group would benefit from the combination of Cowie's purchasing power with the number of vehicles in the British Bus fleet; and
- Cowie had not been aware of any accusations of anti-competitive behaviour being made against it.

Capital investment

6.11. Cowie explained that its bus operations competed for capital with its other divisions. Like all operating companies in the group, bus subsidiaries applied for capital to the group Board, which required bus operations to fulfil the group's performance objectives. Cowie explained that its British Bus subsidiary had a restricted capital spending programme, which had been imposed by the previous owners of British Bus, but it was Cowie's intention to restore capital spending in that operation and it had already commenced a significant investment programme.

6.12. Its capital spending plan for new vehicles for the bus division had been evolving month by month and by the time of the inquiry planned expenditure had totalled approximately £40 million. However, Cowie thought that through its continual review of capital expenditure it would expect that that total might increase to £50 million by the end of 1997. Orders had been placed for new buses to be delivered during the first six months of 1997. Cowie compared its capital expenditure plan with that of British Bus, before the merger, which had been reduced from an original level of £35 million to £17 million a year for 1997 and subsequent years.

6.13. Cowie believed that, following the acquisition of British Bus, the bus division would be able to make savings by removing certain duplicate overhead costs and by provisioning supplies, such as vehicle spare parts, more cost-effectively. In the coming year the group would go out to tender formally for its vehicles like other major bus groups, which would better enable it to pursue its rolling programme of reducing the age of its buses and putting a variety of vehicles with different functional designs into appropriate services.

Organization of tendering between different subsidiaries

6.14. Cowie made the point that since the merger, which was completed at the beginning of August 1996, British Bus and Cowie subsidiaries had not known whether they were competing with each other for the same tenders. The group's bus division was still operating as if it were two separate organizations and had not yet decided how tenders would be submitted in future, although it thought that, in the long term, improved profits might best be assured if there was some kind of competition for tenders between subsidiaries within the bus division. Cowie explained that before acquiring British Bus, individual operating companies of the two pre-merged groups had competed with each other for tenders, on occasion.

Competitive implications of the acquisition

The regulated market in London

6.15. The regulated London market was controlled by Act of Parliament, with LT as the regulatory authority. So far as its bus activities were concerned in London, Cowie explained that its profit margins depended on tendering prices that were calculated to give a reasonable return. It supported LTB's move to tendered net cost contracts, which it regarded as putting the incentive on the operator to become more competitive than did gross cost contracts. Under net cost contracts, benefits to the operator came solely from the improvements in service, which drew customers away from other modes of transport.

Trends in the number of tenderers

6.16. Cowie explained that at its pre-acquisition discussions with the OFT, the latter had indicated concerns regarding the number of actual and potential tenderers in the London market. In particular, in the south of London, the OFT had expressed concerns that in the SLT core operating area there were fewer tenderers than for London generally. Cowie estimated that in certain areas of London (particularly in the north-east of London) there were up to seven or eight tenderers per tendered route. However, it understood that there were perhaps four or five tenderers per route in the SLT core operating area, although it thought details of the number of tenderers were not made public by LTB. Therefore, the OFT had expressed a concern that the removal of British Bus as a tenderer would reduce actual competition in that area. Cowie emphasized the secrecy of the bidding process in which any one bidder was unaware of how many other bidders might be competing: an incumbent operator had to assume that there would be at least one other bidder. Cowie put it to us that competition in the London market was fierce with tenders being renewed on a continuous basis. About half of the company's routes were due for tender by the end of 1998. The market was heavily contested and the merger would still leave a large number of tenderers for each route and would not create any market dominance. Cowie pointed out that adjacent to SLT's core operating area there were other major operators: London General and London Central (Go-Ahead) and Selkent (Stagecoach). Furthermore, as previously mentioned, CentreWest had an operating depot adjacent to the area, as did Metrobus, a substantial, privately-owned operator. Cowie viewed those companies as giving rise to realistic and powerful competition, which, together with other smaller operators, provided a suitable range of competition for Cowie in south London.

6.17. Cowie took the view that at least one reason why the number of bids per tender had been reducing was because the number of invitations to tender issued by LTB had increased. Cowie suggested that, as more potential business arose, tenderers could be more selective than when there was little business for them to pursue. Cowie also pointed out that many incumbent operators had increased responsibilities in having to re-tender for the routes which they operated; with approximately 20 per cent of the network tendered each year there was an increased management and administrative workload on incumbent operators.

6.18. Cowie believed tendered prices had dropped on a consistent basis since 1985, although it was unable to comment on the prices tendered by other operators. It said that its own tendered prices had reduced over the last two years and submitted details of all tenders it had submitted since 1995. To illustrate its point, Cowie had used two examples from its own operations:

- (a) Route 313, operated by Grey Green at a cost to LTB of £478,000 a year. This route was subsequently won by Cowie Leaside at a cost to LTB of £320,000 a year, showing a reduction of 110p per mile in unit cost.
- (b) Route 108, operated by Kentish Bus. Despite submitting a tender £75,000 a year lower than its previous contract, Kentish Bus was not even short-listed. Cowie maintained that both Cowie and British Bus had had to re-tender, as incumbents, at much reduced prices for routes which they did not always retain.

6.19. Cowie estimated that the merged group had between 24 and 25 per cent of the tendered market in London, a figure based on scheduled mileage produced and published by LTB. It said that this was the only published information available giving an indication of market shares. However, Cowie took the view that as routes were being re-tendered on a continuous basis in London, market share was constantly changing. For example, it estimated that even since the completion of the acquisition in the summer of 1996, British Bus and Cowie had lost tendered routes amounting to approximately 1.2 per cent of the London market. Cowie emphasized its view that the London market was heavily contested through LTB's tender procedure and that the merger would not create any market dominance whatsoever within it.

6.20. Furthermore, Cowie pointed to the fact that in south London further new competition would arise from the proposed Croydon Tramlink. This was a new form of public transport operating entirely within the former GLC area and would provide an alternative mode of transport for the travelling public and, therefore, effective competition to bus operators. On routes which would be affected by Tramlink, LTB was offering contracts of only three years' duration. Cowie predicted that this would inject uncertainty into the south London market in the short term, exacerbated by the unquantifiable effects of the construction work. Cowie considered that the combination of these two events would discourage operators from tendering in the short term in the area. However, when the project was complete, and the market restabilized, it anticipated that further tenderers would emerge. It pointed out that Tramlink would be part of LTB's complementary, regulated public transport responsibilities.

6.21. To illustrate its willingness, and that of other operators, to compete, Cowie explained that it had tendered, unsuccessfully, for the whole of the Orpington network, all of which had been run by Stagecoach. Furthermore, it had tenders lodged with LTB for routes in Kingston upon Thames and Sutton, which were currently operated by Go-Ahead. Cowie also explained what it described as LTB's recent change of practice, namely to engage in post-tender negotiations on various aspects of the specified service, including price.

6.22. It thought an artificial limit had been placed on the London bus market by the guidance issued, at privatization, by the Secretary of State for Transport, whereby any one operator in London should have no more than 25 per cent of registered mileage. Cowie's view was that individual routes were the basis of operations and totals of registered mileage were not important. It described bus operators as competing for the market, through the competitive tendering process, and not in the market, as they would with 'on road' competition in unregulated areas. It was suggested that, if misapplied, the 25 per cent rule could operate in an anti-competitive manner, particularly when a fifth of routes would come up for re-tendering each year on a contestable, rolling five-year programme. In principle, any company should have the opportunity of tendering for 100 per cent of the market and the result of winning competitive tenders for routes should not be a concern where fares and operations were subject to close control by LTB. Therefore, Cowie considered that such an outcome in a dynamic market situation would not necessarily be against the public interest.

6.23. Cowie considered that the system of pre-qualification of tenderers within LTB's contract procedure assisted small-scale bus operators to enter the London market. It cited Crystals, Harris Bus and Limebourne as recent examples of such companies winning new work through net cost tenders. The tendering procedure ensured that all tenderers, irrespective of size, received the same information upon which to base their bids.

Contestability in London

6.24. Cowie took the view that competition in the London market was fierce. Contracts were tendered usually for five years, a period which gave certainty of operation and, therefore, encouraged tenderers. Such certainty of operation facilitated market entry as operators could accurately predict budget plans over a defined period of time.

6.25. Cowie submitted that barriers to entry in London were not high. There were 32 pre-qualified bus operators, including the ten former LBL subsidiaries, in London. Such numbers ensured that there was a range of operators, including some large, well-resourced ones, to ensure effective competition. Furthermore, as the average lead time from tender award to the start of the contract in London was nine months, operators had sufficient time to bid for tenders and then acquire the necessary vehicles/infrastructure to operate a route. Thus CentreWest had, in September 1995, tendered for and won routes in Orpington, an area in which Selkent (Stagecoach) had been the incumbent contracted service provider. At the time it had tendered, CentreWest did not have a depot, or operations, in that area. The nine-month lead time had allowed it to create the necessary infrastructure to operate the routes it had won.

6.26. Nevertheless, although barriers to entry in the London market were low, Cowie pointed out that the diverse nature of the market and the tender requirements were such that on many routes it was necessary to have a large, well-resourced operator. Cowie considered fleet size as important from two aspects. First, it considered that 90 per cent of routes in London required a PVR which was sufficiently low as not to be a deterrent to small-scale operators. Cowie thought a small operator would be able to enter the London market on a number of routes, in particular those with a PVR of fewer than 25 buses. It noted that there were many routes coming up for tender in the next two years with PVRs of under 15 buses. Secondly, Cowie acknowledged that large, well-resourced companies were more likely to be able to support routes which required a high PVR. For example, Leaside operated route 253, which was the biggest route in London. This route required 55 buses and 130 drivers. At peak times the buses ran every two minutes. Cowie took the view that it was necessary for a number of operators in London to have the purchasing power and economies of scale to run significant and demanding routes such as the 253. By contrast, many other routes could be run with a smaller infrastructure. An example was route 346, which, like route 253, was a tendered LTB contract, but required only two buses and four drivers.

6.27. On the question of whether ownership, or occupancy, of a depot conferred a significant advantage on an incumbent operator, Cowie thought suitable depot sites were not difficult to find in London. It illustrated its view by citing an informal survey it had commissioned of possible bus depot sites along the A23 corridor. This had yielded 17 possibilities. A similar survey had identified seven sites within a mile and a half of British Bus's Walworth depot. Furthermore, Cowie described a number of depots leased from LTB which it submitted were potentially available to contesting operators. Bus operations could be run from relatively rudimentary premises, provided there was a flat, hard-standing, area, or even by sub-leasing depot space from a competitor, since depots did not need full maintenance facilities. British Bus had, in the past, volunteered to make such space available when it had had spare capacity. The terms of sale of LT depots included a ten-year clawback of proceeds on any disposal. This arrangement meant that a proportion, declining over the ten years, of any profits made from a subsequent sale by the purchaser would revert to LT.

6.28. Cowie explained that in London it would regard a distance of four miles from its depot to the start of a route as reasonable 'dead mileage', although in certain circumstances one mile might be the limit. Outside London the distance could be up to 12 miles. Average traffic speed and the predictability of traffic flow, particularly in some areas of London, were as important factors for consideration as mileage alone. However, Cowie cited Grey Green and County Bus as examples of its own subsidiaries which had won contracts outside their original core operating areas before establishing local depots in their new operating areas. CentreWest had behaved similarly when it had won work in Orpington.

6.29. So far as consolidation of bus company ownership was concerned, Cowie's view was that LT had expected the ownership of bus companies to become more concentrated after privatization. However, Cowie thought all bus operators in London were still feeling their way after both privatization and the introduction of tendered net cost contracts.

'Cross-border' routes

6.30. Cowie recounted that in 1994 LT had issued a Sales Memorandum for the privatization of the LBL subsidiaries. This document had expressed an expectation that, post-privatization, the LBL subsidiaries would operate cross-border routes (that is, across the border of the former GLC area) into the Home Counties. Cowie's view was that for an operator to be able to operate cross-border routes successfully it was necessary for it to participate in the off-bus revenue within the regulated London area afforded by operating section 3(2) services, approved by LTB (see paragraphs 3.35 to 3.38). However, Cowie believed there was little, or no, scope to operate viable, new section 3(2) routes, which had become unattractive, due to increased administration as evidenced by some operators surrendering section 3(2) licences to LTB. The only route SLT had operated cross-border prior to privatization, and, therefore, before Cowie's ownership, had been a non-commercial route tendered jointly by LTB and Surrey County Council, from Croydon into Tandridge District. That route had originally been operated by London & Country, which subsequently won back its operation.

6.31. It was Cowie's view that since privatization there had been little commercial cross-border work from inside London to the surrounding counties because such opportunities as there were had been identified in the past; the mere fact of privatization had not produced additional opportunities. Similarly, within the London urban area the scope for new commercial routes was extremely limited and Cowie considered the economic viability of non-section 3(2) commercial routes as doubtful, except in particular circumstances such as tourist routes in central London.

Unregulated markets

6.32. Cowie described the unregulated market as highly variable. The different areas making up the market had their own geographical and demographic characteristics, giving rise to a wide range of operating practices between its different bus subsidiaries.

Northern Home Counties

6.33. At its pre-merger discussions with the OFT, the OFT had expressed concern that the acquisition would create an area of overlap in Stevenage between Cowie's County Bus and British Bus's Shires operations. Cowie's view was that the area of overlap was insignificant as it took place on two services over a short distance and on infrequent routes. Between the main operating areas of The Shires and County Bus (directly to the south of Stevenage) there was the strong market presence of Sovereign (Blazefield), with a fleet of approximately 115 buses. Cowie acknowledged a further slight overlap in Hertfordshire on route 724.

Southern Home Counties

6.34. Cowie explained that there were no areas of overlap between the operations of Cowie and British Bus in the southern Home Counties. Cowie had never operated in the southern Home Counties and prior to the acquisition had had no intention of operating commercial services from SLT into the Home Counties, as it saw no demand for such services (see paragraphs 6.30 and 6.31).

6.35. If there was a likelihood of cross-border routes developing, there would be enough competitors in south London to compete for such work, namely Stagecoach, Go-Ahead, Metrobus and CentreWest. Cowie also considered that there were sufficient numbers of competitors within the Home Counties. Indeed, Cowie submitted that, even before the privatization of the LBL subsidiaries, private operators did satisfy such demand for cross-border services as they had identified.

North-east England

6.36. Cowie also referred to the OFT's concerns about overlap between the operating subsidiaries of Northumbria (British Bus), United Automobile Services (North East Bus) and certain areas of operation of Yorkshire Bus (British Bus). It held the view that there were no areas of overlap between North East Bus and Yorkshire Bus.

6.37. However, Cowie did acknowledge areas of overlap between Northumbria and United Automobile Services in the city centre of Newcastle. It explained that United Automobile Services primarily operated in Teesside, Darlington and the south and west of County Durham, although the company ran routes north and east into Sunderland and Newcastle, while Northumbria primarily operated to the north of Newcastle and in Northumberland (in particular south-west Northumberland). Furthermore, Northumbria also ran routes into Newcastle.

6.38. Cowie considered that overlap of services between these companies was only on the final leg of the journeys to the termini in the city centre of Newcastle. For North East Bus, the terminus was at the Eldon Square bus station in Newcastle and, for Northumbria, the main terminus was a short distance away at the Haymarket bus station, both in the city centre of Newcastle.

National market

6.39. Prior to exchange of contracts for its purchase of British Bus, Cowie had had no bus operations in the metropolitan markets outside London. Cowie submitted that the merger with British Bus had had no adverse impact on competition in the national market. Indeed, the impact had been positive in that the merged group created an effective third competitor to FirstBus and Stagecoach.

Cowie's plans for the future

6.40. Cowie's strategy was to provide its customers with value in terms of price and quality. So far as the bus division was concerned it regarded the whole of Great Britain as its potential bus market and the merger gave this credibility. The division looked for suitable business opportunities in various parts of both the regulated and unregulated markets, to grow both organically and by acquisition. Cowie told us that the group was not averse to the further acquisition of bus operations, if opportunities arose. It was keen to refute any suggestion that the group was moving into a monopoly situation in any individual bus market. Furthermore, Cowie stressed that it had assessed the strengths and weaknesses of its own operations and those of its competitors and the management skills and resources available to it to compete. Cowie said that it was prepared to compete with companies of any size, and in any market, if it considered that that action would offer the best potential result for its operations. Furthermore, it was part of Cowie's philosophy to encourage autonomy within the group, which for the bus subsidiaries would include freedom to decide when and where to submit bids which might therefore compete with other Cowie subsidiaries. Cowie also foresaw that as efficiencies on existing routes were fully exploited and cost reductions became fewer, operators would be more interested in expanding from their existing bases of operations and competing for tenders throughout London. For example, CentreWest had successfully expanded in Selkent's core operating area even though that area was geographically separate from its main west London base.

6.41. Cowie believed the successful bus company recognized the special characteristics of each different market and provided services at competitive prices to attract customers away from trains and cars. Buses had a long-term potential since there was a strong possibility of future restrictions on the use of private cars in both London and other parts of the country, to the benefit of public transport. It saw considerable potential for increasing passenger usage on its existing routes in London, thus increasing profitability, and a number of promising initiatives had been taken to grow the market on individual routes—for example, route 38 in London.

6.42. Cowie held the view that in time changes were likely in both the regulated and unregulated markets, which might result in a convergence of regimes. The introduction of tendered net cost contracts was one such important change, which had already taken place in London. Cowie regretted that bus operators were not given as much freedom as they would like in the regulated market, particularly when compared with their freedom to operate in the unregulated market.

6.43. Cowie described how the bus division had been involved in innovative improvements to buses, such as emission control, catalytic converters, electronic passenger information systems and the introduction of 'kneeling buses'. Such innovations had been in addition to the high maintenance standards which Cowie attributed to its Grey Green and Leaside subsidiaries. Cowie had seen the continuing promotion of such innovations as an important element in increasing the number of bus users in future.

Remedies

6.44. Cowie explained that it had never received any allegations, or complaints, of anti-competitive behaviour. If it had not acted as a 'white knight' in acquiring British Bus, it would have been highly unlikely that British Bus would have been in a position to compete with Cowie's SLT in south London. Cowie considered that its acquisition of British Bus had given no cause for a public interest concern and, therefore, it had seen no case for remedies. Cowie had not agreed to the divestments proposed by the OFT in mid-1996 and had not changed its view since then. It had been particularly against a divestment of SLT because of the considerable investment in and improvements it had introduced into its operations, which had been in danger of being closed down by the Traffic Commissioner at the time of acquisition, on grounds of safety.

6.45. As a high proportion of routes for which SLT had been the incumbent operator would be re-tendered during the next two years, with a serious risk that some, or all, could be lost, Cowie's view was that it would be unnecessary to take any action against SLT but rather let the tendered market take its course.

6.46. Furthermore, Cowie explained that the management of SLT, Leaside, County Bus and Grey Green had been rationalized prior to the acquisition of British Bus, and prior to the sale British Bus had similarly rationalized the management functions of M&D, Londonlinks and Kentish Bus together with some overhead service functions, to such an extent that a purchaser of any of those companies would have been faced with the task of re-establishing the majority of the management structure.

D G GOYDER (*Chairman*)

J EVANS

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P A BOYS (*Secretary*)

20 February 1997