

## CHAPTER 10

### Conclusions

10.1. Our terms of reference require us to report whether Caledonian MacBrayne Ltd (CalMac) could in providing shipping services, without significantly affecting the quality of service, improve its efficiency and thereby reduce its costs. We have to consider this question with particular reference to the effect which discounts offered by the company have on its net revenue; the scope for reducing its fleet; and its efficiency in adjusting services to match demand, and whether greater efficiency in this matter would increase net revenue.

10.2. We are also required to report on the adequacy of the company's arrangements for obtaining and taking into account the views of those representative of customers; and whether it is abusing any monopoly situation, with particular reference to the tariffs charged and facilities provided on routes on which it is experiencing or has in the last ten years experienced competition, and any failure by it to observe clause 10 of its Undertaking of 15 August 1975 to the Secretary of State for Scotland that, in respect of its approved services, it shall not conduct any transaction (whether or not with the group or with any of its other subsidiaries) otherwise than on arms-length terms.

10.3. Finally, we have to report whether, in relation to any matters falling within the terms of reference, the company is pursuing a course of conduct which operates against the public interest.

10.4. CalMac is a company of modest size; its employees numbered only 780 at July 1982. Nevertheless, it is not an easy enterprise to manage well. It operates a mix of short and relatively long routes over a wide area stretching from the Clyde to Stornoway and in the process serves 50 terminals where the facilities vary from a simple jetty or boat landing to a pier and linkspan capable of servicing a major vehicle ferry within a wide range of tidal flows. The sea conditions include relatively sheltered estuarial waters and some of the roughest open sea to be found around the British coast, while levels of traffic range from a few thousand summer passengers on Tobermory to Mingary to half a million passengers and 200,000 cars and commercial vehicles annually on the Kyle to Kyleakin service. Inevitably, therefore, CalMac's fleet of 32 vessels is diverse, varying in size from a motor launch to a 120-car ferry dedicated to its most exposed route from Ullapool to Stornoway. It follows from the wide spread of its activities that many of CalMac's staff are employed in small units, often in remote locations; control and supervision is difficult and a high level of labour utilisation in many cases not likely to be attainable. The position is alleviated to some extent by sharing staff with MacBrayne Haulage at some locations.

10.5. We believe it is a tribute to CalMac's management and staff that despite the difficulties the company sustains a high quality of service. It is clear from Appendix 1.4 that population on the islands has generally stabilised

in recent years and we do not doubt that CalMac has made a valuable contribution to this achievement. Our identification of areas where we believe the company's performance could be improved should be seen against this background.

10.6. We discuss our main concerns in paragraph 10.7 to 10.49 dealing first with the particular questions in the terms of reference and then going on to certain issues arising from our general study of CalMac's efficiency and costs. We summarise our detailed conclusions and recommendations in paragraph 10.50, and identify our priorities for action by the company in paragraph 10.51. We conclude with our findings on the monopoly situation and the public interest.

### **The particular questions**

#### *(i)(a) Effect of discounts on net revenue*

10.7. In general we found that neither the discount structure for commercial vehicles on individual routes nor the network discount available to two operators is substantially related to any cost savings. With the possible exception of a company which distributes perishable food products and told us that it was doubtful whether it would be in a position to continue this service on the same basis if the full rates were charged, we have not seen any evidence that these discounts have significantly increased traffic. We accordingly conclude that the effect on net revenue has been adverse. We also believe that the discounts are anti-competitive in that they unduly favour the larger haulage firms. We have recommended that CalMac's commercial vehicle discount structure should generally be discontinued and replaced by a system of discounts reasonably closely related to costs, that the new structure should be published and that the company should be accountable for it to the Secretary of State. CalMac will then be able to decide the extent to which revenue should be enhanced or tariffs reduced. We deal separately with discounts on the Gourrock to Dunoon route in paragraph 10.35 and with the question of discounts paid to MacBrayne Haulage in paragraph 10.40.

10.8. We have discussed the matter of fare reductions in Chapter 6 and explained that we regarded the reductions for passenger and car traffic in the form of multi-journey tickets and promotional fares such as Island Hopscotch and Earlybird Saver as discounted fares, but treated off-peak fares as an integral part of the fare structure, although the latter did have an effect on CalMac's net revenue.

10.9. We found that the discounts available on multi-journey tickets were in general unlikely to improve CalMac's net revenue. We have recommended that the company should make available to the Secretary of State and the SSACs information on costs and revenues which will enable the effects of these discounts to be evaluated.

10.10. On the subject of promotional fares, the existence of significant excess capacity on most routes for most sailings implies that these fares, if they generate sufficient extra traffic, will increase net revenue since little in the way of short-run cost will be incurred. We note that the implications

of such a fares policy are important for long-run costs, particularly those appropriate to the assessment of future capacity. Moreover, on routes where demand is high relative to capacity for particular sailings some of CalMac's promotional fares are generating peak traffic at a discount, for example, a relief sailing is needed to Arran on winter Friday nights. We have recommended that the company should attempt to divert peak demand by introducing peak passenger and car fares for summer weekends and, where appropriate, for peak sailings. We have also recommended that CalMac should not exacerbate these peaks through promotional discounts.

*(i)(b) Scope for reducing the fleet*

10.11. We studied the scope for reducing CalMac's fleet broadly in two parts, major vehicle ferries which in general serve the longer sea crossings and small vehicle ferries which usually serve the shorter crossings.

10.12. We found that there is a good case for considering as a matter of urgency the withdrawal of one or other of the two major vehicle ferries providing the Gourock/Dunoon/Kilcreggan services. It would be prudent as a first step to place the vessel in fleet reserve without crew. We estimate that this would produce a net revenue saving of at least £200,000 a year.

10.13. We noted that the level of utilisation of certain other major vehicle ferries in service was on the low side. We have recommended that CalMac should review the position when it has completed its current MAP studies (see paragraph 10.16) but for the present we see no further scope for reducing the number of major vessels.

10.14. We found a very low level of utilisation in respect of certain of the small vehicle ferries and have recommended that CalMac should dispose of two of them which will reduce costs by at least £50,000 a year.

*(i)(c) Efficiency in adjusting services to match demand*

10.15. CalMac and its predecessor companies have provided shipping services to the Highlands and Islands on the west coast of Scotland for many years. Arrangements for support from public funds are now primarily made under the Highlands and Islands Shipping Services Act 1960. Under this Act, the Secretary of State may undertake to provide funds 'for the purposes of maintaining and improving sea transport services serving the Highlands and Islands'. The latest Undertaking of 15 August 1975 provides for support of approved services 'which in the opinion of the Secretary of State are necessary to maintain or improve economic or social conditions'. It is natural that an arrangement of this kind should influence CalMac's own attitude to the provision of services. We noted a strong inclination on the company's part to provide services in the spirit of the Undertaking. We recognise that the problems related to remoteness and low density of population are not unique to the Islands but they tend to be exacerbated by the sea crossing—in some cases a lengthy sea crossing.

10.16. However, there is an extremely wide range of operating ratios<sup>1</sup> on CalMac's services and our fear is that the existence of the Undertaking, which in effect provides for the deficit financing of nearly all the company's routes, has reduced the incentive to minimise its costs and improve revenue by more efficient adjustment of services to match demand. The fact that there is not provision for increasing the grant if the budgeted deficit is exceeded is some constraint on CalMac's costs, and there is a limited incentive to improve performance in that if the company reduces the estimated deficit on which revenue grant has been paid it is allowed to retain the saving. Nevertheless, our impression is that the Undertaking has inhibited the company's approach to major route reviews. The Undertaking does not provide much incentive for systematic market analysis and, until the recent MAP studies, it has largely been lacking. We therefore welcome STG's strong commitment to the early completion and follow-up of MAP, and to assist this process we have recommended that CalMac's staff resources available for MAP should be augmented.

10.17. We are not required to assess the level of need for CalMac's services but we consider that, given the high level of subsidy of CalMac's operations, care should be taken to distinguish so far as possible the needs of users from their desires. To this end, the company should make a greater effort to identify more precisely who is being assisted by its fares policy and the justification for such assistance. Again, MAP should assist in this evaluation.

10.18. We noted the role of the STUCC in providing a forum for the expression of public opinion on the reduction or withdrawal of services. Such opinion will be quite properly reflected in the Committee's recommendations but will tend to be against change and therefore not conducive to the efficient matching of supply and demand. As a counter balance, the Secretary of State is the final arbiter and can take the wider issues of efficiency and value for money into account in his decisions. We would therefore urge CalMac not to be inhibited by the STUCC procedure. We note that following the STUCC inquiry the Mingary service was reduced to summer only. Nevertheless, as revenue was only 8 per cent of route operating costs there is a case for looking at this service again even before the vessel needs to be replaced.

10.19. We also note that revenue was only about a third of the route operating costs of the Millport service. If it were to be withdrawn the quality of service might not be significantly affected in view of the availability of the Largs to Cumbrae service.

10.20. There is a case for critically examining at regular intervals any service with an unsatisfactory operating ratio. There may, for example, be other ways of meeting demand on the route.

10.21. It is also important for CalMac to identify peak costs, given the low average and peak use of passenger capacity we illustrated in Chapter 4. If summer passenger certificates were reduced on some ships, there would be the possibility of a modest saving in crew costs. We noted in Chapter

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<sup>1</sup> The percentage of route operating costs covered by revenue.

3 that the company had made some progress in reducing crew levels, and that the reductions on the Gourcock to Dunoon and Rothesay services had been significant. We have recommended that it should continue with its efforts to reduce manning levels consistently with safety.

10.22. CalMac's investment decisions are another important aspect of the long-term efficient matching of supply and demand. We identified in Chapter 5 a number of weaknesses in the company's approach to investment, with particular reference to the purchase of a new vessel for the Arran service. We noted particularly that CalMac did not include any sensitivity analysis in the Arran study nor were competing options thoroughly tested. Furthermore, there was inadequate consideration of options for dealing with peak traffic.

10.23. We have made a number of recommendations aimed at improving CalMac's investment performance.

10.24. On the matter of standardisation of ships and terminals, we noted that CalMac had already achieved a substantial degree of standardisation of small vehicle ferries. The position is more complex in the case of major vehicle ferries and we recognise that some continuing diversity is inevitable in CalMac's environment. However, given the operational advantage of being able to switch vessels flexibly between routes (see summary of deployment of vessels in Appendix 1.6), it is important that CalMac should have a coherent long-term plan for optimum standardisation, formulated in consultation with local authorities and other owners of terminals. We have recommended accordingly.

10.25. Our terms of reference ask whether greater efficiency in adjusting services to match demand would increase CalMac's net revenue. It follows from what we have said in paragraphs 10.10 and 10.15 to 10.24 that we believe that the company could improve its efficiency in this area and that it would thereby increase its net revenue by taking the opportunities open to it to reduce costs and/or increase revenue.

*(ii) Adequacy of arrangements for obtaining and taking into account the views of those representative of customers*

10.26. The main role of the STUCC is to consider proposals to reduce or withdraw service while the three SSACs set up by CalMac have the more positive function of considering and discussing matters affecting the operation and performance of CalMac's services. Evidence to the Commission has generally acknowledged that there has been a significant improvement in the company's relations with its customers since the formation of the SSACs. We ourselves believe that the Committees have made a promising start. Their role needs to be developed and the spread of representation on the Committees improved. To this end we have recommended that they should be provided with detailed individual route costings so that their discussion of changes in services, which may or may not be on their initiative, may be better informed. For the same reason, we have recommended that the results of the MAP studies should be made available to the Committees when ready. We

noted in paragraph 10.9 our recommendation that they should also be given detailed information about the effects of multi-journey tickets on net revenue. Such material would enable the SSACs to be more involved in the appraisal of options for future action.

10.27. We considered the possibility of making the route costings available to the public at large, for example, by STG publishing them in its annual report. We found that the arguments for and against publication were evenly balanced and decided to confine ourselves to the recommendation in paragraph 10.26.

10.28. We have also recommended that the Committees should admit to their membership representatives of the Freight Transport and Road Haulage Associations. We have noted some disquiet both within and outside the SSACs about CalMac's providing the Chairman and secretariat of the Committees. We believe that there are sound practical reasons for the company's retention of its secretarial role but we have recommended that the Committees themselves should each elect their Chairman who may or may not be from CalMac. We have also recommended that each Committee should publish an annual report on its work which it should make widely available.

*(iii)(a) Abuse of any monopoly situation with reference to tariffs and facilities on routes subject to competition in the last ten years*

10.29. Two of CalMac's routes have been subject to competition in the last ten years—that to Islay and the route from Gourock to Dunoon. In both cases the competition came from Western Ferries.

10.30. We conclude in Chapter 7 that CalMac's decision to resume its service to Islay in April 1973 was crucial to Western Ferries' survival on the route. Its decision, based as it was on the presumption that it could operate without subsidy on the route, was questionable, even given the higher load of commercial traffic at that time. CalMac's revenue as a percentage of operating costs on this route has ranged from 38 per cent in 1978 to 65 per cent in 1981. It is probable that during the whole period of competition one ship of the size of CalMac's *Iona* could have carried all the available traffic. It is scarcely surprising that Western Ferries eventually had to give way to a subsidised competitor. We recognise that the STUCC had reservations about the adequacy of the service to be provided by Western Ferries as sole operator which the Secretary of State ultimately was unable to resolve, but we cannot fail to note that the less cost-effective of the competitors survived on the route, to the detriment of public funds. Although the operating ratios achieved by CalMac on the Islay route have been quite unsatisfactory, we did not find any present abuse of its monopoly position on this route.

10.31. The position on Gourock to Dunoon is more complex. Although the route is presently over-resourced, given the fact that the level of traffic justifies more than one vessel on the grounds of frequency and economy there is a case for having two operators. Certainly the Dunoon and Cowal Tourist Organisation left us in no doubt about its view that the much improved services were a direct result of Western Ferries' intervention on the route.

10.32. However, the excellent level of service on Gourock to Dunoon is presently costly to public funds and inevitably has an effect upon Western Ferries' level of profitability. The different imperatives of a commercially oriented undertaking, which must have the objective of providing shareholders with an adequate return on their investment, and a subsidised nationalised undertaking, are always likely to result in a clash of interest. It can be seen in the provision of resources on the route; Western Ferries provides a utility service in terms of passenger accommodation while CalMac provides spacious passenger accommodation, a bar and other refreshment services, which might be thought to be excessive for a 20-minute crossing. Furthermore, on the matter of fares policy CalMac is in a stronger position to experiment with promotional pricing and to withhold price increases.

10.33. CalMac's 1981-82 Christmas Shopper offer which continued until May 1982 generated a considerable amount of extra revenue and incurred no significant extra costs. Since it did not produce extra losses on the route it cannot be considered predatory although it was obviously designed to have an impact on car traffic, Western Ferries' major revenue generator.

10.34. We can understand CalMac's reluctance to single out Gourock to Dunoon for a fares increase in 1982, particularly given its cost savings on the route. For 1983, STG has told us that its preferred outcome would again be to dispense with a fares increase on its services as a whole, on the basis that its expected modest increase in costs would be met by increased subsidy. Even if this prospect is not realised, the indications are that Western Ferries' difficulties in operating profitably on the route will mount. Western Ferries indicated to us that it would not consider that it had 'any right to continue a business other than in the expectation of profit'. It follows that it is uncertain whether the present pattern of services on the route can be maintained for any length of time.

10.35. We discussed CalMac's commercial vehicle discount structure in paragraph 10.7 and noted our recommendation that it should be discontinued. We make an exception in the case of Gourock to Dunoon. Any substantial reduction in CalMac's discounts on the route could be expected to result in the loss of part of its market share. We doubt whether it is wise for the present structure of discounts on the route to continue, but accept the classical defence of discounting in this instance, that it is meeting competition.

10.36. In considering the state of competition on the one route on which CalMac is experiencing direct competition, we found no evidence of an abuse of its monopoly position. However, we recognise that the circumstances are unusual and that the position is potentially unstable for the reasons we have given in paragraph 10.34. We were unable to come to any conclusion as to how this potentially unstable situation should be resolved. We believe that any satisfactory solution is bound to require consideration of the level of subsidy and the way in which it is made available to operators; matters on which we are barred from reaching conclusions by section 11(8) of the Competition Act 1980.

*(iii) (b) Abuse of any monopoly situation with reference to observance of clause 10 of the 1975 Undertaking that the company shall not conduct any transaction otherwise than on arms-length terms*

10.37. Article 11(b) of the Undertaking is intended to provide for an annual certificate by STG's auditors that CalMac's annual accounts 'have not been materially distorted by any transactions conducted otherwise than on arms-length terms, which have not received the prior consent of the Secretary of State under Article 10'. The Secretary of State has not consented to any transactions being conducted otherwise than on arms-length terms. We also note that Article 11(b) has never been brought into operation.

10.38. In past years STG's charges on CalMac in respect of Headquarters expenses have been on an arbitrary and inconsistent basis. STG proposes that the charge should be 20 per cent in 1982 and that this will be applied consistently in future. A charge of 20 per cent seems to us to be high and we have recommended that it should be looked at again.

10.39. On the matter of CalMac's relations with MacBrayne Haulage, we have considered both the company's charges to and the facilities provided for its fellow subsidiary.

10.40. Taking charges first, we found that CalMac did not charge for MacBrayne Haulage staff when they accompanied their vehicles. In contrast, on routes where unaccompanied vehicles were allowed, CalMac charged hauliers other than MacBrayne Haulage a handling fee equivalent to the passenger fare of the driver. We also found that the overall discount of 22.5 per cent given to the company was neither cost-related nor, as CalMac was a monopoly supplier on the routes used by MacBrayne Haulage, a response to competition. We noted particularly that the effect of this on the Kyle to Kyleakin route was to provide the company with a discount of 22.5 per cent while other hauliers received a maximum discount of 10 per cent. On the Ullapool to Stornoway route, we found that CalMac did not charge MacBrayne Haulage and one other haulier for tractor units.

10.41. On the matter of extra facilities provided for MacBrayne Haulage we noted that, until we raised the matter with STG, CalMac prepared a weekly schedule of Movement of Commercial Vehicles for each Western Isles route giving the date, name of contractor, vehicle contents, length of vehicle and the freight charge, and copied it to MacBrayne Haulage, but to no other haulier.

10.42. We have concluded that the practices described in paragraphs 10.40 and 10.41 amount to significant discrimination in favour of MacBrayne Haulage. By so discriminating CalMac has failed to comply with the conditions of clause 10 of the Undertaking of 15 August 1975 and has abused its monopoly position. We return to this matter in our discussion of the monopoly situation and the public interest in paragraph 10.52.

### *Other issues*

10.43. Our fears about the effect of the Undertaking on CalMac's performance were voiced in paragraph 10.16. It may also have influenced the company's style of management which tends to be reactive rather than dynamic. Its corporate plans are static. Little pressure appears to be exerted on managers either to minimise costs or maximise revenue. The company's use of automatic data processing has been less than we should have expected with the result that it has not attained the gains in efficiency which were open to it by means of greater computerisation.

10.44. Running CalMac requires a full-time executive. We can see how the company has come to the position it is in—it has a Chairman who takes an active part in its affairs and a Deputy Chairman/Chief Executive who is part-time. We believe that CalMac would be better served if it had a full-time Chief Executive and have recommended accordingly.

10.45. We found that CalMac had in the past paid little attention to internal audit. We have recommended that the function should be expanded, and that it should also be strengthened by reporting direct to the Chief Executive.

10.46. We should expect the strengthening of internal audit to contribute to the reduction in revenue losses. However, we were disturbed to find that CalMac was unable to provide any reasoned estimate of these losses despite the indication in a 1979 survey by consultants that the company suffered significant losses by evasion and malpractices, and that it had not implemented any systematic remedial measures since the consultants' report. We are not suggesting that the detection and prevention of revenue loss is likely to be easy over the wide area of CalMac's operations but were glad to be assured by STG that it took a serious view of the matter and intended to ensure that CalMac took positive action to minimise such losses. We have recommended that the company should pursue this task with urgency and persistence. We have also made a number of recommendations aimed at improving CalMac's control over catering.

10.47. We found that the safe manning of ferries was a complex matter, and that in the case of CalMac manning arrangements were complicated by the existence of separate agreements covering the Western Isles and Clyde routes. We agree with CalMac's basic premise that the National Maritime Board agreement is appropriate for long sea passages rather than local ferry operations. We have therefore welcomed STG's opening of discussions with the trade unions aimed at reaching company agreements to cover the Western Isles and recommended that the group makes this a firm objective.

10.48. We consider that CalMac's objective of achieving a common fares structure across routes is reasonable. However, we have noted that it has much work to do in carrying out a necessary review of the data on which fares are based and that it is presently a long way from a common structure. The fares on the Kyle to Kyleakin route are particularly anomalous. We believe there might be advantage in developing the fares structure in the context of groups of routes.

10.49. There was no progress in 1982 towards achieving a common fares structure because the company did not increase fares. We have recommended that there should be a consistent application of the principles underlying the structure even when in general fares do not increase.

10.50. Our detailed conclusions and recommendations are summarised below.

### Summary of conclusions and recommendations

<i>Recommendation Number</i>		<i>Paragraph Number</i>
<b>Financial framework</b>		
1.	It has not been possible to establish that firm remedial action has been taken on variances in actual financial performance against budget. The point made to us that individual costs may have major variations but it was more important to look at the overall outcome, has some force. Nevertheless, we think efforts should also be made to examine individual variations and we conclude that insufficient pressure is exerted on managers to minimise costs. We recommend that action taken on major variances should be recorded and monitored by senior management.	2.104
2.	CalMac's use of computers has been unduly limited. There are further gains in efficiency open to the company by expanding its use of computers and we recommend that following the consultants' report there should be a whole-hearted commitment by it to achieve these gains.	2.105
3.	We recommend that CalMac should consider charging total catering expenditure to Ship Operating Costs and then reallocating to the catering account such crew time and facilities as are actually used for supplying catering facilities to the public.	
	We also recommend that in any event CalMac should:	
4.	(a) re-assess the costs of providing crew meals and other services on board ship to take into account labour costs and overheads;	
5.	(b) assess the contribution that sales to the public make to the recovery of overheads and where unsatisfactory take steps to ensure that the service provided is on an economic basis;	
6.	(c) set target rates of return for sales of food, bar sales and sales from kiosks;	
7.	(d) consider booking all supplies to vessels at retail prices, so that consumption may be reconciled with revenue, and stock and wastage control improved;	
8.	(e) review training arrangements for catering staff with particular reference to physical and financial controls.	2.106

- We found that CalMac's organisation and staffing of internal audit was inadequate. We recommend that:
9. (a) **the internal audit section should be expanded and report to the Chief Executive. It should pay particular attention to revenue losses, and the reconciliation and physical control of cash and stocks;**
10. (b) **training arrangements for internal audit staff should be reviewed;**
11. (c) **liaison with the company's auditors should be improved.** 2.107
12. **STG told us that it would ensure that CalMac took positive action to minimise revenue losses and we recommend that the company should pursue this task with urgency and persistence.** 2.108
- Article 11(b) of the Undertaking is intended to provide for an annual certificate by STG's auditors that CalMac's annual accounts 'have not been materially distorted by any transactions conducted otherwise than on arms-length terms, which have not received the prior consent of the Secretary of State under Article 10'. The Secretary of State has not consented to any transactions being conducted otherwise than on arms-length terms. We also note that Article 11(b) has not been brought into operation. 2.109
13. **STG's charges on CalMac in respect of Headquarters expenses have been on an arbitrary and inconsistent basis. Following comment by the group auditors, STG has decided that for 1982, 20 per cent of the expenses should be charged to CalMac and that this rate will be applied consistently in future. Given that CalMac's share of the revenues of the companies in the group is approximately 11.5 per cent, a charge of 20 per cent seems to be high. We welcome the proposal to make a consistent charge in future but recommend that the level of 20 per cent be looked at again.** 2.110
- Concerning CalMac's relations with MacBrayne Haulage we concluded that a number of practices relating to charges and facilities provided amounted to significant discrimination in favour of MacBrayne Haulage. CalMac by so discriminating has failed to comply with the conditions of clause 10 of the Undertaking of 15 August 1975 and has abused its monopoly position (and see paragraph 10.52). 2.111
- Given that STG's staff pension scheme provides excellent benefits and that there is a commensurately high funding rate, staff contributions of 4 per cent are low and out of line with other public sector schemes. We understand that STG has this matter under consideration. 2.112

	<i>Recommendation Number</i>		<i>Paragraph Number</i>
<b>Efficiency in use of manpower</b>	14.	<p>We have noted that in one or two cases actual crewing is above the safe manning levels requirement. We also note that if the company were to obtain reduced passenger certificates that would not of itself result in an automatic reduction in safe manning levels. <b>We nevertheless recommend that the company should continue to keep under review the passenger certificates of its vessels and the actual manning levels in order to identify opportunities for savings.</b></p>	3.36
	15.	<p>The NMB agreement is structured to meet the requirements of deep sea and foreign sailings, rather than CalMac's operations in the Western Isles. We welcome the opening of discussions with the appropriate trade unions aimed at reaching company agreements to cover the Western Isles and <b>recommend that STG makes this a firm objective</b></p>	3.37
<b>Efficiency of operations</b>		<p>CalMac's resource requirements for the year ahead are basically determined by the timetable of services to be operated. The timetable is therefore the key short-term planning document from which others, particularly cost budgets, are derived.</p>	4.80
		<p>The company operates a total of 27 vehicle ferries comprising 12 major and 15 smaller vessels. In general the major vessels cannot operate on routes normally served by the smaller vessels, <i>nor vice versa</i>.</p>	4.81
		<p>The smaller vessels, eight of which are built to the same design, are flexible in use and can, if required, be deployed on virtually any route served by small vehicle ferries. Two of the older vessels are limited to sheltered waters. All 15 require relatively simple concrete slipways to load and unload.</p>	4.82
		<p>Larger and requiring more complex terminal facilities, the 12 major ferries are less flexible in use. Because of the shore facilities available only four of the major ferry routes can be served by bow and stern door, drive-through ferries of the type now standard on continental and Irish routes. On five routes at least one of the terminals served has a conventional pier only, requiring a vessel fitted with a side loading hoist. Three vessels purpose built for the Rothesay and Dunoon services cannot be used outside the Clyde because of the lightness of their construction, designed for smooth water operation only (and see paragraph 5.42).</p>	4.83
	<p>Of two passenger ferries owned by CalMac one operates an all year service to the Small Isles and the other a summer-only service on the Clyde. The latter is used for less than four months each year.</p>	4.84	

16. All 12 major ferries were in use on at least 60 per cent of the available days between July 1981 and July 1982. However, four of the small ferries were in use for less than 30 per cent of the available days and two for less than 15 per cent, providing an excessive margin of reserve capacity. **We recommend that CalMac should dispose of two of the bow-loading craft which, combined with reductions in related manpower, will result in an annual cost saving of at least £50,000.** 4.85
- The arrangements for the maintenance and repair of the fleet, and shore plant and equipment are generally efficient. 4.86
- The volume of traffic varies considerably from route to route. The pattern of use among routes has varied. Some have seen a rapid growth in use over the last decade coinciding with the introduction of ro/ro. Traffic on Gourrock to Dunoon has declined rapidly since 1976 partly due to abstraction by Western Ferries. 4.87
- Capacity utilisation on a weekly basis is not high even in the peak. Vehicle utilisation is high on summer Saturdays but passenger capacity is over-provided and there appears to be scope for reducing passenger certificates and therefore for modest reductions in crew cost in the short-term (see paragraph 3.36). Attention should be paid to the design of new ships with a view to minimising crew costs for a given number of passengers. Significant economies in crew costs have already been made on some Clyde routes. 4.88
- The peak to off-peak ratio varies between services and is generally lower for cars than passengers. 4.89
17. In the time available we have only been able to look at monthly route costs on two routes, and these may not be typical. The costings showed that the marginal cost of extra sailings in total in the peak period is more than covered by increased revenue. **We recommend that CalMac carry out studies of this nature on all routes, and these in conjunction with loading data will help it to work out the optimum schedule of services.** 4.90
- CalMac's interpretation of the 1975 Undertaking has led it until the MAP studies to take a restricted view on route restructuring. 4.91
- The timetable reviews have been undertaken with regard to loading and cost data and the review process has led to significant changes and savings on particular routes. 4.92

*Recommendation  
Number*

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18. MAP will supply CalMac with a great deal of useful information about its passenger and car traffic. We agree with the view of STG that MAP is of great importance to CalMac, and are concerned that it should be carried out without delay and look at as wide a range of options as possible. **We recommend that CalMac should augment its staff to complete this project effectively and as soon as possible.** 4.93

19. The traffic on the hourly service from Gourock to Dunoon could be carried on one of the two vessels presently employed. Some relief capacity is necessary for the running of the Rothesay service and for the Arran service until the new Arran vessel is delivered. The commercial work carried out would only be sufficient reason for keeping the second vessel if it bore all fixed costs and CalMac at least broke even on her operation. Our calculations show that this is unlikely to be the case and **we recommend that CalMac urgently consider what steps are necessary with a view to withdrawing one of the vessels before the 1983 summer season and pending review of the long-term services on the route.** 4.94

20. **We recommend that discussions be held between CalMac, STG and the Scottish Office to clarify the allocation of costs between approved and non-approved services, with particular reference to the costing of the RNAD contract service.** 4.95

21. **We recommend that consideration be given by CalMac to the future of the Largs to Millport and the Tobermory to Mingary services. If the Millport service were withdrawn, the quality of service might not be significantly affected in view of the availability of the Largs to Cumbrae service. There is a case for looking at the Tobermory to Mingary service again, even before the vessel needs to be replaced.** 4.96

There is also a case for critically examining at regular intervals any service with an unsatisfactory operating ratio. There may, for example, be other ways of meeting demand on the route. 4.97

**Investment**

CalMac's largest category of investment expenditure is ships, but expenditure on terminals has also been significant over the last ten years. 5.36

Inclusion of investment projects in the Corporate Plan is done on the basis of the most immediately perceived need with the general intention of replacing ships every 20 years. Projects are not ranked by rate of return. 5.37

<i>Recommendation Number</i>		<i>Paragraph Number</i>
	Investment plans and appraisals are considered in the New Building Committee. It has a very wide remit and could have an important influence on the development of the business.	5.38
	CalMac has carried out most of its major ro/ro conversion programme and has now entered a replacement cycle.	5.39
	CalMac's 20 year vessel replacement plan submitted in 1981 to the Scottish Office lacks a rigorous framework and implicitly assumes that the network and pattern of ferry services will continue as they are for the next 20 years.	5.40
22.	CalMac's investment appraisal of the replacement vessel for the Arran route was inadequate in the areas of sensitivity analysis, the provision for peak demand, the effect of pricing on demand, speed/frequency optimisation and the evaluation of options. <b>We recommend that these matters should be studied jointly by the company, STG and the Scottish Office with the view to producing a more comprehensive and rigorous system for investment appraisal for the next vessel to be considered. We also recommend that in the course of this study consideration should be given to strengthening the group's expertise in carrying out investment appraisal.</b>	5.41
23.		
24.	It is not clear how far CalMac is pursuing a policy of standardisation of vessels. The case for treatment of the Arran vessel as a special project to be considered separately from the study of vessel design is also unclear. <b>We recommend that CalMac should have a coherent long-term plan for optimum standardisation, formulated in consultation with local authorities and other owners of terminals.</b>	5.42
<b>Fares and Costs</b>	As under the 1975 Undertaking subsidy is given as a whole to the approved services, with the individual exception of Gourock to Dunoon, the levels of fares on routes have become a matter primarily for CalMac to decide.	6.41
	CalMac does not at present possess the data required to assess, in the wording of the 1975 Undertaking, 'the economic and social effects of fares and services on users'. The MAP studies will provide some guidance.	6.42
	Fares have fallen in real terms since 1974.	6.43
	A significant degree of variation in the proportion of costs met by revenue exists between routes. Some of these variations are inherent in the structure of demand, and the density of the population served.	6.44

From 1976 CalMac has adopted a policy such that fares on one route are comparable with those on another rather than fares which attempt to recover costs on individual routes. To achieve comparability CalMac has a standard scale consisting of three elements, pier dues, toll charges and distance charges, the latter two elements being applied on a common basis to all routes. Significant variations exist in actual toll and distance costs per kilometre between routes and CalMac has not taken these into account. Neither has CalMac assessed and taken account of any relative movements in the aggregate toll and distance charges since the data was derived by the consultants in 1975.

6.45

In addition, actual fares differ significantly from scale fares derived from the three elements. Further variation occurs because the relationship between multi-journey, off-peak and standard fares fluctuates considerably between routes.

6.46

The variations in the toll and distance elements between standard, off-peak, and multi-journey fares for passengers and cars are not intended to reflect differences in cost.

6.47

The 6 and 10 journey tickets are in general unlikely to improve CalMac's net revenue, although there may be some exceptions on some routes.

6.48

Whilst most of CalMac's current promotional fares tend to utilise existing spare capacity, others have probably generated traffic on peak sailings with consequent long-run cost penalties. We have identified the Arran route as one where this occurs, and where investment is being undertaken in part to solve a problem which might be dealt with more appropriately by reducing the highest demand peaks through pricing to divert traffic to non-peak sailings.

6.49

The discounts for commercial vehicles are disproportionate to any cost savings which they generate for CalMac. This is so whether discounts are given on a route or network basis. In particular the network discount received by MacBrayne Haulage gives it a significant cost advantage over other hauliers.

6.50

The differential between the charges for cars and commercial vehicles per square metre reflects to some degree CalMac's view of the cost penalty associated with the higher weight of commercial vehicles and also the priorities CalMac has determined from the 1975 Undertaking.

6.51

*Recommendation  
Number*

*Paragraph  
Number*

25. CalMac has not implemented its new fare structure entirely consistently. This has resulted in important anomalies, such as the Kyle to Kyleakin route. We believe that the route should yield greater revenue than it does at present, and we recommend that CalMac should determine the fares accordingly. 6.52
- In 1982 no further progress was made in moving towards the desired fare structure because CalMac did not increase any fares. We would expect the company to alter the present structure in a reasonable period of time, and not cease to make progress in doing so when there is no general increase. There are sufficient anomalies and differences to be corrected for CalMac not to delay. 6.53
26. We recommend that, in the light of our criticisms, CalMac should review its objectives and devise a new fare structure. 6.54
- In general, two main features of the present structure should be retained. These are, first, for passengers and cars, a winter and summer fare, with a discount for multiple journeys. Second, that in determining fares CalMac should continue to identify the three elements of costs represented by pier dues, the loading and unloading of ships, and the distance they travel. These should be given their appropriate weights. This will require an up-to-date examination of these costs and, subsequently, regular examination. 6.55
- Given the evolution of successive Undertakings, and the growing importance of subsidy for maintaining the ferry services, CalMac should regard the present off-peak fare as the basic building block for the new structure of fares for passengers and cars. Each type of basic fare should be based on pier dues, and the toll and distance elements. Pier dues should be those charged where CalMac does not own the piers, and based on comparable charges where it does. We have noted that CalMac has used common toll and distance elements for calculating fares for each type of traffic. However, up-to-date examination of these costs may suggest that, for some routes or groups of routes, costs differ significantly from the average, and that the differences should be reflected in the two elements. 6.56
- The differential for the summer season should reflect the committal of extra resources, and the opportunity open to CalMac to earn additional revenue from tourist traffic. The level of the summer fares should be set so as to maximise CalMac's net revenue during the summer season. 6.57

- Our consideration of the multi-journey discounts has led us to conclude that in general these are unlikely to generate net revenue. Nevertheless, two considerations are relevant here. First, CalMac has favoured travel by islanders by offering discounts for multiple journeys. The second is that there may be some identifiable cost savings from multiple journeys by the same person. For these two reasons there is some justification in CalMac offering discounts for multiple journeys, but we think that the primary consideration in determining the discounts is their effect on CalMac's net revenue. We recommend that the company should make available to the Secretary of State and the SSACs information on costs and revenues which will enable the effects of the discounts to be evaluated.
27. 6.58
- In the matter of very high peaks in demand during summer weekends on some routes, we recommend that because of the long-term cost consequences of attempting to meet the maximum demand which presents itself at one point in time, CalMac should attempt to divert such demand by introducing peak passenger and car fares for summer weekends and, where appropriate, for peak sailings. We also recommend that CalMac should not exacerbate these peaks through promotional discounts.
28. 6.59
- 29.
- In determining the fare for commercial vehicles CalMac should also base it on the pier, toll and distance elements, and we recognise that because of the special importance to the economies of the islands the fare should not distinguish between the winter and summer season. The fare should be a single scale of charges based on length of vehicle, as at present. We recommend that the present system of discounts from the scale be discontinued, and if any discount is to be introduced as a result of CalMac's review of the present fare structure, the company should be obliged to present the case for it to the Secretary of State. We also recommend that any scale of discounts which is subsequently promulgated should be published.
30. 6.60
- 31.
- We believe that it should be possible, and it is desirable, that CalMac should get greater understanding of the cost differences which arise from designing and operating ships with different combinations of passenger, car and commercial vehicle traffic. From such understanding CalMac would gain some guidance about what proportions of ship costs should be recovered from each type of traffic. We also believe that CalMac could benefit in two other ways from this enhanced understanding. First, ship operators in other waters have found that

there is sometimes an economic justification for departing from the conventional multipurpose ship by building specialised ships. As CalMac is working towards a long-term programme of ship replacement such a consideration should be part of its thinking. Second, we believe that greater understanding of the main determinants of costs can only be beneficial if CalMac is to keep up pressure consistently over time for cost minimisation.

6.61

**Competition**

Between 1964 and 1969 David MacBrayne planned the conversion of its route to Islay to ro/ro operation. This involved the company, the Secretary of State, and Argyll County Council in a plan to order a new ship and construct new piers. Within a few months of the ship, the *Iona*, being ordered, Argyll County Council took a decision not to proceed with the construction of the piers, and this frustrated David MacBrayne's intentions.

7.71

The Secretary of State and Western Ferries were unable to agree terms for an undertaking in respect of the route which would have met the conclusions and recommendations of the STUCC. David MacBrayne undertook to operate the service without subsidy, the first of the two crucial decisions which were to determine the future of competition on the route, the outcome of which was the withdrawal of the Western Ferries service at the end of the 1981 summer season.

7.72

By 1973 Western Ferries had established itself as by far the largest carrier of cars and commercial vehicles on the route. David MacBrayne's belief that it could operate a profitable service was conditioned by unreasonable optimism about the rate of growth of revenue and the extent to which costs could be reduced.

7.73

The second crucial factor was the decision by the Secretary of State in 1975 to increase the subsidy given to STG's ferry services, and not relate it to operating results on individual routes. David MacBrayne was able to offer a level of services to passengers, including car passengers which could not be matched by Western Ferries. If David MacBrayne had been required to break even or make a profit on the route we do not believe the company could have continued to operate the service. Because the granting of subsidy gave David MacBrayne the ability to follow a long-term policy we believe that Western Ferries, under financial pressure, took the decisions to sell the *Sound of Jura*, and to sell the lease of the pier at Kenacraig. This hastened the process of the withdrawal of the service in 1981.

7.74

Apart from the single exception of the passenger fare to Iona, all the fares increases on the Islay route were the highest experienced on all CalMac routes between 1974 and 1981.

7.75

CalMac told us that the long-term plans for converting the Gourock-Dunoon route to ro/ro were not influenced by a desire to respond to the threat of entry from Western Ferries which became publicly known in 1969. We accept that this is so. The original plan for conversion to ro/ro was based upon one ship of the *Juno/Jupiter* capacity operating a service with an hourly frequency. Since the conversion to ro/ro CalMac has always had a substantial proportion of the ship and terminal operating costs which have not been met by revenue earned on the route.

7.76

CalMac is presently constrained by the Secretary of State to operate an hourly service, instead of half-hourly which would match Western Ferries, and its own two-ship capacity on the route. The Secretary of State has given a subsidy to CalMac of £250,000 per annum to meet the costs of the passenger component of the service. The intention of the Secretary of State is that the car and commercial vehicle traffic shall be charged commercial rates. In 1982 CalMac, in the light of cost movements, and the amount of subsidy available took the decision not to increase any fares on the Gourock-Dunoon route. STG told us of their hope not to have to increase fares on any route in 1983. Western Ferries told us of the effect of the 1982 decision on its profit expectations for 1982; it regarded the decision on fares as a means of putting financial pressure on it.

7.77

We believe that the present position on the Gourock-Dunoon route is potentially unstable. In contrast to the Islay route, it appears there may be sufficient traffic to support two operators but there is a danger that Western Ferries' profits may be insufficient for it to earn a commercial rate of return.

7.78

Between 1974 and 1980 CalMac's passenger and car fares increases on Gourock to Dunoon were above those experienced on average on other routes but not substantially so. Commercial vehicle fare increases were above the average for other routes and were only exceeded by fares to Islay. CalMac and Western Ferries told us that they discussed their fares between 1974 and 1980 (see paragraph 10.53).

7.79

<i>Recommendation Number</i>		<i>Paragraph Number</i>
	CalMac's 1981-82 Christmas Shopper offer, which continued until May 1982, generated a considerable amount of extra revenue and incurred no significant extra costs. Since it did not produce extra losses on the route it does not support the claim that it was predatory. Our conclusion is contingent on CalMac's operating the route with considerable excess capacity.	7.80
	'Puffer' services compete only on the very margin of the freight market.	7.81
	Air services compete only for a very small section of the passenger market in CalMac's area of operations.	7.82
<b>Quality of service</b>	CalMac has an excellent record of service reliability both in terms of the percentage of scheduled services operated and in terms of punctuality.	8.33
	The vessels operated by CalMac provide a good range and standard of facilities and are maintained in a clean condition.	8.34
	We find that CalMac has made serious efforts in recent years to improve its public image and relations with customers and representative bodies.	8.35
	Apart from some relatively minor matters, STUCC involvement with the operations of CalMac follows proposals by the company to withdraw services. The role of the STUCC is therefore, reactive.	8.36
32.	The three SSACs formed by CalMac have resulted in a significant improvement in relations and mutual understanding between the company and representatives of users. We agree with the company that the role of the SSACs now requires further development. To facilitate this we recommend that the membership of the SSACs should be expanded by adding the FTA and RHA to those bodies listed in the constitution as being represented on the committees. We also recommend that the constitution of the SSACs be amended so as to permit the election by members of a non-CalMac chairman if they so choose.	8.37
33.		
34.	To further enhance the effectiveness of the SSACs we recommend that CalMac should provide members with cost and revenue performance data on a route by route basis. We also recommend that the results of the MAP studies be made available to members when ready and that they be supplied with information on the net revenue effects of multi-journey tickets.	8.38
35.		

<i>Recommendation Number</i>		<i>Paragraph Number</i>
36.	For the benefit of those represented by the SSACs, we recommend that each Committee should publish an annual report.	8.39
	The arguments for and against the publication of cost and revenue performance data on a route by route basis seem to us to be finely balanced and we have limited ourselves to recommending the provision of the data to SSAC members only, (see paragraph 8.38).	8.40
<b>Management and control</b>		
37.	The present arrangement whereby CalMac has a part-time Chief Executive assisted by a General Manager is not satisfactory. The operations and affairs of CalMac are of sufficient importance and complexity to warrant the attentions of a full-time Chief Executive. We therefore recommend that STG takes steps to ensure that the post of Chief Executive is a full-time appointment.	9.44
38.	We found that the extent to which CalMac's functional chief officers at head office also retain line management responsibility impedes efficiency. In our view line management control cannot be effectively exercised at local level from head office. We recommend that CalMac considers ways of delegating greater line management responsibility, particularly to the Masters of the major vessels.	9.45
39.	The company has been preparing five year plans since 1979 for submission to STG and subsequent incorporation in the group forward plans. We recommend that CalMac should seek to develop the plans to include positive cost reduction programmes and the evaluation of alternative strategies for meeting forecast demand.	9.46

### **Priorities**

10.51. We do not regard any of our recommendations as unimportant but some of them appear to us to require priority in their implementation. They are that CalMac should:

- 12 pursue the task of minimising revenue losses with urgency and persistence;
  - 18 augment its staff to complete its Market Analysis Project effectively and as soon as possible;
  - 19 consider what steps are necessary with a view to withdrawing one of its vessels deployed on the Gourcock to Dunoon route before the 1983 summer season;
  - 30 discontinue the present system of discounts for commercial vehicles;
- and that STG should:
- 37 take steps to ensure that the post of Chief Executive to CalMac is a full-time appointment.

## **The monopoly situation and the public interest**

10.52. In reaching our conclusions on the monopoly situation and the public interest, we found that a monopoly situation exists in that CalMac's supply in the area of the islands off the west coast of Scotland and in the Clyde estuary of shipping services, substantially exceeds 25 per cent. We are required by the terms of reference to look at certain questions concerning CalMac's conduct. We believe that CalMac has been able to discriminate in favour of MacBrayne Haulage in the ways that we have described in paragraphs 10.40 and 10.41 above solely because it is a monopoly supplier of shipping services on the routes used by MacBrayne Haulage. We conclude that only in the matter of question (iii)(b), by failing to comply with the conditions of clause 10 of the Undertaking of 15 August 1975, is Caledonian MacBrayne Ltd abusing the monopoly situation existing in its favour, and in this respect is pursuing a course of conduct against the public interest because it has reduced the effective competition between suppliers of haulage services using the routes.

10.53. CalMac and Western Ferries told us that they discussed their fares between 1974 and 1980. It appeared to us that this might well have given rise to an agreement which is subject to registration under the Restrictive Trade Practices Act 1976 and we advised the companies to supply details of their discussions to the Office of Fair Trading. Section 11(8)(b) of the Competition Act 1980 directs this Commission to exclude from their investigation consideration of whether a course of conduct associated with an agreement which is subject to registration under the Restrictive Trade Practices Act 1976 operates against the public interest. We are therefore debarred from reaching any public interest conclusions on these discussions or their outcome.

10.54. We suggested in paragraph 10.4 that despite its relatively modest size CalMac was not an easy company to manage well. We have made a number of criticisms and recommendations which we trust will help the company to improve its performance. It is inevitable that our report should thus concentrate on the deficiencies we found but we should also like to record our appreciation of the high level of operational expertise and motivation in providing reliable ferry services, which we found at all levels in CalMac's organisation.

J D ECCLES (*Chairman*)

R M GOODE

E A B HAMMOND

M S LIPWORTH

B C OWENS

J J WALLIS

N E D BURTON (*Secretary*)  
22 December 1982