6 Views of Stagecoach

Introduction

6.1. Stagecoach explained to us that part of its policy had been to acquire companies which were underperforming by its own standards. (Stagecoach's operating costs were typically 20 per cent below the industry average.) Efficiency gains, and the realization of economies arising from the size of the company and the scale of its bus operations, gave scope for considerable profit growth in its UK business even without further acquisitions. Its passenger volume had increased by 4 per cent in its last financial year, mostly through organic growth, while the national trend had been a decline of 3 per cent a year. In the past year, while the national average fare increase was probably 5 to 6 per cent, Stagecoach's fares had risen 2 per cent. Even this was a result only of the cut in fuel duty rebate, since its policy was not to increase fares except as a last resort. At EMMS fares had last been raised in early 1994, and there were no plans to raise them again at least until June 1996. In the past two years a 6.5 per cent increase in pay had been absorbed by efficiency savings and the realization of economies of scale and size through group purchasing.

6.2. Stagecoach recognized trade unions and had probably the best pension scheme in the industry. Its rates of pay were not below the national average, and were enhanced by a profit-related pay scheme. In general, its employee terms and conditions were comparable with or superior to those of other operators. Staff turnover at EMMS was low.

6.3. While Stagecoach held about 13 per cent of the UK bus and coach market, its investment in new buses and coaches was over one-third of the UK total. Its premium-quality inter-urban services were a particular source of growth. It was a bidder for rail franchises; the mode of privatization adopted by the Government was well suited to bus and coach operators.

6.4. Whilst looking for growth, Stagecoach did not regard itself as a turnover-maximizing company. It reckoned that it could get more profit growth from using selective fare discounts and novel services to generate new traffic than it could by raising fares for existing users. Its investment in new vehicles attracted passengers but also sharply reduced overall operating costs.

6.5. As for the future pattern of the bus industry, Stagecoach expected further mergers among the eight or so companies which now had about 55 per cent of the UK market between them. Following the break-up and sale of the public sector companies, this reconsolidation of the industry was being driven by economies of scale. The process would have gone further had there been legislation to compel the privatization of all local authority bus operations and had not the earlier voluntary privatizations by local authorities been by single tender, excluding non-employee bidders. In the next few years, after all available acquisitions had been made, Stagecoach expected to be achieving growth by competition with other large groups. An extension of route franchising on the London model might occur, and Stagecoach had the experience to cope with it, but this would depend on government policies.

6.6. There would always be a place for small operators, but those using old vehicles were likely to be faced with tighter enforcement of environmental and safety regulations. Stagecoach deplored the presence of operators attempting to expand unsustainably in the hope of being bought out. The funds used for such purchases were removed from the industry but could otherwise have been used for reinvestment.

Jurisdiction

6.7. In the matter of jurisdiction, Stagecoach considered the House of Lords decision in the South Yorkshire Transport Ltd case to have been perverse given the normal meaning of the word `substantial'. Stagecoach did not agree that the present merger was worth consideration even under the terms of that judgment. However, it understood some of the MMC's reasons for proceeding.

6.8. It thought the reference area had been chosen somewhat arbitrarily. It acknowledged the reasons for the MMC's inclination to exclude Doncaster, Rotherham and certain other districts, but wondered whether Mansfield should not be excluded too. CTL had been almost wholly absent from this district, so that the merger would not affect it. Nor had there been any grounds for criticism of the services or fares policies of EMMS there.

6.9. Stagecoach had been unhappy about the action of the OFT in recommending referral of the merger. Stagecoach had offered behavioural undertakings as an alternative to a reference, including either a freeze on fares for a significant period or else a reduction in fares followed by increases below the RPI. It had been prepared to contemplate such undertakings for a period of as much as ten years. The OFT had not been prepared to consider them seriously. Stagecoach had the impression that it was being singled out on account of criticisms by other operators whose own mergers in many cases were not referred. Stagecoach thought also that some local authorities were possibly politically motivated in their opposition to it.

6.10. Stagecoach had no intrinsic objections to the use of either registered vehicle miles or revenue as a measure of market share in the present case. However, both could introduce distortions for various reasons. A more significant concern was that the share of small operators who failed to reply to questionnaires might be under-estimated.

Other modes of transport

6.11. In the operating area of the merged companies, rail services offered some competition and the newly-opened Robin Hood line linking Nottingham and Mansfield could be a serious competitor. It was to be heavily subsidized by Nottinghamshire County Council, and its fares were deliberately being set by reference to existing bus fares. It would in due course extend to Worksop. To compete with the higher speeds of rail, bus fares had to be some 50 per cent lower.

6.12. However, Stagecoach was mainly concerned about competition from private cars and taxis. In the last eight years annual car mileage had risen by 31 per cent and taxi mileage by 41 per cent. Those seeking work needed personal transport, and they did not always consider total running costs when deciding to buy a cheap second-hand car. The rise in car ownership reduced the proportion of the population dependent on buses, so that special price or convenience incentives were needed to win them back.

6.13. Numbers of ex-miners had used their redundancy money to buy taxis. Because of competition amongst them, fares were low. The fares did not vary with the number of passengers. One bus operator in the Mansfield area (Delta) also ran a taxi fleet and competed with Stagecoach on the two fronts.

6.14. Where journeys were local, car owners would normally use their cars, but Stagecoach was competing relatively successfully by introducing cheap but high-quality inter-urban services. These services appealed also to students and the elderly who found rail fares too high. Stagecoach saw these developments as indications that its future earnings were unlikely to be enhanced primarily by fare increases.

6.15. If it were to win rail franchises there was scope for co-ordination of bus and rail timetables and for ensuring that trains were fed by bus services and met by waiting buses. Passengers would otherwise take a taxi. Stagecoach pointed out that fares and services on the rail routes which it might win would be comprehensively regulated.

The merger

6.16. Stagecoach had become established in the Chesterfield area through its acquisition of EMMS for £4.5 million in 1989. In the original management buy-out an external investor had gained a dominating position and sold out to Stagecoach after some 14 months. Stagecoach told us of the efforts applied to turn EMMS round. The business had been over-extended by the management buy-out team into coach operations and bus services in distant locations. Since the acquisition the business had been concentrated and the average vehicle age brought down from 15 to 6 years. Staff working practices were streamlined, and after some union opposition relationships were now harmonious. Customer information had improved. Operating costs were now well below the Stagecoach average. Patronage had fallen steadily for some years, partly because of the economic problems of the area, but the decline had recently been reversed.

6.17. Stagecoach told us that CT89 had come to its attention in September 1994, when Stagecoach had just taken a 20 per cent stake in Mainline. CT89 was in breach of its banking covenants, and trustees of the employee shares saw Mainline as a potential acquirer. The employees had been led to believe that CTL had a value in the region of £3 million, but even with Stagecoach participation in proportion to its 20 per cent shareholding, Mainline was not prepared to offer more than about £2.4 million. Mainline had invited Stagecoach to undertake the management of CT89 for a fee under contract in the event of its bid succeeding. It would be to the advantage of both companies for EMMS to move into CT89's Stonegravels depot and to release the EMMS New Street site. Mainline's bid did not seem to be progressing, and when Stagecoach was required to divest its Mainline stake following the MMC inquiry, Stagecoach decided to make a bid in its own right.

6.18. Stagecoach saw no reason why Mainline or other major operators could not have made realistic offers for CT89. If CT89's financial position had continued to deteriorate, however, offers reflecting this might have been rejected by the employee shareholders. The outcome would then have been receivership.

6.19. Recognizing the plight of CT89, Stagecoach had negotiated a bid which at £3 million gave employees a reasonable exit payment for their shares. It guaranteed that there would be no compulsory redundancies for drivers or for other staff who became drivers. It pursued the bid despite the OFT's discouragement, because without it CT89's 1994/95 accounts were likely to be strongly qualified by the auditors, which would have lost the company the support of its bank. The presence of Stagecoach removed the bank's anxieties. Had it wished to, Stagecoach could have put CT89 out of business by running services on its routes, but Stagecoach's image would have suffered in the process and it preferred to buy the business as a going concern. Other operators, including Trent, LRCC and Peakbus, being aware of CT89's financial difficulties, increased their operations on CTL's routes. These services largely mirrored those of CTL rather than opening up new routes.

6.20. A few days before the deal was concluded, Derbyshire County Council informed CT89 that a pre-sale review had shown a £1.2 million deficit in CT89's account with the county's superannuation scheme. Retirements and redundancies had invalidated the assumptions made in the fund's last triennial review, whose updating was now almost due. Stagecoach assumed this liability without amending its offer price because the employees had a certain understanding of the value of their company and were not responsible for the deficiency. It might have been possible to negotiate a lower price but there would have been a loss of goodwill in the process. Stagecoach also believed that, with CT89 as a going concern, some of the deficit could be worked off by performance of the fund rather than by additional contributions. It later negotiated with the county council to pay a £300,000 lump sum and to pay off the balance over ten years, subject to clearance of the merger. If CT89 had been wound up, the fund would have been a creditor for the full amount.

6.21. Stagecoach estimated that the underlying viable turnover of CT89 was around £5 million. Assuming that Stagecoach could earn its usual margin of 15 to 18 per cent, the price paid represented a price/earnings ratio well within single figures. The goodwill element of some £2.2 million was not excessive. Even after allowing for the pension fund deficiency the price was not unduly high in relation to the size of the business.

6.22. On taking control, Stagecoach had found that a number of wholly unviable activities contributed to CT89's £7 million turnover. It considered that the company could not have survived for more than about eight weeks. On the first day, for example, 2 out of 42 maintenance staff were working on CTL buses and the remainder on other public and private sector vehicles, as a means of raising revenue for the company. This was in spite of the severe shortcomings in the standard of maintenance of the buses. The external workload was on call rather than scheduled, so manpower allocations could not be planned.

6.23. The Stonegravels depot included a canteen which failed a hygiene inspection; a club bar which Stagecoach considered unacceptable on bus premises and which was controlled by outsiders removable only by legal action; offices let to a range of charitable bodies; and an area used for refuse vehicles which was owned by Chesterfield Borough Council and not CT89. A weight-training room, shower and snooker room were provided for staff but little used. Stagecoach had now opened a new canteen on the site.

Effects of the merger

6.24. Following the acquisition of CT89 Stagecoach had unified the company's management with that of EMMS and stripped out intermediate layers. EMMS had moved into the CT89 depot. The management offices were to move there as well after refurbishment. This would release the EMMS New Street depot. Activities other than bus operation had been discontinued as rapidly as possible. Neither the management changes nor the depot rationalization could have been so far-reaching if the two companies had not been located in the same town. For the duration of the MMC inquiry, however, undertakings required by the OFT had halted the further integration of CT89 with EMMS.

6.25. Stagecoach had provided ten new buses, but the undertakings to the OFT did not allow the whole fleet to be repainted in Stagecoach livery. It had introduced preventive maintenance and rationalization of spare-part stocks. CTL's Bawtry depot was now closed, and for the area it had served, garaging and maintenance for both CTL and EMMS were concentrated at Worksop.

6.26. In this eastern part of the designated area, CTL's fleet was particularly run-down. A Nottinghamshire school contract was withdrawn by the county council shortly after the merger when a bus failed following a history of failures under CTL management. Eleven drivers left CTL after the merger, some to join LRCC which had just registered competing services, although Stagecoach had offered them wide-ranging guarantees and assurances. However, the manpower problem had now been solved.

6.27. CTL had been suffering from a severe decline in passengers, and Stagecoach's first priority was to stem this fall. It looked forward to rethinking CTL's routes, particularly where there was scope for cross-town journeys as opposed to termination at the Chesterfield town centre. It also planned to enhance services by running smaller vehicles at higher frequencies.

6.28. Stagecoach was glad to be able to end CTL's practice of frequent fare increases. It had introduced a transferable multi-journey weekly ticket, the Megarider, which was increasing usage with no overall drop in revenue. Stagecoach rejected the view that it had introduced the Megarider primarily as a competitive weapon. The concept had been tried first in Mansfield, where Stagecoach faced little direct competition. Stagecoach was confident that the average level of fares charged by the merged company would increase at less than the rate of inflation; otherwise, an undertaking to that effect could not have been offered to the OFT. Stagecoach said that it was not prepared to pursue short-term profits to please the City of London by raising fares because such a policy would damage its customer base and could not be sustained. It was happy to have a margin in the high teens and no more. Stagecoach saw the aspirations of some other operators for high fares and high returns as unrealistic and susceptible to competitive challenge, perhaps by Stagecoach.

6.29. Stagecoach said that on portions of 11 routes in the Chesterfield area (out of a total of some 130 routes operated by the two companies) EMMS and CTL ran in parallel, EMMS providing mainly for longer journeys and CTL for local traffic. This distinction arose from the past histories of the two companies but it meant that for a long time there had not been an overtly competitive situation. CTL did not have the vehicles to respond to changes in demand or to competitive pressures. EMMS was also constrained by the capacity of its New Street depot in the extent to which it could expand services in Chesterfield itself. Trent had thus been able to register new services and operate them successfully between Clay Cross and Chesterfield. As regards potential competition, CTL and EMMS had had the ability to cause substantial damage to each other. In Chesterfield itself, CTL's fleet was twice the size of EMMS's. If EMMS had attacked it, CTL could have retaliated against EMMS's services in Worksop and Mansfield. There had not in practice been much competition between them, but this was because they had been pursuing their own objectives rather than consciously deciding not to compete with each other.

6.30. Stagecoach did not believe the merger would leave local authorities with too few bidders for tenders. There were still large numbers of small operators interested in such work.

6.31. Stagecoach referred us to an example of competition in the expansion of Delta near Mansfield. This was a taxi firm which had added a rapidly growing bus fleet. It was contending with Trent rather than with Stagecoach for market share. Stagecoach doubted the commitment of Delta for the long term. Trent, whose bus fleet was of high quality, charged relatively high fares. It did not have minibuses in its fleet, and so ran relatively infrequent services. Both companies had slashed fares to levels which were probably not sustainable, and Trent had brought in buses bought from various other companies. Some of the buses came from a different Stagecoach subsidiary and Trent had then used these while still in Stagecoach colours to run free services. Stagecoach had complained to Trent about this.

6.32. Stagecoach accepted our suggestion that a large company which was well run and had new vehicles, but charged high fares and earned high margins, would not be the first choice of target for another large operator wishing to expand. There had not been substantial competition of this nature between the large operators since deregulation. This would come, but not until there had been further consolidation and cost reduction. If other operators were hesitant to take on Stagecoach it was because of its reputation for being profitable and competitive, not because of a reputation for aggressive behaviour. However, there was no shortage of large operators-or subsidiaries of large operators-surrounding Chesterfield, most having fleets larger than that of EMMS. The services registered by Trent and LRCC against CTL were evidence that competition could occur. It was open to larger operators to respond to competition in one area with a response in another. Stagecoach was more constrained than most because of the readiness of the competition authorities to question its actions. It had no immediate plans for significant new incursions into South Yorkshire, but the proposed FirstBus link with Mainline would be no deterrent if opportunities arose.

Views of third parties

6.33. Stagecoach commented to us on some of the views of third parties on which we asked for its views. As regards members of the public (paragraph 5.108), it said that it received extremely few complaints in relation to the number of passengers carried, and that every case was acknowledged and fully investigated. Where the problem arose from operating difficulties the complainant was told exactly what had happened. Stagecoach insisted that in such cases all within its power was done to prevent a recurrence of the cause. Stagecoach confirmed that it had no intention of running down the CTL network.

6.34. Nottinghamshire County Council's allegations (see paragraph 5.28) did not correspond to Stagecoach's perceptions. It did not believe that service shortcomings in the Retford & District area had increased since the merger. Of the individual complaints identified to the MMC by the council, most had arisen before the merger, or were unfounded, or had been dealt with to the council's satisfaction.

Remedies

6.35. If the MMC were to find the merger against the public interest, Stagecoach did not see divestment as a realistic option. It would be difficult to find an alternative purchaser having both the resources and the motivation to finance the fleet replacement that was needed. A purchaser would be reluctant to come forward without a non-competition agreement, and the OFT would block this. Those with nearby operations might themselves be referred to the MMC. Also, 98 per cent of the workforce had voted for the merger and would presumably be disappointed to lose it. Any resulting `bus war' would eventually lead to higher fares to recoup the losses incurred.

6.36. Stagecoach would not have serious problems in observing the MMC's usual menu of possible behavioural undertakings. However, a ban on further acquisitions in the area might be unfair to a one-person business whose owner wished to retire, while undertakings designed to prevent anti-competitive responses to new entrants might allow `hit-and-run' competitors to make malicious incursions. Stagecoach was also wary of an adverse public interest finding by the MMC leading to a recommendation for undertakings, in case the Secretary of State chose instead to insist on divestment.

6.37. Overall, Stagecoach maintained that services in the Chesterfield area would be improved by the merger and that a low-fare policy would be pursued. It had chosen to acquire CT89 when it could have put it out of business and picked up the pieces. Stagecoach was proud of its reputation as an operator and as an employer, and its readiness to disclose information ensured a high degree of accountability.

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22 December 1995