

## Entry

### Summary

1. The main points from this appendix are:
  - (a) There are many possible barriers to entry but the main ones are the threat of retaliation, the existence of network operators and the costs to become such an operator. These barriers apply more to large scale entry and expansion.
  - (b) Whilst there are examples of new entry, all new entrants are small operators, ie niche operators.
  - (c) Entry and expansion have had very little effect on FirstGroup's pricing and frequency of existing services.

### Introduction

2. This appendix begins by looking at possible barriers to entry. It then looks at the extent and effect of entry and expansion.

### Barriers to entry

3. This section looks at a number of possible barriers to entry. When assessing the importance of barriers to entry, individual barriers should not be assessed in isolation but should be considered together with other barriers.
4. We look at the following possible barriers to entry.
  - (a) Threat of retaliation.
  - (b) Multi-modal tickets and networks.
  - (c) Concessionary fares schemes.
  - (d) Overall entry costs.
  - (e) Depots.
  - (f) Cost of buses.
  - (g) Marketing and advertising.
  - (h) Regulatory barriers.
  - (i) Access to bus stations.
  - (j) Shortage of drivers.

## Threat of retaliation

5. About half of the bus operators that responded to a CC questionnaire expressed concern that there would be retaliation from incumbents who are major operators on a route, if they were to consider entering its 'territory'. They said that retaliation in the form of cross-subsidizing the entered route and pricing at a level which would make it unsustainable for the new entrant to operate its new service had been threatened in the past by large incumbent operators.
6. FirstGroup provided two examples of where it had cut fares in response to entry. It offers a discounted weekly ticket on the 175 route in Glasgow because of the low fares offered by Stagecoach's 'Magicbus'. It had not responded in the same way on the 62 route. It has also offered a number of restricted fares within the Stirling area that reduce the fare differential with those offered by small operators. FirstGroup said that to the best of its knowledge it has never offered fares below those of its competitors in these areas.<sup>1</sup>
7. Another form of retaliation, often alleged, takes the form of changes to service frequency. Regarding the changes to service frequency, one of the small bus operators in Glasgow stated that FirstGroup doubled/tripled the frequency of its services on three of the four routes the operator entered in the past two years. Another bus operator stated that it had seen FirstGroup inflict both forms of retaliation (increased frequency and reduced prices) on small operators trying to enter into its 'territory'. FirstGroup told us that it was not aware of any instances where there had been such a change in frequencies, nor had it retaliated to entry with fare promotions in recent years (ie at least the last three years). Operators stated that they would rather not enter bus routes where the current provider was a major operator. A NERA report prepared for the OFT in 1997 on the effectiveness of bus undertakings<sup>2</sup> notes that the incumbent's reputation for aggressive response to entry, combined with an awareness of the increasing disparity in depth of pocket compared with the large operators, acts to discourage small scale entry in this industry (see Annex 1).
8. These views that FirstGroup retaliated following entry do not appear to be supported by data provided by FirstGroup which shows that on almost all of the overlap flows on which it faced new entry or expansion by competing operators, it did not change its services as a result. However, it should be noted that FirstGroup has primarily faced entry and expansion from niche operators.
9. FirstGroup has some of the characteristics required to pose a retaliatory threat. It is by far the largest bus operator in Scotland, it is the only operator with a network in the relevant geographic areas and bus operators in general have the ability to quickly change price and service quality of their services. FirstGroup may be constrained regarding the latter point because of the undertakings agreed following the 1996 Firstbus:SBH report, which impose constraints on its abilities to change fares and service frequencies (see Appendix J).
10. One operator told us that fear of predation was less of a problem on what it referred to as multi-operator territory, ie high volume routes, where it said there was scope for smaller bus operators to operate successfully.

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<sup>1</sup>FirstGroup said that it also offered discounted tickets in Edinburgh for a short period in late 2001 in competition with Lothian, and in some areas it has offered cheap localized fares to encourage short and off-peak trips. Neither were in response to new entry.

<sup>2</sup>*The effectiveness of Undertakings in the Bus Industry*, prepared for the OFT by NERA, December 1997, Research paper 14.

11. On flows where there is an overlap between train services and FirstGroup bus services (see Appendix G), the number of competitors operating besides FirstGroup is usually low (see Table 1). As the table shows, most flows in Edinburgh are either solely provided by FirstGroup or are provided by FirstGroup and one other competitor. This suggests that very few flows in Edinburgh are multi-operator flows.

TABLE 1 **Overlap of operators in Edinburgh region**

<i>Number of competitors</i>	<i>Number of flows</i>
0	99
1	40
2	20
3	3
4	1

163 overlaps total in Edinburgh

Source: FirstGroup and CC Calculations.

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12. In Glasgow, more than half of the overlap flows identified have one or more competitors operating besides FirstGroup. Nevertheless, about 77 per cent of flows are either solely provided by FirstGroup or are provided by FirstGroup and one other competitor (see Table 2).

TABLE 2 **Overlap of operators in Glasgow**

<i>Number of competitors</i>	<i>Number of flows</i>
0	273
1	204
2	68
3	42
4	31
5	2

620 overlaps total in Glasgow

Source: FirstGroup and CC Calculations.

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13. Multi-operator flows represent a small fraction of the total overlap flows in Glasgow. The majority of competitors are small operators, present only on few flows. Smaller operators usually operate limited services, concentrated during the main part of the day. They most often do not operate on Sundays and evenings.
14. One bus operator, which was concerned about predation, said that predatory action was less likely to occur against an entrant which had a network which overlapped with the network of the incumbent bus operator. This entrant, it argued, would be in a better position than entrants with no overlapping networks to respond to the predatory behaviour. Only FirstGroup has a network in all of the relevant geographic areas: Glasgow, Greater Edinburgh and Lothians, and Stirling, Falkirk and Clackmannanshire. Lothian also has a network in Greater Edinburgh and Lothians.
15. FirstGroup told us that it did not have a reputation for predatory behaviour. We note that since 2000 the OFT has carried out a number of investigations into FirstGroup's bus operations in the UK. The OFT has not found any evidence of predation by FirstGroup. One investigation found FirstGroup to have entered a market sharing agreement. [X]

16. FirstGroup said that because it was subject to the behavioural undertakings affecting its bus operations in central and south-east Scotland agreed following the FirstBus:SBH 1996 inquiry, this affected the extent to which it could respond to entry.
17. FirstGroup told us that there were other restrictions on its ability to raise fares on individual flows, such as how such fares would fit with its ticketing structures, the potential for passengers to purchase tickets at lower prices for longer journeys, or to purchase a network ticket such as a Firstcard instead of standard single or return tickets.

### **Multi-modal tickets and networks**

18. There are benefits to network operators, for example in selling their own travel cards. In late 2002, NERA was commissioned by FirstGroup to provide an economic analysis of the competition in the supply of bus services in Edinburgh. FirstGroup have provided us with a copy of this analysis. NERA presented a number of arguments as to why it was difficult for FirstGroup to compete against Lothian. These were: FirstGroup faced the difficult challenge of competing against a very large and aggressive competitor, and moreover one with a more extensive network, higher frequencies and with a large installed base of customers. Lothian's more extensive and denser network gave Lothian advantages that FirstGroup could not match, deriving from network effects. The more extensive network affected the relative value to passengers of a multi-use ticket valid on Lothian's network. The denser network meant that potential passengers might prefer to wait for a Lothian bus even if a bus of another operator arrived first, because they might be concerned about possible long waits on the return journey. This was also one of the barriers to entry given in the NERA report on the effectiveness of bus undertakings (see Annex 1). FirstGroup provided us with data for 2002/03 that showed [redacted] per cent of its passengers in Glasgow used FirstGroup's travel passes ([redacted] per cent of fare-paying passengers). The equivalent figures in Edinburgh are [redacted] and [redacted] per cent.
19. The NERA report on the effectiveness of bus undertakings also noted that having a network allowed the incumbent to meet small scale entry selectively, and economically (see Annex 1). FirstGroup, however, noted that there are some disadvantages in operating a network. It said that a network operator cannot easily tailor services to the details of a section of route because of the need to keep fare structures simple, to maintain a consistent level of quality for the purposes of managing brand awareness, and the logistical challenges of making sure there are enough buses and drivers in the right place. It also noted that network operators pay higher costs than small operators for drivers (compensating for shift working to cover the late working), for marketing (where First invests in stop displays and other wider marketing materials to promote the network) and for buses (which are generally of a higher quality to attract more users onto bus).
20. One of the concerns expressed to us was that following the acquisition by FirstGroup of the Scottish rail franchise, the merged entity would introduce its own exclusive ZoneCard. One bus operator told us that FirstGroup could extend its own tickets across the railway and gain an unfair advantage over its competitors. It believed that FirstGroup's extensive bus network together with the ScotRail network would enable it to introduce tickets to be used exclusively on its multi-modal operation. FirstGroup provided us with data that showed a very small proportion ([redacted] per cent) of its passengers in Glasgow in 2002/03 used SPT's ZoneCard.
21. We have been told that the high price of SPTE's ZoneCard would allow FirstGroup plenty of scope to introduce its own exclusive multi-mode card. The SPTE ZoneCard costs £43.50 for an adult for one week, compared with £10.50 for FirstGroup's all

zone Firstcard. However, SPTE's ZoneCard has many more zone options than FirstGroup's Firstcard in Glasgow, and the zones follow different boundaries making comparisons difficult.

22. Any new multi-mode card offered by FirstGroup would need to take account of additional usage of rail, would have to be priced above FirstGroup's Firstcard and would have to be competitive with SPTE's prices.
23. The introduction of a FirstGroup only network card remains a concern. FirstGroup responded that such a multi-modal card would be unlikely to have much impact on the profitability of operators considering whether to enter or expand on a route where FirstGroup has reduced service levels or raised prices. It said that very few passengers use more than one mode for their journeys as evidenced by the fact that only [%] per cent of First Glasgow's revenue comes from the ZoneCard, and so even if an entrant picked up none of these passengers, the impact on the profitability of entry is likely to be small.
24. One operator expressed the concern that as a merged entity FirstGroup, having acquired the Scottish rail franchise, could temporarily introduce loss-making tickets which would undercut all season, day tickets and single tickets, making it hard for other operators to compete on fare levels. This operator said that this might exclude competitors from the market, and FirstGroup would eventually face no competition and be able to increase prices.

### **Concessionary fares schemes**

25. Concessionary fares on buses are available to persons aged 60 or above and for those registered blind or disabled or having an illness that disqualifies them from holding a driving licence. Travel is free for these users. This fare is available across all operators. FirstGroup provided us with data for 2002/03 that showed concessionary travel accounting for [%] ([%] per cent) of its passengers in Glasgow and a little more ([%] per cent) in Edinburgh.
26. Some types of concessionary fare schemes may place new operators at a disadvantage if it makes it less easy for them to estimate revenue from concessionary fares prior to entry or to ensure that they are fairly reimbursed. This is more likely to be true of concessionary fare schemes based on passes than token-based schemes. In Glasgow the concessionary scheme is based on passes. None of the smaller operators we spoke to felt that these schemes operated as a barrier to entry.
27. FirstGroup believes that concessionary fares have reduced the 'loyalty' value of network ticketing. The concessionary customer is faced with no charge for any operator. The first bus to arrive at a stop is therefore most likely to receive the custom of the concessionary passenger as there is no price differentiation. FirstGroup believes this facilitates entry into bus markets, since a significant proportion of bus users are not loyal to any one operator.

### **Overall entry costs**

28. One bus operator provided us with estimates of entry costs (see Table 3). This shows entry costs (based on a fleet of 80 buses)<sup>3</sup> to be £9 million and £12 million,

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<sup>3</sup>This figure was used as the bus operator said that to be a serious bus competitor required a fleet of 80 buses. Another bus operator suggested a figure in the range of 40 to 50 buses. However, as noted in paragraph 65, FirstGroup disputed whether entry would have to be at a network level in order for entrants to pose a constraint on particular FirstGroup flows and routes.

sunk costs accounting for two-thirds of this total. This operator together with other operators acknowledged that entry costs would be lower for a smaller entrant because of lower quality vehicles and lower overheads but said that such an entrant would be unable to compete with FirstGroup. The smaller operator would not have sufficient network benefits and it could be picked-off by the larger incumbent. This point also made by another bus operator. We are aware of only one operator (McKindless) which has grown to this size through organic growth.

TABLE 3 **Costs of start-up\***

	<i>£ million</i>		
	<i>Cost†</i>	<i>Sunk costs‡</i>	<i>Recovered costs</i>
Buses	3.5	1.4	2.1
Depots	3.5	2.1	1.4
Start-up losses and marketing	3.5	3.5	0
Total	10.5	7	3.5
Total (%)	100	67	33

Source: A bus operator.

\*Based on 80 buses.

†Mid-point of range.

‡Mid-point of range for depots.

29. Contrary to what this bus operator told us, a small bus operator in Glasgow said that a bus company in the Glasgow region could start very small and grow to become a viable competitor. It estimated that the set-up costs for an operation of 20 buses would be £150,000. The buses could be leased and/or purchased second-hand from large operators such as Stagecoach or Arriva. Small depots would be used. Another bus operator told us that it would cost in the region of £100,000 to £150,000 to begin operating on one route. This same operator said that it would cost around £1 million to £1.5 million to begin operating services with a depot and about 50 buses. Another bus operator estimated the set-up costs for an operator with about six buses to be about £250,000. In fact, all recent entry has been at a much smaller scale than network level entry. FirstGroup said that entry at the route level would be reasonably low; for example some operators have no depot at all, second-hand buses could be purchased or leased, and marketing costs would be minimal. Moreover, FirstGroup stated that entry costs for expansion on to new routes by operators already active in the area would be even lower as these operators already have the minimum facilities and know-how needed to run services.

## Depots

30. FirstGroup told us that there was a range of options for depots and facilities from which to operate local bus services. These ranged from the bespoke development of a bus depot on purchased land to the use of contracted maintenance and no allocated facilities. An example of the former is FirstGroup's new depot in Scotstoun, Glasgow at a cost of £5 million for 250 bus capacity. An example of the latter is FirstGroup's depot at Stevenston, which has 17 buses allocated for a PVR of 15, where FirstGroup leases the facility plus maintenance support at a cost equivalent to approximately £[X] a bus per month. FirstGroup said that sufficient premises were available for any operator looking to set up a depot and/or maintenance facilities to either expand its current operations or enter the market.
31. FirstGroup has 20 depots across Scotland. It has one in Aberdeen, ten in Edinburgh (one of which FirstGroup intends to close) and nine in Glasgow (two of which are

vacant). FirstGroup owns [X] of its 20 depots and it has an option to buy [X] of its [X] leased depots. Of the competitors identified by FirstGroup in Edinburgh, only three have more than one depot (Lothian Buses with three, Stagecoach with three and MacEwans with two). In Glasgow, six of the competitors identified by FirstGroup have more than one depot (Arriva, Avondale Coaches, McColl Coaches, McKindless Group, Puma and Stagecoach each of which have two depots although one of those for Avondale Coaches is an outstation).

32. Table 4 shows the number of FirstGroup's buses at each of its depots in Glasgow and Edinburgh and the number of its spare buses.



33. Table 4 shows that FirstGroup has [X] spare buses in the relevant depots in Glasgow. The equivalent figure in Edinburgh is [X]. The number of spare buses and the excess capacity at depots could provide a measure of the flexibility available to FirstGroup to increase its bus services from the relevant depots. This flexibility is, however, limited by the need for spare buses at depots to cover for expected needs for servicing, breakdowns, etc. However, FirstGroup may have spare buses somewhere in its national network, and it might be able to lease other buses or it might reduce service frequencies on marginal routes. Such flexibility might be affected by having to move drivers between depots.
34. Table 5 shows the excess capacity at FirstGroup's largest competitors in Glasgow and Edinburgh at each of their depots.

TABLE 5 Excess capacity of FirstGroup's largest competitors in Glasgow and Edinburgh

Glasgow		No of fleet	Capacity	Excess capacity			
Operator	Depot location						
Arriva	Renfrew	( )	X	( )			
	Paisley						
Stagecoach	Kilmarnock						
	Blochairn						
McKindless Group	Wishaw						
	Rutherglen						
HAD Coaches	Shotts						
Central Bus Co (Coakley)	Motherwell						
<i>Edinburgh</i>							
Lothian Buses	Seafield Road						
	Annandale Street						
	Longstone						
Stagecoach	Dunfermline						
	Cowdenbeath						
	Perth						
HAD Coaches	Shotts						
MacEwans	Johnfield						
	Amisfield						
Horsburgh	Livingston						

Source: FirstGroup and CC calculations on data provided by FirstGroup.

35. Table 5 shows that of FirstGroup's competitors in Glasgow, McKindless has [X] excess capacity, [X] buses at its Wishaw depot. Arriva has an excess capacity of [X] buses at its Paisley depot, a little higher than Stagecoach ([X] buses) at its Kilmarnock depot. In Edinburgh, Lothian Buses has excess capacity of [X] buses at its Longstone depot and [X] buses at its Seafield Road depot.
36. We asked FirstGroup about the distances between its depots and its routes as an indication of the relationship between a bus depot and a route. FirstGroup told us that it had some difficulty in answering our question, as many assumptions had to be made before a view could be taken about the area that could be served from any depot. It said that a depot did not in reality service an area, but rather it serviced routes consisting of origin and destination points. FirstGroup said that as a general proposition it did not disagree with the rule of thumb set out in the MMC inquiry into FirstBus/SBH, suggesting a maximum range of bus services from a depot of 15 to 20 miles in rural areas and 5 to 10 miles in urban areas, apart from infrequent inter-

urban services.<sup>4</sup> FirstGroup considered the services it operates around four of its depots in Scotland (Livingston, Larbert, Cumbernauld and Larkfield) to try and define the area that could be served by a depot. FirstGroup said that the footprint for its Livingston depot did not contradict the rule of thumb. The core local area served was up to a 10-mile radius around the depot, with inter-urban services extending further, some 15 to 25 miles. FirstGroup told us that its experience indicated that in and around Glasgow, from its depots in Larkfield and Cumbernauld, FirstGroup operated quite a dense network of services up to 20 miles from the depot. Around the Larbert depot, the core area served was a 6-mile radius; however, where there was demand on corridors, FirstGroup operated services up to 25 miles away in Edinburgh.

37. FirstGroup provided us with the minimum and maximum distances between its depots and the routes that included the overlap flows as identified by the OFT in its study of this case. Table 6 shows the distribution of the minimum distance for these routes in Glasgow and Edinburgh and the average (mean) distance.

TABLE 6 Minimum distances between FirstGroup's depots and routes

Range (Km)	Number of routes	
	Glasgow	Edinburgh
<1	33	12
1 to <5	19	7
5 to <10	8	4
10 to <15	5	0
15 to <20	1	0
20 to 25	4	2
Total	70	25
Mean (Km)	4.0	3.4

Source: CC calculations on data provided by FirstGroup.

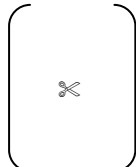
38. Most operators see their depot location as a constraint on the extent of the geographical area they can serve. They explained that the cost of 'dead mileage', ie the cost of positioning a bus on its route made routes unprofitable and unattractive to enter. One operator estimated the maximum distance in terms of time, stating that any route requiring more than 20 minutes to position a bus would not be viable. Some smaller competitors see 20 miles as the maximum radius within which they can operate; others argue it would be possible within 60 miles of their depots. FirstGroup told us that the viability of a route and the positioning time depends on the type of route, and said that in a small number of instances it operated routes which were over 20 minutes drive time away from the relevant depot at their closest point.

## Costs of buses

39. We asked FirstGroup to provide us with estimates of the capital costs of new buses. These are given in Table 7. The costs range from £[redacted] (mini-bus) to £[redacted] (articulated bus).

<sup>4</sup>Paragraph 4.51 of the FirstBus: SBH report.

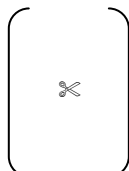
TABLE 7 Capital costs of new buses

Vehicle type	Cost (£'000s)
Double decker	
Articulated	
Single	
Midi (20–40 seats)	
Mini (12–20 seats)	
Coach	

Source: FirstGroup.

40. FirstGroup stated that it was relatively easy and inexpensive to acquire second-hand buses. FirstGroup provided us with a number of adverts for second-hand buses in trade magazines. These showed double-decker buses for sale at prices ranging from less than £5,000 to less than £40,000. NERA stated in its report on the effectiveness of the bus undertakings that larger operators are able to purchase new buses significantly (20 per cent) more cheaply than small operators, and, by virtue of operating ‘younger’ fleets than many smaller companies, also enjoy lower maintenance and operating costs per bus mile (see Annex 1). However, FirstGroup argued that smaller operators had the option of leasing new buses.
41. FirstGroup provided us with estimates of the annual leasing costs for new buses (see Table 8). These costs range from just over £[redacted] (mini-bus) to just under £[redacted] (articulated bus). FirstGroup owns [redacted] per cent of its buses in Scotland; the equivalent figures for Edinburgh, Glasgow and Aberdeen are [redacted], [redacted] and [redacted] per cent respectively.

TABLE 8 Annual leasing costs of new buses

Vehicle type	Cost (£)
Double decker	
Articulated	
Single	
Midi (20–40 seats)	
Mini (12–20 seats)	
Coach	

Source: FirstGroup.

## Marketing and advertising

42. FirstGroup stated that advertising was not a barrier to entry: many local authorities provided passenger information at their expense, as opposed to the operator, through bus stop information, route maps and timetable booklets. In addition organizations such as Traveline, which is an all operator transport service, provides information about operator’s services, regardless of whether they are members or not. FirstGroup told us that if an operator was entering on to a route already served by another operator, then the route was already established from the fact of there being established passenger demand for it. In that case, the introduction of the bus was sufficient by itself to raise awareness, although operators were obliged by law to

provide timetables. Once an existing operator had established passenger demand on a corridor, many passengers were likely to board the first bus that came along. FirstGroup said that its experience of new operator entry was that they did very little advertising (if any), and at most might provide timetables, the printing costs of which were not significant, and were made available on the bus and through existing local authority outlets. New operators entering a route might not need to do any advertising especially if they copied an existing route and route number. The absence of regulation on route numbers makes it a free choice for the operator to adopt bus numbers used by the incumbent.

43. In Glasgow, the total marketing budget for FirstGroup (excluding salaries) was over £[~~£~~] in 2003, approximately £[~~£~~] a bus in Glasgow. 40 per cent of this spend is allocated to generating new demand. Spending will depend on whether the route is a new service or a replacement of an existing service, the latter having a smaller cost than the former. FirstGroup gave us an example of the former and the latter. In the former (new service) costs were £[~~£~~]. In the latter costs were slightly lower at £[~~£~~] (however, in contrast to the previous example this figure related to an existing route served by multiple buses).

### **Regulatory barriers**

44. There are a number of requirements on bus operators and their vehicles (these are discussed in detail in Appendix L). For example, their vehicles require a licence, operators must have appropriate financial standing, services have to be registered 70 days before they can be operated, they have to be operated for a minimum of 90 days. These requirements do not pose a barrier to entry. The restrictions on fares and frequency do not prevent incumbents from being able to adjust these variables rapidly in response to entry (see Annex 1).

### **Access to bus stations**

45. FirstGroup told us that access to bus stations and stances was readily available. It said that in Strathclyde the SPT regulated access to bus stations and stops.

### **Shortage of drivers**

46. One bus operator told us that FirstGroup had a serious driver shortage. FirstGroup told us that driver shortages are always a problem. A small operator also mentioned driver shortage. The level of bus driver shortages has been estimated at about 32,000 across the UK.<sup>5</sup>

### **Extent of entry**

#### ***Glasgow***

47. Table 9 shows the number of new entrants in Glasgow since 1996. All of these operators are small. They are all currently still operating in the Glasgow region. Operators who have exited the market are shown in Table 12.

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<sup>5</sup>Nottingham City Transport 2004.

TABLE 9 New bus operators in Glasgow since 1996 and their size in 2004

Operator	Fleet size	Entry date (where known)
Central Bus Co	50	
S & A Coaches (City Sprinter)	24	
Jay Coach Travel	20	
Glasgow Citybus	15	
Slocoach	13	
Caledonian	11	March 2003
PJ Travel	10	September 2003
Direct Travel	5	
Boyce	?	September 2003

Source: FirstGroup.

48. We asked FirstGroup to provide a list of operators that had started offering bus services in the last three years on any overlap flows in Glasgow. FirstGroup identified 318 overlap flows in Glasgow,<sup>6</sup> of which 126 (40 per cent) had experienced new entry. 88 flows had 1 entrant, 23 had 2 entrants, 1 had 3 entrants and 14 had 4 entrants. FirstGroup told us that most of these multiple entrants involved independent operators coordinating services on a route. The new entrants are shown in Table 10. Most of the entrants are small operators. These numbers do not include entry on other routes and flows that do not overlap with rail services, even where these are in competition with FirstGroup bus services.

TABLE 10 New entrants over last three years on overlap flows in Glasgow

Avondale	42
John Boyce	36
PJTravel	36
McKindless	28
Stagecoach	18
McColls	14
Caledonia Buses	12
Scottish Citylink	2
Beta Buses	1
Canavan	1
MacNairn	1
Slocoach	1
Stepend	1

Source: CC calculations on data provided by FirstGroup.

## Edinburgh

49. FirstGroup identified 93 overlap flows in Edinburgh,<sup>7</sup> of which 13 (14 per cent) had experienced new entry in the last three years. Of the Edinburgh flows, 12 had one entrant and one had two entrants. HAD entered on nine flows, Horsburgh on three and Scottish Citylink on two. Nine of the instances are on the X26/X33 route—mostly HAD buses operating hourly, while FirstGroup operate in the peaks only. Scottish Citylink have taken over part of FirstGroup operations on the 38/38A Stirling-Edinburgh service which FirstGroup said suited Scottish Citylink coaches while

<sup>6</sup>Note that this number excludes the duplicate services which account for about half of the overlaps.

<sup>7</sup>Note this number excludes the duplicate services which account for about half of the overlaps.

FirstGroup's remaining services concentrate on local traffic. The only other entry is Horsburgh on Bathgate-Livingston which FirstGroup told us was negligible in the context of the whole route. As in Glasgow, all the above mentioned operators are still operating in the Edinburgh region.

### **Effect of new entry**

50. We asked for information on the effect entry had on price and service quality.

#### ***Glasgow***

51. We asked FirstGroup what effect the entry had had on its services. Entry appears to have elicited very little response.<sup>8</sup> Most entrants offered lower fares than FirstGroup but FirstGroup said they operated poorer vehicles (124 out of 126 flows).<sup>9</sup> There was little measurable effect on FirstGroup's services (106 out of 126 flows). The measurable effect on frequency of service on the other flows was said to be due to growth in FirstGroup's passenger numbers. On the whole FirstGroup made no changes to its services (112 out of 126 flows). For the remaining services, FirstGroup increased its frequency because, it said, of increasing passenger numbers.

#### ***Edinburgh***

52. Entry also appears to have had very little effect in Edinburgh. There was little measurable effect on FirstGroup's services (11 out of 13 flows). FirstGroup made no changes to its services.

### **Extent of expansion**

#### ***Glasgow***

53. Table 11 shows the operators who have expanded their services on overlap flows in the past three years in Glasgow. Again this does not include expansion on other routes or flows that do not overlap with rail services, even where these are in competition with FirstGroup bus services.

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<sup>8</sup>FirstGroup described entry as having no material effects on its operations, by which it said it meant it could not identify positive responses to that entry that would improve its profits.

<sup>9</sup>We have been told that other operators' fares were on average about 10 to 20 per cent lower than FirstGroup's fares.

TABLE 11 Expansion over last three years on overlap flows in Glasgow

<i>Operator</i>	<i>Number of flows Expanded</i>
McKindless	28
McColls	22
Stagecoach	19
Caledonian	12
Beta Buses	7
Dickson	7
Avondale	6
Glasgow Citybus	5
Slocoach	1
Scottish Citylink	1

Source: CC Calculations on data provided by FirstGroup.

54. FirstGroup provided a list of operators who expanded their existing services on the identified overlap flows in Glasgow. On the 318 overlap flows identified by FirstGroup in Glasgow,<sup>10</sup> there are 104 overlaps (33 per cent) where FirstGroup has observed an existing operator expanding its services. On 96 of these flows, the expansion came from one operator only. On the remaining 8 overlaps, two competing operators expanded their services.

55. FirstGroup also identified 23 overlaps in Glasgow where competing operators have exited and one overlap where a competitor (Canavan) contracted. Table 12 shows the number of operators who exited in the last three years.

TABLE 12 Exit over last three years on overlap flows in Glasgow

<i>Operator</i>	<i>Number of flows exited</i>	<i>Date operated service (from-to)</i>
Coakley	19	25/06/1999 to 08/10/2002
Beta Buses	3	15/10/2001 to 04/09/2002
Stagecoach	1	26/05/1997 to 07/01/2002

Source: CC Calculations on data provided by FirstGroup.

## **Edinburgh**

56. Table 13 shows the operators who have expanded their services on overlap flows in the past three years in Edinburgh.

<sup>10</sup>Again, this number excludes the duplicate services which account for about half of the overlaps.

TABLE 13 Expansion over last three years on overlap flows in Edinburgh

<i>Operator</i>	<i>Number of flows expanded</i>
Lothian	18
HAD	9
Scottish Citylink	4
Horsburgh	3
Harlequin	3
Docherty	3

Source: CC Calculations on data provided by FirstGroup.

57. FirstGroup provided a list of operators who expanded their existing services on the identified overlap flows in Edinburgh. On the 93 overlap flows identified, there are 40 overlaps (43 per cent) where FirstGroup has observed an existing operator expanding its services. On 34 of these flows, the expansion came from one operator, on five of them, from two and on the remaining one, from three.

58. No exit or contraction was observed on the overlap flows in Edinburgh.

### **Effect of expansion**

59. We examined expansion for the effect it had on prices and service quality.

### **Glasgow**

60. Expansion seems to have had a very limited effect on FirstGroup in Glasgow. Regardless of whether the expansion came from smaller niche or from larger scale operators, FirstGroup did not make any changes to the frequency of its services. FirstGroup argued that even with lower fares, competing operators did not prompt them into reaction because they operated buses of poorer quality. The only observable changes on FirstGroup's Glasgow network had been increases in services where there was an increase in passenger numbers. This was, however, not a direct result of expansion from competing operators. FirstGroup did say that it had introduced a discounted weekly ticket on one route where it faced competition from Stagecoach's 'Magicbus' service.

### **Edinburgh**

61. FirstGroup reported that the effect of expansion from competing operators on its services was usually limited even though expansion could occasionally slightly reduce market share or induce the loss of some passengers. The scale of these effects having been limited, FirstGroup has rarely had to react.

62. The only notable case in Edinburgh is the introduction of the limited stop services X5 and X29. These services were introduced to attract longer distance travellers travelling on Lothian operated services. FirstGroup's new services were made attractive by matching Lothian prices and cutting journey time. Lothian is reported to have reacted by decreasing fares, increasing frequency, and using new vehicles across all its main routes.

63. In Edinburgh, expansion from the main incumbent operator (Lothian) has thus had the effect of lowering prices, increasing frequencies and ameliorating the quality of

the busses on the network. Even though expansion from the smaller bus companies does not affect FirstGroup's operations, expansion from the large Edinburgh network operator has a constraining effect on FirstGroup.

## **Conclusion on the effect of new entry and expansion**

64. Overall entry and expansion would appear to have had very little effect on FirstGroup's prices and frequency in Glasgow and Edinburgh. The limited effect could be attributed to the generally small size of individual operators. These operators usually enter and expand in niche markets, with poorer quality buses and limited penetration into the bus network. Even larger operators, such as Stagecoach with its 'Magicbus' operations, have been observed to adopt a niche operator strategy to enter and expand on certain routes in Glasgow. Niche entry seems to be easy, but the overall impact on FirstGroup and the bus network remains modest. None of these operators pose a threat to FirstGroup's network and 24-hour services since most do not have a network and do not operate evenings and late nights.
65. FirstGroup responded that the difficulty or otherwise of entry at the network level had little bearing on the potential impact of the transaction on competition. What was important in that regard was whether there would be entry on to a route where FirstGroup tried to divert passengers from bus to rail. If there was entry on to a route, even from a small operator, this would be an effective constraint on FirstGroup's ability to harm passengers as a result of the transaction. FirstGroup argued that evidence from the NOP survey suggested that entry by a small operator on to a route would be a very effective means of undermining any attempt by FirstGroup to divert passengers on that route from bus to rail. It said that the NOP survey confirmed that the key factors affecting a passenger's choice of mode are the total journey time, and the convenience of the stops.<sup>11</sup> The journey times and stop locations will be more similar for two competing bus operators than for a bus operator and rail. Therefore most passengers that were 'diverted' away from a FirstGroup service would rather use a competitor's buses than use the train, whether or not that competitor is a small operator.
66. It could be the case that smaller operators would enter on routes or sections of routes if FirstGroup were to stop serving them. There seems to be a number of small operators who operate exactly where FirstGroup does not. However, we do not think that entry (or expansion by an existing operator) or the possibility thereof would provide a sufficiently effective source of competition to fully prevent FirstGroup from seeking to take advantage of a loss of competition between bus and rail resulting from the merger.
67. Larger scale entry seems to be much harder in both the Glasgow and Edinburgh region. FirstGroup's entry in Edinburgh has proved difficult because of the response this provoked from the incumbent operator (Lothian). FirstGroup also told us it reduced its weekly tickets when Stagecoach entered the Glasgow market. We also noted that Stagecoach exited some of the routes it served in Glasgow and adopted a niche strategy in order to compete with the incumbent (FirstGroup). FirstGroup still only represents a small fraction of the bus market in Edinburgh and continuously faces strong reactions from Lothian when it competes with it on prices, journey times and frequencies.

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<sup>11</sup>See for example section 5 of the NOP survey (published on the CC web site). The factors cited most frequently as reasons for choosing one mode rather than another were (a) convenience of stops, (b) frequency (which affects wait times) (c) reliability and (d) journey time.

## Reproduction of NERA's comments on barriers to entry<sup>12</sup>

1. Contrary to the views of proponents of de-regulation, the evidence from our case studies suggests to us that small scale entry will be successful only in exceptional circumstances, given the economic characteristics of the local bus industry.
2. There are four fundamental characteristics shaping the feasibility of entry and the nature of competition in local bus markets.
  - (a) Scale effects on both the demand and supply sides of the market. It appears that the very largest operators may enjoy non-trivial unit cost advantages over smaller operators, mainly because of scale at the national market level, and, possibly a lower cost of capital. Such operators are able to purchase new buses significantly (20 per cent) more cheaply than small operators, and, by virtue of operating 'younger' fleets than many smaller companies, also enjoy lower maintenance and operating costs per bus mile. This cost effect will work whenever the incumbent is owned by a subsidiary of one of the market leaders. The cost advantages are reinforced by demand side scale effects. Route entry at a lower service frequency than is offered by an incumbent, which appears to typify many small scale entry situations, usually means that the entrant secures a less than proportionate share of the market. The effect occurs because incumbents have increasingly developed competitive strategies to tie in customers, in the form of discounted return, multi-journey or network tickets, which can only be used on the incumbent's vehicles.
  - (b) Routes constitute separate markets, and so incumbents are multi-market operators. This allows the incumbent to meet small scale entry selectively, and economically.
  - (c) Prices and outputs (service frequencies and timings) can be adjusted rapidly in response to entry.
  - (d) There is limited scope for entrants to differentiate their product, or to reduce operating costs through technical innovation.
3. It is clear from the case studies that the incumbent's reputation for aggressive response to entry, combined with an awareness of the increasing disparity in depth of pocket compared to the large operators, acts to discourage small scale entry in this industry.

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<sup>12</sup>The Effectiveness of Undertakings in the Bus Industry, prepared for the OFT by NERA, December 1997, Research paper 14.