

Entry

Introduction

1. This appendix looks at the extent to which the potential for new entry on to the coach and rail markets acts as an effective constraint on the operating decisions of NEG in the Greater Anglia area and on its overlapping rail services. It may be argued that if there is viable potential for entry, and if this is recognized by NEG, then this threat may act as a constraint on NEG's pricing and service quality decisions.
2. Whilst there are examples of new entry on to the coach market in the UK, there are no instances of new entrants in the Greater Anglia area in competition with NEG on the routes about which we are primarily concerned in the past three years. In the rail market there is one recent entrant in the North-East of England.

Types of barriers to entry

3. This section discusses a number of possible barriers to entry. These barriers are typically classed as:
 - (a) *Natural or intrinsic barriers*: These characterize the necessary costs (or sunk cost) required to set up or expand operations in the market.
 - (b) *Regulatory barriers*: Barriers to entry (and also exit) may arise because of rules and regulations that must be met. Examples of these are health and safety regulations, licences, and intellectual property rights.
 - (c) *Strategic barriers*: Incumbent firms may engage in behaviour such as threatening retaliation, or other non-cooperative behaviour that may serve as effective barriers to entry.

An overview of barriers to entry in the coach market

4. Coach operators do not face regulatory or contractual restrictions in the same manner as do rail operators. Nevertheless, coach operators must adhere to the regulations prescribed by Local Authorities, the Traffic Commissioners, the Department for Transport (DfT) and TfL. These regulations include, inter alia, mobility and access, and planning. These are not believed to be barriers to entry.
5. Therefore, the barriers to entry that are most likely to be present in the coach market are natural barriers or strategic barriers. These include: network advantages and through tickets, NEL's franchise system, level of marketing and advertising, concessionary fares schemes, the cost of coaches, access to stations, the size of the coach market in the Greater Anglia area, possible retaliatory behaviour by NEL, the quality of the road system, and the shortage of drivers. Each potential barrier is considered below in more detail.

Network advantages and through tickets

6. NEL's extensive network coverage may serve as an entry obstacle for operators wishing to enter the market. NEL is able to provide almost seamless interconnections, a provision highly valued by passengers. This is enabled by its level of frequency, connections at hub points such as Victoria Coach Station, and its system of through tickets.¹ Such network advantages may make it less easy for new entrants to compete successfully. Currently, no other operator has a comparable network system in the coach market. NEL believes that even though other operators may not have an extensive network system, there is the possibility that some may be able to 'cherry pick' key routes. However, a large proportion of the passengers use some of these services to make connecting journeys. Two of the key routes in the reference area are profitable for NEL only when considered as part of the network system. Hence, it is unlikely that there would be a credible threat of entry on these key routes. Therefore, NEL's network affords it a considerable competitive strength and a potentially significant barrier to entry.

NEL's franchise system

7. Some of the possible entrants on to the coach market are currently franchisees of NEG. As a franchisee, operators are guaranteed an income. Hence, for many, it may be more profitable to be a contractor rather than a competitor. Nonetheless, being a franchisee of NEL does not prohibit operators from simultaneously being competitors of NEL. This is, however, not a prevalent practice.

Marketing and advertising

8. In the coach market, there is, arguably, limited scope for entrants to differentiate their product from that of NEL and advertising costs and branding may pose a barrier to entry. There is also very little scope for reducing operating costs through innovation.
9. However, new entrants may be able to reduce advertising costs if passenger information is disseminated for free through local authorities or organizations such as Traveline. As in the case of Megabus and Easybus, potential entrants could also make use of the Internet to provide information on their services and to sell tickets.

Concessionary fares schemes

10. NEL offers a range of discounts to its student customers. This group makes up a significant proportion of coach patronage. Therefore, some potential entrants may be put off if they perceive that they may not be able to offer a concessionary fare scheme to students on a similar scale as NEL. This is not likely to be a barrier to entry for bigger operators such as Megabus and Easybus who already target students.
11. In addition to its discount tickets, the recently-introduced reward point scheme may serve to further cement customer loyalty and to tie customers to NEL making it difficult for new entrants to gain customers. NEL does not believe this to be the case.

¹These increase the ease of travelling as well as reduce the cost of travelling.

Cost of coaches

12. New coaches reportedly cost between £150,000 and £250,000. For a small independent operator, such costs may be prohibitive if bought for use by a smaller operator in its own right.² Whilst it may be possible for small would-be operators to purchase coaches at a lower cost on the second-hand coach market, the relatively higher maintenance cost and operating costs per coach mile may outweigh the gain on purchase price. On average, annual maintenance cost per coach is approximately £25,000 and this may be higher the older and smaller the size of the fleet.
13. Moreover, most second-hand coaches pre-date 2002 from when schedule services were required to comply with the Disability and Discrimination Act, Part 3. This means that operators hoping to use second-hand coaches would be at a disadvantage in attracting some passengers. An added disincentive is that whilst most new coaches are sold with an automatic one-year guarantee, second-hand coach purchase does not have this benefit. Moreover, warranties and insurance-type warranties are likely to be more expensive on older vehicles.
14. On the other hand, acquiring second-hand coaches may not be hugely difficult. NEL estimated the number of available second-hand coaches to be approximately 500 at any one time with many of those being less than ten years old³ and the cost to be in the range of £4,000 and £75,000.⁴ Leasing costs fall in the range of £2,000 and £2,500 a month.⁵

Access to coach stations

15. NEL does not own any of the coach or bus stations in the Greater Anglia area. The coach and bus stations are usually owned by the local authority. Most endeavour to treat coach operators equally. However, discounts may be offered to coach operators who meet certain conditions. As a consequence, coach operators may face different charges for the usage of the stations. Ordinarily, discounts are offered for passenger volume. Therefore, small operators who wish to enter the market may be at a disadvantage.
16. In the case of Victoria Coach Station, which is owned by TfL, all coach operators face the same tariffs but operators exceeding 110,000 departures a year are given a 15 per cent discount.⁶ Discounts are also offered on the basis of service continuity and distance—operators who provided shorter-distance services are entitled to a discount.
17. Victoria Coach Station provides added financial incentives for ‘new’ operators. Promotional discounts on Victoria Coach Station’s normal published fees may be granted to new operators and those who have not previously operated from Victoria Coach Station (or who have not operated from Victoria Coach Station within the preceding 12 months). However, if a new operator receives a promotional discount for a service that is already offered by an existing operator, then the discount would also be granted to the existing operator. Therefore, new entrants who wish to operate services on the routes that are already served by NEL are not likely to gain an advantage from these promotional discounts.

²We were not provided with information on overall entry cost.

³A coach usually has a lifespan up to 20 years. NEL normally replaces its coaches after seven years.

⁴This estimate is based on a few advertisements.

⁵This refers to a pure finance lease. Information on operating leases, which includes maintenance costs, was not provided to us.

⁶This discount will not apply to services introduced in direct competition with a new operation at Victoria Coach Station.

18. Except at 9am during the summer, Victoria Coach Station currently has spare capacity for additional coaches at all times. Moreover, all coach operators are afforded equal treatment in its retailing operation and it ensures that the staff are trained to sell all the operators' tickets. In addition, coach operators have access to a bus station as well as bus stops (located on Bulleid Way) that are in close proximity to Victoria Coach Station. Therefore, it does not appear that access to Victoria Coach Station should pose a major hindrance to entry for potential coach operators.

Size of the coach market

19. The size of the coach market in the Greater Anglia area, in particular the overlapping flows considered, is relatively small and may not profitably accommodate additional scheduled operators. Based on the information supplied by NEG, the routes serviced by NEL do not serve a high volume of passengers. For example, the largest (NEL) route within the Greater Anglia area,⁷ which is serviced by only five coaches a day, generated total revenue for the year 2003 of £[x] from [x] passengers. Furthermore, without taking into account network revenues, some of the services, such as the 481 and the 484, are [x]. Hence, unless they enter as part of a wider national network or following the withdrawal of services by NEL, entry on to the coach market in the reference area might not be an attractive prospect for would-be entrants.

Retaliatory behaviour by NEL

20. NEL told the CC that in the past it reacted to new entrants. Indeed, in the MML report, NEL was noted to have reduced fares on services between London and Sheffield following entry by another operator.⁸ NEL also said that when Megabus entered the coach market, it responded by adjusting some of its (fun) fares. In addition, the CC noted in the MML report that even when new entrants were able to offer reasonably low fares, NEL was prepared to match the low fares thereby limiting the new entrant's ability to establish a competitive edge. However, NEG argued that such a response was now disallowed by its Competition Compliance Manual which was adopted in 2000.
21. NEL argued that, unlike in the past, it preferred to adopt a more relaxed approach to new entrants. It stated that it had not altered the frequency of any of its services in response to a new entrant. In addition, it pointed out that for a number of years it had operated services overnight on coaches from Scotland–London alongside a small competitor and had not taken any particular action against them.
22. With both coach and rail operations in the same area, NEG may now have a greater incentive to engage in retaliatory behaviour in the event of new entry than if it only operated coach services. A new coach entrant in the Greater Anglia area may not only take away some passengers from NEL's coach services but may also be able to poach some rail passengers. Potential entrants may be aware of this increased incentive for NEG to respond aggressively in order to defend its territory and may be discouraged from entering. Thus, NEL may be less likely now to face the threat of possible entry in the franchise area.

⁷Largest in terms of passenger volume and total revenue.

⁸Thus, in this instance, NEL's response was to the actual competition rather than the threat of potential entry. However, it was noted that NEL maintained the lower fares even after the new entrant withdrew its services.

Quality of road systems

23. A possible deterrent to the development of new coach services in the Greater Anglia area is the poor quality of the road system to the north and east of the Cambridge–Ipswich section of the A14.

Shortage of drivers

24. It is widely acknowledged that there is a shortage of bus/coach drivers in the UK. Estimates put the national shortage to be around 32,000.⁹ NEL suggested that one of the reasons why First Group did not seek to become one of its franchisees in some areas is that it faced a shortage of bus drivers. A shortage of drivers will undoubtedly have an adverse effect on the ability of new entrants to expand or enter the market.
25. Thus far, it can be surmised that although entry is not impossible, potential entrants on to the coach market on the overlap routes we are considering could be hampered by a number of obstacles. The ones that are likely to be the most prohibitive barriers are NEL's network advantages, marketing and advertising, the size of the coach market in the Greater Anglia area, and the threat of retaliation by NEG.

Possible entrants

26. The recent emergence of three new entrants—Easybus, Megabus¹⁰ and Terravision—in the UK coach market suggest that whatever the existing natural and strategic barriers to entry in the coach market are, they might not be entirely prohibitive. However, though these operators have been able to enter the coach market in other parts of the UK,¹¹ this does not necessarily imply that the potential to enter will be the same for the bulk of the Greater Anglia area. Indeed, the extent to which these potential entrants act as effective constraints on the operating decisions of NEG in the Greater Anglia area is unclear.
27. NEG argued that because of the low profitability of many of NEL's routes,¹² it was unrealistic (though not impossible) that the existing operators Megabus and Easybus would enter the market in the Greater Anglia area.¹³ Hence, it can be assumed that NEL may be able to make pricing and service decisions for the Greater Anglia area without taking into account entry by these operators.
28. Within the Greater Anglia area, First Group is one of the most prominent bus operators. It operates services on many of the shorter flows in the area. Several of its bus services are close to rail stops for most major rail routes. Specifically, it offers services on the route Peterborough–Great Yarmouth (an express bus service (X94)) and Colchester–Stansted Airport.¹⁴ First Group is also considering doubling the service between Peterborough and Great Yarmouth.

⁹Nottingham City Transport 2004, News item *Get On Board in the Market Square—NCT recruitment drive*.

¹⁰Megabus is a subsidiary of Stagecoach.

¹¹NEG noted that (unexpectedly) Megabus had been able to enter the coach market in areas where it did not necessarily have depots.

¹²The reported loss by NEL on some of its routes not facing capacity constraints could be indicative of a situation in which the fares are set below the long-run competitive equilibrium. In such a case, new operators may not wish to enter.

¹³However, conditions may change and render it profitable to enter the market in the Greater Anglia area. It has been suggested by NEG that given Megabus's target passenger group, it might consider serving the university at Norwich. However, Megabus is not currently serving this route.

¹⁴In contrast, NEG does not operate any bus services in the franchise area.

29. NEG argued that First Group had considerable resources throughout the region. NEG pointed out that First Group had a fleet of coaches, established bus depots, service centres, and drivers, which it could use to extend its provision of scheduled coach services within the region if it considered it profitable to do so. In other words, NEL believed that if it were to raise fares or reduce services, First Group was well-positioned to expand its coach operations within the region. However, First Group would not have many of the network advantages enjoyed by NEL.
30. Beside NEL, there are two other independent coach operators in the area that provide scheduled services—Stephensons of Southend and Olympian—but they are relatively small in size. Stephensons operates eight services each day in both directions between Southend and London. These services focus, in particular, on peak-time commuter traffic. Olympian operates five services every day during peak times that are dedicated to commuter travel between Bishops Stortford and London Victoria.

Expansion/contraction by NEG

31. At present, NEL is the largest incumbent. It has been established that NEL operates all major coach services in the Greater Anglia area. NEL operates 19 services within or through the Greater Anglia area and there are no other operators of coach services scheduled on the overlapping routes under consideration.
32. Furthermore, there have been no new (single route or whole network) entrants on to the coach market over the past three years on the overlap routes we are considering. Neither have there been any expansion, contractions or exit during this period. Also, NEL does not currently have plans to expand its services within the Greater Anglia area.
33. While there have been no recent contractions, it may be reasoned that a future contraction is possible. Given the low usage of services 481 (Ipswich–London) and 484 (Clacton–London), we noted that NEL had in the past considered withdrawing these services. Any possibility of a contraction of services in the Greater Anglia area is of particular concern in so far as NEG may use the opportunity arising from its new acquisition to withdraw these services and push passengers on to rail. However, NEG has highlighted the importance of the 481 and the 484 for the revenue from onward journeys for which a substantial majority of the passengers use these services.

A general overview of barriers to entry in the rail market

34. NEG did not believe that there was any prospect of entry on to rail services in the Greater Anglia area. It was of the view that opportunities for regulatory consent, track access space and sufficient market demand were limited.
35. With regard to rail entry, the ORR decides whether new entrants can enter on to the National Rail Network.
36. There are reportedly very few non-franchised applications for open access. Hull Trains has been successful in gaining open access but a recent application by Grand Central was turned down by the ORR because of the degree to which it might take

passengers away from the incumbents.¹⁵ The July 2004 White Paper *The Future of Rail* states 'With capacity increasingly constrained, open access opportunities will be limited, and access rights should not be granted for services which just poach passengers from other services and do not increase the overall market'.

37. The ORR said that while there was no spare capacity during the peak times for the Fenchurch Street–Southend and the Liverpool Street–Southend Victoria routes, there was room for spare capacity during the off-peak times on the London–Ipswich–Norwich line. A reduction of services by one train an hour was planned for the two-track section between Shenfield and Colchester. This was mainly to create capacity for freight. Hence, as indicated by the ORR, any application for open access on that route would face competition from freight traffic.
38. The need to accommodate increasing levels of freight from the Midlands and the South-East to Felixstowe therefore places a significant constraint on other services. Indeed, one of the reasons why the Service Level Commitment for the Greater Anglia franchise has proposed a reduction in the timetabled services is to make more slots available for growing freight traffic.
39. In short, NEG's operations are unlikely to be significantly restrained by new rail entry considerations as the prospects for new rail entrants in the Greater Anglia area are very limited.

¹⁵The ORR was concerned that Grand Central would have been mainly extractive insofar as it would have extracted a significant amount of revenue from incumbent operators if it were to break even. It was believed that there was not enough evidence of customer switching and, given the significant overlaps, most of Grand Central's revenue would have been obtained at the expense of Great Northern Eastern Railway Co Ltd.