IMPACT OF THE RECESSION ON THE RAIL SECTOR AND ITS RESPONSE

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1. INTRODUCTION

1.1 Background

Passenger Demand Forecasting Council (PDFC) members, which include representatives from the Train Operating Companies, DfT Rail, Network Rail, Transport for London, Transport Scotland and the Office of Rail Regulation, have a common interest in understanding the drivers of rail passenger demand.

As part of an on-going research programme, the Council commissioned Accent to undertake research specifically designed to provide a greater understanding of how the industry can respond most effectively in times of recession in terms of maintaining and growing revenue and demand.

1.2 Objectives

The Council's primary aim for this research was to address the following:

- How can TOCs (and the rail industry as a whole) best respond to the current recession (and to downturns more generally) in order to continue to maximise and grow passenger demand and revenue, given the existing regulatory constraints?

This was explored by looking at how the rail industry response had compared with responses in other business sectors.

2. METHODOLOGY

2.1 Introduction

A six phase study was undertaken to meet the research objectives:

The rest of this chapter describes the methodology for each of the six phases of research in detail.

2.2 Desk Research

The desk research looked at business and public confidence issues covering some key ongoing measures. It sought to establish the underlying patterns between confidence and rail/other sector business performance.

2.3 Discussions with TOCs

There are twenty franchised operators (shared between nine owners). We interviewed around a half of these.

ATOC facilitated this process by providing an introductory email. In addition, we assured confidentiality of responses to maximise the potential response.

The interviews were undertaken by telephone. The depth questionnaire explored:

- current trends in rail travel, specifically changes in flows, ticket types and class
- promotions and pricing changes undertaken (with resulting impact) and planned
- customer research undertaken in relation to this and lessons they could share
- perceived regulatory constraints that might inhibit recessionary easing measures
- long term constraints that would deter them from doing things that might cause future difficulties.

2.4 Discussions with Other Sectors

The ‘comparator’ sectors selected comprised travel, retail, catering, utilities and financial services. The specific businesses selected were chosen to broadly map rail’s customer types as shown in the diagram below.

	Business	commuting	Leisure	PND
Travel	Air	Bus	Coach	Air, coach
Retail	Upmarket	Supermarkets	Mass market	Essentials, Supermarkets
Catering	Upmarket restaurants	Fast food	Pubs/Low cost restaurants	Mid range restaurants
Utilities	Utilities	Utilities		
Financial services	Business banks	Banks, building societies		

Chosen sectors were representative of those which were seen to have particularly suffered (eg retail, restaurants, financial services) as well as those which had not suffered so much or even benefited (eg low cost retailers/caterers, public sector organisations, utilities). Ten organisations were covered through telephone interviews exploring the same issues as for the rail representatives.

Representatives from the following organisations were interviewed:

- Visit Britain
- npower
- TfL
- UK Buses
- Tesco Personal Finance
- English Heritage
- BAA
- British Gas
- Cancer Research UK
- Wyeth Consumer Healthcare.

2.5 On Line Survey with General Public

An internet survey of 1,000 UK residents was undertaken to understand their relevant behaviour and perceptions. An online panel company was used for the survey sample.

The survey covered different areas of the country and included urban and non urban residents.

Region, age and gender quotas were set to ensure the sample was broadly representative of the UK population.

The questionnaire focused on:

- Impact of recession
- Current spending patterns
- Current travel patterns including rail
- Awareness of rail pricing and products
- Demographics.

A pilot of thirty interviews was undertaken between 3 and 6 July 2009. A report on the pilot was prepared which recommended minor changes.

The main fieldwork took place between 14 and 22 July 2009.

2.6 On Line Survey with Businesses

An internet survey of 200 UK senior business managers was also undertaken to understand their relevant behaviour and perceptions. An online panel company was used for the survey sample.

Region and business size quotas were set (based on 2007 data from National Statistics) so that the sample was broadly representative of UK businesses. The questionnaire focused on:

- Impact of recession
- Current travel patterns including rail
- Awareness of rail pricing and products
- Company characteristics

A pilot of ten interviews was undertaken on 3 July 2009. A report on the pilot was prepared which recommended minor changes to the questionnaire were made following the pilot.

The main fieldwork took place between 14 and 22 July 2009.

2.7 Workshop

Finally, a workshop was held in August 2009 to discuss the findings.

The attendees included members of the steering group, three TOC representatives who had been interviewed and one other business representative who had been interviewed.

A presentation of the key findings for the five prior stages was given.

The final two slides raised key areas for discussion (based on the findings) and these formed the basis of the workshop.

3. DESK RESEARCH

3.1 Introduction

The desk research looked at business and public confidence issues covering some key ongoing measures. It sought to establish the underlying patterns between confidence and rail/other sector business performance.

The key resource was a review of some general economic trends concerning the recession and prospects for a return to economic stability. It is important to note that the review was conducted in July 2009. In addition, the desk research examined appropriate rail sector documents.

3.2 Overview of Recession

Introduction

During the 1993-2007 period the UK economy enjoyed an exceptional economic upswing: annual real GDP growth averaged almost 3%, while consumer price inflation averaged 1.8%. As was the case with the US economy, such comparative macro stability generated much talk about the Great Moderation and the abolition of boom and bust.

During the year and a half leading up to July 2009, however, things had gone badly wrong. UK GDP began falling in the second quarter of 2008 and continued to contract thereafter. And while the ONS estimated that the second quarter of 2009 contraction, at -0.8%, was substantially less than the -1.8% and -2.4% declines seen in Q4 2008 and Q1 2009 respectively, Q2 GDP was nonetheless over 5½% lower than a year earlier.

Within overall GDP, construction and industrial output suffered most. Service sector activity, however, also suffered, having fallen by 3.8% year-on-year in the second quarter of 2009.

As the following table illustrates, the magnitude of the recent UK economic contraction was more severe than those of its mid -1970s and early 1990s predecessors, with that of the early 1980s – itself the worst contraction since the Great Depression – only marginally worse. Importantly, though, the recent loss of overall economic output has occurred within the significantly shorter time-span of only five quarters.

	GDP peak to trough	Depth (%)	Duration (Qtrs)
Mid-1970s	Q2 1973-Q3 1975	-3.3	9
Early-1980s	Q2 1979-Q1 1981	-5.9	7
Early-1990s	Q2 1990-Q2 1992	-2.5	8
Current to date	Q1 2008-Q1 2009	-5.7	5

Timeline

As with the US recession which began in 2007, few saw the UK recession coming. 2008 saw a continual downward revision of economists' GDP forecasts in response to a chronically worse than expected economic data news flow, but it wasn't until early autumn 2008 that forecasters begun to acknowledge that recession was underway. The growth downgrading process then intensified and continued during the early months of 2009.

Several indicators had actually increasingly suggested during 2007 that all wasn't well with the UK economy. The beginning of the world-wide credit crunch in the summer of 2007 had undermined a frothy and over-valued housing market, with worrying implications for an increasingly over-leveraged household sector. And both the OECD and Conference Board composite leading indicators increasingly flagged up the prospect of a slowing economy from mid-2007 onwards.

Only during the first half of 2008, however, did the closely-watched monthly PMI business surveys – covering manufacturing, construction and services – each slip into sub-50 territory, thereby signalling the onset of outright economic contraction in the second quarter of 2008.

Subsequently, the economic situation deteriorated rapidly, especially from September 2008 onwards, as the financial crisis escalated and the global credit system imploded. As a synchronised global economic downswing rapidly gathered pace, UK exports nose-dived. Meanwhile, private sector domestic demand began to be cut back sharply, with only government spending continuing to increase.

As far as private sector demand was concerned, business inventories were slashed as never before; business investment collapsed and consumer spending shrank for successive quarters. Such back-to-back retrenchment on the part of the previously free-spending British consumer hadn't been seen since the recession of the early 1990s. Partly for this reason, the onset of consumer recession came as a considerable surprise. As has also been the case on the other side of the Atlantic, it was blithely assumed that the consumer would *never* drop by the wayside.

This was the context against which we set out to look at the rail sector response.

3.3 Rail Demand

The previous section discussed the overall economy.

Macro-economic indicators cover a very large number of economic factors and, therefore, represent general trends with some accuracy. Predicting the impact upon rail demand, however, presents other complexities.

Because of the many substitution and income effects for rail, there is no simple prediction to be extrapolated from general economic trends to trends in demand for rail in particular.

The rail industry has produced a number of reports and data which address the possible demand for rail under changing economic conditions.

We here review some of the seemingly most relevant outputs from these reports.

To begin with, we discuss some factors which hold very generally for the demand for rail. These describe general mechanisms influencing demand, although their relative effect in a recessionary economic climate is difficult to determine.

- Main factors that affect **commuter** demand:
  - employment levels (generally decreases in economic activity lead to decreases in commuting although there may be increases in part time work and, therefore, commuting coupled with other more complex shifts)
  - relative prices of substitutes/fares
  - disposable income
  - housing turnover/labour market mobility
  - lower crowding may induce demand.

- Main factors that affect **business** rail demand:
  - GDP
  - relative rail prices
  - business confidence.

- Main factors that affect **leisure** rail demand:
  - employment levels
  - disposable income
  - home prices/net wealth
  - consumer confidence
  - car ownership levels.

It should be noted that two other long term factors have emerged in recent years which will also contribute to a reduction in rail demand in the business and commuter population:

- The technological ease and low cost of tele-conferencing

- The increased use of ‘flexi-time’ in working means that the need for ‘face time’ in the office is decreased.

One main lesson to emerge from the consideration of data relevant to any of these factors is the need to disentangle the many substitution effects between rail and other modes of transport and the need for transport *per se*. There are numerous competing forces moving in opposite directions. This is partly because a number of substitution effects in leisure may in fact increase demand for rail; for instance, more people may holiday within the UK using rail than fly abroad. These effects are far too difficult to discern from the existing data over a relatively short period of recession.

4 MARKET RESEARCH

4.1 Depths Interviews with TOC and other business sector representatives

All respondents felt that they were doing the best they could under the circumstances. However, there were clear differences between the rail and non-rail respondents.

- TOCs reported that the strong growth they had experienced before the downturn had now reversed and that business was stagnant. However, they typically thought they were doing reasonably well. Respondents from other sectors, on the other hand, reported being under pressure or weathering the recession.

- TOCs felt they typically had little flexibility with regard to prices beyond changing the quotas on advance tickets. Non rail respondents felt that price had never been more important and that flexibility in this was paramount but that an enhanced customer service offering was also increasingly important to help differentiate products from competitor offerings.

- TOCs were more likely to be relying on the same mechanisms they had always used to measure and monitor the market, with there being only limited evidence of specific research into the impact of the recession. Non rail respondents appeared to be regularly conducting research into the recession to help measure its impact and identify what customers wanted in that economic climate.

- TOCs said they would respond more quickly to a recession in the future. Non rail respondents also said they would respond more quickly in the future, building on and learning from their experiences this time, identifying those measures that had worked and those that had been less successful.

4.2 Internet survey with the general public

The key findings from the internet survey with the general public were:

- Impact of recession:
  - Two thirds of the general public said that they had less money to spend on things that they want to buy after all the ‘living’ bills are paid.
  - The general public were overwhelmingly pessimistic about the UK economy for the subsequent six months (a net pessimistic balance of -40%) although somewhat more positive about their own circumstances (a net pessimistic balance of -6%).

- Current spending patterns:

- In the last year the general public saved less and spent more: 47% saved less and 50% spent more.
- The main increases in spend year-on-year were on utilities, Council tax, food shopping, TV, insurance and travel to work. The main decreases in spend were on eating out, days out, holidays and mortgage.
- 27% spent more on travel to work and 11% spent less. 23% spent more and 25% spent less on other travel.

- Current travel patterns:
  - Air use fell 17% compared to a year before, car use fell by 9% and rail use fell by 8%.
  - Rail was used less mainly because of cost, poor value for money and making fewer leisure trips.
  - The main changes on balance in how rail was used over the last year was a large reduction in leisure (-15%) and shopping (-12%) trips, an increase in the use of Advance (+14%) and off peak (+12%) tickets and a decrease in First Class usage (-10%).

- Awareness of rail pricing and products:
  - The general public thought rail represented poor value for money compared to other modes.
  - Railcards, Advance and off peak tickets were, however, considered good value for money on balance.
  - Similar and large proportions (44%) thought rail and car provided worse value for money than a year ago.

- Impact of recession by business sector:
  - Rail was perceived worst of all a great variety of business sectors presented in terms of trying to help customers through the recession.
  - Rail was perceived to be mid table in terms of how the public felt that the sector had suffered through the recession.

4.3 Internet survey with businesses representatives

The key findings from the internet survey with businesses were:

- Impact of recession:
  - About half of UK businesses said both profitability and turnover were down year-on-year. About a third expected improvement in both over next the six months.
  - Nearly two thirds of UK businesses were cutting costs with travel being a key area where costs were cut.
  - UK Businesses were pessimistic about the UK economy over the next six months, but much less pessimistic about their own company.

- Current travel patterns:

  - There was an 8% net decrease in rail commuting trips and a 13% net decrease in rail business trips by company staff.
  - The main reasons for making fewer rail commuting trips were more home working and fewer staff.
  - The main reasons for fewer rail business trips were a lower requirement because of the recession and using conference calls/web meetings more or instead of making trips.
  - The largest net falls in mode use over last six months were: car (-18%), rail business (-13%), air (-12%) and rail commuting (-8%).
  - 25% said there had been some change in their company's business travel policy because of the recession. The main changes were to encourage conference calls (50%) and to encourage home working (42%).

- Awareness of rail pricing and products:
  - Businesses (like the general public) thought rail represented very poor value for money compared to other modes.
  - First Class tickets were very poorly rated in terms of value for money: 71% thought First Class Anytime and 54% thought First Class Advance tickets were poor or very poor value for money. Rail Off Peak and Standard Class Advance tickets were most positively rated with over a 40% saying each was good or very good value for money.

- Impact of recession by business sector:
  - Rail was perceived to have been poor in terms of them trying to help business consumers through the recession.
  - The business areas which were seen as having done best were utilities and telephone/mobile/internet companies.
  - The business areas which were seen as having suffered worst as a result of the recession were restaurants, hotels and airlines. Rail was mid-table.

4.4 Workshop

The workshop presented the key findings from the preceding stages (desk research, interviews with TOCs and other businesses and internet surveys with the general public and businesses) and summarised the key messages from the research.

Each of the key messages was discussed and it was concluded that the findings mirrored much of what participants had felt to be the case.

The industry was felt to have suffered from the recession but not as much as other sectors had.

There had been a feeling and a frustration that it was not possible through the franchise structure (and to some extent through regulation) to be as flexible on pricing as the industry had wanted to be. The franchise constraints were felt to be driven by the currently much publicised ‘short’ franchise terms coupled with contracts which it could be argued put more prominence on cost cutting rather than revenue generation.

As a result participants felt that the public and businesses were probably realistic in concluding that the sector had not been as amenable as other sectors in helping people ‘weather the storm’.

It was further felt that there seemed to have been a collective ‘step to the left’ (to the next product down) in purchasing behaviour within the sector with consumers looking to save money in each transaction. It was felt that this could be addressed as the economy came back out of recession

However, participants also felt that there were some changes in behaviour which might have strengthened an existing trend and which may not be so easily countered – this included issues such as home working and tele-conferencing.