Hong Kong Bus Industry in International Context
A stunning shot of a white "fog bow" has been captured by a photographer over Rannoch Moor in the west of Scotland.
Case Study of 3 Distinct Systems

- HONG KONG                        HYBRID
- UK OUTSIDE LONDON                DEREGULATED
- UK (LONDON)                      REGULATED
Essential Attributes of Hong Kong System

- ‘User Pays’ Principle Applies
- Zero Direct Subsidy
- ‘Healthy Competition’ between Modes
- Private Companies with 10 Year Franchises
- Prudent Commercial Principles. Operator takes 100% Revenue Risk
- Government Regulates Service Supply but the Onus of Initiative for changes to Routes, Frequencies and Fares lies with Operators
- Government requires ‘Proper & Efficient’ service and stipulates Minimum levels of quality standards
- Very High Degrees of Public Satisfaction and PT usage in HK
- Low and Stable Fares and High Quality of Service Provision
- Reasonable returns for investors. MBOF Mechanism for fares
## Hong Kong Hybrid Model

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<tbody>
<tr>
<td>Hong Kong</td>
<td>Operators in most cases but subject to Gov approval</td>
<td>Operators but subject to Gov approval</td>
<td>Operators apply to Gov at will. A Basket of Factors considered by Gov</td>
<td>Operators</td>
<td>Operators subject to Gov approval</td>
<td>Medium</td>
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<td>Scotland &amp; All English Cities (except London)</td>
<td>Operators</td>
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<td>Country</td>
<td>Level of Entrepreneurial Space</td>
<td>Cost to TaxPayers (excluding elderly concession subsidies)</td>
<td>Socially necessary services</td>
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<td>Hong Kong (HK)</td>
<td>Medium</td>
<td>Essentially Nil</td>
<td>Cross subsidised within network (c60% of routes but \textbf{MUCH} less of the mileage). Relentless Housekeeping by Operators minimises X Sub</td>
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<td>Singapore/London</td>
<td>Low</td>
<td>Relatively Higher than HK</td>
<td>100% Service Supply subject to specification by GOV</td>
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<tr>
<td>Scotland &amp; All English Cities (except London)</td>
<td>High</td>
<td>Very Low</td>
<td>Government specified social mileage is as little as c5% of overall mileage in the most vibrant of cities (eg Ed/GLA)</td>
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Dispel Some Urban Myths

• Absence of quantity control (Routes and Frequencies) by politicians does not necessarily mean poor service for passengers. Eg Brighton/Edinburgh widely regarded as offering excellent bus services.

• Commercial fares do not necessarily mean unacceptably high fares if the market is either contestable and/or where operators are constantly incentivised to maximise profits by changing routes/frequencies and marketing strategies.

• Commercialised operating model is capable of underwriting high quality services whilst maintaining subsidy levels at low levels (allowing limited public monies to be targeted in education, health and to fill any perceived gaps in public transport market – eg socially necessary services).
Commercialised Systems

- Favourable outcomes when markets are fairly contestable in proportion to the commercial freedoms granted (prevents monopoly profits and ensures high levels of productivity and innovation)
- Works best when the ‘gaps’ which the commercial market are not willing to provide are at lower order.
- Reasonably objective criteria for what constitutes ‘gap’ is needed. Minimises the risk of the ‘invisible equivalent of EU Wine Lakes and Butter Mountains’
- Full transparency of role of state and role of private sector avoids known risks of ‘blanket subsidy’, ‘deficit financing’ & ‘regulatory capture’
- Thrives where there are ‘non adversarial partnerships’ between Local Authorities and private operators.
- Commercial ‘cross subsidisation’ continues to exist to the benefit of taxpayers: But only if market is seen as contestable.
- Undoubtedly serve to reduced ‘X inefficiency’ and thereby achieves lowest unit costs (just as do Gross Cost Contracts)
In Quotes

• “When you’re Pioneering”, Don’t Look for Evidence: Nicholas Ridley

• “He who Pays the Piper, Calls the Tune”

• ‘Cross subsidy should be looked at both from the perspective of the people who pay for it as well as those who benefit from it”’ Hibbs

• “Blanket Subsidy Blunts Cutting Edge of Management”’ The Times

• “Amongst the Inefficient, there will be Slaughter” – Hibbs (1985) & “Innovate of Die”

• “Over Regulation of Bus Industry Introduces Inertia into a Naturally Competitive and Adaptable Industry” (Hobart Paper 1963)
Gross Cost Contract Model

- Limits private sector innovation and entrepreneurial spirit, calling principally on operating skills/cost control skills from contractors. Arguably transfers the demand for entrepreneurial talent from private sector to the Government Agencies.
- Assumes that Government officials can second guess the market demand for bus services and can specify and fund services to meet changing requirements optimally.
- Blurs the distinction between socially necessary services and services that can be provided by the market. Mileage can be under or over provided if not subjected to market tests.
- Fares control can lead to unhealthy ‘consumer surplus’ potentially financed by means of an opportunity cost to other Government services.
- Affordability is a two sided coin.
- Can succeed in securing lowest cost per mile. But the question is always whether the miles are optimal.
- Attracts many bidders; but easy to win by underbidding. And bid costs very high, despite that differentiation between bidders is often low in mature markets.
Hong Kong Hybrid System of Regulation Works Well

• Onus of Initiative for changes in routeings, frequencies and fares is firmly in the hands of Private Operators. Guards against Waste and ensures Innovation is rewarded

• Government retains right of Veto of any Plan and can ultimately can apply sanctions to rogue operators

• Government seeks to balance the interests of individual operators, users, modes recognising that ‘reasonable returns’ are needed to encourage investment without recourse to the public purse.

• Government provides excellent enabling infrastructure for bus operators (eg termini/bus lanes/new roads and tunnels) and makes car usage relatively expensive.
HK avoids common perils of too much prescription from Government

- Tariffs (fares) becoming unduly politicised leading to deficit financing by the public purse
- Taxpayers subsidising fares lower than the market is willing to bear
- Artificially low fares and consequent reliance on public funds mitigating against investment in higher quality and higher capacity
- Excess capacity and political ‘vanity’ routes are avoided/minimised thus eliminating the need for direct subsidies and excess cross subsidy
- Public Expectations of Government’s powers to directly control outcomes are managed such that buses are rarely a major political problem for GOV
- Innovation is not stifled in the marketplace
- Private Sector Investor Interest is High. The mere threat of competition FOR the market combined with the competition IN the market is usually sufficient to maintain high standards & reasonable fares
HK Digest of Transport Statistics 2005-2014

- HK Population up by 7% 2005-2014 (6.8m-7.3m)
- Public Transit Ridership up by 12% (12.5m pax journeys/day)
- Franchised Bus STABLE (3.9m pax trips/day)
- Rail Share now 40.5% market share [up from 34%]. Additional 1.2m pax trips/day, a rise of 32% since 2005
- Bus Ridership tends to increase with a growing population in years when no new railways. Bus still has 48% market share.
- Despite that CAGR growth in private cars=4%/annum over recent years. Taxi Trips actually DOWN by 5% (973K/day)
- Non Franchised Bus (Resident Services) =237000/day up 33% since 2005 despite Cap on Non Franchised Bus numbers. Minibus (capped at 4400 buses) carry 1.8m/day
Healthy Competition Between Modes
Minibuses Fixed at 4350 Vehicles
HK Market Share by Mode (Pax Journeys in million per day)

2014

- All Bus: 6.011, 48%
- Rail: 5.08, 41%
- Ferry/Tram: 0.973, 8%
- Taxi: 0.317, 3%

Bus total includes Public Light Bus and Non Franchised Bus Totals
Bus is Holding its Own, despite threats from Railways, Private Cars, Oil Spikes

- Commercial model in HK has allowed at least one major operator to hold bus fares constant for more than 10 years. And still make good returns.
- Even on the busiest routes, some 80% of bus passengers enjoy seats in the peak (close to 100% during off peak periods).
- Bus is the Mode of Choice for many due to competitive journey times and good individual space. Many of KMB’s most profitable routes use new express highway infrastructure that is parallel with railways.
- The Economic/Regulatory Model is coping well with the Environment. Existing operators seek to Renew Franchises for next 10 years on similar terms.
Breakdown of Bus Market Share (Pax Trips/day in Millions)

- **2014 Franchise**: 3.9, 65%
- **Minibus**: 1.86, 31%
- **Residents**: 0.237, 4%
Vehicle Numbers 2005-2014

- Bus (Fran)
- Coach(nfb))
- Minibus
- Priv Bus
- Car
- Taxi
- LGV/HGV
Absolute Numbers Vehicles 2014

- Private Cars       541,751
- LGVs/HGVs          116,542
- Taxis             18,138
- Non Franchise Bus  6,926
- Franchise Bus      5,972
- Public Minibus     4,350
- Private MiniBuses  3,613
Journey Times

• Rising car ownership has adverse impact on KMB journey times of typical urban route.

• Despite Government support for new road building and bus lanes, bus trip journey times deteriorated by c16% in period 2005-2012
全年平均之班次失誤比率
Average percentage of lost trips for the year

班次失誤與預定班次之百分比
The percentage of number of lost trips to number of scheduled bus trips
Hong Kong System Details

- Permitted Return 9.7% on Average Net Fixed Assets
- Returns above this level are permitted but 50% must be offered back to passengers
- Fare Increase Mechanism refers to a Basket of Factors and is not Automatic. Operators choose when to apply.
- Operators produce Annual Route Development Plan which is implemented subject to Consultation with Government, Trade and Local Councils (deals with structural route changes)
- Less substantial changes (e.g., frequencies, operating hours) can be proposed & implemented anytime
Non Adversarial Partnership Based on Trust. Plus MBOF ‘Comfort Document’

- 1997: Government offered Inflation increases as an option to be considered. Industry said no.
- 2006: Modified Basket of Factors (MBOF)
  - Changes in operating costs and revenues since last fare adjustment
  - Forecasts of future costs, revenue and returns
  - The need to provide the operator with a Reasonable Return
  - Public Acceptability and Affordability
  - Quality and Quantity of Service Provided
  - Formulaic element (but this is also only one factor in MBOF)
  - Supportable fare adjustment rate = 0.5 x Change in Wage Index + 0.5 x Change in Composite Consumer Price Index CCPI (productivity element abolished)
  - In considering the reasonable rate of return to Franchised Operator, reference should be made to Weighted Average Cost of Capital (WACC)
  - In considering public acceptability and affordability, reference should be made to changes in median household income in addition to changes to CCPI
  - Unfettered Power of Determination by CE in Council but subject to consultation with TAC and LegCo
Financial Track Record

• Bus companies have made profits in most years during the last decade.
• For several companies, returns have occasionally been realised that exceed the 9.7% return on ANFA that triggers ‘passenger reward’.
• KMB suffered losses in 2013.
• Financial Turnaround achieved by means of productivity improvements (eg pax/pay mile), lower oil prices and rebasing the schedule.
KMB Financials 2015

HK$

Revenue 6,719,400,000
Other Income 72,100,000
Total Operating Expenses 6,195,600,000
Profit from Operations 595,900,000
Finance Costs (9,700,000)
Profit Before Taxation 586,200,000
Income Tax (98,000,000)
Profit after taxation 488,200,000
Net profit Margin 7.3%
Total Assets 6,317,300,000 (5,448,300,000)
KMB Productivity Improvement

• After a period of declining passenger numbers, financial losses and fare increases, KMB position now healthy and stabilised

• Digest of Statistics reveal that in a 2 year period between Q3 2012 and Q3 2014, KMB eliminated 8% of its revenue earning mileage whilst simultaneously arresting passenger losses and driving passenger increase

• Passengers per pay mile increased by over 10% outperforming industry peer group by substantial margin

• Absolute pay miles reduction in 2 year period= 24 million km/annum: Significantly higher reduction in scheduled miles.
Less is More

1000hrs  

1030hrs  

1100hrs  

[Diagram with blue circles representing time intervals]
Utilise New Road Infrastructure
Area Approach Improves Efficiency of Route Network by Local Consent

• Expressification (Direct Point to Point)
• Route Straightening
• Hub and Spoke

• Consider ‘voting equity’ of and ‘saleability’.
• Packaged proposals. Constantly modified
• Implemented with Public Consent
KMB Innovations

• Non Franchised Coaches operate a network of ‘premium’ express peak relief services from single Estate Developments. Fares are commercial and agreed with Resident Committee and approved by TD. Free market. KMB also runs such express services, often on whole day basis. Recently started premium fare service at 10% premium.

• Typical fare for NT-Hong Kong Island Express is HK$26

• Average Fare in KMB is less than HK$10

• Passengers Value Seated Accommodation. Move to 12.8m double deck buses with 100 seats.

• Real Time Bus Arrival Information direct to your App on the phone

• Innovative Community Engagement Events
New (Scottish) 12m Bus for LWB kit built in China
New (N. Irish) Double Deck for KMB
Similar Buses launched in 1998 still running
Today’s buses look little different from 1993
22 years old & still going in Non Franchised Fleet (Franchise= 18yr max)
HK Bus Travel no Longer an Ordeal as in 1980s
Bus Travel: From Ordeal to Pleasure
Even when bus is 22 years old
A ‘Short’ Double Decker
Land Issues - Depots
Land Issues - Termini
Some Operating Facts at KMB

• c90% of trips in KMB operate ‘on time’ on a typical weekday
• Lost trips less than 1.5% (UK is often 0.5%)
• Buses do 50,000+ km without breaking down in service
• 8650 FTE Bus Captains for 3900 buses
• 1700 Maintenance Workers
• Bus Availability 92.5%++
Entrepreneurial Space in Greater China Emerging?

- High Speed Rail Fares to be set by the market in an effort to attract investment: China Daily recent headline
- Minister of Commerce Gao Hucheng says “China will further ease foreign investors’ access to service sectors (March 13 2016)
- President Xi Jinping “Government will unswervingly encourage, support and guide the development of the private sector” (China Daily 10/3/16)
- Premier Li Keqiang “Government is to continue the delegation of power to lower levels to boost market vibrancy and better cultivate local expertise” (China Daily 9/3/2016)
- “China Vows to make employment a priority” said Vice Premier Ma Kai and to this end “Local Governments should support mass entrepreneurship and innovation as this will create jobs” (China Daily 2/3/16)
NON ADVERSARIAL PARTNERSHIP
ALL STAKEHOLDERS MUTUAL GAIN