



**S B Holdings Limited
and
Kelvin Central Buses Limited**

A report on the merger situation



MONOPOLIES AND MERGERS COMMISSION

S B Holdings Limited and Kelvin Central Buses Limited

A report on the merger situation

**Presented to Parliament by the Secretary of State for
Trade and Industry by Command of Her Majesty
April 1995**

Members of the Monopolies and Mergers Commission as at 29 March 1995

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¹These members formed the group which was responsible for this report under the chairmanship of Mr P H Dean.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests. The omissions are indicated by a note in the text.

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Part I

Summary and Conclusions

1 Summary

1.1. Under the reference (Appendix 1.1) we have to investigate the merger in October 1994 whereby S B Holdings Limited (SBH) acquired the whole of the share capital of Kelvin Central Buses Limited (Kelvin) for consideration worth £11.1 million.

1.2. SBH was created to take over the municipal bus operation of Strathclyde Regional Council in 1993. Before the merger it had a fleet of some 800 buses operating mainly in the Glasgow city area. In the year to end-March 1994 the company generated turnover of £58.2 million and an operating profit of £2.7 million. SBH is owned by its employees and directors, apart from a 20 per cent shareholding acquired by Stagecoach Holdings plc (Stagecoach) in December 1994. That acquisition has been the subject of another reference to us, on which we are reporting separately (the Stagecoach/SBH report).

1.3. Kelvin, a former subsidiary of the Scottish Bus Group, operates mainly in the outlying towns to the north and east of the Glasgow conurbation. Until acquired by SBH it was owned by its employees and directors. In 1993 Kelvin's business, with a fleet of some 500 buses, made an operating loss of £1.5 million on turnover of £27.6 million.

1.4. In that part of Strathclyde region which we identify as the relevant area for the purpose of our inquiry, SBH and Kelvin are the two biggest suppliers of local bus services with 43 and 23 per cent of the total market respectively. Although the operations of the two companies overlap to some extent, actual competition between them immediately before the merger was muted. More important is the loss of potential competition brought about by the merger: Kelvin would probably have been bought by another operator if SBH had not taken it over.

1.5. We identify various factors which are likely to constrain any attempt by SBH to abuse its strong market position. These include the presence of a large number of small operators, heavily subsidized local rail and underground services and, most importantly, the presence of three national operators, each larger than SBH, which surround the SBH/Kelvin area of operations.

1.6. There are benefits which we expect to accrue from the merger, including through ticketing, co-ordinated timetables, a reduction in congestion from the elimination of duplicate services and improvements in the quality of buses. Some but not all of the benefits could have been achieved in other ways. There are also substantial financial savings, the benefit of which may be expected to accrue to the public given our expectation that there will be effective competitive pressures on SBH.

1.7. In our assessment of the public interest we emphasize the crucial importance of potential competition from large adjacent operators, one of which is Stagecoach. Our normal practice in merger inquiries is to take into account post-merger events which we regard as relevant, but the acquisition by Stagecoach of a 20 per cent interest in SBH (see paragraph 1.2) is dealt with fully in the Stagecoach/SBH report. We therefore leave it out of account in assessing the effects of the SBH/Kelvin merger for the purposes of the present inquiry.

1.8. On that footing, and after carefully balancing the considerations mentioned in paragraphs 1.4 to 1.6, we conclude that the merger is not against the public interest. One member of the Group, Professor Eilon, disagrees; his views are set out in a note of dissent following Chapter 2.

2 Conclusions

The reference

2.1. Under the reference (Appendix 1.1) dated 30 November 1994 made by the Secretary of State we are required to investigate and report whether a merger situation qualifying for investigation has been created in that enterprises carried on by or under the control of SBH have within the six months preceding the date of the reference ceased to be distinct from enterprises carried on by or under the control of Kelvin. It appeared to the Secretary of State that the 'share of supply test' in section 64(3) of the Fair Trading Act 1973 (the Act) was satisfied in respect of bus services¹ in the area specified in the terms of reference. The specified area is defined as the districts of Glasgow City, Bearsden & Milngavie, Clydebank, Strathkelvin, East Kilbride, Cumbernauld & Kilsyth, Hamilton, Monklands, Motherwell, Dumbarton, Renfrew and Clydesdale. (We refer to this as the 'reference area'.)

Industry background

2.2. For many years until the 1980s the bus industry was highly regulated and almost entirely in the public sector. The Government then introduced major changes, principally under the Transport Act 1985 (the 1985 Act) which removed quantitative restrictions on the supply of bus services outside London. The 1985 Act also provided for the privatization of the National Bus Company (NBC), which operated in England and Wales, and for the formation of local authority bus operations into arm's length public transport companies. The Transport (Scotland) Act 1989 provided for the privatization of most of the operations of the Scottish Transport Group (STG) including its subsidiary, the Scottish Bus Group. The Scottish Bus Group was the main supplier of bus services throughout Scotland except for local services in the four largest cities (Aberdeen, Dundee, Edinburgh and Glasgow) which were provided by municipal companies.

2.3. In the deregulated market anyone wishing to supply bus services requires a licence to operate public service vehicles but may then introduce services simply by giving 42 days' notice to the Traffic Commissioner for the region concerned. The Traffic Commissioners are responsible for supervising operators' quality of service and safety standards and for seeing that they are properly equipped to carry out the services for which they are licensed. The Commissioners also have powers—which were strengthened by regulations introduced on 1 February 1995—to regulate services in cases of severe traffic congestion.

2.4. The NBC was divided into 72 companies which were privatized between 1986 and 1988, many by sale to management buy-outs. No single buyer was allowed to acquire more than three NBC subsidiaries or to acquire companies operating in contiguous areas. Similarly in the sale of the ten Scottish Bus Group companies in 1990 and 1991, no buyer was allowed to acquire more than two companies, or to acquire companies operating in contiguous areas.

¹As defined in section 159(1) of the Transport Act 1968, as amended by paragraph 1 of Schedule 1 to the Transport Act 1985.

In the years since privatization many former NBC and Scottish Bus Group companies have been acquired by emerging large operators. (In some cases these subsequent acquisitions have been made by companies with operations in contiguous areas.)

2.5. The Government made clear from the time of the 1985 Act that it wanted local authorities to sell off their bus companies. So far it has not taken powers to require them to do so, but it has given incentives and over half of the municipal companies in Great Britain—including most of the larger ones—had been privatized at the time of our inquiry. Of the four Scottish municipal companies, three were sold off to management and employee buy-out teams between 1989 and 1993. Until June 1992 the Government permitted sales to be negotiated with management and employee buy-out teams by single tender, but thereafter it required sales to be by open competitive tender unless consent had previously been given for a single tender process. As with former NBC and Scottish Bus Group companies, some of the former municipal operations which were the subject of management or employee buy-outs have since been taken over.

2.6. In the last few years several companies have grown rapidly, largely by acquisition. According to industry sources seven companies—Stagecoach (the largest), Badgerline Group plc (Badgerline), British Bus PLC (British Bus), The Go-Ahead Group PLC (Go-Ahead), GRT Bus Group PLC (GRT), MTL Trust Holdings Limited (MTL) and West Midlands Travel Limited (West Midlands Travel)—now have some 60 per cent of the UK bus market between them. We refer to these companies as ‘the emerging large operators’. Stagecoach, Badgerline, Go-Ahead and GRT have obtained Stock Exchange listings in the past two years.

The companies

SBH

2.7. SBH was created as the vehicle for a management and employee buy-out of Strathclyde Buses Limited (SBL), the municipal bus operation of Strathclyde Regional Council, in February 1993. The buy-out was carried out without a competitive tender for a consideration of £18.3 million. Of this, £11.8 million was paid on completion, with the remaining £6.5 million (including £2 million in interest) payable in instalments over the following five years. As part of the buy-out SBH also paid a dividend of £5 million to the Council. There were clawback arrangements in the event of a disposal of any SBL depots in the first seven years after the buy-out. SBH gave undertakings, which it said were non-binding, to maintain annual mileage at not less than 85 per cent of previous levels; to maintain fares at or below the national average; to continue recognition of trade unions; and to maintain quality of service. No formal monitoring of the observance of these undertakings was required or performed.

2.8. In broad terms 80 per cent of SBH’s shares were held by its employees, 18 per cent by the executive directors and 2 per cent by managers. The executive directors were given enhanced voting rights for a transitional period of five years. Decisions on certain important matters could be taken only with the consent of the employee-nominated directors, who had to make up at least one-third of the Board. Further details on these aspects are set out in paragraphs 3.26 to 3.28.

2.9. SBH’s business consists principally of the supply of bus services in the Glasgow conurbation: in March 1994 some 80 per cent of its registered mileage was in the district of Glasgow City itself. At the time of the merger it had a fleet of some 800 buses operating from four depots, all within two miles of Glasgow city centre, and employed some 2,200 staff.

2.10. In the year to end-March 1994, the first year following the buy-out, SBH made an operating profit of £2.7 million on a turnover of £58.2 million, a return of 4.6 per cent. This represented a slight advance on the figures for the previous year (see Table 3.2). At 31 March 1994 SBH's net operating assets totalled £21.8 million and its shareholders' funds £21.5 million.

Kelvin

2.11. Kelvin's origins lie in a merger in 1988 between two Scottish Bus Group subsidiaries, Kelvin Scottish Omnibuses Limited and Central Scottish Omnibuses Limited. When the bus industry was deregulated in 1986 these companies had set out to win market share from SBL, initiating a period of vigorous competition lasting until 1989 known as the 'Glasgow bus wars'. SBL proved a resilient competitor and the Scottish Bus Group companies eventually drew back. The merger which created Kelvin was in part a response to the trading difficulties caused by the bus wars and an attempt to establish a company fit for privatization. Kelvin continued to incur losses, however, and these were exacerbated by a 14-week strike by its employees in 1989. In preparation for privatization £6.5 million of Kelvin's £8 million debt to the STG was capitalized and the rest converted into an interest-free loan repayable over ten years. The workforce was reduced by nearly 600 and the remaining employees suffered a pay cut of around 20 per cent.

2.12. Kelvin was acquired by its management and employees from the STG in February 1991 for a consideration of £1. There was no other bidder. The STG took an option to subscribe at par for shares totalling 20 per cent of Kelvin in the event of an offer for a controlling interest in the company being made at any time over the following seven years. Ownership of Kelvin was divided between individual employees, who owned 47 per cent in total, two employee benefit trusts (46 per cent) and the directors (7 per cent). Further information about Kelvin's ownership structure, voting arrangements and the extent of directors' control is set out in paragraphs 3.38 and 3.39.

2.13. Kelvin's principal area of operations is in the outlying towns to the north and east of the Glasgow conurbation such as Dumbarton, Cumbernauld, Coatbridge, Motherwell and Hamilton. In addition to providing local services in these areas it also runs longer-distance services into Glasgow. At the time of the merger it had some 500 vehicles operating from six depots and employed some 1,300 staff.

2.14. Kelvin incurred losses each year from 1990 to 1993 except for 1992 when its results were favourably affected by a change in depreciation policy. In the year to December 1993 it made an operating loss of £1.4 million on turnover of £27.6 million. At 31 December 1993 Kelvin had net operating assets of £8.4 million and shareholders' funds of £6.2 million (see Table 3.3). In the period between the buy-out and the merger with SBH, Kelvin spent some £3.4 million in acquiring the assets or businesses of 16 competing operators. Expenditure on new buses was, however, low.

The merger situation

2.15. In 1993 and 1994 Kelvin continued to experience trading difficulties. In addition the Traffic Commissioner issued a formal warning about the company's maintenance standards in July 1994 and renewed its operating licence for only one year rather than the normal five. As a result of these and other factors Kelvin's Board concluded that the company had no long-term future as an independent operator.

2.16. In August 1994 Stagecoach entered into negotiations with a view to acquiring Kelvin. These reached the point where it was about to make an offer for £10 million. SBH, which had for some time had in mind the possibility of merging with Kelvin, became aware of the situation and itself made an offer worth £11.1 million for the whole of the share capital of Kelvin on 22 September 1994. Three alternative forms of consideration were offered for each Kelvin share: £10 cash, £10 in SBH interest-bearing loan notes or ten new shares in SBH. The offer included several undertakings to Kelvin's employee shareholders: the honouring of existing wage offers; a guarantee of no compulsory redundancies for at least three years; the maintenance (at least) of pay rates and other terms and conditions for three years; the safeguarding of pension rights; and the retention of employee representation and trade union facilities. SBH also undertook that, for three years, at least 50 per cent of new vehicles acquired by SBH would be allocated to Kelvin.

2.17. Kelvin's Board broke off negotiations with Stagecoach as soon as SBH's intention to make its offer became clear. The Board told Stagecoach that it preferred the prospect of Kelvin being acquired by SBH because that would preserve its status as an employee-owned company. At an Extraordinary General Meeting held on 16 October 1994 Kelvin's shareholders voted virtually 100 per cent in favour of the SBH offer and the offer became unconditional on 19 October.

The SBH/Stagecoach agreement

2.18. On 12 December 1994, at SBH's instigation, Stagecoach acquired a 20 per cent holding in SBH by subscribing for new shares. The subscription agreement pursuant to which this transaction took place (the SBH/Stagecoach agreement) gives Stagecoach the right, in the event of an offer by a third party to acquire a controlling interest in SBH in the period to February 1998, to make its own counter-offer, although this would have to be accepted by SBH's Board and 95 per cent of shareholders other than Stagecoach before it could succeed. This transaction was referred to the MMC on 21 December 1994 and the report on that inquiry is being submitted to the Secretary of State in parallel with this one.

Jurisdiction

2.19. Under the Act a merger situation qualifying for investigation may arise where enterprises cease to be distinct and where either the combined enterprise accounts for at least 25 per cent of the goods or services of a particular description supplied in the UK or a substantial part of it ('the share of supply test') or the gross value of world-wide assets taken over by the acquirer exceeds £70 million ('the assets test').

2.20. We are satisfied that, as a result of the transaction described in paragraphs 2.16 and 2.17, enterprises carried on by SBH have ceased to be distinct from enterprises carried on by Kelvin.

2.21. As regards the share of supply test, we noted that the district of Eastwood is part of the Glasgow conurbation and that in it SBH supplies two-thirds of the bus services. In these circumstances we considered that it was sensible to add Eastwood to the reference area (see paragraph 2.1) when addressing ourselves to the share of supply test. In considering the application of this test, the MMC have been previously advised that it is open to them and consistent with the intentions and purposes of the Act to determine what is the most appropriate area, having regard to what is sensible in the context of the business concerned.¹ SBH did not

¹ *Stagecoach Holdings plc and Lancaster City Transport Limited: a report on the merger situation between Stagecoach Holdings plc and Lancaster City Transport Limited*, Cm 2423, December 1993, paragraphs 6.38 to 6.40.

contest our decision to include Eastwood. We refer to the slightly enlarged area as 'the relevant area'.

2.22. In considering whether it is appropriate for us to regard the relevant area as 'a substantial part of the UK' we have had regard to the judgment of the House of Lords in the judicial review of the case of South Yorkshire Transport Ltd.¹ Their Lordships held that the words in question must on their true construction connote a part 'of such size, character and importance as to make it worth consideration for the purposes of the Act'.

2.23. The relevant area represents 3.1 per cent of the UK population. It includes the city of Glasgow, one of the great cities of the UK, and the towns of Airdrie, Clydebank, Coatbridge, Cumbernauld, Dumbarton, East Kilbride, Hamilton, Motherwell, Paisley and Wishaw. We have no doubt that the relevant area is 'worth consideration for the purposes of the Act' and hence 'a substantial part of the UK' for those purposes. This view was not contested in the evidence we received.

2.24. Table 4.7 shows that in March 1994 SBH supplied 43 per cent of bus services in the relevant area, based on registered bus mileage, and Kelvin 23 per cent.

2.25. We therefore conclude that the share of supply test in the Act is satisfied.

2.26. Having found that one of the two tests for jurisdiction (see paragraph 2.19) is satisfied, by virtue of our terms of reference we conclude, for the reasons given in paragraphs 2.20 and 2.25, that a merger situation qualifying for investigation has been created. We have therefore now to investigate and report on whether the creation of that merger situation operates or may be expected to operate against the public interest.

The market

2.27. We have considered the place of bus services in the context of other forms of transport in the relevant area. (Some of the statistical information is, however, available only for individual districts and for Strathclyde region, not for the relevant area as a whole.) Table 4.2 shows that in 1991 19 per cent of people in Strathclyde used buses for the largest part of their journey to work, compared with 10 per cent in Great Britain as a whole. This proportion varied widely among the individual districts of the relevant area, from below 10 per cent in the more prosperous or rural districts up to 31 per cent in Glasgow City (which alone accounts for 39 per cent of the population and 45 per cent of registered bus mileage in the relevant area). 5 per cent of people in Strathclyde used rail or underground as their principal means of travel to work. This is a little below the average throughout Great Britain of 6 per cent, but the proportion in most of the individual districts in the relevant area was above the Strathclyde average.

2.28. The proportion of people in Strathclyde using the car as their principal means of transport to work was 56 per cent, compared with 61 per cent in Great Britain as a whole. As with buses, this proportion varied widely between districts, from 42 per cent in Glasgow City to 73 per cent in Eastwood. Levels of car and bus usage appear to be inversely related. Car ownership in Strathclyde is well below the Great Britain average but has been growing more quickly.

2.29. Strathclyde has an extensive rail network, with 20 routes and 172 stations, 124 of which are within the areas of operation of SBH and Kelvin. Passenger services are operated

¹*R v MMC ex parte South Yorkshire Transport Ltd*, [1993] 1 WLR p.23.

by ScotRail, a division of British Rail, but are subsidized by Strathclyde Passenger Transport Executive (SPTE), a statutory body which has responsibilities in relation to the provision of public transport services acting within policies laid down by Strathclyde Regional Council. In 1993/94 the subsidy amounted to £32 million, representing 85p per passenger journey and 47 per cent of the network's running costs. (In the same year SPTE paid some £15 million to bus operators in Strathclyde for tendered services, but the bulk of this was for school transport: see Table 4.6.) SPTE determines the fares and service levels. It has held down fares in recent years but towards the end of our inquiry it announced an increase of 7.5 per cent to take effect from May 1995.

2.30. The rail network has been increased recently and there are plans for further expansion. There are also uncertainties, however, arising from the planned privatization of the ScotRail franchise in 1996. At about the same time a reorganization of local government in Scotland is due to take effect under which Strathclyde Regional Council will be abolished and new councils will become unitary authorities. Arrangements for the future subsidization of rail services in Strathclyde following this reorganization had not been settled at the time of our inquiry.

2.31. Glasgow has an underground railway, operated and subsidized by SPTE, with 15 stations on a single 6½ mile loop. The subsidy in 1993/94 amounted to some £7 million, representing about 50p per passenger journey and 50 per cent of total running costs (the underground has a flat rate adult fare of 50p).

2.32. SBH submitted that bus operators faced a high degree of competition from other modes of transport, particularly rail and underground but also taxis. A study by SPTE of the extent of competing bus and rail services, taking account of journey times, frequencies, fares and convenience, found that only 13 bus routes competed head-on with rail in 1993, of which Kelvin operated four and SBH one. While, therefore, rail competes directly against buses on certain routes, it does not have the network coverage to be anything like a full substitute for bus services. This is also the view of Strathclyde Regional Council (see paragraph 6.5).

2.33. SPTE administers a multi-operator travelcard scheme called Zonocard, covering bus, rail and underground services. Total revenue under the scheme in 1993/94 was £13.7 million, of which 44 per cent went to ScotRail. SBH and Kelvin together accounted for 32 per cent, about two-thirds of the total amount going to bus operators. This represented some 6 per cent of the combined revenue of SBH and Kelvin in that year.

2.34. Taxi fares in Glasgow are between three and a half and six times greater than bus fares, the difference increasing with distance. SBH argued that taxis were now able to offer multi-destination journeys and that for four people sharing a taxi the differential compared with bus fares was largely eliminated. We accept that taxis provide a limited element of competition with bus services.

2.35. Cars compete with buses in the general sense that they provide alternative forms of transport. There are, however, major differences between buses and cars in respect of price and convenience, while for many bus users—for example, the young and the poor—the option of using cars is not available. While over the long term there is competition between them, for most practical purposes they may be regarded as separate markets.

2.36. In summary, therefore, while there are significant elements of competition with buses from other modes of transport, and the existence of the inter-modal Zonocard is a complicating factor, there are limits to the extent to which the travelling public has a choice of mode other than bus. We consider that our market analysis should focus primarily on the supply of bus services.

2.37. Table 4.7 shows market shares in the supply of bus services in the relevant area at March 1994. SBH had 43 per cent of the total and Kelvin 23 per cent, making a combined share of 66 per cent. The next largest supplier was Clydeside 2000 plc (Clydeside 2000) with 9 per cent. In Glasgow City SBH had 76 per cent and Kelvin 12 per cent. Other districts where SBH and Kelvin together have very high shares were Clydebank (85 per cent), Bearsden and Milngavie (81 per cent), Strathkelvin and East Kilbride (both 76 per cent). In the remaining districts in the relevant area there is little overlap between SBH and Kelvin.

2.38. In Strathclyde region as a whole SBH had 33 per cent of the total market and Kelvin 18 per cent, together 51 per cent. Other significant shares were held by Clydeside 2000 (9 per cent) and Western Scottish Buses Limited (Western Scottish) (7 per cent). The remaining one-third of total registered mileage was provided by 170 other operators.

2.39. Clydeside 2000 is a former Scottish Bus Group company sold to its management and employees in 1991. Its main operating area is to the west of Glasgow in the districts of Renfrew (within the relevant area for our inquiry) and Inverclyde (outside the relevant area). Its turnover in 1993/94 was £15 million. The company experienced financial and operating difficulties in 1994 and was acquired by British Bus, one of the emerging large operators, in November 1994.

2.40. Western Scottish has a similar history, having been bought out from the Scottish Bus Group by its management and employees alongside Clydeside 2000 and being subsequently acquired by Stagecoach, the biggest of the emerging large operators, in July 1994. Western Scottish's area of operations is a large, mainly rural area stretching from the south of Strathclyde region down to the Solway Firth. Its turnover in 1993/94 was £16 million. It has a very small presence in the relevant area (0.4 per cent of total registered mileage), primarily in the district of Eastwood. (Since its acquisition of Western Scottish, Stagecoach has acquired two other bus companies which operate to the south and south-west of Glasgow, namely The Arran Transport & Trading Company Ltd (Arran Transport) and Ayrshire Bus Owners (A1 Service) Limited (A1 Buses). While these acquisitions increased the market share in Strathclyde now attributable to Stagecoach to around 10 per cent (based on March 1994 figures), they did not affect its share in the relevant area.)

2.41. The main operator to the north and east of the relevant area is Midland Bluebird Limited (Midland Bluebird), also a former Scottish Bus Group company. GRT, another of the emerging large operators, acquired the company direct from the Scottish Bus Group in 1990. Its turnover in 1993/94 was £15 million. GRT told us that 6 per cent of Midland Bluebird's turnover arose in Strathclyde region but its share of registered mileage in the relevant area is only 1 per cent.

2.42. In March 1994 7 per cent of registered mileage in the relevant area was provided by tendered (subsidized) services. SBH accounted for 25 per cent of all tendered mileage at that time and Kelvin 16 per cent. The market for tendered services is important to smaller operators (ie companies other than SBH, Kelvin, Clydeside 2000, Midland Bluebird and Western Scottish) which accounted for 55 per cent of all subsidized mileage in the relevant area.

2.43. Bus fares in Strathclyde region declined in real terms between deregulation (in 1986) and 1992, since when the trend has reversed. These trends are likely to have resulted from the policy of Strathclyde Regional Council to hold down public transport fares, as well as the strong competition which developed among bus operators in Glasgow in the late 1980s (see paragraph 2.11). SBH provided information in support of its claim that its fares were generally lower than those of comparable operators elsewhere in Great Britain (see paragraphs 4.64 and 4.65).

Barriers to entry

2.44. Although entry to the bus industry has often been held to be easy, there are a number of factors which may constitute barriers to entry depending on the circumstances in the geographical markets concerned:

- (a) *The need for depot and maintenance facilities.* We were told that there was no shortage of buildings and sites in the Glasgow area which would be suitable for providing such facilities.
- (b) *Access to bus stations and stands.* We received no evidence about current difficulties on this score.
- (c) *Passenger information.* A new entrant may need to incur costs on information provision and advertising to promote its services. The need is less on routes with high-frequency services, as is the case for many routes in Glasgow.
- (d) *Prepaid tickets.* The existence of network tickets (travelcards), season tickets and return fares may constitute a barrier to entry, for example if a large incumbent offers a season ticket exclusive to its own network. SBH offers a number of such tickets for different periods, times of day and categories of passenger (see paragraphs 4.73 and 4.74). SBH told us that it intended to extend its own schemes to cover Kelvin's network as well. In 1993/94 season ticket sales represented a quarter of total revenue for SBH and Kelvin combined. About a quarter of this was revenue from the Zonocard scheme, however, which is open to all operators.
- (e) *Threat of retaliation.* The perceived financial strength of an incumbent, its commitment to an area and its reputation for aggressive response to competitors are likely to be taken into account by potential entrants. Since prospective operators have to register services at least 42 days in advance, incumbents have time in which to plan a response in the form of cutting fares or changing the frequency or timing of services (fares do not have to be notified in advance). None of the three large operators with operations adjacent to SBH's appeared to be deterred by SBH's reputation in this respect. Few of the smaller operators giving evidence expressed concern about likely aggression by SBH.

Public interest issues

2.45. We consider the public interest issues which arise from the merger situation under various headings, starting with effects on competition and then taking account of the benefits which SBH claimed would result.

2.46. We have given careful thought to the relevance for our inquiry of the SBH/Stagecoach agreement (see paragraph 2.18). In a report on a merger situation the MMC would normally address a relevant change of circumstances occurring during the course of the inquiry. This approach can be seen, for example, in *GEC/Siemens/Plessey*.¹ Although that report concerned a merger in contemplation, we consider that the reasoning must also be applicable to a merger in being: 'it is right that in any merger investigation under section 75 of the Act, we should take account of developments occurring during the course of the inquiry ...' (paragraph 6.13 of that report). The same approach emerged in a judicial review of the MMC's report in *British Airways/British Caledonian* (also a merger in contemplation) where the court held that 'the

¹*The General Electric Company plc, Siemens AG and The Plessey Company plc: a report on the proposed mergers*, Cm 676, April 1989.

Commission is ... entitled to take account of the developing situation. It must not shut its eyes to what is going on'.¹

2.47. In the present instance we have been very aware of the interaction between the merger situation which is the subject of this inquiry and the SBH/Stagecoach agreement. Had the SBH/Stagecoach agreement not been referred to us we would have taken account of it in this inquiry. Since, however, there is a separate reference dealing with that agreement, in which we have concluded that there is a qualifying merger situation, it appears to us sensible in the circumstances to defer consideration of the effects of the agreement to the other inquiry. In this way the public interest implications of both situations can be identified separately.

2.48. In addressing the effects of the SBH/Kelvin merger, therefore, we have decided to exclude from our consideration the subsequent acquisition by Stagecoach of a 20 per cent stake in the merged enterprise. Much of the third party evidence for the two inquiries was collected at the same time. In reaching our conclusions in the SBH/Kelvin case, we have been careful to take account only of such evidence as clearly and unambiguously related to that case.

Loss of competition between SBH and Kelvin

2.49. As shown in Table 4.7, the principal areas of operation ('territories') of SBH and Kelvin before the merger were largely distinct. Of the four districts where SBH has over 50 per cent of the market, Kelvin has a significant presence in only one (Clydebank), and in the five districts where Kelvin has over 50 per cent SBH has no presence at all except for Strathkelvin (where it has only 11 per cent). SBH told us that there were nine sections of route where SBH and Kelvin services ran parallel for at least five miles, rising to 160 where they ran parallel for at least one mile. The routes on which there were at least three miles of parallel provision accounted for 33 per cent of all Kelvin's revenue and 38 per cent of SBH's. These figures, however, overstate the proportions of revenue which could be said to be open to competition between the two operators because of the passengers who do not wish to get both on and off the services within the sections of parallel running. Several other operators also run services on parts of these routes (see paragraphs 4.48 to 4.51).

2.50. SBH told us that there had been a degree of competition on commercial services between itself and Kelvin before the merger but this had not been strong, being mainly confined to quality of service. In 1993 Kelvin had pulled out of operating services in central Glasgow and SBH had responded by reducing its services in Cumbernauld, Dumbarton and Monklands where Kelvin was the main operator. SBH said that Kelvin's fares tended to be higher than SBH's except for routes where it ran services in parallel with SBH, where similar fares were charged.

2.51. Competition between the two operators for tendered services had in the past been fierce, according to SBH. Information on 295 tenders which Kelvin bid for but lost in 1992 to 1994 showed that only 20 per cent were awarded to SBH, however. Table 4.9 shows that the subsidized mileage actually registered by SBH and Kelvin is very largely in two different groups of districts. We noted in paragraph 2.42 that the majority of tendered business is taken by a large number of smaller operators. In any event tendered mileage represents only 7 per cent of all registered mileage in the relevant area.

2.52. In assessing the state of competition between the bus companies it is necessary to bear in mind the historical background of the 'Glasgow bus wars' in which SBH had effectively 'seen off' Kelvin and subsequently, taking advantage of the Kelvin strike of 1989, replaced it

¹(1988) 4 BCC 182 at 187.

as the dominant operator in East Kilbride. With its operational and financial weakness Kelvin was not in a position to compete vigorously against SBH even if it had wished to. In fact it did not wish to, but rather had been contemplating a merger with SBH for some time before the deed was done. In March 1994 Kelvin's Managing Director told SBH that he wanted the two companies to work more closely together, and undertook that Kelvin would never initiate aggressive action against SBH.

2.53. Actual competition between SBH and Kelvin immediately before the merger was, therefore, muted. Nevertheless the presence of two large operators in adjacent and, to a degree, overlapping areas is likely to have constrained the behaviour of each of them in some respects, as witness Kelvin's lower fares on routes which it operated in common with SBH.

2.54. A more important factor from SBH's standpoint was the possibility of Kelvin being acquired by a larger, more efficient bus company which could put some much-needed investment into Kelvin and improve its performance. In those circumstances Kelvin would have been a potent threat to SBH because it had all the necessary elements in place—drivers, buses, depots and managers with local knowledge—with which to mount a competitive attack on SBH's territory. (The same is also true in reverse, ie SBH was a potential threat to Kelvin.) Although there had been no outside bidders for Kelvin in 1991 when it was privatized, the bus industry has evolved since then with the emergence of several large operators with subsidiaries in different parts of the country (see paragraph 2.6). Turning round Kelvin would have been a formidable task for any acquirer but Stagecoach was willing to take it on and British Bus told us that it would have been delighted to acquire Kelvin (see paragraph 6.23). We are not convinced by SBH's suggestion (paragraph 5.9) that the Kelvin workforce would have blocked any bid other than SBH's because of their commitment to employee ownership. We believe their reactions would have depended on the price offered and the other options open to them. If SBH had not acquired Kelvin, the most likely alternative is that Kelvin would have been acquired by someone else.

2.55. The merger has undoubtedly brought about a loss of potential future competition between SBH and a strengthened Kelvin. It is not possible, however, to assess with any confidence the significance of this loss since we do not know who would have acquired Kelvin if SBH had not.

Effect on competition from other operators

2.56. SBH submitted that, while the merger would give it a high market share in the relevant area, it should be viewed in the context of developments in the UK market as a whole. The prospect was that the UK market would be dominated by seven or fewer large operators which had been growing rapidly by acquisition. The resources available to these operators, and their geographical diversity, would put them in a strong position to attack medium-sized operators with a single territory. By merging with Kelvin SBH was better able to withstand such attacks and to preserve its independence as an employee-owned company.

2.57. SBH argued further that, measured by total size of group, it would still be only the fourth largest operator with a presence in Strathclyde, behind Stagecoach, British Bus and GRT. The competitive balance in Scotland had been upset by GRT's recent acquisitions of SMT Omnibuses Limited (SMT) and Reiver Ventures Limited (Reiver)—respectively the former Eastern Scottish and Lowland Scottish subsidiaries of the Scottish Bus Group—which, taken with its existing subsidiary Midland Bluebird, gave GRT a band of three contiguous companies stretching from west central to south-east Scotland (see Appendices 3.1 and 3.2). The acquisition of Kelvin was necessary, in SBH's view, to restore the competitive balance.

2.58. We broadly agree with SBH's account of the current evolution of the UK bus industry, summarized in paragraph 2.56, which accorded with views put to us by other witnesses. Our prime concern in this inquiry, however, must be with the merger's effect in the relevant area. In this connection we have given particular attention to the three large operators which have subsidiaries nearby. Just as SBH and Kelvin represented potential threats to each other before the merger (see paragraph 2.54), so Stagecoach, British Bus and GRT are the main sources of potential competition to SBH after the merger.

2.59. After its failure to take over Kelvin, and before its acquisition of a 20 per cent stake in SBH, Stagecoach (via its subsidiary Western Scottish) acquired a depot at Thornliebank, in the south of Glasgow, and registered new services which would have competed with some of SBH's busiest routes. Stagecoach assured us that this was not a ploy to put pressure on SBH: Stagecoach fully intended to operate these services. It had earmarked 18 new buses for the purpose and planned to build up to 60 buses, with set-up costs of about £10 million to buy the buses and establish the depot.

2.60. British Bus, which acquired Clydeside 2000 only in November 1994, told us that it would have to concentrate its efforts in the short term on improving that company's profitability. In the long term, however, British Bus intended to expand into the Glasgow market. While the SBH/Kelvin merger might delay this move, it would not prevent it.

2.61. GRT told us that Glasgow had experienced overcapacity since deregulation and GRT did not therefore have any plans to enter the market there. If, however, the merged SBH/Kelvin were to scale back services too far, GRT would look for opportunities to expand into its territory.

2.62. Leaving aside the link-up between SBH and Stagecoach in accordance with our decision in paragraph 2.48, we believe the merger has not significantly diminished the threat of competition from Stagecoach, British Bus and GRT in the areas where SBH and Kelvin operate.

2.63. It is of course possible for bus companies to set up new operations in areas far removed from their existing territories, although there have been relatively few examples of this. We therefore asked the four other large operators which do not at present have interests in Strathclyde (see the list at paragraph 2.6) whether they had contemplated setting up operations in the region. They all said that they had not, and that the merger had made no difference to their thoughts on the subject.

2.64. SBH also put it to us that there were many small, low-cost operators in Strathclyde—the total of all operators in the region was currently 175 and the number was rising—which would also help to maintain competition. They were particularly active in bidding for tendered contracts. SBH said that it had not tried to force small competitors out of the market by aggressive action. It argued that even before the merger SBH and Kelvin had been large enough to act aggressively towards small operators had they chosen to do so, and that the merger made no appreciable difference to this situation.

2.65. Most of the small operators which gave evidence to us described SBH as a fair competitor, although there have been a few allegations against it of predatory behaviour. SBH has established a separate subsidiary, GCT, as a low-cost operator to compete more effectively against small companies, particularly for tenders. Given that SBH has a reasonably strong financial position and a record of successfully resisting competitive incursion, we believe it is well equipped to counter any real threat to its interests from small operators.

2.66. We do not entirely accept that the merger has made no difference to the position of small operators. SBH was a more formidable competitor than Kelvin and the merger has

extended its influence over a wider area. Yet the competitive position of the smaller operators would also probably have worsened had Kelvin been acquired by someone else. Compared with what would otherwise have happened, therefore, the merger has probably not made a great deal of difference.

Inter-modal competition and the role of SPTE

2.67. SBH argued strongly that, in addition to actual and potential competition from other bus operators, competition from other modes of transport also would prevent the merged company from abusing its market position. Glasgow had the most extensive suburban rail network in the UK outside London, as well as an underground railway in the city centre. Both of these were heavily subsidized by Strathclyde Regional Council through SPTE. Rail fares had not increased for three years. SPTE also used its influence to keep Zonocard prices low. In addition non-car-owning households used taxis extensively as an alternative to buses, and car ownership was growing strongly.

2.68. We have summarized the factual background on these alternative forms of transport in paragraphs 2.27 to 2.35. We accept that bus operations in the relevant area have been affected by the Zonocard scheme and by the Regional Council's policy of subsidizing rail and underground fares. The Zonocard has the effect of reducing demand for bus services and increasing that for rail. This happens because rail is normally faster and more reliable than bus, and passengers are therefore likely to prefer rail when the fares are the same. While buses are usually able to compete with rail because their fares are lower, the Zonocard removes that price differential. The Zonocard also has disadvantages, from the point of view of both bus and rail operators, in that it limits pricing flexibility. For SBH, moreover, it limits the company's ability to use its own travelcard as a competitive weapon against other bus operators.

2.69. Subsidized rail and underground fares limit what bus operators can charge passengers who do not hold a Zonocard. SBH told us that it operated a uniform pricing structure across its operating area, and hence the subsidized fares affect all its services and not just those that directly compete with rail or underground.

2.70. One effect of the merger is to put SBH in a much stronger position in negotiating over Zonocard with SPTE, since the SBH share of Zonocard revenues accruing to bus operators has risen (as a result of the merger) to almost two-thirds and hence its withdrawal would threaten the viability of the whole scheme. SBH told us that it intended, in principle, to continue to participate in the Zonocard scheme but was dissatisfied with its current level of remuneration from the scheme. In the context of discussion on possible remedies for any adverse effects which the MMC might find to arise from the merger, SBH expressed concern that an undertaking to stay in the Zonocard scheme would remove its main negotiating weapon *vis-à-vis* SPTE.

2.71. It is clear that the bus market in the relevant area is affected by political pressure, exercised mainly through the Regional Council's ability to subsidize the rail and underground networks and hence also to influence Zonocard fares, to keep fares low. The merger will strengthen SBH's ability to resist this non-commercial pressure. To the extent that the Regional Council's policies reflect public opinion, however, SBH will be cautious about appearing to oppose them. For these reasons we believe that, while SBH will seek to use its negotiating position to press for higher Zonocard fares, and can be expected to have some success in this aim, the political impetus for low fares will continue to be a constraining factor on SBH.

2.72. The constraint at present exercised by Zonocard and the rail and underground subsidies on SBH's operations and pricing should not, however, be exaggerated. As noted in paragraph 2.33, Zonocard revenues account for only 6 per cent of total revenue for the merged

SBH/Kelvin. As for competition between bus and rail, while the latter plays a more significant role in transportation in the Glasgow area than in the other local markets which have been the subject of MMC inquiries, the number of bus services (whether those of SBH or Kelvin before the merger) which compete head-on with rail or underground is a small proportion of the total. The conclusion that emerges from the SPTE study described in paragraph 2.32 is that for most journeys the choice between rail and bus is clear-cut, and will not be influenced by marginal changes in price.

2.73. Our view is therefore that the overlap between rail (including underground) and bus provides a limited constraint on the operations and pricing policy of SBH. The existence and pricing of the Zonocard reinforce and broaden the effect of this constraint, but as a result of the merger SBH will be in a stronger position to influence Zonocard prices.

2.74. We have dealt with the question of competition from taxis and cars in paragraphs 2.34 and 2.35.

Benefits from the merger

2.75. SBH submitted that the merger had brought, or would bring, the following substantial benefits:

- (a) There were network benefits in the wider scope for linked services and through ticketing. In addition, the enlarged group's ability to rationalize timetables would allow it to eliminate duplication of services and thus reduce congestion while enabling frequencies to be improved.
- (b) SBH followed a low-fare policy and considered that Kelvin's fares were too high. It had frozen a 10 per cent increase in fares which Kelvin had planned for December 1994 and intended to improve Kelvin's use of travelcards, including by price promotions.
- (c) SBH would be able to take the necessary action to improve Kelvin's engineering performance. Increased investment in new buses would improve the quality and reliability of services while reducing fuel consumption and emissions. SBH also planned to standardize the two fleets in order to realize sourcing and engineering savings and to reduce the enlarged group's reserve fleet from 105 to 18 vehicles.
- (d) Economies of scale would be available in the use of depots [*Details omitted. See note on page iv.*], in purchasing, in marketing and selling, and in management. Kelvin's head office would be co-located with SBH's.
- (e) Increased financial strength would enable the enlarged group to run a more complete network, including evening and Sunday services, thus reducing the need for SPTE to subsidize such services.
- (f) The retention of both employee ownership and local control would maintain motivation and responsiveness to local needs.

Of the £4.3 million recurring annual savings and £3.3 million non-recurring savings which it had identified, SBH argued that most arose from the contiguity of the two groups and would not be available to a non-contiguous acquirer of Kelvin.

2.76. Some of these are financial benefits to SBH, while some are actual or potential benefits to passengers. SBH added that there were also financial benefits to the Scottish Office, as successor to the STG, which had received £2 million (net of subscription costs) by exercising

its option to buy 20 per cent of Kelvin and early repayment of the £1 million interest-free loan (see paragraphs 2.11 and 2.12).

2.77. We find some of these points more persuasive than others. Employee ownership does not necessarily make for efficiency: we regard that as a neutral factor in itself. Most of the financial benefits to the Scottish Office would have arisen if Stagecoach had acquired Kelvin for £10 million (see paragraph 2.16). Through ticketing and co-ordinated timetables can, up to a point, be achieved by co-operation between independent operators.

2.78. We accept that some of the financial savings which are available to SBH, notably from the rationalization of services and to some extent depots, would not have been available to any other acquirer. Stagecoach told us that for this reason Kelvin was worth more to SBH than to anyone else. Financial savings only become benefits to the public interest, however, to the extent that they feed through into improved services and/or lower fares. The extent to which this can be expected to happen depends primarily, in our view, on the strength of the external pressures on SBH.

Views of third parties

2.79. The majority of official bodies which gave evidence did not object to the merger. Strathclyde Regional Council thought that, while the merged company would have a large share of the bus market in Strathclyde, the danger of its exploiting that situation would be countered by the interest of large national operators which were already competing in the area. SPTE too considered that, with operators such as Stagecoach, British Bus and GRT in a position to provide competing services, the scope for widespread service reduction and/or excessive fare increases by SBH/Kelvin was probably limited. Only one of the district councils in the region raised objections to the merger. The Traffic Commissioner for Scotland welcomed the merger because it offered the prospect of an improvement in Kelvin's maintenance standards. The Scottish Office, however, considered that the merger was undesirable because it would reduce competition and extend SBH's area of dominance.

2.80. The majority of other bus operators which expressed a view on the merger's desirability—including Stagecoach, British Bus and GRT—did not object. A few of the smaller operators expressed concern that the merger would put SBH/Kelvin in a stronger position to put pressure on their smaller competitors.

Assessment

2.81. We now bring together the various strands in the analysis of the merger's effects and reach an overall judgment.

2.82. We have noted (paragraph 2.53) that actual competition between SBH and Kelvin immediately before the merger was muted, although their presence in adjacent and, in part, overlapping areas was likely to have constrained the behaviour of each of them in some respects. More importantly, there has been a loss of potential future competition between them given the likelihood that Kelvin would have been acquired by another operator if not by SBH (paragraph 2.55). The relative position of small operators has not greatly changed (paragraph 2.66) but the merger has put SBH in a stronger position to influence the pricing of the Zonocard, which is a factor in the inter-modal competition between rail, underground and bus (paragraph 2.73). We have therefore to consider the likely effects of the weakening in competition which the merger has brought about.

2.83. There is evidence to show that demand for bus services is relatively insensitive to changes in price (see paragraphs 4.66 to 4.68). A company aiming to maximize its profits can therefore be expected to put up prices unless it is constrained from doing so by external factors. Similarly a dominant operator can be expected to reduce service frequencies, since in the absence of alternative services such action would reduce costs more than revenue by increasing the average loading of its buses. Although SBH argued that, as an employee-owned company recently emerged from municipal ownership, it retained a public service ethos, our judgment is that its management adopts an essentially commercial approach and recognizes the need to improve the company's profitability. Nor do we place reliance on the undertakings given to the Regional Council in the buy-out agreement (see paragraph 2.7).

2.84. The main question we face, therefore, is whether there are sufficient constraints on the merged SBH/Kelvin to prevent such detriments to the public interest as are postulated in paragraph 2.83.

2.85. The greatest competitive threat to a bus operator which is dominant in a particular territory is likely to come from other substantial operators in contiguous territories. The competition authorities have therefore taken a close interest in mergers between bus operators in contiguous areas. Several have been referred to the MMC in the years since deregulation and the MMC have found nearly all of them to be against the public interest because of their adverse effect on competition. A further consideration is that mergers between operators which are dominant in contiguous areas could lead to the establishment of large stretches of territory, the centres of which would become 'safe havens' too remote from other operators' territories to be vulnerable to cross-border competition. Because of this concern—which was also reflected in the conditions set for the original privatization of the NBC and Scottish Bus Group companies—the development of the emerging large operators has tended to follow a patchwork pattern.

2.86. Evidence received in the present inquiry lends support to the significance of contiguity. The 'Glasgow bus wars' were initiated by Scottish Bus Group companies in areas adjacent to SBL's territory mounting incursions into that territory. British Bus and GRT see their subsidiaries in or near Strathclyde as providing part of the basis for possible incursions into the Glasgow market even though they said they would be likely to acquire depots in Glasgow rather than attempt to run services from their existing depots. Stagecoach has already trodden this path with the acquisition by its Western Scottish subsidiary of the depot at Thornliebank and the registration of services in September/October 1994.

2.87. We agree with SBH that the present merger should be seen in the light of how the structure of the bus industry is evolving in the UK and how that evolution is affecting the competitive balance in and around the relevant area.

2.88. There has been a rapid process of consolidation in the industry in the last few years (see paragraph 2.6). Of the three large groups with subsidiaries in areas adjacent to SBH/Kelvin, Stagecoach is the biggest operator in the UK, over four times the size of the enlarged SBH in terms of number of buses. British Bus is over three times as large. GRT, while only 1.3 times the size of SBH, has the advantages of longer experience in the private sector, geographical dispersion, and a stock market quotation and hence readier access to capital. GRT's recent acquisitions of SMT and Reiver have strengthened it as a potential competitor to SBH. We believe the threat of competitive attack on SBH from any of these three carries credibility. This is particularly true of Stagecoach—leaving aside its investment in SBH (see paragraph 2.48)—which has already made three attempts to obtain a share of the Glasgow market: its Magicbus start-up operation in 1986, its negotiations to buy Kelvin and its planned incursion from Thornliebank. With regard to the 'safe haven' point referred to in paragraph 2.85, we do not believe that the combination of SBH's and Kelvin's areas of operations renders any part of those areas so remote from the three large contiguous operators—each of which already has a presence in Glasgow—as to be immune from competition.

2.89. We have also to consider the extent to which this threat of competitive attack would act as a constraint on SBH. Stagecoach demonstrated that it could very quickly begin to run services on routes which accounted for a significant proportion of SBH's revenue (see paragraph 4.53). Loss of marginal revenue on selected high-volume routes tends to undermine the economics of a network. SBH's profitability is not high and the acquisition of Kelvin, with all its problems, may weaken rather than strengthen SBH financially and in managerial resources in the short term. Moreover British Bus told us that if Stagecoach were to attack SBH, British Bus might see that as an opportunity to mount an attack of its own. We therefore believe SBH will take very seriously the potential competition from these three operators and will be concerned not to provide them with openings.

2.90. Nearly a quarter of the registered mileage in the relevant area is operated by small operators. While these, unlike Stagecoach, British Bus and GRT, are not in a position to present a real challenge to SBH, they can play a useful role in helping to keep it on its toes. Most of them have not objected to the merger.

2.91. As noted in paragraphs 2.34, 2.35 and 2.73, there is some competition from other transport modes and the Regional Council promotes low, subsidized fares for rail and underground travel. At present, there are uncertainties hanging over the future of ScotRail because of planned privatization, and over the future of local authority subsidies for rail and underground because of planned local government reorganization. Nevertheless we believe that competition from other transport modes, particularly rail and underground, represents a further source of pressure on SBH, although in view of the current uncertainties there must be some doubt about the strength of this pressure in the longer term.

2.92. We have thus identified three sources of competitive constraint on SBH's behaviour:

- (a) the threat of competition from the three large operators—Stagecoach, British Bus and GRT—with operations contiguous to those of SBH;
- (b) the existence in the relevant area of a large number of small operators; and
- (c) an element of competition from other modes of transport, reinforced by the existence of the Zoncard and the Regional Council's low fares policy.

The first of these carries considerably more weight than the others but the cumulative effect is substantial.

2.93. The merger may also be expected to produce some clear benefits to the travelling public, such as through ticketing and co-ordinated timetables; a reduction in congestion from the elimination of duplicate services; an improvement in the quality of buses used by Kelvin, and hence in the quality and reliability of its services; and, at least in the short term, a reduction in fares compared with those which an independent Kelvin would have charged. Some but not all of these could have been achieved in other ways. There are also substantial financial savings available to SBH as a result of the merger, more than would be available to another acquirer (see paragraphs 2.75 to 2.78). The benefit of these may be expected to accrue to the public given our belief that there will be effective competitive pressures on SBH.

2.94. We have taken note of the fact that the majority of third parties which expressed a view were in favour of allowing the merger to proceed, or at least raised no objection to it (see paragraphs 2.79 and 2.80).

2.95. A final consideration arises from the merger's effects on the ownership structure of the bus industry. We have noted the rapid process of consolidation which has been taking place and which appears likely to lead to the bulk of the industry being concentrated in the hands of

a small number of companies (see paragraph 2.6). We agree with SBH that the merger improves—though it does not guarantee—its prospects of survival as an independent company in the face of this evolution. Diversity of ownership provides a better opportunity for competition to prevail and we believe this factor should be given some weight.

Conclusion

2.96. In arriving at an overall judgment we have had to balance the various factors summarized in paragraphs 2.81 to 2.95, most of which cannot be quantified. Competition from small operators and from other forms of transport will provide some constraint on SBH, and we have given some weight to the benefits referred to in paragraphs 2.93 and 2.95. But the main factor influencing us is the prospect that potential competition from the three large groups—Stagecoach, British Bus and GRT—with subsidiaries in contiguous areas will prevent SBH from abusing its dominant position in the relevant area. Our conclusion is that the merger does not operate and may be expected not to operate against the public interest. One member of the Group, Professor Eilon, disagrees with this conclusion; his views, of which we have taken full account before reaching our conclusion, are set out in a note of dissent following this chapter.

Note of dissent

by Professor S Eilon

1. My colleagues have concluded that the SBH/Kelvin merger does not operate and may be expected not to operate against the public interest and hence the merger should be allowed to proceed. I dissent from this view.

2. I would like to start with some general observations regarding the scope of competition in local bus markets. The development of the industry in recent years has been characterized by the rapid creation, through a series of mergers and acquisitions, of several large bus companies seeking to establish domains in which they can operate extensive profitable networks. Initially, this led to periods of intense competition, particularly in urban areas, occasionally flaring up in the form of 'bus wars', followed by a tendency for operators to focus on specific areas and thereby create local monopolies. The local monopolists have increasingly adopted a 'live and let live' strategy with respect to their competitors in contiguous areas. It is generally expected that this process of consolidation will continue, until the industry gradually settles down to what may be regarded as that of a steady state.

3. The relative ease of entry into a given market means that there will continue to be a large number of small operators in this industry. Many will target the tendered market, where their low overheads offer opportunities to win contracts against severe competition. Successful bids for tendered services then provide a useful operational and financial base for proceeding to explore openings in the commercial services market. This means that there is generally scope for competition to develop between small operators and a dominant incumbent, but only on a limited scale. A wise large incumbent would not bother to squash small operators and will only occasionally use his muscle to frighten off too many newcomers converging on his patch. But attitudes of large operators vary and evidence given to us suggests that at least some large operators are determined to protect their territory vigorously and are inclined to take whatever action is needed to eliminate predators, particularly when profitable routes are targeted.

4. An attempt by a large competitor to invade a territory already dominated by another large operator immediately raises the prospect of a 'bus war', which may well attract other operators wishing to stake a claim to the whole or part of the territory. The outcome would obviously depend on the relative strengths of the combatants and the degree to which they are determined to pursue the battle and able to devote resources to it. 'Bus wars' are bound to be costly to those taking part, but past experience suggests that they do not last, so that after a relatively short period the intensity of the competition subsides when some of the contestants withdraw and a remaining small number settle down to a 'live and let live' regime, generally with each being allowed to dominate a sub-area with a limited amount of overlapping routes between the survivors.

5. The intensity of competition during 'bus wars' in town centres inevitably leads to excessive provisioning of services and consequently to very damaging congestion. This has led many to question whether free competition is not detrimental to the public interest. It is argued that the frequent services and low fares which the travelling public enjoys for a while during 'bus wars' are outweighed by the detrimental effects of congestion during these wars, followed by reduced services and higher fares which the surviving operators seek to implement for the purpose of recouping at least part of the costs of the wars. It is therefore not surprising that it has been put to us that 'bus wars must be avoided', that free competition has often led to chaotic and unstable situations and that instead of competition in a given area it would be preferable to have a single operator who is able to offer a comprehensive network and ensure regularity and quality of service. I understand the reasons for these sentiments, but I take a different view. I believe that 'bus wars' are transient phenomena involving temporary

ill-effects, and hence they may be a small price to pay if competition is not to be killed off altogether, leaving an area entirely to the mercy of a monopolist. As for the detrimental effects of congestion, I am encouraged by the powers given recently to Traffic Commissioners to take action when they feel that congestion in a particular area is getting out of hand, and in principle this should alleviate the particular detriments of overbussing in the future.

6. I agree with the proposition that network advantages can be brought about by a single operator in an area, but I believe it is perfectly possible for two operators to achieve the same advantages through co-ordinated timetables and transferable tickets. Clearly, as the number of large operators in an area increases, such advantages may be difficult if not impossible to realize, but it does not follow that a single operator is necessarily preferable. It must be appreciated that the advantages secured by a local monopoly must be set against the disadvantages and in this respect perhaps the best position is that of a duopoly (assuming that the area is large enough to sustain it).

7. We now need to consider whether a local monopolist is likely to exploit his power to the detriment of the public with regard to two important issues: fares and frequency of services. One suggestion was that a monopolist would opt for lower fares as the way to increase bus usage, and this would obviously benefit the travelling public. However, I suspect that the main objective of an operator is not to increase bus usage but increase profit, and if we assume that costs at the margin are not affected by usage then his objective becomes that of maximizing revenue. A monopolist therefore has to decide (leaving aside quality of service) whether to increase or decrease fares to achieve this purpose. The answer is surely dependent on the price elasticity of demand.

8. The price elasticity of demand is the ratio of a relative change in demand in response to a relative change in price. Thus, a price elasticity of 1 means that an x per cent increase in price is expected to result in an x per cent decline in volume and similarly a price reduction of x per cent is expected to lead to an increase of x per cent in volume. A general analysis of the effect of price changes on revenue reveals the following:

(a) If the price elasticity of demand is below 1 (ie the market is insensitive to price), a price increase (within bounds) is expected to lead to an increase in revenue (ie the price increase more than compensates for the fall in volume), while a reduction in price causes revenue to decline.

(b) If the price elasticity of demand is above 1 the opposite results obtain.

9. We do not have sufficient data from which an accurate value of the price elasticity of demand in the reference area can be ascertained. However, we have been told that in this business the market is generally price-insensitive (paragraph 4.66). It therefore follows from the above that a monopolist would be very tempted to increase his prices over a period of time. An obvious constraint to fare increases would be the limit beyond which a fare increase would lead to a decline in revenue. This is not a severe constraint when the price elasticity of demand is low, and the lower the price elasticity of demand the greater is the scope to increase prices in order to increase revenue. Furthermore, if the resultant decline in volume is substantial, the operator may proceed to reduce the number of buses in operation and thereby reduce his costs and increase his profit even further. More generally on the provision of services, a monopolist may well be tempted (whether fares are changed or not) to prune the network (by discontinuing loss-making or low-profit routes) and to reduce frequencies on selected routes in order to reduce total costs. There is, therefore, a real risk in my view that, given half a chance, a monopolist would be tempted both to increase fares and reduce services. Both actions would be detrimental to the public interest.

10. Short of regulation, the only effective restraint on a dominant operator with respect to fares and services is that of competition, actual and potential. As for effective actual competition to a bus monopolist, it could come from rail and underground services when alternative travel is available on parallel routes, but in many areas such competition is bound to be limited. Actual competition from small bus operators is not likely to be effective over a long period: their pin-prick attacks on selective routes would have an effect in the short term, but if they become too much of a nuisance, a dominant operator would take steps to drive them out or seriously damage them. The remaining moderating influence on a monopolist would then be that of potential competition. The most effective potential competition would come from a strong operator in a contiguous area.

11. It has been suggested that if potential competition does not become actual then it remains an idle threat and ceases to be credible. However, I take the view that a competition threat can be very effective and when it occasionally erupts into real warfare (even when it is confined to small areas and lasts only for a short period) it serves to alert everybody to the fact that such a threat cannot be ignored. While I agree that completely free competition in this industry may not be possible (and may at times, as in the case of 'bus wars', even have detrimental effects), the contrasting scenario of a benevolent monopolist operating entirely in the public interest may well be a mirage. My contention is that a reasonable state of affairs, which avoids the two extreme scenarios, is that of ensuring potential competition.

12. I now turn to the SBH/Kelvin merger. It is true that the overlap of the SBH and Kelvin routes was not very substantial in commercial services prior to the merger, but it still is the case that in Glasgow SBH and Kelvin account for 88 per cent of the market. Even when we consider the whole of the relevant area they control two-thirds of the market. These are very substantial market shares. As for tendered services, SBH told us that competition between the two operators was fierce before the merger (see paragraph 2.51) and this competition would be lost if the merger is allowed. It is further concluded above (paragraph 2.55) that we are in no doubt of the loss of potential competition as a result of the merger.

13. We further state above (paragraph 2.66) that 'We do not entirely accept that the merger has made no difference to the position of small operators'. In fact, SBH was capable of harassing smaller competitors (including Kelvin) in the past (paragraph 2.52) and in my view the enlarged and more powerful SBH would be even better placed to behave aggressively towards small operators in the future.

14. Other modes of transport would offer very little competition to SBH (see paragraphs 2.34, 2.35 and 2.73) and we comment on the ability of the enhanced SBH to press for increases to Zonocard prices. There is an even greater danger inherent in the merger, namely that SBH could cease its participation in the Zonocard scheme and promote its own card and such moves would badly affect the smaller operators in the area.

15. I have already commented in general terms about the incentive for a monopolist to increase fares in a market which is not price-sensitive and to reduce services. These comments apply, in my view, to the enlarged SBH. The very dominant position of SBH would make it very difficult for small operators to make a significant impact on the commercial services market and the consequences for the public of the potential for fare increases and curtailment of services are therefore very serious.

16. If the merger is not allowed, then the potential competition to SBH would come from Kelvin, or whoever controls Kelvin, operating in a contiguous area to SBH. As stated earlier, I believe that potential competition from a contiguous area is the best, and possibly the only, safeguard that we have within the present state of the market and its prevailing regimes to moderate the potential excesses that local monopolists in the bus industry would be tempted to exploit.

17. The benefits claimed by SBH for the merger are enumerated in paragraph 2.75. I accept that the merger will allow some wasteful duplication of services to be dispensed with, but I believe that as part of the wide-sweeping pruning and rationalization exercises that are bound to take place, some low-volume routes will vanish altogether and frequencies will be reduced on others. I also think that there is plenty of scope for fare increases before newcomers are tempted to mount a serious attack on the market. Such attacks would be repulsed by selective tactics of temporary low fares and high service frequencies, only to be cancelled when the marauders are seen off. Most of the benefits claimed for the merger will accrue to SBH rather than the public and there is no persuasive evidence that such benefits would be passed on in the form of reduced fares and improved services. In any event, the benefits claimed for the merger need to be offset against the detriments that would ensue from the temptation to increase fares and reduce services, as discussed above. There is no lasting benefit to the public in such a scenario.

18. For all the reasons elaborated above I conclude that the creation of the SBH/Kelvin merger may be expected to operate against the public interest and my view is that SBH should be required to divest itself of Kelvin.

S EILON
29 March 1995

Part II

Background and evidence

3 The companies: history, finance and the acquisition

Introduction

3.1. The chapter opens with a description of developments in the bus industry following the important legislative changes introduced in 1985 (paragraphs 3.2 to 3.12). This is followed by details of the regulatory role of the Traffic Commissioners (paragraphs 3.13 to 3.15) and the roles of Strathclyde Regional Council and SPTE in promoting public transport in the relevant area (paragraphs 3.16 and 3.17). The chapter then summarizes the recent history, ownership and financial performance of the two main parties with which we are concerned in the inquiry, SBH (paragraphs 3.18 to 3.31) and Kelvin (paragraphs 3.32 to 3.44). It then outlines the acquisition of Kelvin by SBH (paragraphs 3.45 to 3.51), and SBH's view of the cost savings that will arise as a result of the acquisition (paragraphs 3.52 to 3.54). The chapter concludes with a brief account of subsequent important changes in the structure of ownership of SBH (paragraphs 3.55 to 3.57).

Developments in the industry since 1985

3.2. Prior to 1986 bus services in the UK were provided by local authority-owned operators, by the subsidiaries of publicly-owned corporations, namely the NBC in England and Wales and the Scottish Bus Group in Scotland, and by smaller private operators. The Scottish Bus Group was itself a subsidiary of the STG, the body then responsible for most bus, coach, shipping and ferry services in Scotland.

3.3. In Scotland there were four bus companies owned by local authorities: Grampian Regional Transport Limited (Grampian), Lothian Region Transport PLC (Lothian), Strathclyde Buses Limited (SBL) and Tayside Public Transport Co Ltd (Tayside). These companies operated primarily in and around the cities of Aberdeen, Edinburgh, Glasgow and Dundee respectively. The Scottish Bus Group companies operated in the smaller towns and rural areas outside these cities. The main areas of overlap between the municipal and the Scottish Bus Group companies were on routes on which the Scottish Bus Group companies travelled into and out of the four cities. Appendix 3.1 identifies the Scottish Bus Group and local authority-owned companies and their main areas of operation before privatization.

3.4. In 1985 the legal and administrative framework within which the industry operated underwent substantial change. The primary purposes of the changes were to promote competition and efficiency by removing barriers to entry and to limit the use of public monies in the funding of bus operations. The 1985 Act was the principal measure providing for deregulation of the industry. It abolished the requirement for road service licensing outside London and as a consequence removed all quantitative restrictions on the supply of local bus services. Following the 1985 Act, to operate new services operators need only register with the Traffic Commissioner for the area (see paragraph 3.13) giving at least 42 days' notice of their intention to set up a service. Any subsequent variation or withdrawal of the service also requires this period of notice. To register a new service an operator has to provide the Traffic Commissioner with information on the proposed route, its terminal points, timetable, stopping arrangements and vehicles to be used.

3.5. Taking advantage of the new freedoms allowed by the 1985 Act some of the Scottish Bus Group companies, particularly Kelvin, launched new services in Glasgow in competition with SBL, initiating a period of intensive competition lasting from 1986 to 1989 known as the 'Glasgow bus wars'. SBL proved a resilient competitor and the Scottish Bus Group companies eventually drew back.

3.6. In addition to allowing new entrants to compete against incumbent operators, the 1985 Act also provided for the privatization of the NBC and the transfer of all local authority bus operations into companies operating at arm's length from their owners. Local authorities were no longer permitted to provide blanket financial support for bus services in their areas although they were allowed to subsidize unprofitable services required to meet social needs, which would not otherwise be provided, and to operate concessionary fare schemes for particular categories of people such as the old, the young and the disabled.

3.7. Before privatization the NBC was divided up into 72 companies. These were sold between 1986 and 1988, many to their managements. No single buyer was allowed to acquire more than three NBC subsidiaries or to acquire companies operating in contiguous areas.

3.8. In Scotland the Transport (Scotland) Act 1989 provided for the transfer to the private sector of most of the operations of the STG including its wholly-owned bus subsidiary the Scottish Bus Group. The Scottish Bus Group was divided into ten companies—nine local bus operators and Citylink, a coaching company operating both in Scotland and other parts of the UK. These were sold between August 1990 and October 1991. Five, including Citylink, were sold to management and employee teams, three to companies that have subsequently achieved significant national market shares and two to smaller independent companies. Appendix 3.2 details the disposal of the Scottish Bus Group companies and the subsequent changes in their ownership. When the companies were sold in 1990 and 1991 no buyer was allowed to acquire more than two of them or to acquire companies operating in contiguous areas.

3.9. Local authorities have not been legally obliged to dispose of their bus companies but the Government has given incentives to encourage voluntary sales.

3.10. As at March 1995 less than half the former municipal operations in Great Britain remained in local authority ownership. In Scotland, of the four former local authority-owned companies only one, Lothian, remained in public ownership. The others were sold to management and employee teams as follows: Grampian (1989); Tayside (1990); and SBL (1993).

3.11. Following the implementation of the 1985 Act the industry has undergone significant consolidation. In particular many of the original NBC and local authority companies which were the subject of management and employee buy-outs have been acquired by a number of emerging large national operators. Following the sale of the Scottish Bus Group companies this pattern was also repeated in Scotland. With the exception of Kelvin (see paragraphs 3.32 to 3.44), all the Scottish Bus Group companies sold to their management and employees have been subsequently acquired by large national operators. GRT's acquisitions of SMT (the former Eastern Scottish) and Reiver (the former Lowland Scottish) in late 1994, added to Midland Scottish which it acquired in 1990, have given GRT ownership of three companies with contiguous operations (see Appendix 3.1). Only one of the original Scottish Bus Group companies, Highland Scottish, remains independent.

3.12. By 27 March 1995, according to The TAS Partnership Ltd figures, seven companies—Badgerline, British Bus, Go-Ahead, GRT, MTL, Stagecoach and West Midlands Travel—accounted for approximately 60 per cent of the UK bus market measured in terms of turnover. Of these companies Badgerline, Go-Ahead, GRT and Stagecoach have Stock Exchange listings. The combined market capitalization of these four companies, in mid-March 1995, was some £650 million. A further 4 per cent of the UK bus market is held by Cowie Group plc, a diversified transport group which operates franchised bus services in London.

The Traffic Commissioners

3.13. The Traffic Commissioners are appointed by the Secretary of State for Transport. Each covers one of eight defined Traffic Areas throughout Great Britain. Scotland constitutes one such Traffic Area. Whilst the 1985 Act substantially reduced bus operator licensing requirements, the Traffic Commissioners remain the licensing authority for operators of heavy goods vehicles (HGVs) and public service vehicles (PSVs). As such they exercise powers over the quality of service offered by bus operators and over safety standards. They are responsible for handling disciplinary cases involving the conduct of HGV and PSV drivers, and for ensuring that any operator holding a licence in their area has sufficient working capital and other resources to operate and maintain its fleet.

3.14. The Traffic Commissioners' powers include the ability to attach conditions to an operator's licence if the operator fails to run local services in accordance with the registered details, intentionally interferes with the services of another operator, or operates services in a manner dangerous to the public. The conditions may also prohibit the operator from providing services on certain routes, or even from providing local bus services at all. The Traffic Commissioners have no powers to fix or control fares, however.

3.15. New regulations which came into effect on 1 February 1995 have strengthened the powers of the Traffic Commissioners in areas experiencing significant traffic congestion. Traffic Commissioners can now regulate the number of buses operating on a particular route if requested to do so by the relevant traffic authority and can prevent operators from using duplicate buses where passenger demand cannot be demonstrated.

The role of Strathclyde Regional Council

3.16. Under the 1985 Act the Roads and Transportation Committee of Strathclyde Regional Council is designated as the Passenger Transport Authority for a defined Passenger Transport Area in the Glasgow conurbation. This area consists of 11 of the 13 local authority districts in the relevant area for our inquiry. The Authority has responsibility for formulating public passenger transport policies within its area. In the remainder of Strathclyde region, the Regional Council has responsibility for securing subsidized local services, delegating this to the Roads and Transportation Committee. Concessionary travel for the elderly and disabled is made available throughout the region by the Regional Council. The Regional Council's Education Committee is responsible for securing the provision of free school transport for those entitled to it. In this report for convenience we use the term Strathclyde Regional Council (or the Regional Council) to refer to the bodies described in this paragraph.

3.17. The executive functions required to implement the policies of the Passenger Transport Authority, including the securing of subsidized local services within its area, are carried out by SPTE, a statutory body with functions laid down in successive Transport Acts. For the remaining functions mentioned in this paragraph (with minor exceptions) it acts as the agent of the Regional Council. Its main activities in respect of bus services are inviting tenders and awarding contracts for subsidized and school services; providing infrastructure such as bus stations, bus shelters, bus stops and timetable information; general promotional activities; and administering concessionary fares. It specifies services, fares and standards on the local ScotRail network, manages the Glasgow underground and provides financial support for these services on behalf of the Regional Council. It also administers the Zonocard multi-modal, multi-operator ticketing scheme (see paragraph 4.78).

SBH: history, ownership structure and financial performance

3.18. The predecessor companies to SBH have a long history of providing bus services, primarily in the city of Glasgow. Before implementation of the 1985 Act the operations currently run by SBH, excluding those of Kelvin, were administered by SPTE.

3.19. In accordance with the 1985 Act SBL, a company wholly owned by Strathclyde Regional Council, took over the bus operations of SPTE on 26 October 1986. On 19 February 1993 SBL was acquired by Strathclyde Buses (Holdings) Limited, a company established and owned by the directors and employees of SBL (the buy-out). On 21 April 1993 Strathclyde Buses (Holdings) Limited changed its name to S B Holdings Limited.

3.20. On 1 August 1993 SBH incorporated a wholly-owned subsidiary Comlaw No 313 Limited, which trades as GCT, and on 15 November 1994 it acquired Kelvin, the second largest bus operator in the relevant area (see paragraphs 3.32 to 3.44). Thus SBH now functions as a holding company with three wholly-owned trading subsidiaries—SBL, GCT and Kelvin. In this report, except where the context otherwise requires, we use the term SBH to embrace the activities of SBL and GCT, but excluding Kelvin.

3.21. Characteristics of the market for local bus services in the relevant area and SBH's share of this market are provided in Chapter 4. SBL, which is SBH's most important subsidiary, operates primarily in the district of Glasgow City, which in March 1994 accounted for some 80 per cent of its mileage. SBL operates from four depots all located within two miles of Glasgow city centre. At the time of the merger it operated a fleet of 737 vehicles and employed some 2,200 staff.

3.22. GCT operates from a designated area of SBH's Knightswood depot. GCT is a separate operating unit with its own management, employees and terms and conditions of employment. It provides approximately 2 per cent of the registered bus mileage in the relevant area and operates mainly tendered services. (For a description of tendered services in the relevant area see Chapter 4.) At the time of the merger it operated a fleet of 80 vehicles, all hired from SBL but operating with GCT's own livery. SBH told us that the rationale for GCT was to create an operation within SBH which, by achieving a lower cost base, could more successfully supply certain niche markets, in particular tendered services or routes which had low patronage. SBH told us that the lower costs of GCT compared with SBL were achieved by running an older fleet, paying lower wages and utilizing less management and less engineering resource.

3.23. The February 1993 buy-out of SBL from Strathclyde Regional Council was a closed sale carried out without competitive tendering. Consideration of £18.3 million (including £2 million of accrued interest)—representing 32p per £1 of turnover acquired—was payable as follows:

TABLE 3.1 The buy-out of SBL: consideration payable to Strathclyde Regional Council

	£'000
<i>On completion:</i>	
Cash	11,833*
<i>Deferred consideration:</i>	
Three equal amounts of £1,500,000 payable on the second, third and fourth anniversary of completion	4,500
Accrued interest payable on 19 February 1998, the fifth anniversary of completion	<u>2,000</u>
	<u>6,500</u>
	18,333

Source: SBH.

* £647,000 of this amount was paid by SBH to the Regional Council through SBH's Employee Share Ownership Trust.

3.24. As part of the buy-out SBH paid an interim dividend of £5 million, plus an associated tax credit of some £1.7 million, to the Regional Council and undertook to complete an existing order of £5.6 million which the Regional Council had placed to acquire 55 buses, mainly to replace those destroyed in a fire at SBH's Larkfield depot in May 1992 (in effect the order was completed using the insurance proceeds resulting from the fire). In addition, for seven years after the buy-out, clawback arrangements would apply in the event of the disposal of any SBL depot. Clawback would apply to the net proceeds over an agreed indexed base value. For the first five years the clawback percentage was set at 80 per cent, subsequently reducing to zero on a daily basis over the next two years.

3.25. SBH also undertook that, subject to using its best endeavours to operate the business in a commercial, efficient and profitable manner, it would maintain annual total mileage at not less than 85 per cent of pre-buy-out levels, 'having responsible commercial regard for the needs of the community in respect of marginal, evening and Sundays services'; endeavour to maintain fare levels at or below the national average; recognize and support the role of trade unions; and maintain the existing quality of service. SBH told us that both it and the Regional Council considered these undertakings to be a statement of best endeavours rather than a legally binding commitment. No formal monitoring of the observance of the undertakings was required under the buy-out agreement or has been performed in practice.

3.26. After the buy-out the share capital of SBH was divided into three classes—'A', 'B' and 'C'. At 22 September 1994, the time of the offer for Kelvin, the 'A', 'B' and 'C' shares represented 80 per cent, 2 per cent and 18 per cent respectively of SBH's issued share capital. The 'A' shares were held by or on behalf of individual SBH employees, the 'B' shares by or on behalf of managers and the 'C'

shares by executive directors. The shares held on behalf of employees and management were held by an Employee Benefit Trust (EBT) and a Management Benefit Trust (MBT) respectively.

3.27. Prior to the acquisition of Kelvin the SBH Board consisted of three executive directors and two directors nominated by employees. Whilst SBH was 80 per cent employee-owned, for a five-year period ending 19 February 1998 (the Transitional Period) SBH's Articles of Association enable the executive directors via their holding of 'C' shares to exert strong control over the company. Holders of 'C' shares have voting rights of 25.1 per cent at any general meeting. For resolutions involving the appointment or removal of a director or the alteration of the number of directors, these voting rights increase to 50.1 per cent. During the Transitional Period the voting rights attached to 'C' shares can only be exercised as a block.

3.28. The powers of the executive directors were offset to a degree by those of the employee-nominated directors who, under SBH's Articles, were entitled to make up at least one-third of the Board. The consent of the employee-nominated directors was required for certain important matters including any share allotment or issue; the sale of all or part of the company during the Transitional Period; any changes in Directors' contracts including their contracts of employment; any changes in the Articles; the payment of dividends during the Transitional Period; any acquisitions; and any capital expenditure exceeding £1.5 million per annum.

3.29. The financial performance of SBH over the last five years is summarized in Table 3.2.

TABLE 3.2 SBH: financial summary

	<i>Year ending 31 March*</i>					<i>£'000</i>
	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993†</i>	<i>1994</i>	
Turnover	50,727	53,719	56,832	56,940	58,153	
Operating profit/(loss) before interest	522	(952)	111	2,437	2,666	
Interest payable	(41)	(29)	(3)	(62)	(977)	
Interest receivable	1,098	1,186	925	1,259	430	
Profit after interest	1,579	205	1,033	3,634	2,119	
Expenditure on passenger vehicles	6,989‡	343	77	169	6,199§	
Net operating assets	19,547	17,174	13,865	22,435	21,844	
Average net operating assets	16,275	18,360	15,519	14,936	22,139	
Shareholders' funds	18,025	18,207	19,033	20,855	21,527	
						<i>per cent</i>
Ratio of operating profit to turnover	1.0	N/A	0.2	4.3	4.6	
Ratio of operating profit to average net operating assets	3.2	N/A	0.7	16.3	12.0	
Average number of employees	2,604	2,620	2,589	2,543	2,443	
Turnover per employee (£)	19,480	20,503	21,951	22,391	23,804	

Source: SBH.

*The 1990, 1991 and 1992 figures show the results of SBL. The 1993 results show the combined results of SBL and SBH. The 1994 results show those of SBH including GCT which commenced trading in August 1993.

†SBH's 1993 results include extraordinary income of £6.7 million representing an excess of insurance proceeds over the net book value of the assets, being 60 buses and significant property, damaged or destroyed following a fire at the Larkfield depot on 18 May 1992. This income is not included as part of the profit after interest figure stated above for 1993. During 1993 SBH also revalued property and vehicles by some £1 million and £4.7 million respectively.

‡Includes an amount of £3.1 million classified in the 1989 accounts as 'assets in the course of construction'.

§Includes an amount of £3.1 million classified in the 1993 accounts as 'assets in the course of construction'.

3.30. Prior to the buy-out SBH's underlying profitability remained low or negative, the results being subject to significant exceptional accounting charges reflecting continued rationalization. In the years immediately preceding the buy-out the level of investment in the fleet was low.

3.31. Since the buy-out SBH has focused on enhancing profitability by improving its internal operating efficiency. Measures taken include a 3 per cent reduction in wages for existing employees, a 20 per

cent reduction in the employment package offered to all new employees and further redundancies. SBH has also increased its investment in vehicles. In the period since the buy-out, including the £5.6 million spent to replace buses lost in the May 1992 fire at SBL's Larkfield depot, investment in vehicles has totalled some £8.3 million.

Kelvin: history, ownership and financial performance

3.32. Kelvin is both the holding company and the only trading company within the Kelvin group of companies.

3.33. Kelvin's predecessors have a long history of providing bus services both in the Greater Glasgow conurbation to the north of the River Clyde and in Lanarkshire since the early part of this century. In 1948 the company was nationalized and in 1968 ownership was transferred to the STG.

3.34. From the mid-1980s, due partly to economic decline in its operational area, Kelvin's predecessor companies had a poor trading and reinvestment record. In 1988, in order to create an operation that, following privatization, would be better able to retain its market share and sustain future competition, the company Kelvin Scottish Omnibuses Limited (Kelvin Scottish) which operated mainly in and around Glasgow to the north of the River Clyde was merged with Central Scottish Omnibuses Limited (Central Scottish) which ran services mainly in the Lanarkshire area, to form Kelvin. On 13 February 1991 Kelvin was acquired by its management and employees from the STG.

3.35. Characteristics of the market for local bus services and Kelvin's share of this market are described in Chapter 4. In summary, Kelvin operates a less concentrated network than SBH with particular emphasis on serving the corridors linking outlying towns with Glasgow city centre. At the time of its acquisition by SBH, Kelvin operated from six depots spread across the Glasgow conurbation, with 512 vehicles and nearly 1,300 employees.

3.36. Before privatization Kelvin experienced significant trading difficulties, due in particular to a damaging 14-week strike which ended in mid-1989, and was reliant upon the financial support of the STG. As part of the preparations for privatization £6.5 million of Kelvin's debt to the STG was capitalized, the number of employees was reduced by almost 600 during 1990 and 1991 and a pay cut of around 20 per cent was introduced for remaining employees. The financial weakness of Kelvin was reflected both in the agreed sale price of £1 and in the fact that, uniquely in the Scottish Bus Group privatization, the sale attracted only one bidder.

3.37. Under the sale agreement the STG converted a further £1.5 million of Kelvin's debt into an interest-free loan. £0.5 million of the loan was repayable on completion with the balance repayable in five equal annual instalments between 1997 and 2001. The STG was granted an option (the STG option) giving it the right in certain circumstances—principally the acquisition of a controlling interest in Kelvin—to subscribe at par for shares totalling 20 per cent of Kelvin's enlarged share capital. The option applied until February 1998 or, if later, the date of the full repayment of the STG loan. There was also a clawback arrangement providing that, in the event of the sale of certain Kelvin properties in the seven years after the buy-out, the net proceeds over an agreed base value would be payable to the STG.

3.38. Under Kelvin's Articles of Association at that time its Board of Directors was limited to a maximum of eight members. Prior to the acquisition by SBH the Board of Kelvin consisted of four executive directors, three employee-appointed directors and one non-executive director. The minutes of Kelvin's Board meetings reflect the importance placed on employee- and staffing-related matters. Kelvin's Articles of Association also required that, on certain matters including the disposal of the whole or a substantial part of the company's share capital, approval of 95 per cent of shareholders was required.

3.39. The ownership of Kelvin immediately before its acquisition by SBH was divided between employees who owned 46.9 per cent, directors who owned 7.3 per cent and two EBT companies (established with the purpose of encouraging and facilitating the holding of shares by and for the benefit of employees) which together owned 45.8 per cent.

3.40. The financial performance of Kelvin over the four years to December 1993 is shown in Table 3.3.

TABLE 3.3 Kelvin: financial summary

	£'000			
	Year ending 31 December			
	1990	1991	1992*	1993
Turnover	25,463	25,751	28,553	27,557
Operating profit/(loss) before interest	(5,286)	(781)	582	(1,436)
Interest payable	-	(55)	(75)	(70)
Interest receivable	-	99	33	21
Profit/(loss) after interest	(5,286)	(737)	540	(1,485)
Expenditure on passenger vehicles	46	504	1,114	120
Net operating assets	9,211	9,068	9,997	8,438
Average net operating assets	11,723	9,085	9,532	9,217
Shareholders' funds	1,677	7,459	7,589	6,196
Average number of employees	1,556	1,439	1,523	1,425
Turnover per employee (£)	16,364	17,895	18,748	19,338

Source: Kelvin.

*During 1992 Kelvin increased the period over which traffic vehicles were to be written off from 15 years to 17 years. The 1992 results contain a one-off accounting adjustment which reduced the depreciation charge for that year by some £1.4 million. Kelvin told us that the adjustment was made to correct over-provisions in earlier years.

3.41. In the period following the buy-out Kelvin invested approximately £3.4 million in acquiring the assets or businesses of 16 competing operators. With the exception of the acquisition of Stagecoach's Magicbus subsidiary in April 1992 for £840,000, the vast majority of this expenditure represented payments for goodwill, including the rights to livery and to operate the existing routes of operators. Kelvin told us that in each case the initiative for the investment came from the vendor rather than Kelvin.

3.42. Kelvin continued to incur significant losses and its reinvestment in new buses also remained low. In the company's 1993 Annual Report the directors stated that, over the longer term, Kelvin needed to invest more than £2.5 million per annum in new vehicles in order to ensure its survival. This figure significantly exceeded Kelvin's entire investment in new vehicles in the preceding ten years. Due diligence work carried out by SBH prior to the merger forecast pre-tax losses of around £900,000 for 1994.

3.43. During 1993 Kelvin came under heavy competition in a number of areas which caused it to restructure its activities and in particular to withdraw services from the East End of Glasgow and close its Springburn depot. At this time Kelvin claimed to have been adversely affected by the continued freeze on Zoncard and other transport prices. In addition it encountered difficulties with the Traffic Commissioner concerning its Vehicle Operator's Licence. In July 1994 the Traffic Commissioner renewed Kelvin's licence for only one year rather than the normal five. The 1994/95 licence, which terminates on 30 June 1995, was accompanied by a formal warning about maintenance standards. Kelvin also faced the possibility of having to meet unprovided taxation liabilities, as a result of the Inland Revenue challenging Kelvin's earlier utilization of certain pre-privatization tax losses.

3.44. These factors, combined with announced changes in Government policy on fuel duty rebates and refunding of statutory sick pay, resulted in the Kelvin Board increasingly forming the view that the company had no long-term future as an independent operator.

The acquisition of Kelvin by SBH

3.45. Before the merger the Boards of both SBH and Kelvin had each been considering options for their future ownership. Of particular concern was the need to raise capital for investment as well as the implications of the consolidation of ownership of the larger national operators in Scotland. SBH told us that it began formal discussions with Kelvin about a possible merger in September 1993. These

culminated in SBH putting a merger proposal to Kelvin in March 1994, but the Managing Director of Kelvin then told SBH that Kelvin's three employee-appointed directors wished Kelvin to gain a better understanding of SBH before further consideration could be given to the merger. However, he also assured SBH of his wish that the two companies should work more closely together. He undertook that Kelvin would never initiate aggressive action against SBH, nor would it talk to any third party regarding the sale or transfer of a material part of its business.

3.46. In mid-August 1994 Stagecoach approached Kelvin with a proposal to take over the company (the two companies had previously discussed such a possibility in the summer of 1993). On 25 August 1994 the companies reached agreement on the terms of the Stagecoach proposal. These valued Kelvin at around £10 million including a payment of £2.0 million to meet the cost of the STG option.

3.47. SBH became aware of the Stagecoach-Kelvin negotiations and on 7 September 1994 informed Kelvin of its intention to make an offer for the company. On 12 September 1994 SBH detailed the agreed terms of an offer worth £11.1 million, including a payment of £2.2 million to meet the cost of the STG option. Kelvin immediately terminated its discussions with Stagecoach, informing Stagecoach that the Kelvin Board's preference for the SBH offer related more to 'ideology', ie the employee-owned ethos of SBH, rather than financial aspects of the respective proposals.

3.48. On 22 September 1994 SBH's offer document for Kelvin was issued. SBH stated that the merger would establish a new force in the UK passenger transport industry and establish a strong base from which to create future growth, possibly including acquisitions outside Scotland. The offer represented 40p per £1 of turnover acquired. It included a number of undertakings in relation to the then existing employees of Kelvin: the honouring of existing wage offers; a guarantee of no compulsory redundancies for at least three years; the maintenance of basic rates of pay and other terms and conditions for at least three years; the safeguarding of pension rights; and the retention of employee representation and trade union facilities. SBH also gave a commitment that for the following three years not less than 50 per cent of any new vehicles acquired by SBH would be allocated to Kelvin. Appendix 3.3 provides a chronology of events relevant to the acquisition of Kelvin.

3.49. As consideration for each of their Kelvin shares shareholders were offered three alternatives:

- (a) a cash offer of £10; or
- (b) £10 of SBH interest-bearing loan notes; or
- (c) ten new shares in SBH.

The loan notes were unconditional, unsecured obligations of SBH which could be redeemed by holders after 1 July 1995. Under certain conditions SBH has the right to redeem all the notes at any time. In any event SBH is required to redeem all outstanding notes not later than 1 October 2008. Under the share alternative all new SBH shares issued were to rank *pari passu* with existing 'A' shares. The SBH offer was approved by virtually all Kelvin's shareholders on 16 October 1994 and became unconditional in all respects on 19 October 1994.

3.50. In summary, the two Kelvin EBT companies took up their consideration in the form of loan notes and the Kelvin executive directors in the form of shares, while the STG took cash for the shares acquired following the exercise of its option. Of the consideration payable to Kelvin's employees, 76 per cent was in the form of cash, almost all the balance being in shares.

3.51. Partly in order to facilitate the acquisition, on 6 November 1994 SBH increased its authorized capital from £914,625 to £1,316,426 by the creation of 8,036,020 ordinary 'A' shares of 5p each. Of these additional shares 1,591,050 were issued to Kelvin shareholders.

Savings resulting from the acquisition

3.52. SBH prepared for us an analysis of the cost savings it expected to achieve as a result of the acquisition (see Table 3.4).

TABLE 3.4 SBH/Kelvin: analysis of post-acquisition cost savings identified by SBH

	£'000	
Item	Recurring	Non-recurring
[<i>Details omitted. See note on page iv.</i>]		
	4,267	3,344

Source: SBH.

[*Details omitted. See note on page iv.*]

3.53. SBH told us that it proposed to reduce frequency of service by between 20 and 25 per cent on over 20 routes currently served jointly by SBH and Kelvin. The reduction in mileage is approximately 5 per cent of SBH's and Kelvin's combined registered mileage. SBH said that this reduction in frequency would enable it to remove up to 60 buses from service and to realize associated labour and support costs savings. These revisions would be combined with the running of certain existing Kelvin services from other Kelvin and SBH depots, [

Details omitted. See note on page iv.

]

3.54. SBH told us that the merger would enable it to standardize the SBH and Kelvin fleets and thus not only cut purchasing and engineering costs but also reduce the size of the enlarged group's reserve fleet from 105 to 18 vehicles. More attractive procurement terms might be obtainable, in particular in the sourcing of spare parts and in advertising.

Subsequent events

3.55. On 28 October 1994 the Chairmen of SBH and Stagecoach met. At the meeting the Chairman of SBH suggested that Stagecoach should take a 20 per cent equity holding in SBH. On 14 November 1994 the companies entered into a Subscription Agreement and on 15 November 1994 a Stock Exchange announcement of the deal was made. The transaction was completed on 12 December 1994.

3.56. The two companies agreed a value for SBH of £41.5 million and a price of £8.3 million for the Stagecoach investment. Consideration was £1.5 million in cash and the balance of £6.8 million in the form of Stagecoach shares (which were immediately sold by SBH). The agreement gave Stagecoach the right, up to February 1998, to maintain its equity holding and hence its voting rights in SBH at 20 per cent and to make a counter-offer in the event of any bid for SBH. This transaction was referred to the MMC on 21 December 1994 and is the subject of a separate inquiry.

3.57. With the benefit of the cash received as a result of the agreement with Stagecoach, SBH bought back substantial numbers of shares of former and current employees. By mid-March 1995 SBH had acquired some 3.5 million shares, representing some 14 per cent of its total issued share capital after completion of the Subscription Agreement. The price per share was the auditors' valuation, as at 1 January 1994, of 98.5p. The buy-back, which has cost SBH £3.5 million, is expected to be formally completed by 31 March 1995.

4 The market

Introduction

4.1. This chapter describes the market for bus services in the area where most of the operations of SBH and Kelvin are located. It opens with background information on this area (paragraphs 4.2 to 4.5) and follows with a review of modes of transport in general (paragraphs 4.6 to 4.35) and the market for bus services in particular (paragraphs 4.36 to 4.68). This review includes details of the market shares of the main suppliers of both commercial and tendered bus services in the area. Finally we consider barriers to entry into the market for bus services (paragraphs 4.69 to 4.85).

The relevant area

4.2. The area specified in the terms of reference for the inquiry comprises the local authority districts of Glasgow City, Bearsden & Milngavie, Clydebank, Strathkelvin, East Kilbride, Cumbernauld & Kilsyth, Hamilton, Monklands, Motherwell, Dumbarton, Renfrew and Clydesdale (the reference area).

4.3. Our investigations showed that in addition to the reference area, the district of Eastwood, which is adjacent to Glasgow City, is an area where a high proportion of registered bus mileage is operated by SBH. We accordingly added this area to our inquiry. This enlarged area (the relevant area) is shown in Figure 4.1. It covers some 350,000 hectares (1.4 per cent of the geographical area of the UK) and has a population of 1.8 million (3.1 per cent of the UK total).

4.4. For a number of the aspects discussed below statistics are available only for Strathclyde region as a whole. This region covers the relevant area plus the districts of Argyll & Bute, Inverclyde, Kilmarnock & Loudoun, Kyle & Carrick, Cunninghame & Doon Valley and Cunninghame. Where Strathclyde region figures are used the text indicates that this is the case. The relevant area represents 77 per cent of Strathclyde region's total population.

Population

4.5. The average population density of the relevant area is 5.0 persons per hectare, compared with a UK figure of 2.4 persons per hectare. However, as Table 4.1 shows, within the relevant area there is considerable variation in density ranging from Glasgow City, with 34.5 persons per hectare, to Clydesdale with a density of only 0.4 persons per hectare.

TABLE 4.1 Population density in the UK and in the relevant area, 1993

	<i>Population</i>	<i>Area (hectares)</i>	<i>Density (heads per hectare)</i>
Bearsden & Milngavie	41,050	3,647	11.3
Clydebank	46,580	3,560	13.1
Clydesdale	58,290	132,505	0.4
Cumbernauld & Kilsyth	63,930	10,298	6.2
Dumbarton	78,500	47,703	1.6
East Kilbride	85,360	27,748	3.1
Eastwood	60,930	11,563	5.3
Glasgow City	681,470	19,778	34.5
Hamilton	107,500	13,214	8.1
Monklands	102,590	16,800	6.1
Motherwell	143,730	17,483	8.4
Renfrew	201,150	30,885	6.5
Strathkelvin	85,670	16,705	5.1
Relevant area	1,756,750	351,889	5.0
UK	58,191,000	24,410,000	2.4

Source: The Municipal Yearbook 1995. Population figures are 1993 estimates (based on the 1991 Census). The estimated population figure for the UK is for 1993 and has been provided by OPCS.

Modes of transport in the relevant area

Overview of modes of transport

4.6. SBH told us that bus services in the relevant area faced significant competition from other modes of transport, particularly car, rail and underground, and taxi. In this section we describe the characteristics and relative importance of such modes of transport. We then summarize the policies of SPTE, which through its financial support for local transport services plays an important role in the market.

4.7. Table 4.2 shows the different modes of transport used for travel to work, district by district.

TABLE 4.2 Mode of transport used for travel to work, 1991

Percentage of employees and self-employed persons travelling by:

<i>District</i>	<i>Train or underground</i>	<i>Bus</i>	<i>Car</i>	<i>Motor or pedal cycle</i>	<i>Foot</i>	<i>Other</i>	<i>Total</i>	<i>Bus and car combined</i>
Bearsden & Milngavie	8.4	7.4	71.1	0.7	6.4	6.0	100	78.5
Clydebank	9.4	24.7	47.5	0.7	13.1	4.6	100	72.2
Clydesdale	2.6	6.3	64.6	0.5	16.1	9.9	100	70.9
Cumbernauld & Kilsyth	4.0	20.6	59.4	0.7	11.0	4.3	100	80.0
Dumbarton	7.0	12.0	59.1	1.6	14.2	6.1	100	71.1
East Kilbride	2.6	17.4	63.5	0.6	10.8	5.1	100	80.9
Eastwood	7.0	8.9	72.9	0.7	4.7	5.8	100	81.8
Glasgow City	7.9	30.9	42.4	0.9	12.9	5.0	100	73.3
Hamilton	5.1	15.5	61.6	0.5	12.1	5.2	100	77.1
Monklands	5.4	14.6	61.6	0.5	13.6	4.3	100	76.2
Motherwell	3.1	20.0	58.7	0.5	12.8	4.9	100	78.7
Renfrew	5.3	19.8	57.4	1.0	11.6	4.9	100	77.2
Strathkelvin	4.9	15.9	64.4	0.8	8.2	5.8	100	80.3
Strathclyde region	5.1	19.2	55.9	0.9	12.7	6.2	100	75.1
Great Britain	5.8	9.9	60.8	3.0	11.8	8.7	100	70.7
Conurbations in Great Britain	6	22	59	2	9	0	100	81.0

Source: 1991 Census returns, Report on Strathclyde region Part 2.

Notes:

1. If respondents used more than one mode, the Census records the mode with the greatest distance. If they travelled by different modes on different days, the Census includes the most frequently used mode.
2. The 'other' category includes people working at home and those whose mode of transport was not stated.
3. Department of Transport Statistics, National Travel Survey 1991/93 figures are used for conurbation comparisons.

4.8. Table 4.2 illustrates *inter alia* the relative importance of car and bus travel in the relevant area. In 1991 these modes of transport made up some 56 per cent and 19 per cent respectively of journeys to work in the region. The comparative figures for Great Britain were 61 per cent and 10 per cent. Table 4.2 shows that although levels of bus usage vary from district to district, the combined bus and car figure is fairly constant (between 71 and 82 per cent). This suggests that levels of car usage and bus usage are inversely related.

4.9. The relative importance of different modes varies significantly between districts. For example, in Glasgow City, which has 39 per cent of the population of the relevant area, 31 per cent of people used the bus as their primary means of travelling to work and 8 per cent used rail and underground.

Cars

4.10. In 1991 there were 258 cars registered per 1,000 population in Strathclyde region, compared with a figure of 363 for Great Britain as a whole. Between 1985 and 1990 the rate of growth of car ownership in Strathclyde region was some 8 per cent higher than the average for Great Britain. However, there are considerable variations between districts in the relevant area.

4.11. The highest levels of car ownership are in the more affluent districts of Bearsden & Milngavie and Eastwood as well as the rural districts such as Clydesdale. The lowest levels occur in the more densely populated urban districts such as Glasgow City and Clydebank.

4.12. Table 4.3 shows the percentage of households with car(s) available, district by district.

TABLE 4.3 Car availability by district

	Percentage of households with car(s) available		Increase %
	1981	1991	
Bearsden & Milngavie	79.0	82.6	4.5
Clydebank	39.4	41.5	5.3
Clydesdale	62.8	68.3	8.8
Cumbernauld & Kilsyth	54.5	60.1	10.3
Dumbarton	53.2	59.2	11.3
East Kilbride	61.8	65.4	5.8
Eastwood	78.5	82.2	4.7
Glasgow City	29.4	34.5	17.3
Hamilton	51.1	56.7	11.0
Monklands	44.0	49.8	13.2
Motherwell	44.7	51.5	15.2
Renfrew	49.5	53.5	8.1
Strathkelvin	65.2	68.9	5.7
Strathclyde region	45.4	51.1	12.6
Great Britain	60.6	66.6	9.9

Source: General Register Office for Scotland, Census Monitor for Strathclyde Region 1991.

Rail

4.13. The rail network in Strathclyde region is arguably the most extensive outside London. The infrastructure network is now the responsibility of Railtrack, while passenger services are provided by ScotRail, a division of British Rail. At 31 March 1994 the network had 20 routes, 292 route miles, 172 stations and 135 sets. In 1993/94, excluding journeys to or from places outside Strathclyde region, there were 37.6 million passenger journeys covering a total of 378 million passenger miles. Approximately 125,000 journeys were made on the system every weekday. Loaded train miles in 1993/94 were 8.44 million. This is approximately 8 per cent of the mileage registered by bus operators (although it should be noted that a train normally has a considerably higher capacity than a bus). Of the overall network, some 124 stations (72 per cent of the total) are within the area served by SBH's operating companies.

4.14. ScotRail services in Strathclyde are at present supported by SPTE on behalf of Strathclyde Regional Council under section 20 of the Transport Act 1968. For 1993/94 the subsidy amounted to £32 million, which accounted for 47 per cent of the system's operating costs or 85p per passenger journey. This represented a decline in support per passenger from 89p in both 1991/92 and 1992/93 (both at 1993/94 prices). At the time of our report SPTE expected the subsidy in 1994/95 to be almost the same amount in money terms, excluding adjustments to compensate for the pre-privatization restructuring of British Rail. As a condition for providing the subsidy, SPTE determines the fares, timetables, service levels and investment. In January 1992 rail fares increased by 9 per cent, but there was no increase in 1993. Although some single fares were increased in January 1994, single fares below 95p and all return and season tickets remained unaltered. Financial pressures have required another fare freeze, announced for January 1995, to be overridden: SPTE expects to introduce an average 7.5 per cent rise in rail fares from the end of May 1995.

4.15. A proposed north/south rail link in Glasgow known as CrossRail is currently under consideration and could become operational by 1998. CrossRail is expected to offer greater access to the city centre for rail users, additional interchange and through service possibilities, and better links with the underground. Strathclyde Regional Council also has plans to develop a 40 km light rail network north of the River Clyde. Such a service could become operational by the year 2000.

Local government reorganization and rail franchising

4.16. Financial and policy support for the rail network from April 1996 is subject to uncertainty for two reasons. First, under local government reorganization Strathclyde Regional Council will cease to exist in April 1996. Its responsibilities will be assumed by 12 unitary councils within its former boundaries, in most but not all cases conforming to the boundaries of the existing districts. SPTE will continue, but the passenger transport area in which it will co-ordinate rail services on behalf of the new councils has not yet been determined. The amount of financial support available for the rail network will be decided by the new councils jointly.

4.17. Secondly, the Office of Passenger Rail Franchising expects to invite tenders to operate the ScotRail network before the end of 1995. Companies or other bodies wishing to tender were invited to submit applications by 17 March 1995. Both SBH and Stagecoach applied. The closing date to apply for prequalification to bid for ScotRail has now been extended to 2 June 1995. The new arrangements separate the provision of track and stations, with the capital expenditure this may involve, from train operation.

4.18. These developments mean that rail fares and the development of new rail lines will depend on new decision-makers. Forecasting in these circumstances is particularly hazardous, but it seems likely that in the future rail fares will bear down less heavily on bus fares rather than more.

Underground

4.19. Glasgow's underground covers 15 stations on a single 6½-mile loop. The system can offer peak frequencies at intervals as low as four minutes. In 1993/94 there were 14.3 million passenger journeys covering a total of 25.8 million passenger miles. The total average cost of providing a passenger journey on the underground is approximately £1 of which revenue support from SPTE—which totalled £7.1 million in 1993/94—is approximately 50p per passenger, with a flat rate adult fare of 50p. This fare has been unchanged since January 1992. In March 1995 SPTE announced that the increase in fares on the supported rail system would be accompanied by a rise in underground fares from 50p to 60p, also to take effect from May 1995.

Park and ride

4.20. Strathclyde Regional Council also promotes a park-and-ride scheme, making use of 4,600 car parking spaces located at urban train stations and some underground stations. The scheme aims to discourage commuter use of private cars to travel to Glasgow city centre. SPTE estimates that users of

the park-and-ride scheme make an average of almost 7,000 return journeys every weekday. Use of these facilities at rail stations has grown by 45 per cent in the ten years to 1993/94.

Taxis and other modes

4.21. There are a large number of taxis licensed to operate within the relevant area and bus operators which gave evidence to us generally agreed that they provided an element of competition with their services. Table 4.4 shows the number of taxis licensed by district councils in the relevant area. In the district of Glasgow City there were some 2,800 taxis licensed at December 1994, which represented one taxi for every 230 of the population. This contrasted with more dense taxi provision of approximately 170 persons per registered taxi in Manchester, but lower density of provision of 340 persons per registered taxi in Birmingham and 350 in Leeds. (SBH argued that on a like-for-like comparison of districts, taxi provision in the Manchester conurbation, too, was less dense than in Glasgow.)

TABLE 4.4 Hackney and private hire taxi licences issued by district councils at 7 December 1994

<i>District</i>	<i>Private and hackney licences</i>
Bearsden & Milngavie	158
Clydebank	260
Clydesdale	48
Cumbernauld & Kilsyth	200
Dumbarton	265
East Kilbride	277
Eastwood	171
Glasgow City	2,828
Hamilton	436
Monklands	283
Motherwell	407
Renfrew	2,010
Strathkelvin	304
Total	7,647

Source: SBH.

4.22. Other modes of transport used in the reference area include ferries, cycling and walking. There is little evidence on how direct the competition is between these modes and provision of bus services.

Inter-modal competition

4.23. SBH submitted that there was a high degree of inter-modal competition facing bus operators, particularly from rail and underground services. As an example, it said that Kelvin express services which competed with rail offered reduced fares in order to compete effectively.

4.24. On the other hand, examination of rail service frequencies and the number of route miles registered by bus operators and the railways suggests that the network density (route segments multiplied by frequencies) offered by rail does not approach that offered by bus operators. Although rail may be a strong competitor against some bus routes, particularly express routes on certain corridors, it does not offer the network coverage to be a full substitute for local bus services.

4.25. Analysis by SPTE of competing bus and rail services to and from the centre of Glasgow (where 'competing services' were judged by journey time, frequency, fare levels and personal convenience) is shown in Table 4.5. This suggests that the level of competition has declined substantially since deregulation although SPTE believes there were still 279 competing journeys at April 1994.

TABLE 4.5 Bus journeys which compete with rail

Competing bus journeys per day

Before deregulation	605
At deregulation	979
April 1987	749
November 1987	750
April 1988	797
November 1988	806
March 1990	355
April 1991	255
April 1992	283
April 1993	287
April 1994	279

Source: SPTE.

4.26. The 1993 figure represents 13 routes, of which SBH and Kelvin between them ran five (SBH one and Kelvin four). In terms of bus journeys, the SBH route represented a total of seven peak journeys and three off-peak; Kelvin offered 40 peak and eight off-peak journeys.

4.27. This information suggests that there is not a high level of direct competition between bus and rail. SPTE recognizes that it is normal for the journey time by train to the centre of Glasgow to be faster than the equivalent journey by bus, but argues that in many cases the penetration of housing areas by buses results in a door-to-door journey time which is at least as fast as by train. In general, circumstances make it obvious to consumers which mode of travel is best for them and marginal changes in price will not affect choice of mode.

4.28. Taxi services also provide an element of competition with local bus services in the relevant area. Without a detailed origin and destination survey it is difficult to assess the extent of direct competition with bus services. However, it is clear that taxi fares are much higher than bus fares. In the district of Glasgow City (where SBL operates over 80 per cent of its total registered mileage) a journey by taxi of one mile costs over three and a half times the equivalent cost by SBL service. This gap increases with distance so that a two-mile journey costs four times as much by taxi as by bus, and a four-mile journey almost six times as much. On the other hand, we received evidence that it was common practice in some cases for taxis to be shared between perhaps four people each going to different destinations. This use of shared and multi-destination taxi journeys reduces the gap in fares between bus and taxis: SBH presented figures showing that for four people sharing a taxi the difference was largely eliminated.

Subsidized transport services

4.29. In the relevant area some public transport services are provided with the help of subsidies from SPTE. These subsidies cover some bus, rail/underground, taxi and ferry services.

4.30. There are three main respects in which SPTE administers support for local bus services: tendered services (including school transport), a Dial-a-Bus scheme and a concessionary travel scheme.

4.31. First, SPTE provides subsidies for services which are considered socially necessary but would not otherwise be provided. For supported services it invites operators to tender on the so-called net basis whereby the operator bids for the subsidy but keeps all passenger revenue and takes all revenue risk. Suppliers of tendered services are obliged to observe a tariff scale set by SPTE which establishes the maximum fares per mile on all tendered routes. Children travel free on school transport services, so bids cover the total revenue for these. The supply of, and competition for, tendered services are discussed in paragraphs 4.56 to 4.62.

4.32. Secondly, the Dial-a-Bus scheme provides a bus service for people with impaired mobility. In 1994 the scheme had a fleet of 35 vehicles operated by ten bus companies, providing 20 subsidized local services across an area covering 98 per cent of the region's population. The costs of Dial-a-Bus contracts totalled £883,000 in 1993/94.

4.33. Table 4.6 shows the costs of subsidized bus services which have been supported by SPTE within Strathclyde region in recent years.

TABLE 4.6 **Costs of subsidized bus service provision in Strathclyde region**

<i>Period</i>	<i>£ million</i>			
	<i>Local services</i>	<i>Dial-a-Bus</i>	<i>School transport</i>	<i>Total</i>
1988/89	4.30	0.45	9.72	14.47
1989/90	4.47	0.70	11.09	16.26
1990/91	4.29	0.75	11.47	16.51
1991/92	3.92	0.77	11.48	16.17
1992/93	3.73	0.79	11.00	15.52
1993/94	3.69	0.88	11.01	15.58

Source: SPTE.

Note: Actual costs are shown apart from those for 1993/94, which are estimated out-turn.

4.34. Since 1989/90 this form of support has fallen in real terms. Between 1992/93 and 1993/94 the cost of support per bus mile (including Dial-a-Bus) was reduced from 54p to 50p.

4.35. Thirdly, SPTE administers a concessionary travel scheme which is the largest in the UK and applies to the whole Strathclyde region. Holders of concessionary travel cards are entitled to travel up to ten miles on bus, rail, underground and ferry for the concession fare of 25p. For journeys over ten miles half fare is charged on rail, while on bus services full fare is charged for the portion of the journey over ten miles. In 1993/94 over 400,000 people qualified for the scheme (being of pensionable age or physically disabled), representing some 17 per cent of all Strathclyde residents. At 31 March 1994 117 bus operators participated in the scheme. Payments to operators are calculated to reimburse the loss of revenue on tickets sold, subject to a deduction to allow for the extra traffic generated. In the year 1993/94 SPTE paid out £14.7 million to local bus operators under the scheme (excluding payments under the Dial-a-Bus scheme shown in Table 4.6).

The supply of local bus services

4.36. Strathclyde is characterized by the large number of bus operators in the region—175 in total at 31 March 1994. However, the vast majority of these operators individually account for a very small proportion of bus mileage. The three largest operators (SBH, Kelvin and Clydeside 2000) between them accounted for three-quarters of all registered miles in the relevant area.

4.37. The market experiences a high turnover of operators and service registrations. For example, in 1993/94 28 operators entered the market in Strathclyde region and ten left, and there was an average of five changes to registrations per working day.

Competition within the relevant area

4.38. As in earlier MMC reports, we use registered bus mileage as the measure for calculating operators' market shares in the reference area and its individual districts.

4.39. There are only limited parts within the relevant area where large operators compete with each other directly. Rather, these operators tend to have their own well-defined territories, which are generally a legacy of operating areas prior to deregulation. These areas are shown in the maps at Appendices 4.1 and 4.2.

4.40. SBH's operations are concentrated in the district of Glasgow City and some adjacent areas, together with East Kilbride. The network provides dense coverage within this area and does not extend significantly into outlying regions—there is little or no presence, for example, in the districts of Dumbarton, Hamilton or Motherwell. This contrasts markedly with Kelvin's network, which is much

more diffuse and serves important corridors between satellite areas and the city centre. Kelvin services run in every direction other than the west and south-west, where Stagecoach's subsidiary Western Scottish and British Bus's subsidiary Clydeside 2000 operate. They extend as far as Helensburgh and Alexandria in the north-west, Stirling in the north, beyond Falkirk and Grangemouth in the east and to Carlisle in the south-east.

4.41. Similarly, other major operators in the relevant area operate a few services in areas occupied by SBH and Kelvin. Midland Bluebird operates to the north-east of Glasgow, Clydeside 2000 in the area to the west, and Western Scottish to the south-west. Each of these has a main area of operations separate from those of SBH and Kelvin but runs some inter-urban services into Glasgow.

4.42. Clydeside 2000 operates 218 buses based at depots in Paisley, Inchinnan, Johnstone, Thornliebank and Greenock. The company, formerly part of the Scottish Bus Group and sold to its management and employees in 1991, was acquired in November 1994 by British Bus, which has some 4,400 buses. Clydeside 2000's turnover in 1993/94 was £15 million.

4.43. Midland Bluebird operates 258 buses based at depots in Balfour, Bannockburn, Larbert and Linlithgow. The company was acquired by GRT from the Scottish Bus Group in September 1990. GRT told us that some 6 per cent of the £15 million 1993/94 turnover of Midland Bluebird arose in Strathclyde region. GRT's total turnover in that period was £40 million. In October 1994 GRT acquired SMT, which has a fleet of 366 vehicles providing bus services around Edinburgh and the Lothians, and in November of that year it acquired Reiver, which operates in the Borders and East Lothian with 174 buses. At March 1995 GRT had some 1,700 buses.

4.44. Western Scottish is another former Scottish Bus Group company acquired by its management and employees in 1991 alongside Clydeside 2000. It was acquired by Stagecoach in July 1994. With its headquarters in Kilmarnock, it operates in a wide area south of Glasgow extending to the Solway Firth. It also operates in the isles of Arran and Bute and on the Cowal Peninsula to the north-west of Glasgow. Two smaller companies, Arran Transport and A1 Buses, became part of Western Scottish after their acquisition by Stagecoach in October 1994 and January 1995 respectively. They increased Western Scottish's market share in Strathclyde region from 7.4 to nearly 10 per cent (taking March 1994 registered mileages), with a March 1995 total of 405 buses, but they do not operate in the relevant area.

Competition at the district level

4.45. Examination of registered mileage by district confirms the view that head-to-head competition amongst larger operators is limited. Table 4.7 shows the percentage of total bus mileage in each district which is registered by the major operators individually, and by other operators grouped together.

TABLE 4.7 Percentage of total mileage in each district of the relevant area registered by each operator at March 1994

	SBH	Kelvin	Clydeside 2000	Midland Bluebird	Western Scottish	Other operators	Total	SBH and Kelvin
Bearsden & Milngavie	36.5	44.0	0.0	12.3	0.0	7.2	100	80.5
Clydebank	57.0	28.4	0.0	0.0	0.0	14.6	100	85.4
Clydesdale	0.0	12.6	0.0	0.0	4.1	83.2	100	12.6
Cumbernauld & Kilsyth	0.2	52.9	0.0	9.8	0.0	37.1	100	53.1
Dumbarton	2.9	35.0	0.0	1.8	0.0	60.4	100	37.8
East Kilbride	67.1	8.4	0.0	0.0	0.0	24.5	100	75.5
Eastwood	68.1	0.0	0.6	0.0	11.2	20.2	100	68.1
Glasgow City	76.2	11.6	2.8	0.6	0.3	8.6	100	87.8
Hamilton	0.0	61.0	0.0	0.0	0.3	38.7	100	61.0
Monklands	0.0	69.9	0.0	0.0	0.0	30.0	100	69.9
Motherwell	0.0	56.7	0.0	0.0	0.0	43.3	100	56.7
Renfrew	8.2	0.2	54.6	0.0	0.0	37.1	100	8.3
Strathkelvin	11.7	64.4	0.0	7.3	0.0	16.7	100	76.1
Relevant area	42.7	23.4	8.7	1.2	0.4	23.6	100	66.1
Strathclyde region at:								
March 1994	33.0	18.1	9.4		7.4	32.1	100	51.1
1993	33.7	19.5	10.9		7.2	28.7	100	53.2
1992	32.6	18.9	10.6		7.6	30.1	100	51.5

Source: SPTE, Oxford Transport Studies Unit.

Notes:

1. Figures do not necessarily add to 100 due to rounding.
2. Figures prior to 1994 are not available in fully disaggregated form for Strathclyde region, so Midland Bluebird figures are included within 'Other operators'.

4.46. Table 4.7 shows that SBH and Kelvin combined accounted for around two-thirds of the total registered bus mileage in the relevant area at March 1994. In five of the 13 districts their dominance was even more marked, with more than three-quarters of bus mileage being registered by the combined grouping. In Glasgow City, the most important single district in the relevant area with 45 per cent of all registered mileage, they together accounted for nearly 88 per cent of total mileage.

4.47. Table 4.7 also shows that, while there is little overlap in the districts served by the major operators, where this was the case in March 1994 it generally involved SBH and Kelvin. There were only five districts in March 1994 where two or more of the large operators shown separately each had a 10 per cent or greater share of registered mileage; in four of these districts, including the important Glasgow City district, the companies involved were SBH and Kelvin.

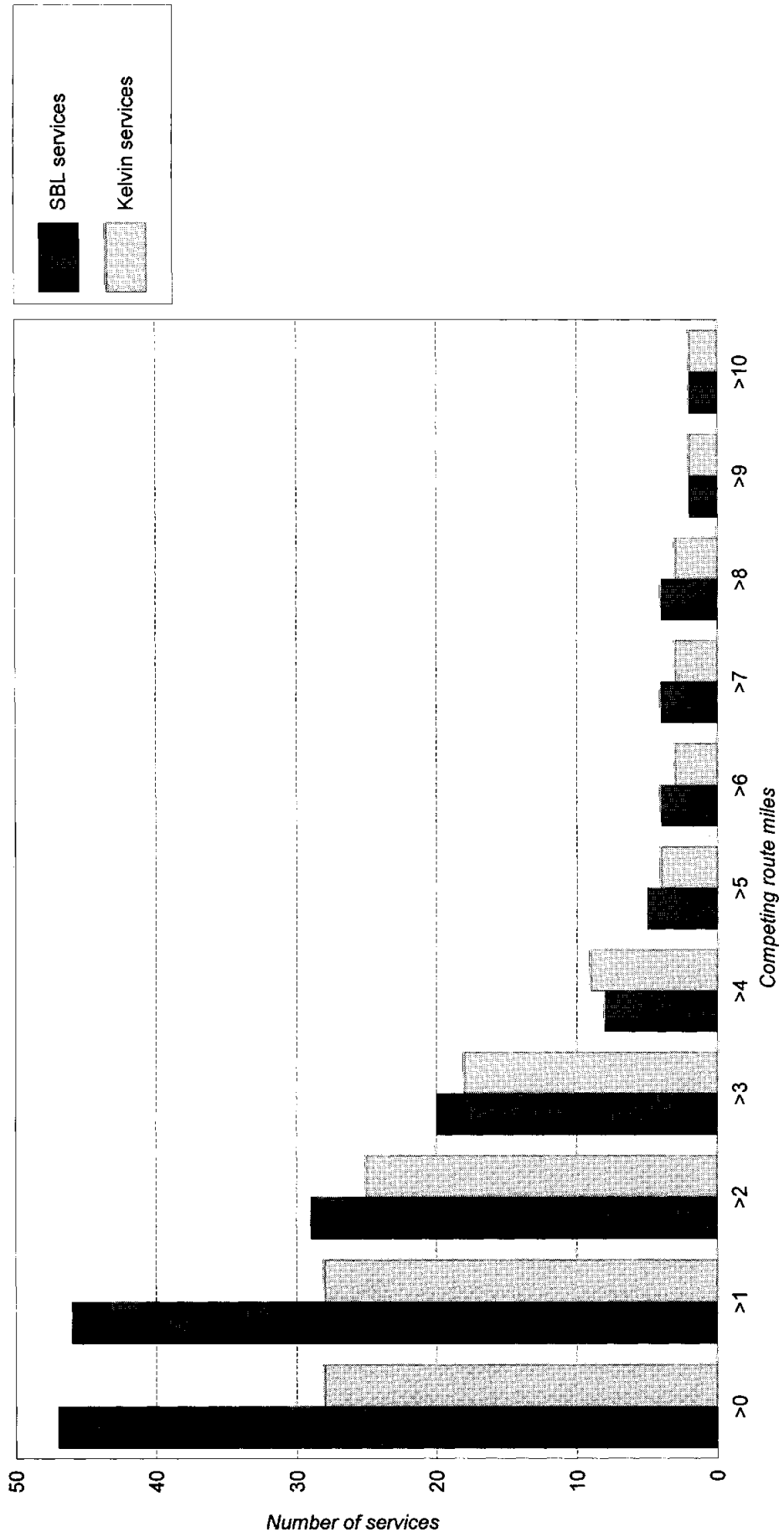
Competition at the route level

4.48. To look in greater detail at the extent of actual or potential competition between SBL/GCT and Kelvin we asked SBH to provide information on routes where there is some element of parallel running between the two companies. Figure 4.2 shows the number of SBH and Kelvin services over which SBH estimated there to be some element of parallel running between the two companies.

4.49. This information suggests that the whole length of the routes where there was more than three miles parallel service provision accounted for some 33 per cent of all revenues generated by Kelvin and 38 per cent of revenues for SBH. However, these figures may considerably overstate the shares of revenue that could be said to be open to competition because of the proportion of passengers who do not wish to get both on and off the services within the parallel sections.

4.50. Some small operators also ran services (including tendered services) along some length of these particular routes. They included Henderson Travel, Hutchison, McDade, A&J Ballantyne, Canavan, Red Lion and Weir's Tours Ltd. A number of these Kelvin routes were shared with Midland Bluebird.

FIGURE 4.2
Competing SBL/Kelvin services



Source: SBH.

4.51. SBH has provided several route maps outlining service frequencies along those sections where there are parallel operations by the two companies. The main routes where there is parallel running are Cambuslang–Glasgow, the Dalmarnock/Rutherglen corridor, Clydebank–Glasgow, Drumchapel–Glasgow, the Partick corridor, the Shettleston Road and Edinburgh Road corridors, the Cumbernauld Road corridor, the Tollcross Road corridor and the Bishopbriggs corridor. These routes include some of the main radial arteries running out of Glasgow city centre to the south-east, east, north and north-west.

4.52. A review of operating areas at the regional, district and route levels suggests that SBH and Kelvin operate in areas which overlap to a greater extent than those of any other major operators in the relevant area. However, proximity of services and parallel running indicate no more than potential competition. Vigorous competition for passengers need not occur on a route simply because two or more operators are present on it for some length: for example, on a limited number of routes Kelvin and Midland Bluebird have operated common ticketing and shared services.

4.53. On 15 September 1994, drawing on Western Scottish operating licences, a Stagecoach subsidiary, Stagecoach Glasgow Limited (Stagecoach Glasgow), applied to register new services from Castlemilk to Auchinairn and from Pollok to Easterhouse. These registrations were subsequently cancelled but on 26 October 1994 Stagecoach Glasgow registered a different service from Pollok to Easterhouse and a new service from Pollok to Drumchapel. These were long, high-frequency services operating across some of SBL's most valuable routes. They would have competed against SBL services which, as a whole (that is including some sections where there would not have been parallel running), represented over a quarter of its on-bus revenues for 1993/94.

4.54. On 4 November 1994 Western Scottish acquired a depot at Thornliebank in the south of Glasgow as the intended base for the operation of the Stagecoach Glasgow services.

4.55. Stagecoach applied to cancel the 26 October registrations on 7 November 1994 during the course of its negotiations with SBH. The Castlemilk–Auchinairn service was taken over by SBH and started operating on 19 November 1994. The registration was cancelled with the Traffic Commissioner with effect from 28 December 1994. The deregistration of the Pollok–Easterhouse and Pollok–Drumchapel services took effect before they were due to begin operations.

Competition for tendered services

4.56. Competition for commercial services contrasts with the position in the market for tendered services, where competition is intense.

4.57. Some 7 per cent of all registered bus mileage in the relevant area is provided by subsidized contracts. Within Strathclyde region there were 229 active subsidized contracts at 31 March 1994 (some of which covered more than one service).

4.58. Table 4.8 shows the annual registered bus mileage district by district. In some areas subsidized services account for a significant proportion of all bus services whilst in others this element is negligible. Despite having by far the highest number of subsidized miles of all the districts Glasgow City's subsidized mileage as a proportion of total mileage in the district is relatively low compared with many of the other districts.

TABLE 4.8 Annual registered bus mileage by district at March 1994

	<i>Unsubsidized</i>	<i>Subsidized</i>	<i>Percentage subsidized</i>	<i>Total</i>
Bearsden & Milngavie	702,730	209,500	23.0	912,230
Clydebank	2,349,847	136,288	5.5	2,486,135
Clydesdale	1,402,426	593,584	29.7	1,996,010
Cumbernauld & Kilsyth	2,949,442	316,503	9.7	3,265,945
Dumbarton	2,197,167	509,108	18.8	2,706,275
East Kilbride	3,777,550	181,342	4.6	3,958,892
Eastwood	1,411,526	27,032	1.9	1,438,558
Glasgow City	35,351,845	1,856,218	5.0	37,208,063
Hamilton	3,596,560	232,027	6.1	3,828,587
Monklands	3,096,054	364,936	10.5	3,460,990
Motherwell	6,010,107	548,530	8.4	6,558,637
Renfrew	10,895,847	317,630	2.8	11,213,477
Strathkelvin	<u>2,869,563</u>	<u>438,148</u>	<u>13.2</u>	<u>3,307,711</u>
Total	76,610,664	5,730,846	7.0	82,341,510

Source: Bus service provision 1993/94, SPTE.

4.59. The proportion of subsidized bus service provision undertaken by operators in each district within the relevant area varies significantly, as shown by Table 4.9, but it is clear that of the major operators, SBH and Kelvin are the principal providers of these services and together account for over 40 per cent of all subsidized mileage in the relevant area. Clydeside 2000, Midland Bluebird and Western Scottish are not large providers of subsidized services in this area. However, the market for tendered services is more important to smaller operators. At 31 March 1994 companies other than SBH, Kelvin, Clydeside 2000, Midland Bluebird and Western Scottish accounted for some 55 per cent of all subsidized mileage in the relevant area.

TABLE 4.9 Percentage of total subsidized mileage in each district registered by each operator at March 1994

	<i>SBL</i>	<i>Kelvin</i>	<i>GCT</i>	<i>Clydeside 2000</i>	<i>Midland Bluebird</i>	<i>Western Scottish</i>	<i>Other operators</i>	<i>Total</i>	<i>SBL, GCT and Kelvin</i>
Bearsden & Milngavie	58.1	1.0	9.1	0.0	11.0	0.0	21.0	100	68.1
Clydebank	83.1	0.0	2.9	0.0	1.5	0.0	12.4	100	86.0
Clydesdale	0.0	0.0	0.0	0.0	0.0	3.2	96.8	100	0.0
Cumbernauld & Kilsyth	0.0	38.8	0.0	0.0	2.5	0.0	58.7	100	38.8
Dumbarton	0.0	31.0	0.0	0.0	8.4	0.0	60.5	100	31.0
East Kilbride	0.6	0.0	11.6	0.0	0.0	0.0	87.8	100	12.2
Eastwood	0.0	0.0	55.6	11.1	0.0	0.0	33.3	100	55.6
Glasgow City	38.5	5.5	15.2	0.4	1.6	0.0	38.8	100	59.2
Hamilton	0.0	18.0	0.0	0.0	0.0	0.0	82.8	100	18.0
Monklands	0.0	35.1	0.0	0.0	0.0	0.0	64.9	100	35.1
Motherwell	0.0	18.8	0.0	0.0	0.0	0.0	81.3	100	18.8
Renfrew	35.9	5.4	5.0	28.0	0.0	0.0	25.8	100	46.2
Strathkelvin	<u>0.5</u>	<u>58.7</u>	<u>1.6</u>	<u>0.0</u>	<u>1.1</u>	<u>0.0</u>	<u>39.3</u>	<u>100</u>	<u>60.7</u>
Total	18.5	16.3	6.3	1.8	1.9	0.3	54.9	100	41.1

Source: SPTE, Oxford Transport Studies Unit.

Note: Figures do not necessarily add to 100 due to rounding.

4.60. In terms of route mileage the tender market does not represent a large proportion of the businesses of SBH or Kelvin but there is significant competition between them: of the tenders for which Kelvin was unsuccessful from August 1992 to July 1994 (including bids for school contracts), 59 (20 per cent) were awarded to SBH.

4.61. In general SBL and GCT do not compete directly for tendered contracts, GCT being more successful in gaining tenders than SBL because of GCT's lower cost base. For this reason GCT concentrates on competing for tendered services, with buses used for tendered operations accounting for almost 60 per cent of GCT's total number of buses in 1994. The comparable percentage for SBL was some 2 per cent.

4.62. There is a degree of inter-modal competition for tenders: of the 295 bids which Kelvin lost, ten were won by ScotRail. SPTE also awarded contracts with an estimated total hire value of nearly £1 million to taxi operators for 1994/95.

Fare levels

4.63. Bus fares in Strathclyde region declined in real terms between deregulation (in 1986) and 1992, since which time the trend has reversed. At March 1994 the fares index calculated by SPTE for the reference area showed that fares had risen by 35 per cent since deregulation, compared with the 45 per cent increase in the Retail Price Index over the same period. A restraining influence on trends in fares in the relevant area may be SPTE, through its impact on subsidized services (discussed in paragraph 4.31), on ScotRail (paragraph 4.14) and underground fares (paragraph 4.19) and on Zonocard pricing (paragraph 4.78).

4.64. SBH told us that it believed its fares were generally lower than those of comparable operators. It provided information on average fares charged by a selection of other operators¹ across a range of fare stages² which supported this claim. On the other hand, SBH said that Kelvin fares were generally about 12 per cent higher than SBL fares for equivalent stages.

4.65. The information provided by SBH showed that average fares per mile for almost all operators follow similar patterns, declining sharply from the first stage level to approximately 40 per cent of this at the tenth stage and then gradually tapering to about 20 per cent at the twentieth stage. Of the operators covered, only West Midlands Travel fares were cheaper than SBL for any significant range of journey lengths up to six miles.

4.66. A key question is the extent to which a dominant operator might be able to raise fares. This will depend on consumer sensitivity to price changes which is influenced in turn by fundamental demand characteristics (such as journey purpose) and availability of substitutes (such as other modes of transport). In the case of the market for local bus services there is a substantial body of research³ which suggests that demand for bus services is relatively insensitive to fare changes. Thus if fares are increased (within bounds), while some traffic will be lost as customers switch to other modes or cease travelling, the net effect on revenue will be positive.

4.67. This overall picture of low customer sensitivity to price changes was confirmed by bus operators who told us that as far as on-bus sales in their market were concerned, demand sensitivity to fare changes appeared to be fairly limited (at least in the short term and over a modest price rise). The market may be more sensitive to price rises on season tickets, and SBH told us that it focused on promotions of season tickets in particular. However, price sensitivity for season tickets will also reflect the non-price factors of joining a particular ticketing scheme, such as network size and convenience for the user's primary journey.

4.68. An informal comparison of movements in bus fares and patronage in the relevant area, produced by SPTE, also suggested that there had been very little correlation between price movements and demand in the period since deregulation.

Barriers to entry

4.69. This section considers the degree of contestability and barriers to entry in the market for local bus services in the relevant area.

¹Lothian, GRT, WMT, Greater Manchester Buses (both North and South) and Midland Bluebird.

²These data were compiled by The Harris Research Centre in a report dated January 1995, based primarily on information from PTEs and local authorities. The basis for the data is standard average fare stages, although it is recognized that movements away from standard fares and stage lengths can arise on certain routes.

³One summary is Goodwin, PB: 'A Review of new demand elasticities with special reference to short and long run effects of price changes' in the *Journal of Transport Economics and Policy*, vol XXVI no 2, May 1992.

4.70. The impetus for deregulation of local bus services was a belief that, as the bus market was thought to be contestable (due to the relative ease of entry and exit), operators would be forced by competitive pressures to provide efficient and keenly-priced services.

4.71. The degree of contestability in this context will depend on the effectiveness of barriers to entry to the market.

Travelcards and prepaid ticketing

4.72. Travelcards and other forms of prepayment are an important element in the economics of local bus service provision because they define networks in areas where there is more than one operator. In the absence of travelcards passengers would be free to choose between different operators along different stages of their journey without incurring any cost penalty (assuming similar fare structures). By offering travelcards or other prepaid tickets an operator with a comprehensive network is able to attract customers and can obtain significant market power if a large proportion of passengers use such tickets. Competition for these passengers is mostly based on comparisons between networks rather than individual services, materially disadvantaging smaller operators or new entrants, which will find it more difficult to attract passengers already committed to an incumbent's network.

4.73. SBH offers a number of season and other prepaid tickets that are dedicated to SBL and GCT services, the main ticket being the 'Super Transcard', which operates across seven zones at all times and on all days. These tickets can be bought for 1, 4, 10 or 52-week periods. Off-peak, prepaid tickets offered by SBH centre on the 'Super Change Saver', which is a book of tickets which are torn off individually for each journey.

4.74. Other prepaid tickets offered by SBH include the 'SuperGran Card', which costs £6.00 for a four-week period and cuts the cost of 25p concession journeys to 1p per trip, and 'SuperMum/Dad Cards', which offer discounts on family travel across the SBH network.

4.75. The main outlets for the sale of SBH prepaid tickets are officially appointed agents, principally newsagents, none of which are owned, leased or rented by SBH, and most of which also sell the multi-operator Zonocard, discussed below.

4.76. Kelvin offers a different, zoned travelcard scheme based on the 'Network Saver Ticket', acceptable on all Kelvin services. The company also has reciprocal ticketing arrangements with Midland Bluebird on three jointly-operated services. Tickets are available for periods ranging from one week to one year. Network Saver tickets are available from certain travel offices and newsagents.

4.77. SBH told us that it intended to integrate the Kelvin network card into the SBH schemes.

4.78. Multi-operator travelcards reduce the effectiveness of network loyalty by enabling customers to switch from one operator to the next without any extra cost. Zonocard is the main multi-operator scheme in the relevant area, with 85 operators (including buses, rail, underground and ferries). Administration of the scheme is funded by SPTE. In 1993/94 revenue was £13.7 million. Although ScotRail dominated the allocation with 44 per cent of the total, SBL and Kelvin together accounted for 32 per cent of the revenue (this represented approximately 65 per cent of total Zonocard revenue going to bus operators). SBH maintained that the Zonocard was underpriced in relation to the benefits which it conferred and submitted documents showing that other bus operators had also expressed dissatisfaction with Zonocard prices in recent years.

4.79. Multi-operator tickets represent an important source of income to SBH, but significantly less so than its own travelcard schemes. SBH told us that in 1993/94, for SBH and Kelvin together, a quarter of revenue from ticket sales came from season tickets, and revenue from multi-modal tickets accounted for slightly less than a quarter of this (ie about 6 per cent of total revenue).

Threat of retaliation

4.80. The characteristics of the bus industry mean that it is relatively easy to take predatory action. Buses can readily be moved from one area to another and put into service, subject to a 42-day notice period of registration. Furthermore markets are typically fairly localized so that a predator can easily target a competitor.

4.81. It is also possible for an operator to use excess capacity to threaten predatory intent. In the bus industry excess capacity may be held in the form of a significantly larger fleet, or maintenance of a greater number of operator discs (which require an advance payment to the issuing Traffic Commissioner) than are needed for the services which an operator has registered. Both of these options represent a cost to an incumbent, but provide the ability to respond quickly and to set up services at lower marginal cost than an entrant can (because the costs are already sunk).

4.82. SBH told us that neither it nor Kelvin maintained an excess capacity for the networks which they operated.

4.83. If a bus operator establishes the reputation of being prepared to behave in a predatory manner, in some cases this may serve as a barrier to entry. A potential entrant is likely to consider an incumbent's perceived financial and operating strength, apparent commitment to a particular area and reputation for aggressive responses to competition.

4.84. Although a small number of allegations of predatory behaviour against SBH have been made by other operators in the relevant area, the survey of these operators which we carried out in the course of the inquiry revealed very few complaints against SBH.

Resources

4.85. We received no evidence that there were any barriers to entry in the relevant area in the form of limited availability of resources, such as depots, vehicles or staff. We were told that there was no shortage of existing buildings which would be suitable for conversion as depots or suitable land available for construction of new depots and maintenance facilities. Other necessary support facilities and resources appear to be freely available. While substantial financial resources would be needed for the establishment of a new network (Stagecoach estimated that the new operation it planned at Thornliebank would cost £11 million to set up), the costs of entry on a small scale are low. We received no evidence that provision of passenger information or access to bus stands currently constituted a barrier to entry in the relevant area.

5 Views of SBH

5.1. This chapter summarizes the views of SBH, provided to us in written submissions and oral hearings. A member of the Kelvin Board, who had served on it before the merger, took part in one of the hearings. We saw no need to seek separate evidence from Kelvin representatives.

Introduction

5.2. SBH explained to us that it had been formed to acquire SBL from Strathclyde Regional Council in February 1993. Directors and management owned 20 per cent of the shares and employees the remaining 80 per cent, though until February 1998 the executive directors had enhanced voting rights.

5.3. SBH had made a formal bid for the share capital of Kelvin on 22 September 1994, following intermittent discussions with the Kelvin directors over the previous year. These had concluded that Kelvin could no longer survive independently other than in the short term. Kelvin had been owned by its employees and management after a buy-out in February 1991 from the Scottish Bus Group. It had lost market share in the 'bus wars' of the late 1980s and a subsequent strike and continued to be unprofitable, although cost-saving measures including voluntary redundancies and a voluntary pay cut had progressively reduced its rate of loss. It could not finance vehicle replacements, and faced the risk that the Traffic Commissioner would condemn its fleet and remove its operating licence.

5.4. SBH told us that the two companies shared a public service tradition combined with a commercial approach. They were committed to employee ownership, though in each case the executive directors had day-to-day control. Because of this shared commitment, SBH did not believe the Kelvin employees would have been prepared to vote in sufficient numbers for a merger with Stagecoach, which had been under negotiation before SBH's bid, or indeed with any other external bidder. SBH noted with satisfaction that some 80 per cent of Kelvin employee shareholders accepted SBH shares in lieu of part of the cash offer, a gesture of considerable confidence in the light of Glasgow's unstable employment climate.

The reference

5.5. SBH maintained that the merger, though leading to a high market share in the reference area, should be considered in the context of developments in the UK as a whole. In its view the UK bus market would come to be dominated by seven or fewer listed companies enjoying geographical diversity. Seven companies currently accounted for some 55 per cent of the UK market. Their growth by acquisition was restrained by competition legislation only to a limited extent. The listed companies had ready access to finance, but they faced stock market pressures to show evidence of growth. As opportunities for acquisition diminished, they would have to grow by competing against incumbent operators. These need not necessarily be contiguous, since the large groups could establish a major presence from start-up anywhere in the UK. Their group resources would enable them to outstay medium and small operators whose territories they chose to contest even if these were relatively efficient. Medium-sized employee-owned bus companies would be placed at risk if competition forced them to reduce their scale of operations, partly because of pension commitments to redundant employees.

5.6. By merging with Kelvin, SBH would be better able to withstand direct attacks by other large operators. It had moved towards the critical mass needed to gain the financial advantages of flotation and thence to link up with other surviving comparable enterprises. It aimed to become a group having some 1,800 to 2,000 buses, preferably spread over more than two localities.

5.7. SBH had been disappointed to find its own merger referred to the MMC, since the Secretary of State for Transport had approved the privatization as a single unit of West Midlands Travel operating a greater number of buses in a single area (1,700 compared with SBH/Kelvin's 1,300), and at the time facing relatively little competition. SBH did not see contiguous mergers as necessarily more anti-competitive than patchwork acquisitions. The overall financial strength of the acquirer was more important. The behaviour of a company after making a contiguous merger, especially if under the surveillance of a Passenger Transport Executive, would be more exposed to public scrutiny. SBH asserted that opportunities for small operators would be unaffected, since the merger would not significantly enhance either company's ability to compete with them.

5.8. SBH said that its acquisition of Kelvin would have the short-term effect of reducing its financial strength, because of the loss of liquidity arising from cash payments to former Kelvin shareholders, and from the reduction of its net asset value on account of the goodwill element of the price paid.

5.9. SBH saw less public interest benefit arising if Kelvin had been bought by one of the other major operators—even a contiguous one. However, there had been indications that the Kelvin employee shareholders would have blocked any bid other than that of SBH, leaving the Kelvin business to continue to decline—to the detriment of the travelling public.

Competition

5.10. SBH said that as an outcome of the 'Glasgow bus wars' immediately following deregulation in October 1986, it had gained market share from the Scottish Bus Group subsidiaries, since their competitive onslaught had proved unsustainable. After that, SBH and Kelvin had competed, but not fiercely. It had mainly been a matter of service performance. SBH described the circumstances in the summer of 1993 when SBH withdrew its services from the Monklands, Cumbernauld, Dumbarton and Paisley areas while Kelvin pulled out of central Glasgow. Kelvin had earlier withdrawn from East Kilbride, where its services had met with public dissatisfaction. The changes had not been concerted, but SBH had become aware in particular that Kelvin would have to rationalize its activities because of financial pressures. SBH itself had given up services which it had found unremunerative, partly because of the number of competitors.

5.11. Recent relationships were indicated by a letter which SBH showed us from Kelvin's Managing Director dated 31 March 1994. This proposed among other things that the two companies should work towards a merger when the time was right and assured SBH that Kelvin would not discuss a possible sale of the company with any third party, and would never initiate aggressive action against SBH and its subsidiaries.

5.12. SBH told us that where the services of SBH and Kelvin now overlapped, the scheduling was at times wasteful and failed to provide an ideal service. Kelvin's fares matched those of SBH on overlapping routes but were higher elsewhere. Because of the proliferation of small operators, the merger would not reduce competition for tendered services. SBH and Kelvin had competed fiercely for tenders in the past, and GCT had won many of them, but in general SBH and Kelvin were two among many in that market. SBH saw a continuing place for small low-cost operators, which would play a part in maintaining competition. It pointed to evidence from SPTE that small operators had increased in number in Strathclyde (there were now some 175) while declining elsewhere in Scotland, which suggested that neither SBH nor Kelvin had behaved particularly aggressively towards them, although it was open to them to do so. This situation was unlikely to change after the merger. SBH's practice had been to charge uniform fares, neither undercutting competitors nor exploiting captive markets. Its profitability showed no indication that it was overcharging. SBH was encircled by subsidiaries of the major bus groups, which could increase or add to their service levels within SBH's operating area if SBH overcharged or offered inadequate standards of service.

5.13. SBH said that the merger was necessary to restore the competitive balance in the area. That balance had recently changed prior to the merger on account of acquisitions by major groups. British Bus had acquired Clydeside 2000, which was a significant actual and potential competitor, and Stagecoach had acquired Western Scottish. GRT had acquired SMT (formerly Eastern Scottish) and Reiver (formerly Lowland Scottish): these, with Midland Bluebird which it already owned, comprised a band of three

contiguous ex-Scottish Bus Group companies. SBH pointed out that the Secretary of State for Scotland had ruled that when the Scottish Bus Group was privatized no purchaser could buy more than two companies and that these should not be contiguous, so that sustained and fair competition was promoted.

5.14. SBH said that it offered a low fares policy. Its cumulative fare increases since deregulation had been below the Retail Price Index and significantly below the average for increases in UK bus fares in that period. It said that it had promoted season tickets and other off-bus payment methods, to the benefit of the travelling public in terms of both cost and convenience. It had persisted in offering fare concessions for children without Regional Council financing, and its example had overcome the attempts of other operators to charge full fares for children at certain times. If another major bus group had acquired Kelvin, the overall level of fares in the region would have been more likely to rise than with the SBH/Kelvin merger. SBH stated that it had achieved passenger growth since deregulation, against the trend of significant decreases for the rest of Scotland and the UK. It claimed that this demonstrated the success of its past fares and other commercial policies.

5.15. SBH contended that competition from other modes of transport significantly affected bus usage and prevented the merger from giving an opportunity to raise the level of fares. Its uniform pricing structure meant that this applied even where there was no direct competition. Nearly half the cost of Glasgow's suburban rail network was met from public funds rather than from fares, and the underground flat fare of 50p would have to be doubled to meet the cost of a journey in full. The Zonocard also limited bus operators' freedom to compete on price. Rail fares had not increased in the past three years. As for availability, rail lines had been reopened, investment was continuing, train frequencies were high, and almost all potential passengers within SBH's main operating area lived within one mile of a rail or underground station. Further light rail projects were in preparation. Other modes of transport competed too. There was a local tradition of walking and cycling to work as an alternative to public transport. The Glasgow conurbation had more taxis per head of population than comparable cities, taxi fares were lower than in most other areas, and non-car-owning households used taxis extensively as an alternative to the bus. Taxis could now carry five passengers, and were permitted to offer multi-destination journeys. Car ownership was growing (from a low base relative to the UK as a whole), and retail parks served mainly by cars and taxis rather than buses were becoming more common.

Benefits of merger

5.16. SBH told us that it had been able to benefit customers, both before and after its own privatization, by a low fares policy. It had achieved this on the strength of efficiency savings, particularly in pay and conditions of employment, traffic management and purchasing. However, the merger would provide further opportunities to benefit customers, the Strathclyde local community, the Government and the environment. Kelvin had already stripped out many of its excess costs in order to survive, but on its own it suffered from a poor passenger base and heavy competition.

5.17. The benefits listed by SBH included the following. With a single network, there would be more through journey options and network links. With co-ordinated timetables there would be more stability, less unjustified service duplication and at the same time improved frequency co-ordination, and a better ability to maintain service despite demographic trends. Coverage would be better maintained in the event of local disasters, such as the floods of December 1994. The improved financial viability of the full commercial network would make the combined group better able to cover gaps in services, such as evenings and Sundays. There should be less need for SPTE to subsidize such services.

5.18. Through ticketing would be available over a wider area. There was the possibility of bringing other operators into wider bus season ticket schemes. In principle SBH intended to continue to participate in SPTE's Zonocard scheme, though it was dissatisfied with its remuneration from this under current SPTE policy and practice. Kelvin's customers might have access to all the concessions offered by SBH. Marketing, selling, information and other customer services could all be extended and made more accessible, with economies from pooling of resources. Kelvin's head office would move alongside that of SBH, thus allowing central administrative services to be consolidated. [*Details omitted. See note on page iv.*] Kelvin would, however, retain its business identity; it was large enough for this to make sense in management terms.

5.19. SBH considered that Kelvin's fares were too high and that Kelvin had not made good commercial use of season tickets, particularly *vis-à-vis* the Zonocard. SBH had scrapped Kelvin's plans for a 10 per cent increase in fares in December 1994. It had offered a price promotion to stimulate take-up of Kelvin's season tickets, and had offered free travel on SBH's services for holders of Kelvin tickets covering three zones or more.

5.20. The risk to Kelvin's services arising from recent engineering difficulties would be significantly reduced. Increased capacity to invest in new buses would improve passenger comfort and reliability and would reduce fuel consumption and emissions. Environmentally harmful congestion would also be reduced as a result of the elimination of wasteful vehicle duplication. The enlarged group's reserve fleet could be cut from 105 vehicles to 18.

5.21. SBH contended that the combination of two employee-owned companies would maintain their motivation, with benefits in customer care, and their local control would ensure responsiveness to local needs and contribute to the local economy. This might include participation in novel local transport initiatives.

5.22. SBH believed that employee shareholding and local accountability were in line with government policies. The merger itself had benefited the taxpayer by virtue of the provision in Kelvin's privatization agreement which allowed the STG to subscribe for 20 per cent of the share capital at par in the event of a sale of a controlling interest in the company. The option had been exercised by the Scottish Office as successor to the STG. The shares were bought by SBH at the offer price, the proceeds net of subscription costs being nearly £2 million. SBH had also repaid a £1 million interest-free loan from the STG which Kelvin could not have redeemed on its own in the near future.

5.23. SBH discussed with us the cost savings expected to arise from the merger. It identified £4.3 million annual recurrent savings and £3.1 million non-recurrent savings which could be achieved while still maintaining service levels to match passenger needs. Of these savings, SBH considered that £142,000 and £614,000 would be the respective amounts obtainable by a non-contiguous acquirer of Kelvin, whose only obvious cost-saving option would be the closure of one depot. A non-contiguous acquirer could not rationalize Kelvin's route network without detriment to its own service levels. The savings realized by SBH would benefit customers by releasing resources for re-equipment and for containing fares. The analysis was not intended to cover potential efficiency gains unrelated to the merger; SBH had not yet had the opportunity to scrutinize all aspects of Kelvin's current procedures.

5.24. Despite the substantial savings which would result from network rationalization, SBH maintained that quality of service would be broadly unchanged. Otherwise, there would be greater opportunities for competitors.

Remedies

5.25. The idea of divestment as the outcome of an adverse finding by the MMC was not one that SBH was prepared to contemplate, partly because employee reaction would be so hostile. If divestment of Kelvin was required by the Secretary of State, it would reduce the development prospects of SBH to such an extent that the best option for the residual part of SBH would probably be sale to a larger bus group. This would remove from the scene an independent operator which was employee-owned, operated a low fares policy, had increased patronage since deregulation, competed fairly and met quality standards.

5.26. Among other hypothetical remedies discussed, SBH was prepared to accept any reasonable undertakings short of divestment. These included SBH and Kelvin bidding separately for tenders; restrictions on SBH's ability to raise fares and cut services; and a requirement for the merged group to continue to participate in multi-modal and multi-operator ticketing arrangements promoted by SPTE. SBH stated that it would prefer not to comment on remedies relating to the Stagecoach shareholding in SBH, because SBH did not have unilateral control over the shareholding and because the shareholding was already the subject of a separate MMC inquiry.

6 Views of third parties

6.1. This chapter summarizes views received from the Scottish Office, the Department of Transport, the Traffic Commissioner for Scotland, local government, bus operators, associations and professional bodies, and trade unions. Some third parties combined their comments on this merger with those on the Stagecoach acquisition of a 20 per cent shareholding in SBH. Where it was possible to divide their evidence we have done so.

Scottish Office

6.2. The Scottish Office said that its policy was to seek to maximize opportunities for fair competition between bus operators. The merger of SBH and Kelvin reduced competition and extended SBH's area of dominance. The merger was undesirable, and the fact that it might provide an effective barrier to an aggressive incomer made it no less so. However, a divested Kelvin would be very vulnerable, particularly if Stagecoach were allowed to keep its 20 per cent holding in SBH, unless it could be supported or acquired by another strong company.

Department of Transport

6.3. The Department of Transport said that the SBH/Kelvin merger must be considered in the light of what had happened elsewhere in Scotland. Provided that there were other large groups in adjacent areas the merger would be acceptable as a counterweight to them.

Traffic Commissioner for Scotland

6.4. The Traffic Commissioner said that his main concern was for road safety. Kelvin had an elderly fleet of buses and suffered, the Commissioner suspected, from under-investment. In June 1994 the Traffic Commissioner had called the company to public inquiry because its buses were poorly maintained and had curtailed its operator's licence to terminate on 30 June 1995. If the licence were to be renewed, Kelvin would have to satisfy initially the Vehicle Inspectorate, and subsequently the Traffic Commissioner, that its maintenance standards had significantly improved. Kelvin was working hard towards this and the Commissioner did not wish to prejudge the outcome. However, he believed the company's progress would always be hampered by lack of investment. He therefore welcomed the merger with SBH which not only had higher maintenance standards but also offered a better financial base.

Local government

Strathclyde Regional Council

6.5. Strathclyde Regional Council gave written evidence and attended a hearing. It said that Strathclyde had one of the lowest rates of car ownership in Great Britain and the rail network, although the largest suburban network outside London, was oriented towards Glasgow city centre with large areas of the region not having ready access to a railway station. Most public transport journeys were therefore made by bus and although the existence of the rail network might help to mitigate the dangers of market

dominance in some areas, in itself it was insufficient to allay fears of an abuse of monopoly powers by large bus operators.

6.6. The intense competition resulting from deregulation had been a mixed blessing, particularly in Glasgow. Main roads were choked and minor routes neglected, and the buses in use tended to be older. The predicted move towards a concentration of larger and fewer operators had taken longer than expected to arrive. The Regional Council was concerned about the changes of routes and timetables which were taking place daily and bewildering passengers, particularly tourists.

6.7. The Regional Council thought that although the new company resulting from the SBH/Kelvin merger would have a large share of the bus market in Strathclyde, the danger of its exploiting that situation would be countered by the interest of large national operators which were already competing in the area. The merger would therefore not be against the public interest. However, Stagecoach's acquisition of a 20 per cent shareholding in SBH could lead to excessive market dominance in some parts of Strathclyde to the possible long-term detriment of the travelling public and of the Regional Council's budget for subsidized local services and school transport.

Strathclyde Passenger Transport Executive

6.8. SPTE gave written evidence and attended a hearing. (See paragraph 3.17 for a description of this organization.) It said that it was responsible for seeing that an overall network of services, including rail, was provided to meet the total transport needs within the area of its responsibility. Strathclyde Regional Council determined the policies under which SPTE worked, and made the finance available to provide subsidies.

6.9. SPTE provided us with information on the tenders it had received for subsidized services over the last few years, many of which had been from small operators who tended to compete in this way rather than on commercial services. It told us that small operators were careful not to upset the large operators. In general the large operators had their own territories and there was little overlap between them.

6.10. The merger between SBH and Kelvin was likely to result in a rationalization in the supply of commercial bus services, particularly because of Kelvin's recent losses and the low profits of SBH. If this rationalization was achieved by reducing the excess provision which existed on many main routes, the result could be an enhanced service for the public with reduced congestion and fewer delays. If, however, the rationalization was achieved by reducing services on less well-used routes and/or at periods of lower demand, there would be adverse implications for passengers. The loss of such services could not be met by subsidized services because of financial constraints on the Regional Council. However, with operators such as Stagecoach (through Western Scottish), GRT (through Midland Bluebird and SMT) and British Bus (through Clydeside 2000) in a position to provide competing services in the region, the scope for widespread service reduction and/or excessive fare increases by SBH/Kelvin to the significant detriment of passengers was probably limited. However, if Stagecoach had a 20 per cent share of SBH, competition would be less and SPTE's fears regarding potential adverse effects would be heightened.

6.11. In general, providing there was significant remaining competition SPTE was not concerned over the merger between SBH and Kelvin. In fact by strengthening Kelvin it could make the company better able to resist competition from other operators. If Kelvin had not been acquired by SBH it would have been likely to go out of business. SPTE would then have been concerned that a national operator might have moved into the area and cut down on services and charged higher fares. Such an operator would be likely to concentrate its resources primarily on other, more profitable areas of the country whereas an indigenous company like SBH, with staff and vehicles already in the area, would not.

Other local authorities

6.12. We invited local authorities in the relevant area to give views. *Cunninghame District Council*, *Inverclyde District Council* and *Kilmarnock & Loudoun District Council* told us that the merger had no implications for their districts and therefore they did not wish to comment.

6.13. *Bearsden & Milngavie District Council* said that the merger should not be allowed to continue. Widening of choice was one of the principal benefits envisaged for the consumer at the time of bus deregulation but subsequent mergers had restricted choice. There was a danger that this merger would cut down services even further.

6.14. *Monklands District Council* noted that 50 per cent of Monklands' households had no car. It said that Kelvin was a major employer in the district but SBH had disappeared from many, if not all, of Monklands' internal routes with the result that there would be virtually no route duplication within the proposed new company. The Council had no objections to the proposed merger provided that SBH gave assurances on the future of the Kelvin depot at Airdrie; that the rural routes which provided vital links to Monklands' villages were maintained (and possibly enhanced and extended); and that current services became more efficient and reliable, making their use a realistic option for the public.

Bus operators in Strathclyde region

6.15. We invited bus operators with services in Strathclyde region to comment on actual and potential competition in the local bus market and to give their views on the merger. We received 23 responses. Some operators were also invited to hearings.

A & J Ballantyne

6.16. A & J Ballantyne (Ballantyne), which operates in the Motherwell district, said that it had been forced to abandon a route in Monklands because of harassment by a Kelvin driver. Its only concern over the SBH/Kelvin merger was that any changes to times or routes of buses that the company made should be introduced to benefit the public rather than just to coincide with Ballantyne's.

Bowman's Coaches (Mull) Ltd

6.17. Bowman's Coaches (Mull) Ltd, which operates in the Argyll & Bute district, said that the merger would be detrimental to the travelling public in the long term. A safeguard which it would like to see introduced would be tighter control by the Traffic Commissioner in relating services to need.

British Bus plc and Clydeside 2000 plc

6.18. British Bus, one of the emerging large operators, attended a hearing together with the Managing Director of its subsidiary company, Clydeside 2000, whose main operating area is to the west of Glasgow. Clydeside 2000 had become an employee-owned company in 1991. Since then it had experienced financial difficulties and in November 1994 had been acquired by British Bus.

6.19. British Bus told us that its long-term strategy was to continue as an independent transport operator. It believed that the UK bus industry would polarize at a considerable rate over the next few years until there were six or fewer large operators. It would be the medium-sized operators which would be squeezed out: smaller ones would continue to offer some competition. Within towns there was really only room for one large operator but within the major conurbations and their environs, eg Glasgow, it would be possible for two companies to operate side by side. British Bus aimed to have a presence in all major conurbations. Nationally, there was at present little head-to-head competition between the major operators.

6.20. After British Bus had purchased Clydeside 2000 it had sold Thornliebank, one of the company's five depots, to Stagecoach. However, the sale did not mean that British Bus had no plans to acquire a greater share of the Glasgow market: in fact expansion in the area was part of its long-term objective. In the short term, however, it wished to improve Clydeside 2000's profitability and Thornliebank, the smallest of its depots in terms of turnover, was poorly located with high overheads. Clydeside 2000 now had an agreement to rent part of the maintenance facilities for 18 months (until May 1996) and its head office was still on the premises. If the level of operations there was not maintained the buses and head

office would probably be moved to another depot. When British Bus wished to expand in the area it could do so from another location.

6.21. British Bus regarded the Stagecoach registrations in Glasgow (see paragraph 4.53) as a serious attempt to enter that market. Stagecoach had chosen the most lucrative of SBH's routes in the south-west of Glasgow. If it were to put in 60 buses, this could be enough to reduce substantially SBH's profits of around £2 million a year. Having weakened SBH, Stagecoach would then expand.

6.22. If, as a result of the Stagecoach/SBH inquiry, Stagecoach had to divest its holding in SBH, British Bus expected that Stagecoach would resume competition with SBH. Provided the MMC's recommendation did not preclude it from doing so, British Bus itself might then make overtures with a view to acquiring part of SBH. If SBH did not respond, British Bus would consider increasing the competition in Glasgow at the same time as Stagecoach did.

6.23. British Bus agreed that the people of Glasgow might have been better served if one of the big national operators, rather than SBH, had taken over Kelvin. British Bus itself would have been delighted to acquire Kelvin and would still be interested in doing so if, as a result of the MMC's inquiry, SBH were required to divest. But British Bus made clear that it had no objection to the merger. In the long term British Bus intended to expand into the Glasgow market and while the merger might delay that move, it would not prevent it.

6.24. Clydeside 2000 said that although each local operator had its own 'patch' there had been competition between SBH and Kelvin in certain areas and it expected the merger to lead to rationalization of services in these areas. Although in the short term this might disadvantage passengers because buses were less frequent, in the long term it would be beneficial because the new company would become stronger and therefore able to invest in new vehicles, better levels of service and better trained drivers.

Clyde Coast Coaches Ltd

6.25. Clyde Coast Coaches Ltd, which operates in the district of Cunninghame, was not concerned over the SBH/Kelvin merger, provided that the company remained within its present operating area.

Golden Eagle Coaches

6.26. Golden Eagle Coaches, which operates in the Monklands district, said that the fierce competition since deregulation had caused it to stop some local services. It had no concerns over the SBH/Kelvin merger (with or without the Stagecoach shareholding) which it believed would strengthen the company against competition.

Govan Minibus Company

6.27. Govan Minibus Company (Govan), which operates in the Glasgow City and Renfrew districts, said that the company had been started in 1991 to provide services in areas not served by the larger operators. It had expanded where it thought there were opportunities to provide convenient services at a reasonable price. Immediately after Govan commenced operations SBH had started to offer intense competition on two of its routes and this incident had been the subject of an Office of Fair Trading (OFT) inquiry. SBH had subsequently withdrawn from the two routes. In May 1994 Govan had decided to compete on a Govan-Paisley route where SBH was the sole operator. Since then SBH had competed fiercely and had introduced up to five untimetabled buses a day on the route. Govan said that duplication of buses was justified only if the passenger traffic warranted it and this particular route was now considerably overbussed. The economies of scale resulting from the merger with Kelvin together with the involvement of Stagecoach would enable SBH to put even more buses on to the route to the detriment of the passengers.

GRT Bus Group PLC

6.28. GRT, one of the emerging large operators, had acquired Midland Bluebird in September 1990 (see paragraph 4.43). At a hearing it told us it envisaged that over the next five years public transport would benefit from the initiatives which were taking place at present and this would ultimately reverse the decline in passenger numbers. GRT hoped to work closely with local councils to improve the services offered and attract the public away from private cars and on to buses. Strathclyde was a region where such improvements were already taking place, although at a slower pace than in some other areas.

6.29. GRT believed that in the long term the number of medium-sized operators in the UK was likely to diminish and between five and ten large operators would evolve. It was nevertheless likely that several hundred small operators (with between 5 and 75 buses) would continue to serve local markets. This development paralleled that of the retail sector where large national companies had thrived alongside hundreds of smaller, more locally-oriented shops. Over the last few years the larger operators had been gaining market share principally by acquisition. Because of this, competition between them had in many cases been limited to skirmishes on the fringe, rather than all-out competition on all fronts for each other's passengers. In the future, however, as acquisition opportunities decreased, there was likely to be more direct competition between them. GRT would like to increase its geographical spread, and since buying Midland Bluebird had acquired companies in other regions of the UK. GRT believed Glasgow had been overbussed since deregulation and was not currently an area where a start-up from a new base would be attractive.

6.30. Although Midland Bluebird operated services from Falkirk and Stirling into Glasgow which passed through areas where SBH and Kelvin operated, it was very much the minority operator there. Less than 6 per cent of GRT's turnover came from Strathclyde region. GRT was unaware of any anti-competitive behaviour by either SBH or Kelvin.

6.31. GRT had no concerns about the SBH/Kelvin merger. Without it Kelvin would have been acquired by another operator or would have gone out of business. There did not appear to have been a resulting reduction in competition but it was likely that the supply of buses in the area would now be better matched to demand. If the merged SBH/Kelvin scaled back services too far, GRT would be looking for opportunities to expand into its territory. GRT would not be in favour of divestment of Kelvin by SBH, as it did not believe the merger to be against the public interest. The merger had, in GRT's opinion, strengthened the competitive position of Kelvin and as a result the combined organization would be stronger and a more effective competitor in what was a very competitive market served by many operators.

Lippen Coaches

6.32. Lippen Coaches, which operates in the Glasgow City and Renfrew districts, said that both SBH and Kelvin worked to high professional standards and it was unaware of any anti-competitive behaviour by either of them. It had no concerns over the merger but, in general, it would like some form of protection for the smaller operators to be introduced.

McGill's Bus Service Limited

6.33. McGill's Bus Service Limited, which operates in the Glasgow City and Renfrew districts, said that it had enjoyed a professional relationship with SBH for many years and thought it unlikely that this would change. It had no fears of predatory competition as a result of the SBH/Kelvin merger and the subsequent Stagecoach shareholding. Its only real concern was that, following deregulation, small low-cost operators had picked good routes and creamed off the passengers from existing services. Such competition was wasteful and diluted essential revenues required, *inter alia*, to reinvest in new buses to sustain high-quality local bus service operations.

Oban & District Buses Ltd

6.34. Oban & District Buses Ltd, which operates in the district of Argyll & Bute, said that the merger between SBH and Kelvin had obviously reduced competition in the areas concerned. The small independent operators in those areas were likely to be squeezed out as there was now less scope for them to compete with one large company than there had been with two medium-sized ones which in turn were competing with each other.

Puma Coaches

6.35. Puma Coaches (Puma), which operates in the Glasgow City district, alleged that SBH and GCT ran empty buses simply to spoil Puma's service. They also carried out other anti-competitive practices including 'blocking in' at termini and bus stops. In April 1993 Puma had started a local service after requests from residents. However, SBH had rerouted a service on to Puma's route and it had been forced to withdraw. The merged SBH/Kelvin would have a monopoly in Glasgow as a result of the merger. A closer watch should be kept on SBH to monitor its behaviour towards smaller operators.

Thomas Rowe & Sons

6.36. Thomas Rowe & Sons (Rowe) operates services in the Cumnock & Doon Valley district. Whilst it did not think that the merged SBH/Kelvin would move into its area, it feared that the merger might force smaller operators out of the Glasgow/Lanarkshire area and into the rural areas and tendered business which Rowe needed to maintain its business. SBH/Kelvin should be required to show that any contracts it undertook or routes it operated were commercially viable and not undertaken to squeeze out other operators.

Stagecoach Holdings plc

6.37. Stagecoach, whose subsidiary Western Scottish with its headquarters in Kilmarnock operates in a wide area to the south and south-west of Glasgow, gave written and oral evidence. It confirmed to us that it had corresponded with the OFT about the SBH/Kelvin merger before the matter had been referred to the MMC. Stagecoach had been opposed to the merger on grounds of reduction in existing and potential competition. Anticipating SBH's likely claim that the Stagecoach registrations in Glasgow (see paragraph 4.53) indicated potential competition with a merged SBH/Kelvin, it pointed out that the planned size of its Thornliebank operation (a build-up to 60 buses) would not have made much impact on SBH with its 1,300 buses. Stagecoach had fully intended to operate the services, however, earmarking 18 new buses from within the group and envisaging a start-up investment in buses and the depot of some £11 million. There had been no question of using the project to force SBH to enter negotiations.

6.38. Stagecoach was concerned that the process of privatization, in Scotland and elsewhere, was creating groupings of bus companies with an unfair competitive advantage because of the favourable terms of the employee buy-outs. Now that the SBH/Kelvin merger had been completed, however, Stagecoach thought divestment as a result of any conclusions the MMC might reach would be damaging to the public interest because of the missed opportunity to restore Kelvin to profitability, the loss of synergistic benefits (including investment in fleet replacement) from amalgamation with SBH, and last but not least the likely opposition of both SBH and Kelvin employee shareholders. Stagecoach had earlier prepared a bid for Kelvin [*Details omitted. See note on page iv.*]. This intended bid might, in Stagecoach's view, have succeeded if the SBH/Kelvin merger had been referred to the MMC *before* the Kelvin employees voted on the SBH offer for their shares. Stagecoach had been advised that an understanding reached earlier between Kelvin and SBH (see paragraph 3.45) was not an obstacle to a merger with Stagecoach. SBH was able to move quickly because it was free from the obligations that applied to a listed company. The shared ethos of employee ownership in SBH and Kelvin also made the transaction easy to carry through.

6.39. It was reasonable to say that Kelvin was worth more to SBH than it was to Stagecoach because of the depot and route rationalizations which could be achieved. The merger would not significantly

diminish competition because there had been none before in any real sense. The overall effect of the SBH/Kelvin merger would be a gain in profitability for both operations. Depending on the policies adopted for fleet replacement and fares, there could be a favourable impact on both the volume and quality of the service offered.

6.40. If Kelvin was divested from SBH, Stagecoach believed it would inevitably be acquired by one of the major groups. In that event, the degree of competition in the Glasgow area would not be greatly different from the present situation. Given the pressure for growth in the industry, any purchaser would have to pay a substantial price, absorbing resources which could otherwise be used for reinvestment in Kelvin.

Weir's Tours Ltd

6.41. Weir's Tours Ltd (Weirs), which attended a hearing, told us that it ran commercial and tendered services within Strathclyde region. It had competed with Kelvin in the west of Dunbartonshire until the latter withdrew from the area in October 1992 after Weirs had taken most of Kelvin's revenue by increasing the frequency of the buses on the route and providing a reliable service. Weirs' services in Dunbartonshire now connected with Kelvin's but did not compete with them.

6.42. Weirs thought SBH was an efficient and competent company which engaged in fair competition. It had seen no difference in the attitude of the two companies since their association and had no concerns over the merger, which it believed would stabilize the market. If the merger was not allowed to stand, Weirs thought both companies would be more vulnerable to take-over by one of the large operators, which might then attempt to eliminate the small operators.

Whitelaws Coaches

6.43. Whitelaws Coaches, which operates in the districts of Hamilton, Clydesdale, East Kilbride and Motherwell, said that it had a joint timetable with Kelvin on some routes. It was concerned that a combined SBH/Kelvin might attempt to increase the number of buses on the joint routes and it would like to see a safeguard on the merger which would prevent this happening.

Other local operators

6.44. Another operator said that SBH and Kelvin had both overbussed certain areas in order to drive out new entrants. The fear of their operating in a similar manner in the operator's existing area had prevented it from expanding its operations. It thought that within the next four years SBH and Kelvin would be running most of the services in the region and smaller companies would find it difficult to stay in business. If the merger were allowed to stand the new company's route registrations and cancellation of services should be restricted.

6.45. A second operator said that Kelvin had previously put extra buses on to its route to run in front of this company's buses. It was opposed to the SBH/Kelvin merger because increasing the size of the company increased its ability to put the small operators out of business.

6.46. A third operator said that it had had a good working relationship with Kelvin since deregulation. Although it had not seen any anti-competitive practices from Kelvin or SBH in the past, it was no longer possible for this operator to compete with SBH in, for example, Glasgow City without fear of reprisals in its 'home' districts. It was concerned that once SBH and Kelvin had integrated their operations the new company would be able to quote 'blanket prices' for tendered services, eg one price for a large number of school contracts or subsidized local services across the Glasgow conurbation. The merged SBH/Kelvin would be able, for example, to use a bus on a commercial service to pick up a number of schoolchildren as part of its normal route at no extra cost, or to reroute an existing commercial service at minimal cost, compared with other operators which would have to meet the full cost of the contract. This would enable the new company to compete for tenders at prices which other operators could not match. SBH was already doing this in the district of Glasgow City and it would easily be able

to incorporate schools and routes in Kelvin's area. If the merger was to continue the companies should be required to tender as two separate entities.

6.47. As far as commercial services were concerned, the high capital investment necessary to reinvest in the merged company's fleet would make it difficult for SBH/Kelvin to compete aggressively. However, the operator was concerned that the Stagecoach shareholding would enable it to do this.

Other large operators

6.48. We asked four emerging large operators which do not at present have interests in Strathclyde—Badgerline, Go-Ahead, MTL and West Midlands Travel—whether they had contemplated setting up operations in the region. They all said that they had not, and that the merger had made no difference to their thoughts on the subject.

Associations and professional bodies

Confederation of Passenger Transport UK—Scotland

6.49. The Confederation (previously known as the Bus and Coach Council) told us that as both SBH and Kelvin were members of the Confederation it thought it improper to comment on the merger.

National Federation of Bus Users

6.50. The Federation is a voluntary organization set up in 1985 to protect and promote the interests of bus users. It said that the SBH/Kelvin merger would be more likely to benefit than to disbenefit consumers, largely because it would *reduce* competition. The high level of competition with many buses on main routes, which began even before deregulation, had not produced a network of services which were as attractive and easy to use as they should be.

6.51. The merger would enable the companies concerned to focus attention and resources on producing a more passenger-friendly network instead of simply duplicating each other's services. It would reduce the level of competition but, judging from the number of operators running services in the area, there would still be enough competition from other operators to keep the merged company alert.

Scottish Association for Public Transport

6.52. The Scottish Association for Public Transport, a group which campaigns for coherent and environmentally sensitive transport policies, believed that a reversion to a smaller number of bus operators—compared with intense competition yielding minimal or negative profit margins—offered better prospects for buses (and public transport generally) to make significant inroads into the share of the market held by private cars, and to identify opportunities for sustained increases in passenger numbers.

6.53. The Association thought the SBH/Kelvin merger, together with the Stagecoach shareholding, would be acceptable subject to undertakings. Measures should be taken to monitor excess profits and the merged company should be required to participate in Zonocard ticketing at fares no greater than they were at present and to increase fares at specified rates below inflation rates. It should also restrict maximum adult 'on-vehicle' fares to not more than 50p for distances below three miles with 10p increments for distances greater than three miles (with annual revisions to be agreed by the MMC).

Trade unions

Scottish Trades Union Congress

6.54. The Scottish TUC told us that it represented transport unions and other workers and their families across the whole of Scotland, including Strathclyde. It thought the SBH/Kelvin merger would secure passenger services and maintain employee ownership and was preferable to the acquisition of Kelvin by a large operator from outside the region, which would be likely if SBH were forced to divest. The Scottish TUC did not believe the merger would have a significant impact on transport competition in the operating area. The bus industry in Strathclyde competed with subsidized rail and the underground, as well as with private cars and taxis.

P H DEAN (*Chairman*)

A G ARMSTRONG

N F MATTHEWS

M R PROSSER

S EILON, being a member of the Group, dissents from the conclusion for the reasons set out in the note of dissent included in this report.

A J NIEDUSZYNSKI (*Secretary*)

29 March 1995

APPENDIX 1.1
(referred to in paragraphs 1.1 and 2.1)

The reference and background

1. On 30 November 1994 the Department of Trade and Industry (DTI) sent to the MMC the following reference:

Whereas it appears to the Secretary of State that it is or may be the fact that a merger situation qualifying for investigation, as defined in section 64(8) of the Fair Trading Act 1973 ('the Act') has been created in that—

- (a) enterprises carried on by or under the control of S B Holdings Ltd (being a body corporate incorporated in the United Kingdom) have within the six months preceding the date of this reference ceased to be distinct from enterprises carried on by or under the control of Kelvin Central Buses Ltd, and
- (b) as a result the condition specified in section 64(3) of the Act prevails, or does so to a greater extent, with respect to the supply in the specified area of bus services (as defined in section 159(1) of the Transport Act 1968, as amended by paragraph 1 of Schedule 1 of the Transport Act 1985):

Now therefore the Secretary of State, in exercise of his powers under sections 64, 68 and 69(2) of the Act, hereby refers the matter to the Monopolies and Mergers Commission for investigation and report within a period ending on 8 March 1995.

In relation to the question of whether a merger situation qualifying for investigation has been created, the Commission shall exclude from consideration one of paragraphs (a) and (b) of section 64(1) of the Act if they find the other satisfied.

In this reference 'the specified area' means the districts of Glasgow City, Bearsden and Milngavie, Clydebank, Strathkelvin, East Kilbride, Cumbernauld and Kilsyth, Hamilton, Monklands, Motherwell, Dumbarton, Renfrew and Clydesdale.

30 November 1994

(signed) CHARLES BRIDGE
*An Assistant Secretary in the
Department of Trade and Industry*

2. On 30 November 1994, in a press release announcing the reference, the DTI stated that the Secretary of State considered that the acquisition by SBH of Kelvin raised competition concerns in the operation of the bus market in and around Glasgow which merited investigation by the MMC.

3. On 27 February 1995 it was announced that the Secretary of State for Trade and Industry had agreed that the reporting period should be extended to 29 March 1995.

4. The composition of the Group of members responsible for the present investigation and report is indicated in the list of members in the preface.

5. Notices inviting interested parties to submit evidence to the MMC were placed in:

Coach and Bus Week *Daily Record*
Glasgow Herald *Glasgow Times*
The Glaswegian

6. We received written evidence from the Scottish Office; the Department of Transport; the Traffic Commissioner for Scotland; Strathclyde Regional Council; SPTE; local authorities; bus operators; the National Federation of Bus Users; the Scottish Association for Public Transport; and the Scottish Trades Union Congress. We held hearings with five of these parties.

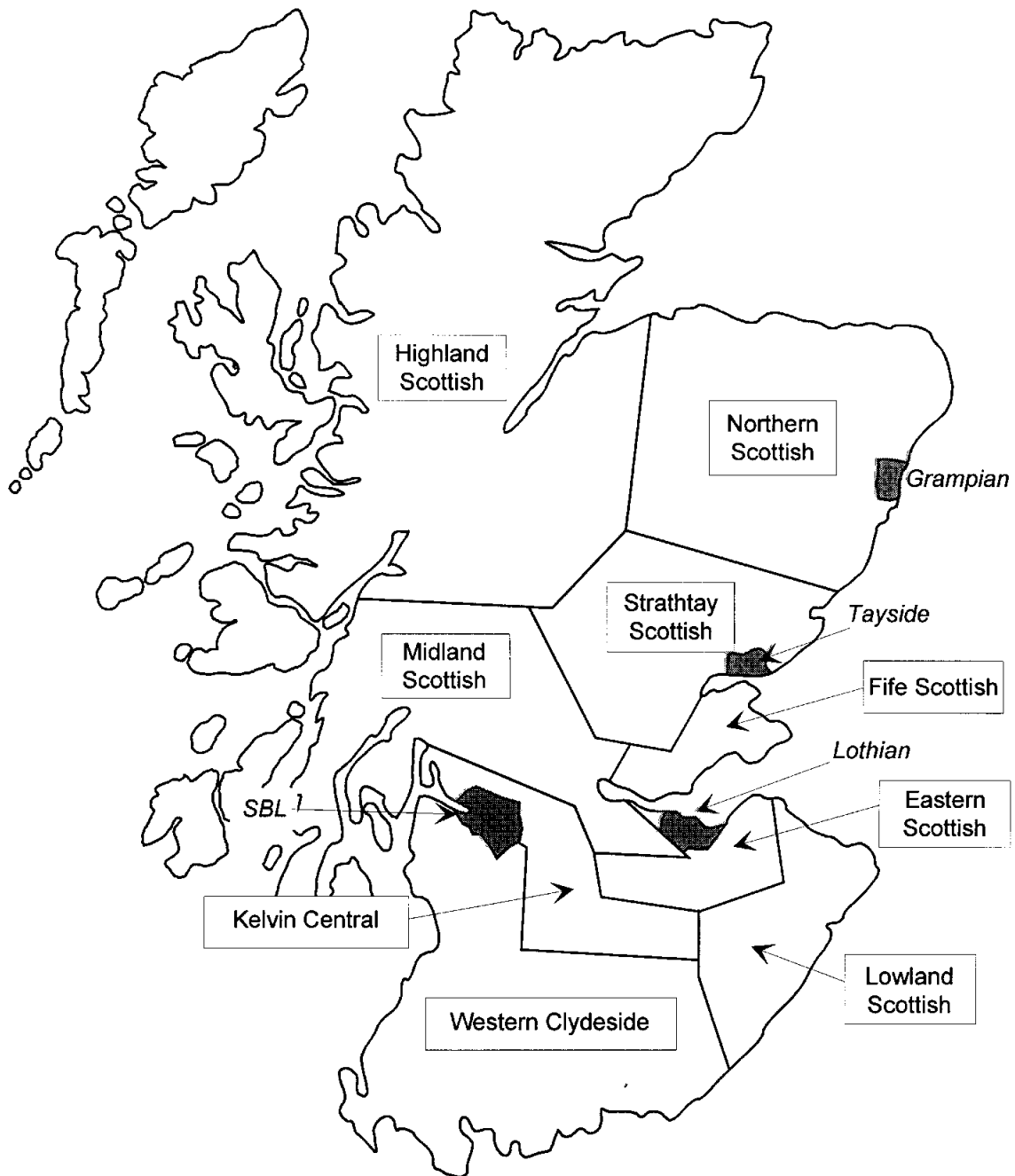
7. Questionnaires were sent to bus companies operating in the area and the results of the survey are reflected in Chapters 4 and 6.

8. We received written evidence from SBH and the company attended three hearings.

9. A visit was made by members of the Group, accompanied by staff, to Glasgow to view SBH's operations and facilities there.

10. We should like to thank all those who helped us in our inquiry, particularly SBH.

Scottish Bus Group and local authority-owned companies: principal areas of operation prior to privatization



Source: Based on the National Audit Office Report on the Sale of the Scottish Bus Group—August 1993.

Notes:

1. The tenth of the Scottish Bus Group companies, Citylink, is not shown on this map. Citylink was a coaching company which at this time operated services throughout Scotland and elsewhere in the UK.
2. The above map shows the principal areas of operation of the nine Scottish Bus Group-owned local bus operators (whose names are shown in boxes) and the four local authority-owned bus companies (whose names are shown in italics) prior to the commencement of the disposal of the Scottish Bus Group companies in 1990. In the areas covered by the operations of the local authority-owned companies there was a degree of overlap with one or more of the Scottish Bus Group-owned companies.

APPENDIX 3.2
(referred to in paragraphs 2.57 and 3.8)

The disposal of the Scottish Bus Group companies and their ownership as at March 1995

Company	Originally acquired by	Date acquired	1989 operating profit/loss	Sale price £'000	Subsequent acquirer (if applicable)	Date subsequently acquired (if applicable)
Eastern Scottish	MEBO*	September 1990	1,007	9,500	GRT	October 1994
Fife Scottish	Stagecoach	July 1991	1,387	9,111	-	-
Highland Scottish	Rapsons/Clansman†	August 1991	(123)	800	-	-
Kelvin	MEBO*	February 1991	(3,515)	-	SBH	October 1994
Lowland Scottish	MEBO*	August 1990	685	3,100	GRT	November 1994
Midland Scottish	GRT	September 1990	1,090	8,500	-	-
Northern Scottish	Stagecoach	March 1991	(45)	5,667	-	-
Strathay Scottish	Yorkshire Traction	June 1991	217	1,900	-	-
Western Scottish‡	MEBO*	October 1991	N/A	N/A	Stagecoach	July 1994
Clydeside	MEBO*	October 1991	N/A	N/A	British Bus	November 1994

Source: Based on the National Audit Office Report on the Sale of the Scottish Bus Group, August 1993.

* MEBO refers to acquisition by a management- and employee-owned company.

† Highland Scottish was acquired jointly by Rapsons Coaches and Clansman, owner of Citylink. In March 1993 the ownership of Highland Scottish passed wholly to Rapsons.

‡ In May 1989, as part of the reorganization of the Scottish Bus Group, Clydeside was merged with Western Scottish. The merged Western Clydeside company was sold to Western Scottish's management in October 1991 for £1 million with an immediate onward sale by Western Scottish of the previous operations of Clydeside to a new company, Clydeside 2000, which was owned by its employees (76 per cent), Luton and District Transport Limited (19.2 per cent) and the then Chief Executive of Luton and District Transport Limited (4.8 per cent).

Note: The table excludes details of the sale of Citylink (see Appendix 3.1). Citylink was acquired from the STG by Clansman, a company owned by Citylink's management and employees, for £265,000 on 30 August 1990. Clansman, which by then had changed its name to Saltire Holdings Ltd, was subsequently acquired by National Express in 1993.

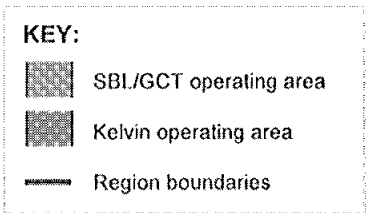
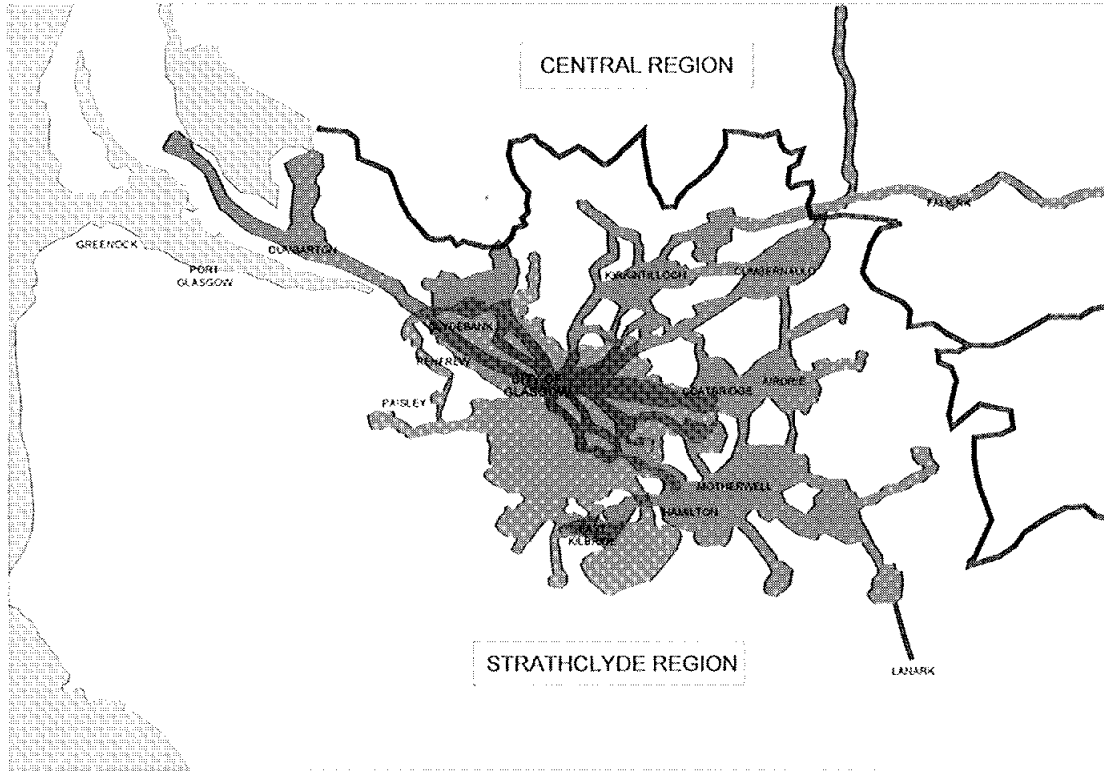
APPENDIX 3.3
(referred to in paragraph 3.48)

Chronology of events

<i>Date</i>	
August 1986	Start of 'Glasgow bus wars' (lasting approximately three years).
13 February 1991	Kelvin buy-out from the Scottish Bus Group.
10 April 1992	Sale of Stagecoach's subsidiary Magicbus to Kelvin for £840,000.
18 May 1992	Fire at SBL's Larkfield depot.
19 February 1993	SBH acquires SBL from Strathclyde Regional Council for £18.3 million.
31 March 1994	Kelvin terminates its discussions with SBH in respect of its possible acquisition by SBH.
18 July 1994	Stagecoach acquires Western Scottish for £6 million.
25 August 1994	Stagecoach reaches agreement with the Kelvin Board, subject to due diligence enquiries and the preparation of a public offer document, to acquire Kelvin for £10 million.
7 September 1994	SBH writes to Kelvin outlining its intention to make an offer.
12 September 1994	SBH writes to Kelvin with details of its proposed offer.
13 September 1994	Kelvin informs Stagecoach of its preference for SBH as an acquirer.
22 September 1994	SBH issues offer document for Kelvin.
Early October 1994	Chairman of SBH makes attempts to request meeting with Stagecoach.
7 October 1994	GRT acquires SMT (the ex-Scottish Bus Group company Eastern Scottish) for £10.3 million.
16 October 1994	Kelvin Extraordinary General Meeting to approve SBH's offer.
19 October 1994	SBH's offer for Kelvin becomes unconditional in all respects.
28 October 1994	First meeting between SBH's Chairman and Stagecoach.
1 November 1994	British Bus acquires Clydeside 2000 for £1.3 million.
7 November 1994	GRT acquires Reiver (the ex-Scottish Bus Group company Lowland Scottish) for £2.4 million.
14 November 1994	Stagecoach/SBH Subscription Agreement signed.
15 November 1994	Stock Exchange announcement of Stagecoach/SBH agreement.
30 November 1994	SBH acquisition of Kelvin referred to the MMC.
12 December 1994	Listing of new Stagecoach shares and SBH's disposal of these shares.
21 December 1994	Stagecoach/SBH transaction referred to the MMC.

APPENDIX 4.1
(referred to in paragraph 4.39)

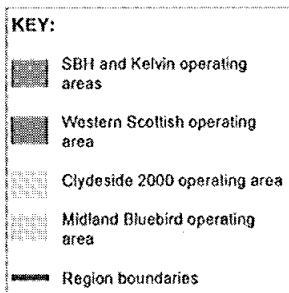
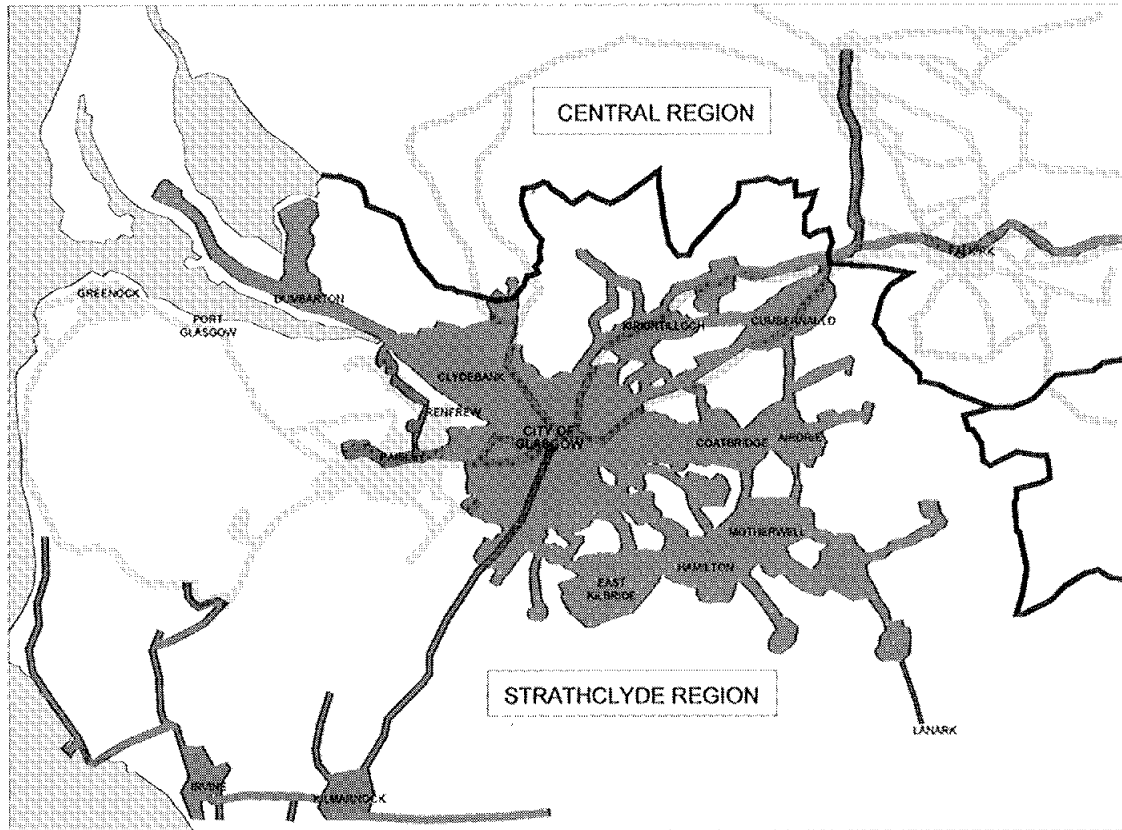
Operating areas and overlap of SBH and Kelvin



Source: SBH.

APPENDIX 4.2
(referred to in paragraph 4.39)

Large operators contiguous with SBH/Kelvin



Source: SBH, SPTE.



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