

Bus Franchising: Advice for Local Transport Authorities

11 September 2024

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1. Bus franchising and the Competition and Markets Authority

- 1.1 The CMA is the UK's principal competition and consumer authority. It is an independent non-ministerial government department, and its responsibilities include carrying out investigations into mergers and markets and enforcing competition and consumer law. The CMA helps people, businesses and the UK economy by promoting competitive markets and tackling unfair behaviour.¹
- 1.2 The CMA has a role in providing advice and recommendations to government and public authorities.² The CMA's advice and recommendations are made with a view to ensuring that policy decisions take account of the impacts on competition and on consumers.
- 1.3 We would encourage Local Transport Authorities (LTAs) to contact the CMA if they have queries on the contents of this advice paper or wider competition considerations.

Importance of bus markets

- 1.4 Bus transport is a crucial part of the UK's transport infrastructure, particularly for those on low incomes, those without access to private transport and those in vulnerable circumstances. Buses are the most used mode of public transport in the UK, both inside and outside of London with approximately 3.4 billion passenger journeys in the year ending March 2023.
- 1.5 Improved public transport networks benefit passengers through improved choice, service, better value fares, and making it easier to get around. They benefit residents through improved air quality and reduced congestion. They also benefit the economy through improving geographical mobility, contributing towards growth, and productivity. The CMA works with national and local bodies to provide competition and consumer advice to inform policy making across all modes of public transport.
- 1.6 Policymakers in the UK, Scottish and Welsh governments are exploring policy measures to enhance bus services. The Welsh Government is currently

¹ The CMA's statutory duty is to promote competition, both within and outside the UK, for the benefit of consumers.

² Under Section 7(1) of the Enterprise Act 2002, the CMA has a function of making proposals, or giving information and advice, "on matters relating to any of its functions to any Minister of the Crown or other public authority (including proposals, information or advice as to any aspect of the law or a proposed change in the law)."

delivering bus reform towards an integrated network;³ the Scottish Government has recently introduced secondary legislation giving Local Transport Authorities (LTAs) power to form Bus Service Improvement Partnerships (BSIPs) or franchising frameworks;⁴ and in England there has been widespread adoption of Enhanced Partnerships (EPs) in response to UK government funding and policy and, in some areas, the introduction or development of franchising plans.

- 1.7 Guidance from the Department for Transport sets out some of the key features of bus franchising: *“In a bus franchising scheme, LTAs will determine the details of the services to be provided – where they run, when they run and the standards of the services. Typically bus operators provide their services under contract to the LTAs who can let whatever sort of contract they feel is appropriate. No other services can operate in the franchised area without the agreement of the franchising authority.”*⁵ In a bus franchising scheme, LTAs set fares and ticket types, typically receive revenue from ticket purchases, and make payments to bus operators (therefore LTAs hold ‘revenue risk’).
- 1.8 For the past 40 years, London has been the only area in Great Britain that has operated a bus franchising model, whilst the rest of England, Scotland and Wales have operated largely deregulated or partnership bus models. During this time, London’s bus market has followed a very different path to national averages – in 2020 4% of London buses were zero emission buses (ZEB) compared to 1% across England,⁶ in London excluding the pandemic there has been consistent vehicle mileage from 2006/07 whereas areas outside of London have seen a significant decline in vehicle mileage before the pandemic and has not recovered to pre-pandemic levels.⁷ ⁸ Greater Manchester Combined Authority (GMCA) will be the first city-region outside London to have fully franchised buses under local control. With limited experience of bus franchising in the UK, and more LTAs expected to pursue franchising, there is real value in policymakers pooling their expertise and experience and working together with the bus industry to help ensure that franchising is implemented in way that will have the most positive impact for passengers, residents, and local economies.

Background and other CMA work

³ [Bus reform for Wales: our roadmap to franchising | GOV.WALES](#)

⁴ [Transport \(Scotland\) Act 2019 and Bus Services | Transport Scotland](#)

⁵ [Setting up a bus franchising scheme - GOV.UK \(www.gov.uk\)](#).

⁶ [Zero emission buses: local authority toolkit - GOV.UK \(www.gov.uk\)](#)

⁷ [Annual bus statistics: year ending March 2023 \(revised\) - GOV.UK \(www.gov.uk\)](#)

⁸ Other factors beyond franchising may have contributed towards the benefits discussed.

- 1.9 This advice follows previous CMA input into the Bus Services Act 2017 (“BSA 2017”) which amended the Transport Act 2000 (“the Act”) and gave new powers for LTAs in England to improve local bus services through EPs, Advanced Quality Partnership Schemes (AQPSs), franchising or Advanced Ticketing Schemes.⁹ It also reflects more recent developments such as the 2021 National Bus Strategy for England, which has led to the widespread adoption of EPs and the introduction of franchising schemes.¹⁰ It also takes into account recent developments in Scotland through the expected adoption of Bus Service Improvement Partnerships (BSIPs) and franchising frameworks, and in Wales through franchising.¹¹
- 1.10 Under current legislation, the CMA is a statutory consultee for bus franchising proposals in England and Scotland as part of the Bus Services Act (2017) and the Transport (Scotland) Act 2019 respectively. At the time of publication, the CMA has engaged with three English combined authority franchising proposals and the Welsh Government’s “one network, one timetable, one ticket” franchising proposal.^{12,13}
- 1.11 The CMA is also a statutory consultee to EPs in England and to BSIPs in Scotland.¹⁴ In 2023, the CMA published an advice paper for LTAs that are developing, monitoring or varying EPs.¹⁵ Prior to the publication of the EP advice paper, the CMA had reviewed over 50 draft EP plans and schemes, providing both aggregated and bespoke high-level feedback on competition issues related to EPs and the impact on passengers.
- 1.12 In both EP and franchising LTA engagement, the CMA has looked to support and enable LTAs to identify and understand the impact of their proposals on

⁹ We use LTA to refer to any entity that may introduce franchising in bus markets (for example (mayoral) combined authorities as well as local transport authorities). While processes to establish franchising will differ across such entities and across the nations, this does not substantively affect the relevance of the advice of this paper.

¹⁰ This paper does not provide advice on the formal processes to establish franchising. That is produced by the relevant government.

¹¹ Any reference in this paper to a ‘franchising scheme’ will capture franchising frameworks in Scotland.

¹² [CMA response to Welsh Government’s Bus Services White Paper - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/cma-response-to-welsh-government-bus-services-white-paper) - although the CMA was not a statutory consultee for the franchising proposal in Wales, the CMA chose to respond highlighting the importance of effective competition in a franchised market.

¹³ Only combined authorities have pursued franchising in England to date.

¹⁴ We reference Enhanced Partnerships (EPs) throughout the advice paper. Any reference to an EP will also be relevant to a Bus Service Improvement Partnership, we see these as equivalent options. We have chosen to only reference EPs as the CMA has reviewed many EP consultations and there are numerous live EPs in England.

¹⁵ [Bus Enhanced Partnerships – CMA advice for Local Transport Authorities - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/bus-enhanced-partnerships-cma-advice-for-local-transport-authorities) - while drafted in response to widespread adoption of EPs in England, we would expect the paper to be helpful to LTAs establishing BSIPs in Scotland.

competition and how to facilitate effective competition to help deliver their policy objectives.

Purpose of this advice

- 1.13 Franchising is one of a number of options available to LTAs. Where on-road competition in deregulated bus markets is not delivering benefits for passengers, or where decision makers consider that their wider policy objectives are not being delivered by the market, policymakers have several options at their disposal. These include franchising models and strengthening or forming statutory partnership arrangements.
- 1.14 Each policy option comes with its own benefits and risks, which will vary depending on the individual circumstances of a given LTA, such as the existing local bus market, current number of operators and local geography. It is essential that decisions on the merits of pursuing franchising are based on an understanding of the local context.
- 1.15 The CMA understands that further bus franchising proposals are likely to be developed in coming years. In response to this expectation, this advice is intended to help LTAs that are considering franchising proposals or developing franchising plans. It consolidates and builds upon competition insights and reflections from our franchising proposal reviews to date. The CMA's intention is to assist LTAs in meeting their policy objectives, by helping LTAs to think about how different interventions may affect markets, the role competition can play in supporting the objectives of LTAs, and franchising design considerations that may help promote competition and thereby help deliver long-term policy objectives.
- 1.16 This advice is not intended to be prescriptive, or exhaustive. Any assessment of competition is not static, and bus markets in which LTAs and operators engage change.
- 1.17 The decision about whether to pursue franchising or partnership arrangements is not for the CMA, that is for LTAs with the knowledge and understanding of their local areas. However, we hope this advice helps LTAs in taking these decisions as it explains the conditions which should enable franchising to work effectively over time.
- 1.18 To date, the CMA has responded to consultations from Greater Manchester Combined Authority (GMCA),¹⁶ Liverpool City Region Combined Authority

¹⁶ [20-0362_Bus_Reform_Support_Documents.pdf \(ctfassets.net\)](#) pg 1236

(LCRCA),¹⁷ West Yorkshire Combined Authority (WYCA,)¹⁸ and the Welsh Government.¹⁹ The CMA understands that its engagement to date with bus franchising has been viewed as helpful and constructive.

- 1.19 All the proposals the CMA has engaged with to date seek to take local authority control over the entire bus network. This advice paper is based on our response to these proposals, i.e. where the entire area of the LTA is proposed to be franchised. However, the CMA expects that it will also have relevance to other types of franchising scheme.²⁰
- 1.20 This advice does not constitute formal guidance but intends to help LTAs in deliberating or developing franchising proposals. Further CMA guidance and advice papers include:
- (a) [CMA advise paper Bus Enhanced Partnerships: Advice for Local Transport Authorities 2023.](#)
 - (b) [Office of Fair Trading \(2009\): Guidance on the application of competition law to certain aspects of the bus market following the Local Transport Act 2008;](#)
 - (c) [OFT guidance on The Transport Act 2000, and the Transport \(Scotland\) Act 2001.](#)

¹⁷ [CMA response to Liverpool City Region Bus Franchising Consultation - GOV.UK \(www.gov.uk\)](#)

¹⁸ [CMA response to West Yorkshire Combined Authority Bus Reform Consultation - GOV.UK \(www.gov.uk\)](#)

¹⁹ [CMA response to Welsh Government's Bus Services White Paper - GOV.UK \(www.gov.uk\)](#)

²⁰ In England there are other types of franchising schemes: in particular, there may be more than one franchised area; and the area or areas could complement an enhanced partnership (EP) that covered the rest of the LTA. DfT's franchising guidance states 'Under this approach, franchising may be a more deliverable and less resource intensive option for the authority than if it were introduced across the whole of their area.' However, any form of franchising is likely to have a greater administrative and financial burden on an LTA than continuing with an EP scheme. ([Setting up a bus franchising scheme - GOV.UK \(www.gov.uk\)](#)). A similar situation also applies in Scotland where a franchise can cover either the whole of, or parts of the LTA area. In theory it could also be restricted to a single corridor or route.

2. Why is competition important in franchising?

- 2.1 In this section we discuss the essential role that effective competition has to play in franchising, and broader considerations for LTAs to maximise the success of a franchise. In the next section we discuss how LTAs can support and facilitate this.

The role of competition in franchising

- 2.2 Franchising fundamentally changes the nature of a local bus network. The introduction of franchising will effectively end competition *in* the market and replace it with competition *for* the market, removing competition on the roads and applying it instead through a competitive tendering process. This transition can create irreversible structural change in the market. Operator exit is an example of this – bus operators may exit the market if they do not win, or are unable to compete for, a franchise.
- 2.3 Competition *in* the market is driven by operators reacting to the actions of passengers and competitors on an ongoing basis. Operators risk losing passengers to other bus operators (or other modes of transport), if their passengers are faced with high prices, low quality, or a poor choice of bus routes. This has a direct negative impact on the revenues of operators which in turn provides a signal to the bus operator to improve their offer. On the other hand, an operator that is able to charge lower prices than their competitors, provide a better service and/or improve their network will be rewarded with more passengers. The combined presence of revenue risk and competition between operators for passengers should therefore – in principle – provide direct and ongoing financial incentives to operators to improve their overall offer to passengers.
- 2.4 Even where there is effective competition between operators, this may not meet all the objectives of LTAs. For example, there may be routes that are not commercially attractive and therefore served by the market that LTAs wish to be served for social or other policy reasons. Similarly, LTAs may wish to encourage the adoption of lower or zero emission vehicles at a faster rate than would be delivered by operators reacting to passenger priorities. Such wider considerations are evident in longstanding LTA involvement in bus markets, including more recently through partnership arrangements.
- 2.5 By ending competition *in* the market, franchising removes these ongoing signals and incentives for bus operators, and shifts revenue risks to the LTA. This is instead replaced by competition *for* the market through periodic but often infrequent tendering processes for operators to deliver franchises. Effective competition between operators to win franchises is therefore very

important to franchising working well. If operators anticipate a competitive tendering process, this will influence their perspective on what is required of them to win a franchise and will lead them to submit more attractive bids. Critically, this need for effective competition does not only apply to the first time a franchise is tendered, but each future re-tender for the franchise. Where firms compete intensely for the rights to a franchise this can help to drive:

- (a) lower prices;
- (b) higher quality;
- (c) innovation and efficiency improvements.

Driving lower prices

2.6 In a competitive pool of bids, operators are more likely to compete intensively on price for the rights to run services. The expectation of strong market participation will put pressure on operators to submit their best possible bid to give them the best chance of winning the franchise contract, driving bid price down. To achieve a lower bid price, an operator is incentivised to improve efficiency to increase cost savings which in turn allows the operator to maintain margins through lower bid prices. Any fall in bid price ultimately results in cost savings for the LTA, which may enable lower fares to be set for passengers by the LTA or greater investment by the LTA (eg in improving or acquiring depot and fleet assets). When competition is weak there is less pressure on operators to submit competitively priced bids and the LTA may be forced to pay above the expected level.

Driving higher quality

2.7 Compared to competition *in* the market (deregulated market), operators do not face the financial risk of loss of customers due to poor service/quality. Franchising tenders therefore generally set minimum quality/service levels to ensure standards are kept to a required level. Raising quality and service levels can be an underlying objective of franchising; but to achieve this, LTAs need to make sure that those levels are met and are achievable over the period of the franchise.

Innovation and efficiency improvements

2.8 Sustaining and improving quality under franchising also depends on there being a credible threat of competition for a franchise in future re-tenders. Without this, there are reduced incentives to meet those quality/service levels because the firm is less likely to get 'punished' by losing the franchise. Even

where there are financial or other penalties relating to service levels, if there is limited competition for franchises this cost may be 'baked in' to higher bid prices in the first place. Effective competition for franchises may even lead to increases in quality above the minimum service levels if this is something that is rewarded in the tendering process.

Additional roles for LTAs under franchising that were previously delivered through competition

2.9 In a deregulated bus market, market forces play a central role in the price of fares and the network design – as a result the LTA plays only a partial role in managing the market.²¹ Transitioning to competition *for* the market through a franchised network shifts to the LTA factors that were previously wholly or partially determined by the market. The transition to a franchised network will increase the expertise and resource required to run the network. Our discussions with Combined Authorities about franchising have indicated this need should not be underestimated. Specific examples include:

- (a) **Procurement and tendering processes** – LTAs will need the relevant expertise to manage a procurement process in the initial franchising cycle and the cycles into the future.²² Building the expertise early will be critical in selecting appropriate franchise contracts and effectively engaging with operators. The LTA may also need to guide bus operators with limited experience or capabilities on how to make competitive bids through a tendering process, to maximise the number of participants in the process, and help not to disadvantage smaller operators.
- (b) **Network design, bus frequency and responding to demand** – in a deregulated market, bus operators will adapt their network to changes in demand to maximise profit and LTAs typically undertake an important but partial role in wider planning of the network, for example, under an EP an LTA can work with operators to improve co-ordination and reliability of the network. In a franchised system, the LTA will have complete ownership in monitoring the demand of routes and make its own decisions on adapting the network and timetables.
- (c) **Ticketing** – Under a franchised model LTAs will be responsible for setting the range of tickets such as 'day riders' or 'weekly passes' and setting their pricing. This may create opportunities for LTAs to simplify

²¹ Albeit LTA has a bigger role in an EP/BSIP the role it would play in a franchising model is significantly larger.

²² This resource may come in-house or through third parties that specialise in procurement and wider services.

fares and in some areas, there will also be opportunities to manage and run multi-modal tickets that combine bus and tram tickets. Commercial expertise will be required to ensure passengers receive a good deal while managing the LTA's commercial considerations.²³

- (d) **Implementing innovations** – In a franchised market LTAs will hold a much greater responsibility to drive innovation, as operators are likely to have a lower incentive to innovate. This potentially could be mitigated through rewarding high performing operators through remedial action plans – covered in section 3. Innovating the network through bus passenger service data is an example of how an LTA can implement innovations in a franchised market: the UK government requires bus operators and LTAs to openly publish information about routes and timetables but there may be scope to go further with data on passenger use, common routes, and congestion, for example.²⁴ The CMA would encourage LTAs to consider what skills and monitoring it needs in place to collect and analyse such data as well as the skills for broader innovations to aid long-term franchise improvements for the benefit of passengers and local economies.

²³ For information regarding ticketing schemes and competition law please see [Public transport ticketing schemes block exemption guidance: CMA53 - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/publications/public-transport-ticketing-schemes-block-exemption-guidance)

²⁴ The requirement of bus operators and LTAs in England to openly publish information regarding routes and timetables.

3. Design of franchising

- 3.1 Section 2 set out why competition for franchises initially, and over-time, is critical to achieving the objectives of franchising. While several factors influence the level of competition in any given area (eg the existing local bus market, current number of operators and local geography), LTAs have a key role to play in facilitating effective competition for franchises. Below we discuss how LTAs can design franchising schemes to benefit from competition.
- 3.2 We have identified four broad areas in which the design of the franchising schemes could facilitate competition (all are considered in further detail in the paragraphs which follow):²⁵
- (a) **Access to fleets and depots:** infrastructure can represent a high barrier to entry and expansion for new or growing operators. A well-designed asset strategy may allow new entrants into the market, or enable the return of past operators, without being hampered by the high fixed costs of purchasing infrastructure.
 - (b) **Design of individual franchises:** Design features, such as the number and size of franchises, will have significant impacts on an operator's ability and incentive to bid for franchises and the outcome of franchising awards may in turn dictate the number of operators left competing in the market. Franchise design should seek to best enable competition amongst a range of potential operators now and in the future.
 - (c) **Transitioning to a franchised network:** moving from a deregulated market to a franchising scheme can create operational, network and ticketing challenges. There are some design considerations, for example, how a partnership scheme may be used during the transition process, which may affect competition and passengers that are specific to the transition process.
 - (d) **Longer term considerations:** Looking beyond the initial tendering process of franchising, it is important to consider factors that will help ensure the long-term success of the franchise, such as the shape of future franchising awards and an evolving asset strategy.

²⁵ There may be trade-offs between some of these areas and other considerations that it is for LTAs to make judgements on (for example resource or LTA cost implications).

A) Access to fleets and depots

- 3.3 To operate a franchise, an operator needs both vehicles and appropriate garaging/depot space to store and maintain buses. Operators may need to secure space for electric vehicle charging points and ensure grid access is available when selecting depot locations as greener fleets develop.²⁶ The ability for operators to access or acquire these assets, potentially at short notice, will significantly affect the ability of different operators to compete for franchises. It is therefore typically the case that LTAs undertaking franchising plan to acquire some degree of fleet and depot infrastructure.

Fleets

- 3.4 Where an LTA opts to acquire the bus fleet for a franchising scheme, it is unlikely that it will be able to acquire a complete fleet upfront before the scheme becomes operational. In all franchising proposals the CMA has engaged with to date, the LTA has intended to gradually progress towards complete fleet ownership over time.
- 3.5 Therefore, not having or not having access to fleets is often a barrier to entry for at least the initial round of franchising. To combat this, franchising proposals have used a residual value mechanism (RVM). An RVM guarantees the price an operator with fleets can expect to receive for its fleets. This helps protect its investment in assets should the operator be unsuccessful in winning the franchise. This also provides certainty to operators that win a franchise that are willing to expand in the area or redirect an existing fleet but, face the risk of losing that franchise in subsequent re-tenders. The pool of buses collected through an RVM can be used to facilitate entry by new operators that may not have required infrastructure. This is particularly relevant for new entrants.
- (a) There may be a case whereby credible operators bidding for franchises may not be able to procure vehicles in time for the start of a contract, particularly if they are a new entrant not currently operating within the area. The LTA should consider the merits of offering to procure vehicles for credible operators, which could be supplied through purchasing through a RVM for unsuccessful operators. This is likely to keep them in the procurement process, enhancing the number of credible bids in the tendering process, building a stronger pool of bids improving competition in the initial and potentially subsequent retenders.

²⁶ Greener fleets through the acquisition of zero emission buses (ZEB) have commonly featured in LTA bus service improvement plans in England.

- (b) The LTA should examine the current condition of fleets available and the average age of the fleet. If the fleet is old or not up to current standard, any new operator may be required to upgrade the fleet themselves, which they may not be inclined to do. A (potentially generous) RVM may be required to incentivise upgrades.
- (c) If an LTA chooses to use a RVM, the effectiveness should be monitored regularly. The LTA may benefit from investing in the commercial skills needed to respond appropriately to feedback as it emerges. In the absence of guaranteed operator success in future franchising rounds, it is important an RVM works well to encourage operators to invest in their fleet. If an RVM isn't used, an alternative approach should be taken for fleet replacement during any transition phase towards LTA fleet ownership.

Depots

- 3.6 Depots are essential to any bus network and must be a key consideration for LTAs when developing franchising proposals. Unlike fleets, depots are an illiquid asset that cannot be moved or developed easily. Operators unable to access to depot facilities will find themselves unable to operate in the market and credibly bid for a franchise.
- 3.7 Access to depots is therefore a key aspect to increasing competition *for* the market, as it facilitates more intensive competition between existing operators and potential new entrants. This is likely to be fundamental when tendering large franchise contracts, whereby in many cases the incumbent is the only operator with access to a suitably sized depot to deliver the service. Therefore, for the LTA to drive effective competition between bus operators it is likely they will need to provide access to depots in the contracts. They may, depending on the size of the franchise and the resources available to the LTA, provide this by deciding to acquire a number of large strategic depots before franchising is implemented. In previous franchising proposals that the CMA has engaged with, the LTA has looked to acquire or lease large strategic depots. Access to these depots is then included as part of winning a large franchise contract for operators, enabling them to operate the franchised routes effectively.²⁷
- 3.8 To acquire current depots, the LTA will be required to negotiate with incumbent operators/existing owners of the depots. Early engagement with

²⁷ Noting there will still be a number of depots likely to be owned by incumbent operators when franchising is implemented.

owners is important to mitigate the risk of not securing the asset in time for franchising implementation. Allowing a sufficient period to ensure depot acquisition is achievable also mitigates the risk to operators and LTAs of a 'stranded asset' – a bus depot owned by the incumbent operator that has been unsuccessful in the tendering process and not has been acquired by the LTA. The operator carries the risk that the 'stranded asset' cannot be used to create revenue as part of the local bus network. The LTA is at risk of not controlling a strategic asset to be used to run the franchise efficiently.

- 3.9 However, there are several risks to depot acquisition if incumbent operators were to exit the market. The acquisition of land in suitable strategic locations for bus depots and obtaining planning permission can be difficult. Operators may choose to dispose of depots for a purpose outside the bus market which would reduce depot capacity. Operators may also look to delay the sale of any depot to attempt to extract a higher price from an LTA under the assumption that the LTA demand for the depot will grow the closer to the implementation of franchising. While there may be scope for LTAs to acquire land through brownfield sites to build new depots, or through compulsory purchase options, this may affect timeframes in which franchising can be delivered.

B) Design of individual franchises

- 3.10 Our observations on the design of individual franchises are broken down into five separate areas that LTAs should consider:
- (i) **Understanding the local context:** knowledge of the existing network to shape the design of any potential franchising network,
 - (ii) **Size of the franchise:** franchise lots should offer a variety of different sized packages to encourage competition from multiple potential operators.
 - (iii) **Length of franchise:** if franchises are tendered too frequently this may blunt an operator's incentive to invest in the network, whilst too long between tenders could lead to stasis in the market.
 - (iv) **Interventions that limit operator market share:** some LTAs have considered proposals to limit the possibility of a single operator winning all individual franchises. Careful consideration is needed to ensure any LTA intervention to limit market share does not undermine long-term competition.
 - (v) **Ability for the LTA to oversee franchising and take remedial action:** effective scrutiny of operators is essential in ensuring franchised agreements are adhered to and passengers are getting the benefits committed to.

i. Understanding the local context

- 3.11 LTAs are likely to have extensive knowledge of their existing network and should use this expertise to develop the design of the franchise to suit the local market conditions of the LTA.
- 3.12 This includes an understanding of the existing nature of competition in their local areas, and who is likely to compete for franchises. Relevant factors may include the number of competitors and their historical market shares, potential operator entry or exit, the range of business models active in the market, the nature of existing government and public authority interventions and the extent to which the market is currently delivering good outcomes and wider policy objectives.²⁸ This sort of market understanding, alongside direct engagement with industry, should inform the objectives of any interventions (such as franchising) and build a picture of how such changes might play out in practice (e.g. who may bid for what types of franchise contracts in different areas).
- 3.13 This local market understanding should also inform the shape, size, and details of individual franchises. It may also inform some of the practicalities of tendering processes, for example whether individual franchises are all tendered at the same time or broken down into tendering rounds (which may include multiple but not all individual franchises).
- 3.14 All franchising proposals reviewed to date have included staggered rounds of tendering. This can benefit the ability of different operators to effectively compete for franchises, as well as likely reducing the practical burden on LTAs from running tendering processes. Staggering rounds of tendering for individual franchises can create more bid opportunities for operators, particularly if they are unsuccessful in the early tenders. This gives operators the chance to learn from failed bids and improve the quality of their bids and may encourage operators to bid for more individual franchises than they would otherwise. As well as helping to maintain the number of operators available to bid in future rounds.

ii. Size of the franchise

²⁸ A number of existing sources that provide potentially relevant information to gather to understand markets including: [CMA Market Investigation Guidelines](#):CC3 pp 24-30 (noting for example, market shares, nature and characteristics of the products and substitutes, nature of the customer base, legal and regulatory framework, industry practices, the history of the market, and market outcomes such as prices, profitability, quality, innovation and other non-price indicators); [HM Treasury Green Book](#) (noting for example, evaluation of previous interventions and what works, background academic research, specially commissioned research or surveys, and international comparisons); and [Government Commercial Function Market Management Guidance Note](#) pp 11-13. This list is indicative, and the CMA can provide further sources and information on understanding markets.

- 3.15 When designing franchising, LTAs should consider a mix of individual franchises that could be delivered by operators of differing scale. Larger individual franchises will require higher peak vehicle requirement (PVR) specifications alongside greater mileage demands. Such characteristics are likely to attract a greater number of credible bids from larger operators. Smaller individual franchises with a lower PVR and mileage demands may be more likely to attract small and medium operators (SMOs) or potential new entrants that may be better equipped or willing to run these franchises than higher PVR franchises.
- 3.16 Good franchise design should enable SMOs and other operators (including non-incumbents) to compete, imposing a credible threat of competition and maintaining a pipeline of potential competitors in subsequent retenders. The primary aim of designing smaller individual franchises should not be to protect incumbent SMOs or other operators, but to give efficient operators the opportunity to successfully compete for franchises and impose a threat of competition to larger operators that may seek to acquire both small and large individual franchises.
- 3.17 LTAs should consider designing a system that gives efficient operators in the market (and efficient operators in markets outside the LTA) the opportunity to expand in subsequent tendering processes. LTAs could look to tender progressively larger franchises through combining smaller franchises from the initial tendering process. Efficient operators that may have acquired small individual franchises in the initial tendering process or shown efficiency in other markets will then have the opportunity to bid for larger franchises in subsequent retendering processes, encouraging a phased level of growth and a threat of competition to larger operators.
- 3.18 Giving efficient operators (SMOs and new entrants included) the platform to compete to expand their services in subsequent retendering processes, through winning or the threat of competing for more or larger franchises, is likely to improve the quality of the bid to successfully acquire a franchise and may lead to increases in overall service level of the network, benefitting passengers – the case for rewarding higher performing operators is covered in paragraph 2.9d, section 2.

iii. Length of the franchise

- 3.19 The length of individual franchises (the time between tendering and subsequent re-tendering) may also provide a lever for strengthening the pipeline of potential competition for future retendering of individual franchises. In the franchising proposals the CMA has reviewed to date LTA's have typically proposed a 7-

year interval between individual franchise tenders.²⁹ Including a shorter-term franchise contract or franchise contracts in the overall set as well as longer-term franchise contracts of individual franchises may facilitate a greater pipeline of potential competition for longer franchise contracts by providing more regular opportunities for entry or expansion. This may also help the LTA better understand how market conditions are changing ahead of the re-tendering for longer franchises – this may be particularly helpful given the initial process of franchising is likely to substantially change the structure of the market and some operators may have left the market entirely.

iv. Interventions that limit operator market share

- 3.20 The CMA encourages LTAs to avoid structuring franchising in a way that intentionally maintains market structure or protects incumbents, as this is likely to reduce the intensity of competition and the benefits it can bring. This could manifest itself through a lack of pressure on operators to compete intensively in future franchise rounds (leading to higher costs for the LTA and ultimately passengers or taxpayers) and a lack of pressure to innovate and keep quality of service high for passengers.
- 3.21 We understand, however, in the initial round of franchising LTAs may implement proposals that restrict the possible market share of single operators in order to mitigate the risks of significant structural change and operator exit. Significant structural change and operator exit may undermine competition *for* the market in future franchising rounds.
- 3.22 Such measures present an inherent trade-off between awarding each and every franchise to the ‘best’ bid at the time of franchising and encouraging a credible range of strong bids in the future re-tenders. Judgements on this trade-off are likely to depend on individual context of the local market and the CMA is happy to discuss this on a case-by-case basis with LTAs who are considering these restrictions.
- 3.23 In general, however, the CMA would strongly encourage LTAs considering such measures to treat them as a transitional measure in the first round of franchising to help promote competition for subsequent re-tenders. Such measures should avoid protecting specific operators, particularly in re-tenders, as this will likely undermine the effectiveness of competition for individual franchises and the outcomes for passengers in the longer term.

²⁹ Seven years is typically chosen as it represents the half-life of a bus hence, after two full franchising rounds, a bus will need to be replaced which offers efficiency gains.

3.24 The CMA has encountered two forms of restrictions to date:

(a) *Direct limits on the number of franchises a single operator can win*

(b) Indirect restrictions intended to limit the number of franchises a single operator can win (such as restricting which routes can be operated from strategic depots)

3.25 Directly limiting the number of franchises a single operator can win may offer greater opportunities to other operators to compete and potentially win franchises. This may keep more existing operators in the market or result in new operators being able to win franchise contracts to enter the market.

3.26 In addition to the inherent trade-off noted above, there is a risk that capping the number of franchises an operator can win inhibits competition rather than encourages it. This may happen if the cap and mix is too strict relative to the number of credible potential competitors. This is also likely if caps are used in the long-term, especially if they in effect protect specific firms rather than facilitate competition across individual franchises. However, achieving a mix of different operators within a franchised area may enhance competition in the longer-term.

3.27 The CMA has also encountered an indirect restriction where restrictions on depot access were aimed to ensure that SMOs were not restricted or excluded from the market. Under this proposal, the LTA required that smaller individual franchises could not be operated from a large franchise depot provided by the LTA as part of larger franchise contract. Whilst larger operators could still bid for these smaller franchises, they may have less incentive to do so and would not be able to achieve any potential efficiencies from using depots across the different sets of franchises.

3.28 If an LTAs only objective of a restriction is to limit potential market share, a direct restriction would be expected to be less likely to introduce an unanticipated distortion or inefficiency than an indirect restriction. Indirect restrictions are more likely to be appropriate where they are intended and been designed to serve objectives in addition to limiting potential market share (for example to achieve a particular efficiency).

v. *The ability of the LTA to oversee franchising and take remedial action*

3.29 In the absence of competition *in* the market driving standards to attract passengers, LTAs will include performance requirements in franchise contracts. LTA's having the capacity to effectively monitor these standards, and a mechanism to impose measures or penalties on operators that do not meet these standards, will help LTAs to achieve the benefits they envisage

from franchising. In the absence of this, passengers may face lower standards for the duration of the franchise contract (typically 7 years), and the effectiveness of competition *for* the market may be undermined.

- 3.30 LTAs should also consider commercial incentive schemes to reward high-achieving operators. Having a franchised agreement, in place of a deregulated market, means that LTAs will need to directly reward investment and innovation which benefits passengers (within franchise and / or through tendering criteria).

C) Transitioning to a franchised network

- 3.31 Transitioning to a franchised network is likely to result in permanent change to the market. LTAs should consider how best to facilitate this transition in a way that encourages competition for future franchise re-tenders and delivers benefits for passengers in the short, medium and long term.

Supporting operators to engage with franchising

- 3.32 LTAs should look to engage with all potential operators before the initial tendering rounds.³⁰ Some operators are likely to have significant advantages outside of running buses that may assist them in the tendering process. For example, they may have the resource to hire individuals or firms that specialise in tendering processes, who can advise and shape bids to maximise the chances of success. Other (smaller) operators may not have that resource available. Engaging with all operators early, as well as upskilling/informing them on what is required in the bidding process is likely to provide a more competitive tendering pool. Specific examples could include helping operators understand what is expected in potentially less straight forward elements of a bid, such as quality.³¹
- 3.33 LTAs should also consider their role in the feedback process of successful and unsuccessful bids. Operators who are successful and unsuccessful in the first rounds of bids can benefit from feedback on how to improve their chances for subsequent rounds if the feedback is of a high standard. This may lead to higher quality and more competitive credible bids.

Potential impacts of implementation timing and sequencing

³⁰ This should not be limited to incumbent operators.

³¹ Further information on tendering processes and market engagement can be found via the government [sourcing playbook](#) – specific references to early market engagement can be found on page 16.

- 3.34 There will be a period of time between franchises being awarded and franchises becoming operational. The optimal length of time for this will depend on a number of factors, some of which are included in this paper (e.g. the need for time for LTAs or operators to acquire fleets or depots).
- 3.35 Existing operators who do not win any franchises will cease to operate in the area when the franchises become operational. This may bring a risk that such 'exiting' operators may wind down some of their operations in the period between franchises being awarded and becoming operational (for example if they identify other opportunities for their fleet), which could affect network coverage or frequency. LTAs may seek to mitigate this risk, for example through existing partnership arrangements, use of RVM mechanisms (as discussed earlier), and through ongoing engagement to understand the plans of 'exiting' operators.
- 3.36 In practice, it is unlikely for large franchising schemes that all individual franchises will become operational at the same time. All franchising proposals the CMA has currently engaged with have planned for the individual franchises to come into operation over multiple phases (sequential operationalisation). This is likely to at least in part reflect the operational challenge of practically implementing and 'switching over to' a franchised operation.
- 3.37 In some cases, tenders for individual franchises may not take place until after the implementation of franchises tendered at an earlier date. In these cases, any structural change due to the implementation of those earlier franchises may also reduce the pool of potential operators that may compete in later tenders.
- 3.38 Transition periods where some bus services are operating under the new franchise model and other bus services are operating under the existing market model can also risk confusion for passengers. This may be due to time-limited changes in fares, networks, access to information, or applicability of existing tickets (for example existing multi-operator tickets).
- 3.39 The CMA has also seen proposals for pre-existing statutory partnership mechanisms to be used to replicate elements of the final franchising model (e.g. ticketing and fares) across all areas at the same time, including those areas where franchising has not yet become operational.³² While this is likely to reduce risks around passenger confusion, and potentially accelerate the

³² For the avoidance of doubt there is no requirement for a BSIP or EP scheme to be in place when transitioning to franchising.

benefits to any passengers, it may exacerbate risks around early exit or service reductions from operators. Such proposals should be based on a strong understanding of the local market and how operators are likely to react.

Cross boundary services

3.40 In any LTA, there will be cross boundary services with neighbouring transport regions. When transitioning to a franchised scheme LTAs will have the option to issue permits for cross boundary services which allows operators travelling from outside the specified franchising zone to operate within the franchised network.³³ These permits can contain standards which require operators to perform at a specified level which would be expected to raise standards of cross boundary services.

D) Longer term considerations

3.41 Encouraging effective competition for future franchise re-tenders is critical in principle to the long-term success of a franchising proposal. This is reflected in the considerations around franchise design and process decisions set out above.

3.42 These decisions will need considering and reviewing over time, for example in respect of future franchise awards. This might include ensuring that routes and services adapt to the changing needs of passengers and communities over time. This might also include ensuring that operators that continue to operate in other markets can return to a region and bid for franchises in future rounds, even if previously unsuccessful, which may be most effectively supported by an evolving asset strategy.

3.43 Further actions that LTAs may need to take over time include:

- (a) **Use of bus passenger data:** if LTAs can provide open access to fares, timetabling, and live bus location data to third parties, such as app developers, this can lead to further insights on passenger demand and travelling habits. The ability of the LTA to access and interpret data coming out of franchising rounds will play an important role in determining the long-term effectiveness of the franchise and franchising as a model. Bus passenger data can be used to assess the performance of the current network and hold operators to account. LTAs should also consider what additional feedback or information

³³ Noting that Scottish legislation does not have equivalent to those in English legislation on service permit schemes. The CMA understands, however, that is nothing in legislation that would prevent Scottish LTAs from developing permit arrangements for services that should be exempt or excluded from the franchising framework.

operators may have that could be used to improve the network over time.

- (b) **Adapting the network:** LTAs (with the assistance of bus passenger data) should look to adapt the network to changing passenger demands to improve long term ridership. The LTA can elect to run more services in areas with higher levels of demand and potentially taper off services in areas with lower demand. This may lead to long-term commercial benefits and could potentially give the LTA more margin to cross-subsidise routes. These routes may not be profitable but have benefits to wider society for example, connecting small villages that may not have a public transport option available.
- (c) **Opportunities for operators to grow:** as mentioned in paragraph 3.17 LTAs should consider creating opportunities for efficient operators in the market to grow. LTAs should continually look to engage with operators beyond the initial tendering process and into subsequent retenders, to gain an understanding of what barriers operators may have when looking to bid for larger individual franchises. The LTA then may be able to mitigate some of the barriers that may persist.
- (d) **Collaborating with other LTAs:** the CMA encourages LTAs considering franchising to engage with other LTAs that are pursuing or have implemented franchising proposals. These LTAs are likely to have developed substantial expertise and will be well placed to share best practice and learnings from a range of aspects. Collaboration will support a stronger franchised market across regions that is likely to be mutually beneficial to passengers, businesses and communities across LTAs.