



Workshop report – Benchmarking the outcome of competitive tendering

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A B S T R A C T

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Workshop 1 was concerned to identify the real results of competitive tendering, and experience on how to make it work better, using evidence from the rail and bus sectors in a large number of countries spread around the world. It was found that competitive tendering had generally been successful in terms of quality and costs, but problems had occurred in a number of cases, so careful attention must be paid to the design of tendering exercises, details of the contract, risk-sharing arrangements and the approach to any re-negotiation found to be necessary. As a result, an important conclusion is that the tendering authority needs a high degree of expertise in these issues; any thought that competitive tendering relieves the public authority of the need for expertise in public transport is mistaken.

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1. Introduction

The main question of Workshop 1 was: How has competitive tendering (CT) performed as a regulatory benchmark over the last two decades? This included quantitative and qualitative comparison of CT with other strategic solutions (direct awarding, negotiating) as well as comparison of different CT tactical and operational methods, according to the following questions:

- What are the real results and effects of tendering?
- How to make the tendering process work better?
- How to improve the contract as a linking pin between the tendering and concession period?
- How to design concession management, the main challenge after tendering?

14 papers have been presented, of which 6 dealt with rail and 9 with bus transport. There were participants from as many as 10 countries in Europe (UK, Germany, Sweden, France, Poland, Spain), Asia (Japan, Kazakhstan), Australia, and South America (Brazil), which provided a real world overview.

2. Papers

The first set of papers focussed on CT in railways. Nash began the railway part of the workshop, comparing passenger rail service

franchising experience of two leading European countries – Great Britain and Sweden. Nash concluded that an important advantage of the Swedish model is the common use of gross-cost contracts with performance incentives. Fares and service levels are usually determined by the franchising authority and rolling stock is also procured by them. The model had succeeded apparently with high and generally stable cost reductions (20–30%), increased services and rapidly rising patronage. This had worked better than the British approach, which was to use net-cost contracts with more freedom to the operator, but where there had been many problems with unrealistic bids and costs had actually risen. It appeared that some combination of longer franchises, more appropriate risk sharing and stronger penalties for surrendering franchises might improve the situation.

Kain compared British railway franchising with Australian experiences of rail in Melbourne and bus in Adelaide. Kain focused his conclusions on avoiding unrealistic bidding, which seems to be a key issue, because all of the Melbourne rail and tram contracts and half of the initial British contracts have been renegotiated, despite good economic conditions at the time. This can be achieved by transferring only cost risk to the operator, not revenue risk as well as by not awarding contracts when there is doubt that the franchisee can deliver on its commitments.

Smith presented a quantitative study of British railways' efficiency, based on stochastic frontier analysis of the data, concerning all British franchises between 1996/1997 and 2005/2006. Smith found that after high efficiency gains in the first years after privatisation (1996/1997 to 1999/2000), a substantial efficiency improvement (18%) had been achieved. In the subsequent period

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(1999/2000 to 2005/2006) costs have risen in real terms at 29% against 1999/2000 and 15.5% against 1996/1997, more than offsetting the earlier gains. This was partly due to external factors attributable to fuel prices, and partly due to rapidly rising labour costs. There was clear evidence that costs had risen faster where franchises had been renegotiated or replaced by management contracts. There did appear to be economies of traffic density, so costs would be reduced if overlapping franchises were combined into a smaller number of bigger bundles.

Merkert focused on the issue of transactions cost dynamics in British franchised passenger train operating companies over the period 1996/1997 to 2007/2008. He revealed, that despite a relatively low share of transaction costs in total cost (at the maximum no more than 4.7%), transaction costs have risen substantially faster than operating costs (the transaction sector has increased by more than 83% and its share in operating costs has increased by some 49% over the relevant period), especially between 2000/2001 and 2005/2006. Whilst the number of transaction (management and admin) staff appears to be under control now, their relative costs (wages, pensions etc) are still increasing above inflation. Merkert's results suggest further that with respect to transaction costs the optimal contract duration should be some 5 years and 4 months. Whilst he revealed interesting relationships between the duration, the remaining time and the complexity of franchise contracts (with Department for Transport (DfT) specified contracts being the most complex) on the level of transaction costs he found no significant difference in transaction costs between management/renegotiated contracts and "normally" operated ones.

Jansson presented Stockholm's experience of gross-cost contracts with quality incentives. This model currently seems to be an optimal solution in many cases. Nevertheless the Swedish case showed that the complicated way of calculating incentives, their relatively low level and many external factors influencing quality indicators, meant that there was no discernable quality improvement as a result of the incentives. The author recommended developing simpler incentive schemes, based on passengers' willingness to pay for quality in order to get a welfare optimum and to consider inviting two bids – with and without incentives. Also in-house operation in a few areas may give the authority better knowledge on the quality – cost trade-off.

A paper by Sharipov dealt with current state of and prospects for Kazakhstan passenger rail franchising. He also presented a quality perception survey, conducted within management staff of authorities and operators. The author concluded that current low quality services can be improved if contract duration was lengthened from 1 to 3–7 years and public subsidies were higher.

There followed a series of three papers on CT in bus operations in Germany.

Beck presented outcomes of CT of suburban bus services in Germany, a country with a domination of direct awards. According to the author, average efficiency gain varies between 15% and 31%, of which only 5% (so ca. 2% of general contract value) is consumed by transaction costs. Additionally, the quality of services has increased – for example in the region of Frankfurt the average age of a bus declined from 7.8 to 4.4 years. The number of bidders was initially very high (5–7 bidders on average), but currently is declining. One of the reasons is using net-cost contracts, which favour incumbent operators.

Augustin presented evidence on the probability of operator change as a result of suburban bus transport CT in Germany. She noticed, that this indicator had fallen from 91% between 1997 and 2004 to 38% in 2008 and was positively correlated with the length of operation period and the number of vehicles within a bundle.

Walter focused on the efficiency of German communal companies, operating different modes of public transport (bus, tram, and light rail urban transport). Using multiple-output stochastic frontier

analysis, he found that the mean efficiencies lie between 0.849 and 0.952, according to the model. This suggests an average of 0.14–0.44 bn EUR yearly saving potential if the cost frontier ('ideal' minimal cost) had been achieved. He also showed that higher outsourcing rates and high vehicle utilisation increase efficiency.

There followed papers dealing with public transport in France, Brasil, Japan and Poland. Faivre d'Arcier presented the French model of urban public transport, which is based on complete network tendering (76% of all networks), net-cost contracts (70%) and Transport Tax, paid by employers, as a main financing source. He concluded that costs increasing much faster than incomes (farebox and Transport Tax) will cause in the reference scenario a rise of over 60% in the deficit by 2015. The only way to avoid the deadlock is to increase both farebox revenue and operational efficiency. Brasiliero presented a paper analysing different bus transport tenders in Brazilian metropolitan areas. The main problem in Brazil is high entry barriers to the market, which causes a low number of bids within a tender.

Sakai compared efficiency of Japanese private and public bus companies, both operating in a theoretically self-financing regime, but having access to special subsidy programmes and with contracting out at the level of the individual garage. On the one hand, he found that subsidies make public companies more capital- and labour-demanding. On the other hand, private operators with management contracts have only a small amount of freedom in decision making, which makes their efficiency gains very small.

Wolanski compared experiences of different Polish cities. Using stochastic frontier analysis, the author concluded that when a Passenger Transport Authority (PTA) has been already established, CT leads to an average 13% cost efficiency gain against direct award. Additional 7% savings can be achieved if the tendering rules are pro-competitive. Surprisingly public companies operating in cities without a separated PTA – managing their networks on their own – appeared to be only around 6% less efficient than private companies, chosen within a tender, when additional PTA costs were included. What is more interesting, the efficiency of public operators is highly differentiated. Some of them can be as efficient as private ones, and in other cases, CT could even bring 30% cost reduction against direct award.

The presentation by Bray set out a framework and methodology to assess the relative merits of competitive tendering and negotiation as means to procure continuing services following the end of an existing service contract. The methodology took account of the efficiency of existing tender prices, current service quality performance, current operator entrepreneurship, current operator–authority relationships, contract complexity and completeness, expected strength of the supplier market, and the period since previous open market testing. Based on a case study in Adelaide, the paper illustrated that in cases where the existing contracts are both effective and efficient, negotiating a further contract with the incumbent operator may be a better solution than re-tendering. Lower transaction costs and the avoidance of uncertainty during a possible transition between operators can further reinforce the case for negotiation. The paper stressed the need for the credible threat of competitive tendering during negotiations, and noted that a negotiated approach is not a desired long term solution if cost-effectiveness is a concern and hence needs to be combined with threatened or actual periodic competitive tendering.

3. Key issues

3.1. What are the real results and effects of tendering?

The very first point to make is that the real problem of many transport systems (especially railways) is underinvestment. In

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