



Recognising and Fostering the Sustainability of Family Business:

A Submission to the Senate Committee Inquiry into Family Business In Australia.

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1. Committee Terms of Reference

In undertaking an Inquiry into Family Business in Australia, the Senate Committee has requested Submissions from individuals and corporations on the operation of Australia's family business sector, with particular reference to:

1. the definition of 'family business'
2. the availability and reliability of information and statistics about family business in Australia;
3. the contribution of family business to the Australian economy, in terms of financial, social, employment, innovation and sustainability outcomes
4. structural, cultural, organisational, technological, geographical and governance challenges facing family business
5. the role of family trusts in facilitating family business;
6. access to and the cost of finance and insurance for family business;
7. family business responses to the challenges of the GFC and post GFC resilience

BusVic appreciates the opportunity to put its views before the Committee. Those views concentrate on the vital importance of recognising and fostering the sustainability of family businesses in Australia.

Ninety percent of BusVic's membership consists of trans-generational family businesses and given the organisation's vision is 'to ensure the perpetual resilience and relevance of Victoria's bus and coach operators', this Submission is in keeping with that endeavour.

Sources

This submission that draws on three sources:

1. analysis historically undertaken by BusVic,;
2. information supplied to BusVic;
3. research currently being undertaken by the writer as part of a PhD at Monash University.

2. Executive Summary

BusVic's role as the voluntary professional association is to form, spread and legitimize the adoption of guiding family business values as a specific type of governance practice. BusVic has transparently and efficiently, negotiated in good faith, most Victorian bus service contracts on behalf of Victoria's bus operators for decades. Operational, tactical and strategic mutual benefits typically result from this method of procurement. However, the value of this delivery model is under threats on various fronts: a new accreditation regime perceived to be onerous by operators is causing family businesses to exit the industry; the declining population of some regional and rural centres is reducing the level of demand for school bus services and; globalisation has seen a change in the skills, values and interests in some families' 'next generation' and some are choosing to discontinue the trans-generational family business.

The most significant threat however is that multi-national enterprises are entering the market, particularly through state government run competitive tendering processes that allocate the rights to operate various services. Importantly, tender assessment requires balancing price and quality aspects of the bids received by Government, and as the latter is inherently difficult to assess, price unfortunately becomes the key determinant. The notion of community social value is not even an consideration, which sees price win over quality and social value. The NEIER Report of 2011 (Addendum 1) confirms this. Because of these threats, family businesses in the route bus and school bus sectors of the industry are facing an uncertain future. These realities are threatening the social value that flows from the current industry structure.

Given there have been several recent tender failures in the Australian bus and coach industry, this concerning form of market failure requires regulatory intervention. We submit that negotiating performance based contracts, as opposed to competitive tendering, can assist in dealing with such concerns. We further recommend that policy be developed and legislation introduced that supports not just local procurement, but the social value of procurement as well, in order to provide a more level playing field and sustainable operating environment for family businesses in the bus and coach industry in Australia.

This submission also outlines the cultural characteristics and capabilities of the family business governance model and the multi-national governance model. This submission suggests that family bus operators have capabilities that are largely non-replicable by non-family firms, and may also deliver the family firm a competitive advantage and superior performance. Indeed, family controlled firms indexed in Standard and Poor's 500 have been found to outperform their managerially controlled peers and that private firms are more efficient than public firms (Anderson and Reeb 2003).

3. About BusVic

Bus Association Victoria Inc (BusVic) is the voluntary professional association for Victoria's accredited route, school, tour and charter and non-accredited (registered) bus and coach operators. We represent the best interests of members in a variety of ways, most importantly in respect of their relationship with Government and its Agencies, including contract negotiation and legislative and regulatory compliance.

BusVic's role as the voluntary professional association is to form, spread and legitimize the adoption of guiding family business values as a specific type of governance practice. Since the 1940's, BusVic has played a central role as carriers and promoters of desired government practices, values and organising principles. Importantly, BusVic, are agents of change and as such are able to exert influence on the governance practice of family businesses within the bus and coach industry.

The State Government has chosen to negotiate a performance based contract with BusVic, as the representative of the State's bus operators, in good faith for decades. BusVic then commends a template contract to the collective operators. This method has proven successful in the long term as it reduces Governments' transaction costs. However, the value of this delivery model is under threat from multi-national enterprises entering the market, particularly through state government run competitive tendering processes that allocate the rights to operate.

Over the years, BusVic has implemented agglomeration initiatives and purchasing programs that have assisted family business bus operators reduce costs and remain competitive. Mobilising operators' businesses with finance, insurance, bus inspections, spare parts and industrial relations (just to name a few), are areas that BusVic has taken collective action on to resolve common problems.

4. Sustainability

Big and small businesses are recognising the need to adapt to a new social climate of community accountability. For this submission, we take a stakeholder approach to sustainability that includes four aspects as follows:

1. Societal influence; a measure of the impact that society makes upon the corporation in terms of the social contract and stakeholder influence
2. Environmental impact; the effect of the actions of the corporation upon its geophysical environment
3. Organisational culture; the relationship between the corporation and its internal stakeholders, particularly employees, and all aspects of that relationship
4. Finance; an adequate return for the level of risk undertaken

Further, we suggest these four aspects, whilst broad, are key dimensions of sustainability and are all equally important. The financial, social and environmental performance of the corporation is very much about stewardship. To an extent sustainability is about adding or creating value. The creation of value by a firm commonly adds to welfare for society at large. This can be measured in terms of well-being which can lead to increased productivity and increase motivation. And as Aras (2008) suggests, increased welfare is self perpetuating.

5. Industry Facts

National

The ABS Census of motor vehicle – January 2011 identifies 87,883 registered buses in Australia. Extrapolating a 2003 Fact Sheet from Professor David Hensher of the University of Sydney *Passenger Transport Activity in Australia*, we submit that in Australia there are presently:

- 54,487 small buses
- 8788 medium buses
- 24,607 large buses

The vast majority of large and medium buses in Australia are manufactured locally. As of 2011 almost 80% of new buses sold in Australia were manufactured in Australia and more than 90 per cent of the buses large and medium in operation are built in Australia. There are 15 bus manufacturers who build their buses locally.

There were more than 7500 new buses delivered to the Australian market in the five years to 2011. This is a turnover of almost \$3 billion.

There are more than 50,000 people employed in the Australian bus industry. This includes employees in bus and coach operations, the Australian bus manufacturing sector and parts and service suppliers to the industry.

Victoria

The Victorian bus and coach industry alone employs some 8000 staff. Total income was estimated at \$1.1 billion for 09/10. Some 72% of employees work full time and 81% are bus drivers.

Unfavourable Conditions

Family bus operators in Victoria are currently implementing succession strategies (exiting) for three main reasons:

1. The declining population of some regional and rural centres is reducing the level of demand for school bus services, so the State government is rationalising the number of contracted services (supply) in response to this demographic shift;
2. Globalisation has seen a change in the skills, values and interests in some members of families' 'next generation' and some are choosing to not enter the family business that was started generations before them.
3. As a result of legislation passed in 2009, operators have had three new requirements placed upon them which need satisfying by December 2015:
 - ◆ demonstrate to the safety regulator capability to operate a bus service, by having a safety regulator enter the business and audit the operation

- ◆ demonstrate to the safety regulator the competency to operate a bus service, and the most common way of doing this is for previously accredited operators to complete two units of a Diploma level 'Safety Management Course' at Monash University, and for operators not previously accredited to complete four units of the Safety Management Course
- ◆ apply to the safety regulator to become accredited (or have previous accreditation renewed) with no guarantee of receiving accreditation

These aforementioned three sub points has caused a significant degree of distaste and uncertainty for bus and coach operators, as they had to undertake a similar process twelve years ago, when an accreditation regime was introduced into Victoria and operators then had to complete a Certificate III level 'Transport Management Course' at Monash University. Many operators do not appreciate having to prove their competency and capability to the State once more, despite having a world-class safety track record and, as such, are selling.

Since 2008, the amount of accredited members of BusVic has reduced from 550 to 470 and this rate of decline is expected to continue. Thus, the decline of family business bus operators in Victorian is a consequence of increased regulation, changing economic patterns and social values. Unfortunately, as families exit the industry, intellectually property and legacy are, to an extent, lost. This paradigm is not in keeping with sustaining family businesses in the bus and coach industry.

Tendering Threat

For at least the last twenty years, most Victorian bus service contracts have been procured via the method of negotiation, not tendering. A departure from a negotiated performance based contract (NPBC) and a move to competitive tendering would place the family governance model under threat as a significant amount of social value would be lost, particularly in regional and rural centres.

There have been some recent developments in the procurement of land transport services both internationally and locally which show the failings of competitive tendering.

All European Union member nations are mandated to tender the procurement of services, however there can be exceptions made. Interestingly, the rights to the UK's West Coast rail contract were taken from Virgin recently through tender, much to Virgin's annoyance. Virgin challenged through the courts, and they have forced a re-tender/revision etc. In this instance, the franchisee pays a price and makes money purely from the farebox (revenue from tickets sold). Virgin alleged the new winner would not be able to make money unless they cut services and quality.

Similarly, in South Australia, in April 2012, reports emerged of an operator that was appointed in July 2011 to run about half of Adelaide's route bus network was 'bleeding', as a result of the competitive tendering process, because of unexpected costs. It has been claimed congestion and major CBD developments were not helping the on-time running of the services. The Minister came under attack and it was suggested by some that Government made a short-sighted decision in awarding the tender to the operator with the cheapest price.

Also in April 2012, the Western Australian Government announced a 'new deal for WA School Bus Operators' which allows bus operators to continue their contract indefinitely, subject to an ongoing need for the service and to the meeting of a number of KPIs. Those that meet the KPIs will have their contracts renewed without going to open tender. There are some 700 contracts involved. Further, there are about 150 contracts outside of the current negotiated contract that have been tendered recently and BusWA is now working with the WA Government to determine the best way to bring those into the non tendered domain. This is a sensible outcome.

In New South Wales, on the 1st May 2012, Minister Berejiklian announced that private bus operators will be required to competitively tender for existing metropolitan bus contracts 'to drive service improvements to customers'. This is bewildering policy and a classic example of a young Government making a decision at the recommendation of a bureaucracy that has failed to inform itself properly as to the costs and benefits of tendering versus negotiating performance based bus contracts. It's also ironic that a Liberal government should adopt a policy that could potentially shut down some inter-generational family bus businesses. The NSW Government seems indifferent to cracking the real chestnut and privatising the state owned and inefficient State Transit Authority.

Importantly, the National Express withdrawal of 2003 from Victoria showed what happens when companies aggressively bid for contracts, that is, when margins are set below minimum market acceptable commercial requirements.

Seventy per cent of Melbourne's current route bus contracts, all of Victoria's current country and regional urban route bus contracts, the V/Line (coach) marketed contracts and the current school bus contracts are contracted to 2018 – 2020. These were negotiated transparently and in good faith between 2006 and 2010. Despite some of these operators having a unique legal predicament and the fact that BusVic has an unwavering commitment to present an exceptionally competitive value proposition to the State Government prior to the expiry of the current contract, it is clear that if the contracts were tendered, it would have a significant impact on the economic and social wellbeing of the State. Whereas, a negotiated renewal of the existing performance based contracts, with performance-pressure through benchmarking, would avoid this and deliver outcomes in line with strategic or societal goals.

6. Characteristics of Bus Governance Models

Many characteristics of family businesses are non-replicable by non-family firms. This is the subject of the writer's Doctoral thesis and I hypothesize that these characteristics could deliver family firms a competitive advantage on delivering societal outcomes.

We now briefly outline these characteristics so the Committee can understand the richness of the social fabric of family firms and how the preservation of this capability is extremely important in fostering family business.

Cultural Governance

A family firm can carefully husband resources, due to the fact that the family owns those resources. Family firms have the ability to employ idiosyncratic criteria and set goals that deviate from the typical profit maximisation concerns of non-family firms. These characteristics of the family form of governance provide family firms with advantages in efficiency, social capital, and opportunistic investment demonstrating how and why the family form of governance is unique and what the outcomes of that uniqueness might be. Organisational culture can be a strategic resource that generates a sustainable competitive advantage.

Social capital

Social capital is primarily a metaphor about advantage. Social capital adds value to the community, as well as the firm. Community level social capital is a term that describes a phenomenon whereby firms invest in social capital through norms of behaviour and access to resources such as mutuality, trust, and respect for one another. In this regard, the social capital that is captured at a community level is one that yields corporate well-being. These benefits accrue from knowledge sharing, lower transaction costs due to improved communication, and coherence of action.

The level of civic engagement is a key indicator of the health of the community. There appears to be a growing consensus that social capital represents the ability of individuals or groups to secure advantages through membership in social networks or other such social structures.

Family firms are embedded in their communities and through those communities are able to weave common interests and shared values into their specific environments. Moreover community level social capital suggests that family influence is both developed and exercised in networks that stretch beyond the family firms' boundaries.

In 'Regions Matter: How Localised Social Capital Affects Innovation and External Knowledge Acquisition' (2012), Laursen et al build on Marshall's 1890 argument that "geographical proximity promotes knowledge spillovers that benefit firms knowledge production i.e., positive externalities in the form of ideas that are taken up by others and combined with suggestions of their own; and thus becomes the source of yet more new ideas" (Marshall 1890, p.332).

Laursen argues that geographically bound social capital is the key transmitter of knowledge spillovers within geographically constrained areas and that the resulting existence of localized social capital has implications for firms' abilities to innovate. The reason why this paper is important is because it is, we believe, the first to identify a geographically localised social capital as a key factor in promoting firm level innovation in regional areas and to provide quantitative evidence to support this.

Laursen suggests that geographically bound social capital facilitates joint learning for innovation and reduces the search and transaction costs of both contractual and non-contractual interaction among the economic stakeholders in the region. Further, they assert that interaction on innovation between a local firm and its environment has two essential requirements: the exchange of information/knowledge, and the provision of trust to support joint activities in a highly imperfect market. North (1989) suggests that once economic relations extend beyond the local level transaction costs relating to monitoring and enforcement increase markedly, and the local social network has to

be replaced and/or complemented by formal organizations and institutions. Laursen hypothesizes that high levels of geographically bound social capital, in terms of social interaction in the home region, may generate competitive advantage for local firms in the form of innovation because localized social capital favours information and knowledge flows among firms and external stakeholders within regions. Given that regional social capital is defined in terms of norms and networks, it favours innovation because it helps to connect people across different organizations and to combine their knowledge components with particular regions. Laursen calls this 'localised collectivity effect'. Whereas explicit knowledge may be relatively easy to obtain through minor efforts, such as reading journals or benchmarking, social interactions and closeness between firms that facilitates the exchange of the deeper, tacit components of knowledge.

Not only does localized social capital connect knowledge workers through collectivity effects, but it also improves the functioning of knowledge connections by alleviating potential moral hazard problems through the creation of trust. This is a key point. Laursen terms this the 'localised trust effect'. In other words as firms interact via the interactions of their employees, they learn about each other and develop trust based on shared notions of fairness. Laursen suggests that high levels of regional social capital generates an environment that facilitates the process of search for complementary knowledge and increases trust among the parties involved through localized connectivity trust affects.

Although Laursen's paper samples about 2400 Italian manufacturing firms from 21 Italian regions, it is Eurocentric and based on an industry somewhat different to bus operations, however it finds that being located in a region characterized by a high level of social capital leads to a higher propensity to innovate. This is very important.

Entrepreneurship

Family firms are an important source of economic development and growth. Family firms create value through product, process, and service innovations that fuel growth and lead to prosperity. The long-term nature of family firms' ownership allows them to dedicate the resources required to innovation and risk-taking thereby fostering entrepreneurship. Furthermore, the kinship ties that are unique to family firms are believed to have a positive effect on entrepreneurial opportunity recognition (Barney, 2003).

Long-term Orientation

When organisations have a short-term orientation, they are likely to favour financial, rather than strategic controls. In contrast, strategic controls reflect a long-term orientation and require an understanding of the task at hand, the risks involved, and the potential trade-offs among the choices managers might make.

An important feature of family firms is that there is less concern over opportunistic behaviour by agents (Zahra 2004.) Family centred non-economic goals (Chrisman 2010) are rarely present in non-family firms. Family centred non-economic goals are likely to reflect the values, attitudes, and intentions of the firms dominant decision-making process.

Stewardship

Family owners and managers often tend to have lengthy tenures and anticipate long careers, not only for themselves but for their offspring. Therefore they can be parsimonious stewards – careful to ensure that today's actions do not jeopardise the longer term prospects, or that an obsession with futuristic ambitions does not rob the firm of resilience or sustainability. Family owners' needs often span different time horizons: current needs such as income, dividends, and secure employment of family members; intermediate term projects and investments in capabilities and resources to perpetuate success across the long tenures of most family CEOs; and long-term projects to ensure a robust company for future generations. This is preservation of traditions from the past increasing family security as it encourages productive talent that can sustain the firm during periods of crisis or renewal, and family community status that provides access to resources today and builds reputation for the future.

Structure

Many family firms employ flat, informal, "organic" organisational structures. Flat structures allow organisations to be more responsive to immediate and unexpected challenges and opportunities than taller more hierarchical and bureaucratic designs. However they also make necessary wider spans of control and therefore, require employees to adopt broader roles and job definitions – jobs that demand significant individual initiative and a wide array of skills.

Geographic Linkages

There is evidence that suggests that firms have a broad preference for connections to other firms that are nearby. As it is possible that some of the knowledge shared and exchanged through family business interlocks will be tacit, this knowledge is difficult to transfer and requires the parties to it to openly trust each other. Many family business executives serve on civic and community boards, and invest family wealth in the local areas where the family resides (Palmer 2001). These activities increase the likelihood of meeting and working with other family business executives in the local area, providing shared experiences and the development of trust, and leading to an important source of outside directors for family businesses.

Economic Development

Chang et al (2008) suggests that a region (non-metropolitan area) with a less developed economy will be characterised by a lower average incomes leading to lower demand for goods and services, potential scarcity of financial capital and skilled labour, and possibly lower profitability. The prevalence of family firms in the region will be affected by the region's level of economic development. The three theories mentioned previously suggest that family firms in comparison with non-family firms may have a lower cost of operation, lower cost of financial capital, and better access to resources. They hypothesise that family firms will be more prevalent in regions that are less prosperous and that fewer ventures might be started and fewer might survive without the family governance option. This suggests the economic development of the region seems to influence the prevalence of family firms.

Performance

Some studies conclude the performance of family firms is worse than non-family counterparts, which suggests that the family's desire for capital preservation, stability, and risk aversion keep the firm from pursuing strategies that might otherwise improve performances, but would also threaten the family's continued control. Conversely, research suggesting that family firm performance is superior to others suggests that families are better stewards of firm resources because of an overall aversion to managerial opportunism.

Now, there is evidence that family firms retained their advantages in more developed economies and in highly codified legal environments. For example family controlled firms indexed in Standard and Poor's 500 have been found to outperform their managerially controlled peers and that private firms are more efficient than public firms (Anderson and Reeb 2003).

The superior performance of family firms is even more evident in emerging markets where they are viewed as 'engines' of the economy (Whyte, 1996). This is consistent with Kemp's (2012) assertion that family firms account for 60-70 per cent of jobs in most OECD countries and that for many OECD governments trying to protect their economies (and themselves) small business emerged as a way to rebuild trust with the public and attempt to restart their economies.

Memberships

Community-based social capital enhanced through membership in a community of, for example, founder led firms, professional service organisations, or non-profit entities, if linked to compensation practices and norms across those communities, might open up a multitude of new avenues for understanding the value of family businesses (Lester 2006). Having an industry representative body that both invests in R and D and coordinates systems, not necessarily in the immediate geographic community, but on behalf of a 'community of interest', or collective of like-minded family businesses are but two centrally co-ordinated tasks which bring benefit to the collective.

Carney (2005) asserts transactions stemming from membership in social networks tend to rest upon one of several "axes of solidarity", such as kinship, ethnicity, and community and political affiliation which formed the basis for interpersonal trust. Carney suggests social capital generates value for a firm because it reduces transaction costs relating to search, screening, adjustment, and contract enforcement. Carney also suggests that it is probable that the efficiency advantages of family governance diminish with large firm size. Carney also discusses how business groups that have extensive social capital can influence the political agenda, capture policy initiatives and reverse institutional developments that generate competition from new entrants.

Non-Family Firm Characteristics and Capability

It is fair to say that most of the family firms operating in the Australian bus and coach environment are of a small to moderate size, and that most of the large firms operating are of a multi-national enterprise (MNE), non-family nature.

Resources

Large, non-family, often multinational enterprises strengths lie mostly in resources. The relative strengths of large business are predominantly material (economies of scale and scope, financial and technological resources, etc.).

The financial strength of the mega firm, mainly non-family businesses, arise out of scale economy involved in financing. The cost of most financial transactions does not increase in proportion with scale, which means large transactions cost less per dollar. Because larger firms engage in bigger financial transactions, they have lower financing costs. The cost benefits are currently reflected in the market opportunities for the larger firms. The mega firm can typically get access to funds at a lower cost than its smaller counterparts. (This is consistent with Victorian bus replacements.) The mega firm's capital costs for long term funds are also less because of better access to the national stock and bond markets and the scale of their financial operations.

Size

Lawler and Galbraith (1995) suggest size has not assured large companies success, rather, it has contributed to the large companies problems by causing them to be come internally focused and concerned with maintaining and managing their internal relationships, in essence, they have become more bureaucratic and control oriented as a way of coping with the coordination and communication problems caused by large size. Whereas Birley & Norburn (1993) suggest the small business owners can 'hold the firm in the palm of his hand' and as a result, adapt quickly. They go on to suggest that reporting systems in large businesses have become the end, not the means. This is a key point.

Winger (1994) says the non-family 'mega firm' is responding to the current times, mostly around retrenchment, removing bureaucratic fat, disposing of operations not related to core concerns – most mega firms are beginning to show more concern with developing an organisation that fosters innovation and entrepreneurship. Brady and Voss (1995) reaffirm this by suggesting internal factors keep corporations from growing.

Decision Making and Customer Orientation

Large non-family firms gravitate toward centralized coordination of their many activities. They assume that central control can produce synergies among the varied parts of the organisation; as a result, the whole will be worth substantially more than the sum of the parts. All too often this assumption proves to be false, - particularly when the organisation has diverse businesses and where the environment is changing very rapidly. This leads to slower decision making, poor coordination, higher overhead costs and an inability to move in quick decisive ways. Lawler and Galbraith (1995) go a step further and suggest this internal focus leads to a fatal problem: the organisation loses contact with its customers and does not focus on satisfying their needs. Instead it focuses on internal practices, like negotiating budgets and measures of operating effectiveness, rather than on figuring out how they are contributing to customer satisfaction and total organizational effectiveness. Timely, responsive decisions are best made close to the point of contact with the customer of the external environment, which is difficult to do in an organisation that is structured to facilitate top down decision making.

Knowledge Transfers

The role of the speed of knowledge transfer in the realm of knowledge management in multinational enterprises has been neglected. Given the possession of proprietary advantage knowledge is a source of competitive advantage for a firm, Dierickx and Cool (1985) postulate that a firm's competitive advantage depends on how quickly and how efficiently a firm can develop or acquire inimitable knowledge. Competitive pressures require multinational enterprises to develop their capabilities for replicating knowledge within and across the firm faster than the similar efforts of their competitors. As the speed of knowledge transfer is critical for multinational enterprises to build their competitive advantage, a multinational enterprise that is unable to transfer the new knowledge to its subsidiaries quickly risks becoming a fount of new ideas for competitors and losing its competitive advantage. A foreign subsidiary's geographic distance and distinct cultural differences magnify the problem encountered in transferring knowledge across the breadth of the multinational enterprise's organizational structure.

Complexities associated with the transfer of knowledge across national borders are difficult to resolve. These complexities arise due to differences in the technological infrastructure, the level of economic development, cultural differences, attitudinal differences between home and host countries, and different languages. These complexities may contribute to conflict and cultural misunderstanding which can hinder the flow of knowledge and learning between different foreign subsidiaries with the multinational enterprise.

Prior research has examined the difficulties of transferring tacit and complex knowledge within the organisation, the importance of motivation and absorptive capacity for transferring knowledge, and the relevance of central network positions in inter-organisational knowledge transfers.

International Standardisation Versus Local Adaptation

The Economist (1995) says large companies are learning to combine economies of scale in product development with sensitivity to local tastes. The thrust behind interest in multinational enterprises' need for local adaptation is based largely on economic considerations, where for example, consumers' preferences lead firms to change product lines. This is certainly the case in the context of some Western countries, however it is nowhere near as true where the social environment may be highly significant. For example, where religion, ideology or national culture predominates, whilst expanding internationally, multinational enterprises are often called upon to operate within these social contexts. This gives rise to the behaviour of multinational enterprises differing outside of their home base. There is evidence that multinational enterprises are now more responsible in their operations abroad than local or national firms in the same countries, due to higher global scrutiny of their operations. By engaging with their social environment, firms build valuable capabilities which contribute to their competitive advantage. Some multinationals voluntarily adopt policy and regulation as some cannot rely on governments to regulate their environmental conduct. Multinational enterprises need to maintain their legitimacy in both the host country and the parent company and therefore find themselves in a situation of institutional duality (Westney 1993). Further, multinational enterprises face internal pressures to conform to the parent company's core structures and practices. Contemporaneously, they find themselves influenced by institutional forces in their

country of origin as well. All of this requires a large degree of adaption by the multinational enterprise in order to maintain legitimacy.

In fact, Naguib (2008) asserts that a multinational service oriented enterprise's legitimacy and profitability depend on its ability to adapt. To an extent, we suggest this is evidence of a multinational enterprise endeavouring to replicate the well documented contribution that the family business makes to their local community.

Replication

The previous point also gives rise to the notion of large companies wanting to replicate the characteristics of a small company. Labate (1992) says large firms are splitting their assets into smaller, more efficient, more independent businesses, where large firms make their businesses more decentralized and give people the freedom to act without going to headquarters for permission. The Economist (1995) says multinationals are 'mimicking their smaller competitors by shrinking their head offices, removing layers of bureaucracy and breaking themselves up into constellations of profit centre's. They are learning to combine economies of scale in product development with sensitivity to local tastes.

Brady & Voss (1995) confirm the message for multinational businesses is to identify and emulate small company-like growth tactics, get the managers to 'think small'. There appears no shortage of firms who have decentralized authority, listen to customers, hire carefully, control costs, and focus on continuous training and education for their employees, all of which are small company mantras.

A personal acquaintance of the writer who owns a marketing communications firm recently told me of an experience he recently had where a multinational client of his gave him specific instruction to develop a communications campaign for a new product they are bringing to market shortly and that the product could not have any link whatsoever back to the multinational organisation who is behind it. The product had to look and feel 'local'.

Motivated Labour

Kotkin (2000) raises the notion of an absence of an employee 'community' in large or non family firms; many employees are demanding a higher quality of work. 'Small tribes of employees are more viable economic entities than they used to be. When a company has between 10 and 100 people, it feels like a tribe – that primordial unit of human organisation. Belonging to a small team exerts an emotional pull on employees. Corporate CEOs are pining for ways to get that small company soul and small company speed inside our big company body. You can't create a small-company feel unless you create a small company.'

Moates & Kulonda (1990) suggest a sense of teamwork among supervisors, superiors and employees, the clarity of the company mission and individual responsibilities, a closeness to the customer, easier and more intense communications, and a stronger sense of personal identity could all be positive results of small company size.

Multinational Enterprises and Community Welfare

The social and economic fate of the community is integrally tied to the competitive position of the corporation in the global economy. There is now objective scientific data that shows that communities in which small businesses predominated have a higher level of civic welfare than communities in which small business is dominated by big. Mills and Ulmer (1946) conclude that communities whose residents actively participated in the social and political life of the community manifested higher levels of well-being and welfare. Importantly they also identified the economically independent middle class as the driving force behind civic engagement.

Lyson's (2006) quantification confirms big business counties displayed greater economic inequality and that small business cities are found to be the most favourable environment for the development and growth of civic spirit and that a more balanced economic life and greater industrial stability is provided in the small business cities. Critically, Lyson suggests sociologists and economists would be well served to revisit the core assumptions that underlie our understanding of both socio-economic attainment processes and approaches to regional and community development. Lyson concludes that the re-emergence of an economy organised around locally co-ordinated, smaller scale, technologically sophisticated, and globally competitive enterprises is both theoretically and practically possible and that a rethinking of conventional notions is in order.

7. Discussion

Having considered the aforementioned cultural characteristics and capability of both large, small, family and non-family, *we assert that the marginalisation of the family business capability will reduce the industry's competitive advantage, reduce performance and reduce the social value family businesses bring to their community. Any initiative therefore to preserve and proliferate the legacy, contribution and performance of the family firm should become policy of Government. The adoption and proliferation of policy that sees the negotiation of performance based bus service contracts, as opposed to Governments' tendering bus service contracts, is the most important and key strategic measure that Governments' can implement for the Australian bus and coach industry.*

The service contract that a bus operator has with a Government provides the largest basis of certainty for a bus operator. The divergence of procurement policy around the country and the world however raises several questions and threatens the degree of this bus operator's certainty.

On the Government side, we ask what degree of competency is prevalent in the bureaucracy in assessing suitability of tender submissions? What is the extent of Government's general commitment to staying at the cutting edge of best practice bus procurement methods in order to reduce the 'them and us' mindset and fast-track much needed utility to patrons? Sadly, despite frequent encouragement from Industry, some Governments remain indifferent, almost nonchalant about contract education.

Is it solely the operator's responsibility if the tender amount isn't covering operating costs? No. A bureaucracy should have the wherewithal to know what operating costs for a bus service are. It's not rocket science! Labour, fuel and the cost and how resources combine to produce outputs for a bus service are all known - the only real variable is margin. So why do some bureaucracies think value for money equals cheapest price? We respectfully suggest lack of education on 'the opportunity cost'.

Lastly, who ultimately pays when on-time running is missed and operators struggle to meet their contracted commitments? The user (patron).

Importantly, tender assessment requires balancing price and quality aspects of the bids received by Government, and as the latter is inherently difficult to assess, price unfortunately becomes the key determinant. The notion of community social value is not even on the radar, which sees price win over quality and social value. The NEIER Report of 2011 (Addendum 1) confirms this.

On the industry side, industry is putting a lot of time and energy into presenting its position on contracting to all levels of Government in a united and consolidated manner. Whilst the prevalence of two voluntary professional association's in a few States shows there is a difference of opinion on some operating and contracting issues, the federal industry body, BIC, has developed a national contracting position which runs counter to what recently occurred in NSW and SA.

So what does this mean for bus business governance? Small business or big business? Neither. It's about the family. Many of Victoria's established local bus routes were started by the incumbent operator (not the Government as is the case in other parts of the world), long before public transport had the degree of relevance that it enjoys today (and this gives Victorian operators a unique legal predicament). Public transport remains part of the solution to complex societal issues such as congestion, emissions, social exclusion and the like. Because the local inter-generational family bus operator knows their local area intimately, they can add far more value and respond quicker than large multinational companies with regard to service changes. Local bus operators typically have depots strategically located to minimise any dead running costs just because they've owned the land for generations, and therefore are able to pass on that competitive advantage in price to Government.

We should also question why some Governments may want to deal with less operators and big multinational, non-family operators at that. Why is the OECD very interested in the importance of family business since the GFC? It's because jobs are preserved in family businesses - 60 to 70 per cent of jobs in most OECD countries in fact. Since the GFC, small and conglomerate family based businesses have emerged as a way to rebuild trust with the public and Governments are throwing record sums of money at fostering small business innovation and capability. This is counter to big multi-national non-family corporations who seem to be in the media frequently of late announcing redundancies.

Further, family firms boast a highly developed sense of loyalty and maintain a constant focus on their core business. Successor generations capitalise on IP and relationships that have stood the test of time. Some Governments might think they are getting 'value for money' awarding a major bus service contract to a company that is prepared to cut their margin to very low single digits or indeed have no margin at all to enter a market, but nothing could be further from the truth.

The 2011 NEIER (Addendum 1) confirms a switch to non local owners in pursuit of margin reductions involves potential costs which are all too often ignored. If there was a deliberate attempt by Government's to work with big non-family, multi-national bus operators at the expense of family business operators, we would see a decline in service quality, declining patronage and a decline in suppliers' commitment to the operator which could offset the benefits to local residents and the

Government. *In fact, NEIER concludes there would be a net social welfare loss to the State. Lower contract payments would also translate into reduced reinvestment by operators into many regional and rural economies.*

8. Recommendations

Negotiated Performance Based Contracts

So how should Government's buy bus services? Despite tendering being an EU requirement and 'the norm' in many parts of the world, there is a plethora of research from around the globe that shows that negotiating performance based bus contracts can be a very effective method of procurement of bus services. This is because the process is undertaken in a transparent, open book manner, it requires independently verified performance benchmarking of efficiency and effectiveness, the process is overseen by a probity auditor and the contract is publicly disclosed. Importantly, the transaction costs associated with tendering typically exceed negotiation transaction costs.

We believe that, for public transport services, the broad objective(s) of government should be to provide a good quality, integrated and continually improving service for a fair price, with reasonable return to operators that gives value for money under a regime of continuity and community obligation (Hensher and Stanley 2008).

Stanley (2009) confirms that international experience with competitive tendering of previously government provided bus services is summarised in Wallis and Hensher (2007). They conclude that, in most cases, competitive tendering reduced the cost of services by 10-50%, the scale of saving depending on the efficiency of the previous monopoly operator, a range of factors relating to the design and management of the tendering process and whether or not a strong market of potential bidders existed. In subsequent retendering, Wallis and Hensher note the tendency for cost increases, sometimes due to unsustainably low initial tender prices and/or to a shortage of bidders.

There have been several failures of competitive tendering for three reasons:

1. contractual reasons: the contract provided too little freedom and/or effective incentives for the operator;
2. market reasons: the development potential of the concession was too small for development;
3. organisational reasons: cultural differences between authorities and operators, and/or operator incompetence.

The evidence that savings from competitive tendering diminish beyond first round tenders, together with dissatisfaction with what competitive tendering has delivered for service improvements in some jurisdictions, has encouraged the search for alternative awarding mechanisms that can sustain performance pressure (Wallis and Hensher 2005).

The Thredbo Conferences were established in 1989 and the objective of the conference series is to provide an international forum to examine passenger transport competition and ownership issues, reporting on recent research and experience and developing conclusions on key issues. The focus is

on determining the effects of different forms of competition, ownership and organisation for land-based passenger transport on operators, users, governments / funders and society as a whole. The conference series is directed towards a broad audience of policy makers, planners, decision makers on infrastructure and service operators, consultants, researchers, academics and students, and is recognised as one of the most important international forums for analysis and debate of competition and ownership issues in land passenger transport. BusVic has been a supporter of the Conference Series for twenty years.

An important development over the past five Thredbo Conferences has been the focus on the theory and practice of negotiated performance based contracts (NPBCs), particularly as an alternative to competitive tendering, as a means to award the right to provide service.

A common rationale for NPBCs is to deal with the inevitable uncertainty that creates difficulty for ex ante contract specification and tender bidding, by adopting an awarding mechanism that can be adaptive and sustain performance pressure during the course of the contract. These areas of uncertainty relate, in particular, to questions that relate to service quality, which have proven to be much more difficult to specify in tender requirements than price but are increasingly recognised as the key to desired policy outcomes. By focusing on performance pressure during the contract, NPBCs reflect alliance contracting as used in such areas as building and construction and infrastructure Public Private Partnerships more broadly. Competitive tendering remains a fall-back mechanism in the event that service providers operating under NPBCs do not measure up adequately against their key performance indicators.

A further important rationale supporting NPBCs is that we believe this contract form is most likely to support a trusting partnership between purchaser and provider, particularly for system planning, and that, given scarce skills on both sides, such a relationship is more likely to maximise goal achievement through service provision than an awarding mechanism based on competitive tendering (Stanley 2007). Australian bus contracts have been pioneers in the development of NPBCs, founded on trusting partnerships, whereby contracts are re-negotiated with existing operators, subject to meeting certain conditions.

The STO Model

At present, several state Governments' are preparing strategies or 'vision statements' for land transport. The Victorian Government is developing their Metropolitan Planning (and Transport) Strategy (MPS), Infrastructure NSW has recently released some of their vision for NSW Government and the Queensland Government is looking to develop its strategy.

The following diagram demonstrates a model for achieving strategic, or societal objectives. The strategic (S) level articulates the vision. It is BusVic's view that the BIC/UITP/ARA Report entitled Moving People (2011) articulates a set of land transport strategic or societal outcomes perfectly and we would be well placed if these were adopted nationally:

1. **Congestion Management.** To manage congestion costs, improving economic competitiveness and quality of life in our cities.
2. **Environmental Improvement.** To achieve sustainable cuts in transport greenhouse gas emissions.
3. **Social Inclusion.** To ensure adequate accessibility options are available to all
4. **Health and Safety.** To make the transport system safe and encourage healthier transport choices.
5. **Energy Security.** To increase our energy security by reducing our reliance on imported fossil fuels.

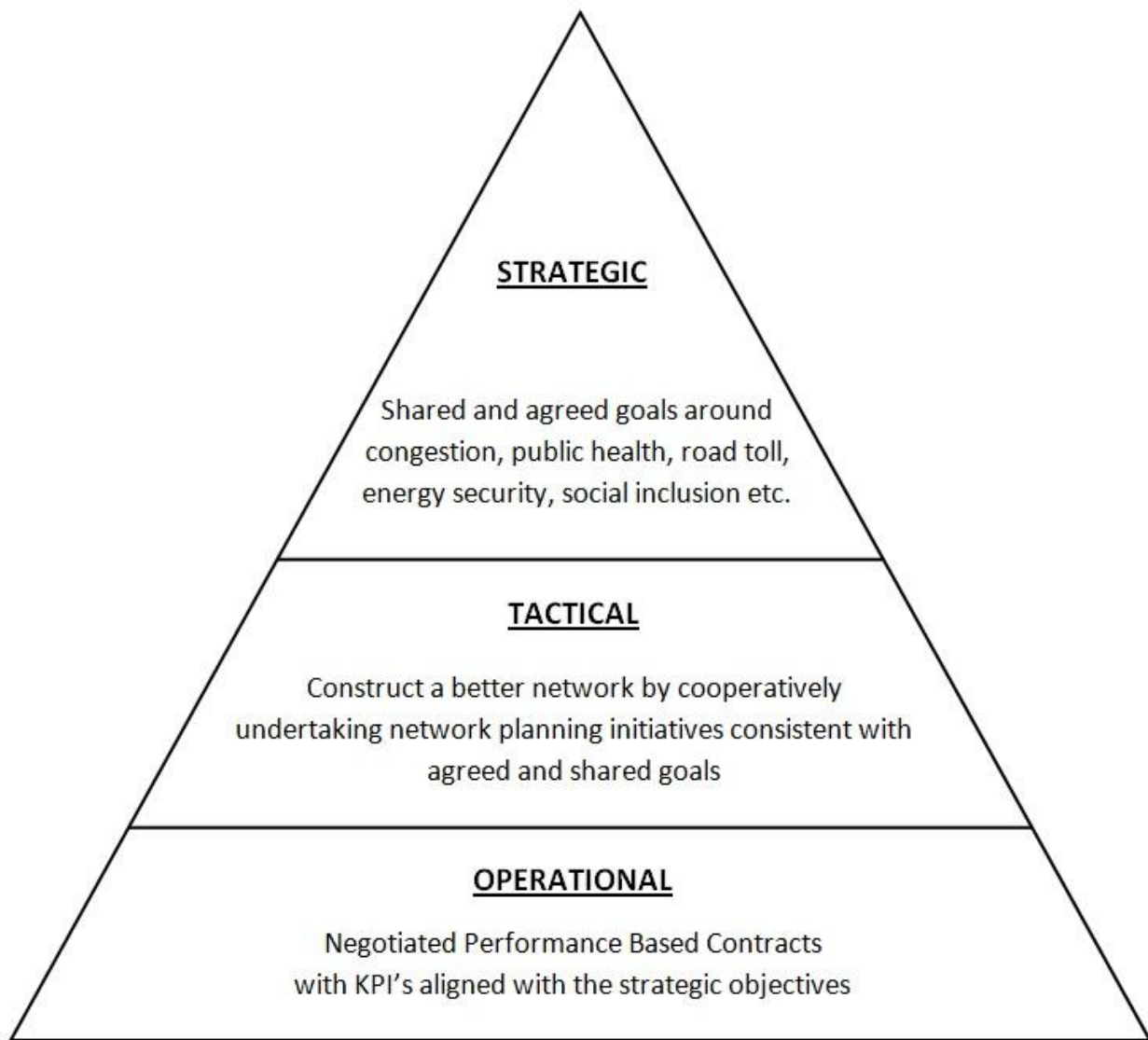
To achieve the aforementioned strategic outcomes, co-operative initiatives between Industry and State will be necessary. This is the tactical (T) level. T level initiatives would include:

- measures to construct a better bus network, particularly on the urban fringe, by co-operatively designing services that will maximise value for the host community
- demonstrate how a negotiated contract will see Government reduce its transaction and service delivery costs
- demonstrate how the voluntary professional association is uniquely placed to steward service changes and service improvements amongst operators in order for the Government to realise strategic objectives
- show the relationship between NPBCs and the growth in service kilometres between 2005 and 2012 resulted in a 70% growth in patronage in Victoria

The contract becomes the operational (O) level means to facilitate the (T) and the (S). In essence, having agreed and shared goals around congestion, emissions, social inclusion etc facilitated the execution of the (T) and the (O).

Key to achieving the sort of outcomes that a negotiated performance based contract can aid in realising, is trust. An even-handed co-existence (often referred to as a trusting partnership) between Industry and State is fundamental to linking the contracted operational requirements with tactical level network planning and strategic objectives.

We assert that the achievement of these strategic and tactical endeavours is more likely with a negotiated performance based contract in place, as shown in the following diagram:



New Legislation Required

New thinking is required to preserve or sustain family businesses in the Australian bus and coach industry. The 2011 NEIER report underpins the need for legislation to be introduced that supports the sustainability of family bus and coach operators. It is vital that no economic or social factors are foregone when Governments are procuring. Despite quality reductions and cost increases still resulting in tendering situations both internationally and locally, tendering proves popular amongst governments.

Legislation, regulation and administrative requirements should be introduced that obligates Governments to give the strongest consideration to procure locally. Such legislation would aim to create a new market based competitive philosophy that prices in the social value that this document talks about. In short create a new competition philosophy for the public sector. If it is public money it should serve the public not the private good.

Such a philosophy was recently introduced in the UK that has had considerable success with much legislation including most notably the Localism Act of 2011 and the Public Services Social Value Act 2012. We believe there is considerable appetite in Australia for something similar. Such a philosophy would argue for a new communitarian philosophy, based on the Australian notion of 'a fair go' and allied to that there is an opportunity to perhaps create a 'Public Services Social Value Act'. Such a movement would empower local communities; give municipal councils and neighbourhoods more power to take decisions and shape their own area, rather than adhering to the old top-down planning system.

What would be in this Act? We quote from Social Enterprise UK who produced a [guide](#).

For the first time, all public bodies...including local authorities will be required to consider how the services they commission and procure might improve the economic, social and environmental well-being of the area.'

Essentially the act would allow, indeed ask, regulators and government to contract for many of the economic and social added value of localised provision. We believe such an act would give real traction to the economy by allowing innovative small and local businesses to compete on a level playing field.

What would be the aims of such an endeavour? To help foster and generate a pro local and pro social civic service philosophy that can add real value to current best value legislation; to foster and augment a wider debate about the merits of buying local. Such a measure would recognise and foster the sustainability of bus family businesses in Australia.

9. Conclusion

BusVic has transparently, efficiently and in good faith, negotiated most Victorian bus service contracts on behalf of Victoria's bus operators for decades. Operational, tactical and strategic mutual benefits typically result from this method of procurement.

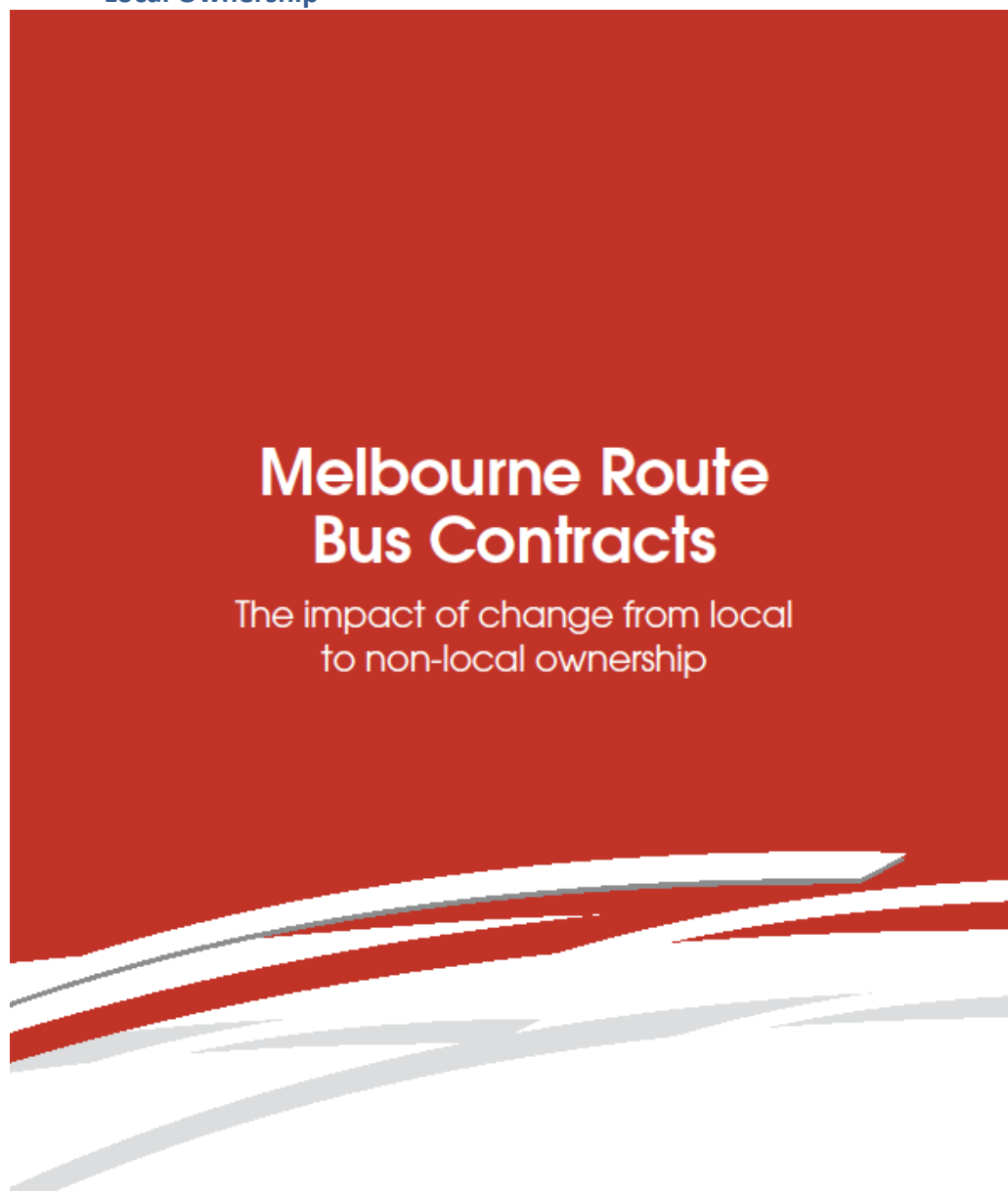
This submission has shown however, that the value of this delivery model is under threats on various fronts: a new accreditation regime perceived to be onerous by operators is causing family businesses to exit the industry; the declining population of some regional and rural centres is reducing the level of demand for school bus services and; globalisation has seen a change in the skills, values and interests in some families' 'next generation' and some are choosing to discontinue the trans-generational family business.

The most significant threat is that multi-national enterprises are entering the market, particularly through state government run competitive tendering processes that allocate the rights to operate various services. Importantly, tender assessment requires balancing price and quality aspects of the bids received by Government, and as the latter is inherently difficult to assess, price unfortunately becomes the key determinant. The notion of community social value is not even a consideration when state governments' evaluate tenders, which sees price win over quality and social value. The NEIER Report of 2011 (Addendum 1) clearly demonstrates what the state government foregoes in the event it awards contracts to non-local operators. Because of these threats, trans-generational family businesses in the route bus and school bus sectors of the industry are facing an uncertain future and threatening the social value that flows from the current industry structure.

Given there have been numerous local and recent tender failures in the Australian bus and coach industry, this concerning form of market failure requires regulatory intervention. We submit that negotiating performance based contracts, as opposed to competitive tendering, can assist in dealing with such concerns. We further recommend that policy be developed and legislation introduced that supports not just local procurement, but the social value of procurement as well, in order to provide a more level playing field and sustainable operating environment for family businesses in the bus and coach industry in Australia.

This submission also outlines the cultural characteristics and capabilities of the family business governance model and the multi-national governance model. This submission suggests that family bus operators have capabilities that are non replicable by non-family firms, and may also deliver the family firm a competitive advantage and superior performance.

10. Addendum – Melbourne’s Route Bus Contracts: the Impact of Change from Local to Non-Local Ownership



July 2011 - A report for Bus Association Victoria
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Executive summary

The objective of this study is to assess the costs and benefits of changing the ownership of a bus operator contract from a local (that is, Victorian owner) to an out of Victoria owner and of most relevance to a foreign based owner.

In the course of the study a survey of experts (Government administrators, suppliers to the industry, consultants) was undertaken. The core view was that the biggest risk to the bus industry from changing ownership to out of state owners would come if the change of ownership occurred because of margin reduction in the bid to secure the contract where the bid margin was below the level for long-run sustainability.

In this case the new operator would attempt to restore some profitability by:

- (i) changing the characteristics of the workforce input below the levels for optimum productivity (eg by requiring unpaid overtime and/or same output by reduced headcount);
- (ii) reducing dollar per hour labour costs by the substitution of less experienced, younger less qualified employees for experienced, older local qualified employees; and
- (iii) outsourcing overhead services to jurisdiction of the head office which is becoming more common with the introduction of high speed broadband.

The ultimate cost to the Victorian community of this will be a decline in service quality, declining patronage, a decline in suppliers' commitment to the operator which in the long-run could well offset the benefits to Victoria residents if not the Government.

The evidence for this view is anchored in fact. It reflects the experience in Victoria and elsewhere in Australia with the British operator National Express which took up a bus operation in Victoria in 1998 and walked away from the contract five years later.

It is also based on what has happened in other international jurisdictions, such as the Netherlands, where the costs reduction focus in bus contracts is now viewed as outweighing the benefits.

The study methodology

The study methodology involved building a model of a bus franchise where the structure reflected the views of the industry experts of the important transmission mechanisms for cost/benefit outcomes for a change in ownership of a contract. Also the requirement was to set parameter values within reasonable bounds of empirical estimates or expert assessment.

The model was benchmarked to the contract size and cost structure of the Melbourne contracts that have the potential to have a change of ownership by open bids after 2012.

The study findings: the default case

The default case involves a change of contract ownership from a local to another local owner with a reduction in margin assumed to be 2 percentage points.

For the 2 percentage point reduction in margin (that is, from 9 to 7 percent) the results are as follows.

- In terms of the welfare indicator (measurable or headline private and public consumption) the benefits to Victoria would range from zero percent of the contract value up to 1.7 percent, depending on whether the cost savings were allocated to expanding the bus network or channelled into general public consumption such as health and education. If the contract benchmarks set the standard for the rest of the Melbourne bus industry, then the benefits could reach 20 percent of the contract value, in terms of the consumption indicator.
- In the case of the wider social benefits that are not directly incorporated in measures of economic activity and consumption, for the 2 percentage point margin reduction with the savings channelled into network expansion, the benefits would be around 6 percent of the contract value and double this if ample attention was paid to expanding the network in localities of under-servicing. If the cost savings were extended over the rest of the industry, then the benefits could be between 3 and 6 percent and above the total metropolitan contracts value.
- In the case of a transfer of ownership to an out of state owner, the outcome would be a loss of between 0.8 and 4.3 percent of the contract value for no spillover effects to the rest of the industry. This comes from the outflow of all the margin income to outside Victoria.

Study findings – the most likely case

It is unlikely, however, that margins will be able to be reduced below 9 percent on a sustainable basis.

Assuming that this is the case and the assumptions that:

- (i) margins are reduced by 2 percentage points;
- (ii) ownership is transferred to an out of state operator;
- (iii) cost savings are transferred into bus network expansion; and
- (iv) taking into account reasonable expectations for cost reduction, overhead outsourcing out of state and reduction in service quality,

then the expected outcome would be a headline net welfare loss to Victoria of between 5 and 7 percent of the contract value. The best case of the change-over in terms of the social benefits/passenger bus trips would be a gain of just under 2 percent of the contract value.

For a 5 percentage point margin reduction, the loss of headline welfare would be between 5 and 11 percent of the contract value.

1. Background and study objectives

The Melbourne Metropolitan Bus System is supplied by around 25 independent operators (including school buses) which have exclusive access to a defined route network. The contracts are generally for seven years with contracts negotiated by an "open book" negotiation process and a three year rollover opportunity. That is, payments to contractors to operate services are based on assessment of the operator's actual costs and benchmarking against what the costs should be if practical efficiency improvements were undertaken. The contract sets out the payments that will be made to the operator during a contract period based on the kilometres of service, hours of operation and peak bus requirements. All fare revenue is returned to the Government. There is also a KPI regime that will provide incentive payments for new patronage growth and incentive/penalty provisions for operational performance.

The bus system to the 1990s was a mixture of public and private operators. When the operational responsibility for the trains was privatised, the public bus services were separated into two operations which were privatised by public tender.

One of these purchasers was by the British operator National Express, which purchased the previously public bus services that operated in the northern, north-eastern and eastern suburbs of Melbourne. This purchase occurred in 1998. The operation was named National Bus. The remainder of the public bus system in 1998 was taken over by a consortium of local operators under the name of Melbourne Bus Link (MBL). The National and MBL contracts are five year contracts.

Since the privatisations there have been no open tender contract renegotiations. This stems from the 1988 attempt by the then Melbourne Transit Authority to call tenders for all Melbourne's bus routes. Some routes were taken away from existing operators and given to a company, which until then operated only school and charter buses. This was successfully challenged in the courts and the routes restored to the original operators. One reason for the judgement was that the licences to operate bus routes as well as the routes themselves were the property of the established operator and not the State Government.

The judgement took into account the fact that the buses and supporting infrastructure was owned by the bus operators. To be able to put the contracts out to competitive tender at the end of each contract period, the Government would have to make sufficient payments to purchase the assets from the operators and achieve certain other requirements about expectations of operators to continue in business. In the new contracts, from 2008, this was not done with explicit recognition given that the open book roll-over negotiation process would follow the initial seven year period.

This situation does not prevail for the two privatised contracts as the Government maintains substantial equity in these assets and the possibility of open tender renegotiation has been provided for post 2012 in the 2008 renegotiations.

1.1 The National Express withdrawal

In 2003 National Express relinquished its National Bus contract to an existing locally owned operation. Indeed, National Express walked away from many of its Australian bus, rail and tram contracts at the same time. The National Express experience has left a deep imprint on the bus industry. In terms of the costs of what happens when companies aggressively bid for contracts, that is when margins are set at below minimum market acceptable commercial requirements. National Express bid is understood to have been significantly under the prevailing industry benchmarks in terms of margin. The flow-on effect can be cost cutting, declines in employee morale, a decline in performance, safety risks and lost market opportunities.

The stakeholder views of the advantages of local ownership vis-a-vis non-local ownership, and especially foreign ownership, given below in this study was influenced by the National Express experience.

1.2 Study objectives

In the event that the two eligible Melbourne route contracts are put out to tender, the objective of this study is to assess the costs and benefits of local versus non-local ownership of bus contracts.

2. Locally owned versus non-locally owned business

The issue as to the most appropriate firm structure and ownership in terms of maximising regional economic growth has been part and parcel of the economic debate from time immemorial. The truth of the matter is that the issue can never be resolved in terms of one unqualified conclusion. The reason for this is straightforward. The appropriate firm structure and ownership for an industry is not independent of the technological base and the drivers of unit costs that prevail at a given point in time.

In terms of the long-running economic debate, the main thread of argument has been between small scale enterprises and large scale enterprises. The ownership issue has been more indirect since small scale enterprises are more likely to be locally owned than large scale enterprises. That is, does a region with small scale enterprises (and by implication more locally owned enterprises) have a faster growth rate measured in terms of real income per capita than regions dominated by large scale enterprises? The findings in the literature are mixed, as one would expect given that the outcome depends on the industry structure prevailing in a particular region.

For example, in a region where retail is an important contributor to economic activity the introduction of a large investment by a national or international retail chain which significantly reduces the contribution of locally owned small scale retailers is not unexpectedly found to be a negative for regional development.

This comes from the reduction in real incomes retained in the region, not only because of the elimination of locally owned capacity and therefore income to local households, but also because of the reduction in total hours of work required from scale efficiencies and because of the monopsony power of the retail chain in terms of labour demand which enables the chain to reduce real income on a dollar per hour basis. Even if the retail chain uses its market power by passing on the efficiency gains to local consumers, the real income gains from this source have limited impact on the regional economy because of the leakage of expenditure to other regions in the nation as a result of the narrow focus of the industrial base.

Another polar example would be the case of the electronics industry, or at least the mass market electronics industry. For mass produced electronic equipment the only regions where such activities will exert a positive sustainable impact on employment and real income growth per capita will be enterprises operating facilities at new world class scale. That is, very large enterprises that, because of scale, can never have significant local ownership.

In contrast regions which depend on consumer electronic production for facilities which are significantly below best practice scale, even if significantly locally owned, face lengthy periods of stagnation and then contraction when plants are finally closed.

In a recent paper using a data base that had not been employed before, D. Fleming and S.J. Goetz, "Does Local Firm Ownership Matter", The Northeast Regional Centre for Rural Development, The Pennsylvania State University, 2010, found that local ownership did matter with qualification.

The data base lists firm size and ownership structure of firms by United States counties which have not been previously used in regional economic growth modelling. Using the per capita income growth over the period 2000 to 2007 by county as the variable to be explained, the study found that along with standard core variables, such as county resident educational attainment, density, etc. that economic growth was strongly correlated with the density of locally owned firms. The impact of non-locally owned firms was weak and relatively insignificant. In terms of firm size, locally owned small firms of up to 99 employees were a particularly strong driver of economic growth, while medium and large non-locally owned firms exerted a particularly significant negative impact on regional economic growth.

There are a number of reasons that are cited in the literature for the benefits of locally owned businesses.

2.1 Retained local income

Locally owned businesses tend to be a positive for regional development because of their greater capacity to retain income within a region. This comes from:

- (i) the owners/managers living in the region which means all net surplus from their region activity goes into regional household income;
- (ii) the local firms are, from necessity or because of membership of local networks, more likely to outsource to local firms rather than import goods and services from other regions; and
- (iii) community involvement by the owner/managers could well mean \$/hour employee rates are higher for locally owned enterprises than for similar non-locally owned enterprises.

In relation to (i) above, although products are now supplied on a national or international platform, the fast broadband age is increasingly globalising services. As fast broadband becomes increasingly available there is increased risk that non-locally owned enterprises will import services from head offices, or the supply chain members of the enterprise which are likely to be located outside the region. Element (ii) is more likely to apply in non-metropolitan regions than in metropolitan regions.

2.2 Benefits from direct community involvement

Direct involvement in the community by owner/managers can improve productivity and spill-over regional economic benefits because of:

- (i) short distances between owners and customers enabling rapid response to developing business opportunities;
- (ii) an incentive to run the businesses in the best interests of the local community;
- (iii) more flexibility in working decisions which substitute short run bottom line outcomes for wider community benefits and, therefore, better able to maximise the long run profitability of the enterprise to the long run benefit of the community; and
- (iv) to greater commitment of employees which reduces labour turnover costs and increases institutional knowledge and commitment to the enterprise.

3. A survey of stakeholders

A survey of stakeholders in the bus industry was undertaken. The survey focused on industry experts who were not contract operators. The main points made, in terms of the downside of non-locally owned operators, were:

- (i) risk of increased dead running costs (if change of ownership involves the need to develop new depot sites). The risk is that bus operational costs could increase by between 5 and 15 percent;
- (ii) risk that orders for new business will be directed from local suppliers to interstate or overseas suppliers involving loss of carriage investment of around \$0.3 million per bus;
- (iii) reduction in unit wage costs which may, in the longer run, impact on service quality;
- (iv) missed productivity increase opportunities (patronage increases) from absence of local knowledge;
- (v) costs to suppliers and representatives of the industry if an operator terminates a contract because of under-bidding. The risk of this is perceived to be greater for non-local owners.

There was an additional element that those who thought local ownership was important, at least local ownership in the context of a long term perspective that is allowed for by the open book negotiation process. The longer the horizon for decision making, the more likely that decisions and investments which have a long lead time in reaching maximum benefit will be taken. This is particularly important to ensure long term cost minimisation in the industry.

On the other side, those who did not see advantages in local ownership were:

- (i) sceptical about the advantages of local knowledge;
- (ii) stressed that non-local owners could improve performance benchmarks from new innovations, although modern communications and efficiency was reducing these probabilities; and
- (iii) noted that in terms of their observations that there was little difference between performance standards of locally owned and foreign operators.

In this regard one of the stakeholder surveyed made the comment that the Dutch experience is that competitive tendering does not lead to much service innovation, mainly because authorities do not relinquish sufficient control to enable operators to innovate. Authorities tend to specify the routes and timetables, with operators just running the services and looking to fine-tune routing, to minimise dead running. In short, the focus is on maximising profits by cutting costs, rather than improving services – this at a time when the goal is to grow patronage, which needs a focus on service improvement, not cost containment. As a result, many Dutch operators are now interested in contract mechanisms focused on lifting service quality.

4. The bus contract model

A simple bus contract model will be developed in this chapter that captures the key practical elements that can give an insight into the benefit of local versus non-local (especially foreign) ownership of bus contracts. The model will be representative of the scale of the two contracts that could possibly be put out to open tender in 2012. The details of the resultant operation are given in Table 1.

Table 1 Representative contract characteristics

Total revenue (\$m)	40
Trips (million)	8
Cost structure (percent)	
Driver costs	45
Fuel	12
Maintenance	10
Overhaul (labour)	6
Other overhaul	9
Capital	9
Margin	9

If all other costs were at optimum efficiency on an hours basis and since the Government will determine the capital contribution, or at least the resale value if the operator loses the contract in subsequent renegotiations, then the only variable that can be adjusted in a competitive tender is the margin or the rate of remuneration on a dollar per hour basis. However if the workforce output was stretched through unpaid overtime (maximum technical efficiency) productivity would decline. Optimum hours input is the average hours per employee that maximises productivity defined in terms of service quality.

The model developed below assumes that if the contract had continued on in the hands of the original owner the level of patronage would have remained the same in the new contract period as the previous contract period. All dollar values are in terms of 2010 year prices.

4.1 Direct cost reduction

Even if the operator of the contract is working at optimum efficiency, in terms of hours input, a new operator can attempt to reduce nominal costs by reducing benefits and substituting less experienced for more experienced staff and less skilled for higher skilled staff. Hours input could be also reduced below optimum standards. Hence, the cost savings will be given by:

$$cs = r_i \cdot (dc + mc) \quad (1)$$

Where:

- cs = potential cost savings;
- r_i = cost savings coefficient;
- dc = driver costs; and
- mc = maintenance costs.

Further, provided that the 9 percent prevailing margin is near a market required average, then the pressure to reduce savings will not be independent of the successful bid margin. That is:

$$r_1 = r_0 \cdot ((.09 - bm) / .009)^{0.55} \quad (2)$$

Where:

bm = the successful bid margin which will be 9 percent or less.

That is, the greater the bid margin is below the prevailing and market justified margin, then the greater the proportional incentive to reduce nominal costs which is reflected in the assumption of the 0.55 elasticity. Equation (2) assumes that the maximum incentive to exploit the potential for nominal cost reduction is at the zero bid margin case.

4.2 Patronage reduction

The greater the loss of the skills, experience and morale of staff the greater the likelihood of maintenance problems, service termination, schedule disruption, etc. That is, patronage is likely to decline.

That is:

$$pat_1 = pat_0 \cdot (1 - r_2)^{r_3} \quad (3)$$

Where:

pat_1 = patronage under new contract holder;
 pat_0 = patronage under previous contract owner; and
 r_2 = elasticity of patronage with respect to cost reduction efforts.

If the previous contract owner indulged in feather bedding practices, then r_2 would equal zero. That is, nominal cost reduction could be achieved without patronage loss.

4.3 Outsourcing potential

In the age of high speed Internet, a non-local operator has substantial opportunities to outsource overhead activities, either currently carried out from within the firm or purchased from the local community, to their head office's support infrastructure in another State or country, or to the local supply chain supporting the head office. Overhead costs are assumed to account for 13 percent of total revenues.

$$os = osr \cdot (ol + oo) \times 0.9 \quad (4)$$

Where:

os = outsourced costs to other jurisdictions;
 osr = outsourcing ratio;
 ol = overhead labour costs
 oo = other overhead costs,
 and:
 $osr = r_4 \cdot ((.09 - bm) / .009)^{0.55} \quad (5)$

That is the pressure for outsourcing will be a function of the reduction of margin below normal.

The 0.9 coefficient assumes a 10 percent import of services by previous contract owner.

A non-local owner can reduce headline margins significantly and not reduce effective margins because of the economics of sale from outsourcing. Assume that the new contract owners will outsource half of overhead costs to their non-local head office and associated local supply chain. Also assume that the outsourced costs of the outsourced services are effectively reduced by half because of increased utilisation of head office staff and volume discounts from the local supply chain. This means that the new operator would have been able to reduce the headline bid margins by 3.3 percentage points and not in effect have altered the realised margin from the 14 percent benchmark. All the income from the outsourced cost would accrue to a non-Victorian jurisdiction.

4.4 Use of Government savings

The Government savings from margin reduction are assumed to be allocated to expand the network which in turn will increase patronage.

That is:

$$pat_2 = pat_1 (1.0 + 0.14 - bm)^{r_4} \quad (6)$$

Where:

pat_2 = patronage (that is person bus trips) after Government uses cost savings to expand network; and
 r_4 = elasticity of patronage with respect to network expansion.

The network is expanded by placing more buses on the road.

4.5 Benefits of network expansion

By expanding the network the Government increases community benefits from bus travel from:

- (i) reduced congestion costs to the community overall;
- (ii) reduced CO₂ and insurance costs from lower accidents; and
- (iii) reduced costs of social exclusion.

The total increase in community welfare from these reduced costs is:

$$cw = (pat_2 + pat_1 - pat_0) \cdot r_5 \quad (7)$$

Where:

cw = community welfare benefits in \$m from increased bus patronage; and
 r_5 = community benefit per passenger bus trip in dollars.

4.6 Headline consumption: the welfare minimum

In order to reach overall conclusions, the impact on the Victorian economy of non-local ownership of bus contracts vis-a-vis local ownership sum of the outcomes needs to be able to be expressed in terms of one indicator. For this study "headline" consumption expenditure is adopted, or the sum of private and public consumption expenditure as shown in the National and State Accounts.

The impact on Victorian consumption expenditure in terms of the variables from above is:

$$hc = \frac{((0.14 - bm) \cdot R_0) \cdot (1 - D_1) + 0.14 \cdot R_0 \cdot D_1 + D_1}{(cs + cs) \cdot r_1 + cw \cdot r_2}$$

Where:

- hc = impact of change in bus contract ownership on Victorian headline consumption expenditure, in \$m;
- R_0 = total annual revenue for original contract;
- D_1 = 1 if new contract owner is non-local and 0 if new contract holder is local;
- R_1 = multiplier for Victorian consumption expenditure with respect to bus industry activity; and
- rs = conversion ratio from total real benefits per bus trips into headline consumption.

5. Evaluation methodology: uncertainty and probability

The model developed above relies on seven parameters. However, a great deal of uncertainty surrounds the settings of the parameters and, in some cases, the literature offers little guidance. The parameter values will determine:

- (i) the trade-off between margin reduction and operating cost reduction;
- (ii) the potential for outsourcing;
- (iii) the response of the community to increased bus services in terms of enhanced patronage;
- (iv) the social benefits of bus services; and
- (v) the relationship between social benefits and economic benefits.

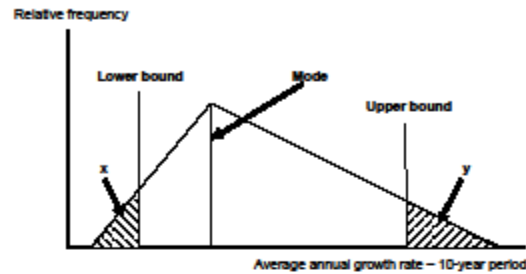
The interactions of all the parameters will determine the overall outcome.

One practical way to accommodate uncertainty into the analysis is to adopt explicit probability density functions which will define the degree of uncertainty involved.

5.1 The quantification of uncertainty: the Trigen distribution

To program the development of the quantitative framework requires a probability distribution which can be easily adopted to capture the probabilities of outcomes for any 10-year period which reflects the experiences from the historical record. Such a distribution is the Trigen distribution.

Figure 1: The Trigen distribution



The Trigen distribution is depicted in Figure 1. It is a triangular distribution which requires the specification of five parameter values to define its proportions. The five parameter values are:

- (i) the mode;
- (ii) the lower bound;
- (iii) the upper bound;
- (iv) the probability that the lower bound will be exceeded (in a lower outcome), or area x in Figure 1; and
- (v) the probability that values will be taken which are lower than the upper bound (or 1 minus the area y in Figure 1).

The methodology involved specifying Trigen distribution for each of the parameters, that is, r_1 to r_7 in the model. The Trigen probability parameter settings are given in Table 2.

Thus, from Table 2, the lower bound for a bus trip in social value terms is set at \$12 a trip with zero probability that the outcome can be lower. The upper bound value is set at just under \$30 with zero probability it can be higher. The mode value is set at \$18 a trip with a mean value, in terms of the Trigen distribution, of just under \$20. The selection of the parameter values in Table 2 will be explained. In short the upper and lower bounds follow the outcomes of John Stanley's work on the value of reducing social exclusion. Stanley's work indicates that the upper bound applies to one third of passenger bus trips. The lower bound estimate applies to the remaining two thirds of passenger bus trips. The movement across the Trigen distribution captures the benefit of putting an extra bus on the road. At worst it will carry passengers where only the lower bound social value applies. At best it will carry passengers where only the upper bound applies. The mode value reflects the outcome where a bus will carry one third of passengers where the upper bound value applies and two thirds where the lower bound applies.

Table 2 Trigen probability distribution parameter settings

Variable	Coefficient	Lower bound	Mode	Upper bound	Probability of lower outcomes		Mean
					Lower bound	Upper bound	
Final labour cost reduction	r_2	0.0	0.08	0.15	0	100	0.077
Trip reduction elasticity	r_3	0.1	0.2	0.5	0	100	0.267
Outsourcing rate	r_4	0	0.4	0.5	0	100	0.30
Network expansion elasticity	r_5	0.1	0.31	0.5	0	100	0.300
Social benefit per bus trip (\$)	r_6	12.0	18.0	29.8	0	100	19.9
Consumption conversion rate	r_8	0.10	0.20	0.35	0	100	0.22
Consumption multiplier	r_7	0.4	0.51	0.60	5	90	0.51

6. The selection of probability distribution parameters

This section discusses the selection of the variables given in Table 2.

6.1 The network elasticity (the r_5 parameter)

The network expansion elasticity is given by coefficient r_5 in the model. This elasticity produces the increase in patronage from an increase in network scale.

The literature suggests the parameter is around 0.3. This value has been embedded in the bus contract patronage incentive agreed with DOT as a reasonable broad service elasticity. This is why the mode of the Trigen distribution for r_5 in Table 2 is set at this value. However, there will be considerable variation around the value depending on which segments of the network are expanded. Some local areas would produce relatively high elasticities if:

- (i) car ownership was low;
- (ii) other modes of public transport were not available; and
- (iii) local employment was relatively low.

In the reverse case the patronage increase from network enhancement would be low. The range of these possible outcomes are incorporated into the analysis by setting the lower bound for r_5 at 0.1 and the upper bound at 0.5, which produces an overall mean value near to what is suggested by the literature.

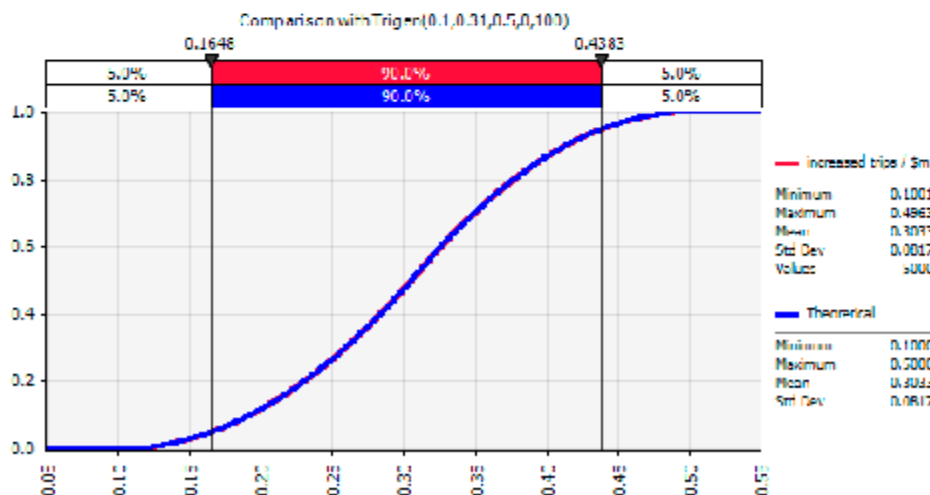
The shape of the cumulative probability distribution that is generated by these parameter settings is given in Figure 2. The cumulative distribution indicates that there is only a 5 percent probability that the elasticity will be below 0.16 and a 5 percent probability it will be above 0.44.

6.2 The outsourcing rate (r_4)

The overhead component of bus industry employment consists of:

- corporate service managers;
- finance and planning managers;
- supply and distribution managers;
- transport service managers; and
- accountants.

Figure 2: Cumulative probability distribution
Patronage network elasticity (\$ million) – 5 percentage point margin reduction



The outsourced overhead components consist of accounting, legal, information technology, marketing and business service support services. These are all services which are being outsourced because of the availability of high speed broadband and the rate of outsourcing will increase as the capacity of high speed broadband increases and the productivity of associated applications increases. Increasingly, bus service operators will be able to secure these services from anywhere in the world. Non-local owners with access to capture or supporting overhead services in other jurisdictions will be able to import these services into Victoria.

The capacity therefore to outsource will be a function of the characteristics of any new non-local operator.

From Table 2, the probability parameter settings imply a mean outsourcing rate of 30 percent. However the extent to which this technical rate of outsourcing is exploited will depend on the margin reduction pressure as per equation (5). The full potential rate of outsourcing (out of State) will only be exploited at zero margin.

6.3 The cost reduction potential rate (r_0)

The potential for reduction of driver and maintenance costs in man hour terms is limited. The potential reduction from this source will be less than 5 percent. There is also scope for reduction in non-award benefits. The most fruitful potential for cost reduction would be the employment of lower skilled and relatively inexperienced employees compared to the previous contract owner.

Then, together the maximum cost reduction of driver and maintenance costs is set at 15 percent with zero chance of exceedence. The mean value is 7.7 percent.

Such a reduction, for a variety of reasons maybe achievable, but would involve a loss of efficiency and performance which will ultimately reduce patronage. The same comment applies here as per the outsourcing rate. The extent to which this technical rate of nominal cost reduction is exploited will depend on the margin reduction pressure as per equation (2). The full potential rate of nominal cost reduction will only be exploited at zero margin.

6.4 The trip reduction elasticity (r_1)

The trip reduction elasticity measures the extent that cost reductions impact on patronage. From Table 2, the lower bound is set at 0.1 while the upper bound is set at 0.5. The mean value is 0.27. Some stakeholders surveyed for this study would place this elasticity value considerably higher, in terms of a mean expected outcome, as summed up by the statement "overseas owners simply do not understand the Australian labour market and practices".

6.5 The social benefit consumption conversion rate (r_2)

In J.K. Stanley and D.A. Hensher, "Economic Modelling", estimates are given to the value of bus trips in Melbourne. The results are summarised in Table 3. The calculations are based on 100 million trips.

The key issue here is to convert these benefits to increases in household consumption. Congestion costs will perversely increase household consumption because of increased fuel and mechanical repair costs. However, assuming this is offset by reductions in other expenditures, the main transmission cost for congestion time savings to consumption expenditure is via the use of the time to work longer hours or work the same hours more productively. This potentially can be large given the high rate of gross product produced to the value of travel time allocated to the bus passengers, or at least the motor vehicle users who benefit from additional bus patronage. However, as can be seen from Table 3, the conversion rate from travel time savings into real consumption expenditure is assumed to be one quarter. This is also conservative in that it does take into account the costs on real incomes from increased road projects that will be needed to offset congestion cost increases.

Currently passenger motor vehicle traffic is exempt from carbon taxes. However, this is unlikely to remain the case over the medium term. A conversion rate of 0.5 is assumed.

Annual savings will translate into lower insurance pressures. Because of imported insurance services a conversion rate of 0.5 is also assumed.

The benefits from reduced social inclusion will vary. Reduced crimes and social security support directly will reduce taxes and increase consumption. Increased employment will reduce the need for migration and associated infrastructure costs. On the grounds of conservatism, a conversion rate of 0.2 is adopted. For other bus users' benefits a minimal conversion ratio is adopted.

The above logic produces a weighted average conversion rate of 0.2. From Table 3 this is adopted as the mode for the probability distribution. From Table 3 the lower and upper bounds for the conversion ratio are set at 0.1 and 0.35 to give a mean value of 0.22. Again, the actual value would be significantly higher if congestion rates were higher and there was substantial under-provision of public transport infrastructure in some regions subject to increased bus services.

	\$ million annual	Conversion rate
Congestion time and fuel savings	588	0.25
Greenhouse gas emissions	21	0.5
Accident cost savings	15	0.5
Bus user benefits from social exclusion	784	0.2
Bus user other benefits	384	0.05
Total benefits	1,802	0.19

6.6 The average trip benefit value (r_p)

In the modelling framework the conversion rate is applied to the average trip total social benefit which, from Table 3, is \$18 per trip. However, the minimum resulting from this value could be where there is no social inclusion concept from the trips which would reduce the \$784 million social exclusion benefits to zero and increase the other bus user benefits to \$591 million. This would give a maximum bound for the average trip benefit of \$12. The upper bound is where all trips reduce social exclusion. This gives a total upper value of \$29.8 per trip. Hence, the probability distribution settings in Table 3.

6.7 The consumption multiplier (r_c)

In NIER's, *The Economic Contribution of the Bus Industry to Victoria by Local Government Area*, February 2010, the contribution of the Victorian bus industry to economic activity in Victoria was estimated. For a total industry revenue of \$870 million, the contribution was:

- (i) 10,900 to employment;
- (ii) \$931 million to gross state product at factor cost; and
- (iii) \$440 million to consumption at factor cost.

As explained above, the analysis here is using consumption (either Government or household) as the welfare indicator. Hence, the critical ratio here is the Victorian Bus Industry consumption to revenue ratios. This is 0.51.

However, there will be considerable variation in this ratio depending on enterprise structure, the allocation of income between direct household income and superannuation funds, etc. Accordingly, a lower bound of 0.4 is set from Table 2 and an upper bound of 0.6.

7. The default cases: margin reduction from contract ownership change

The two default cases are:

- (i) change of contract between two local resident organisations; and
- (ii) change of contract from a local organisation to a non-local organisation.

Nothing else changes and the Government uses the savings to expand the bus network. That is, the default cases involve setting r_p , r_c and r_s all to zero. The default case also adopts only the mean value for the other parameters.

Table 4 shows the impact for two variants in terms of margin reduction, that is, either a 2 percentage point or 5 percentage point reduction, and two variants in terms of quarantined and non-quarantined outcomes. In the former, the benefits are limited to a particular contract, while in the latter, the benefits accrue to all other contracts. That is, the margin struck in the contract forms the new benchmark for all other contracts applying to metropolitan bus route contracts.

It should be noted in the Table that the costs of extra bus trips are financed out of contract cost savings. All the cost saving are allocated to this purpose.

Table 4 shows that for the default case of a margin reduction, the change in ownership that is restricted to local enterprises generates \$1 million trip benefits for a marginal decline in headline consumption. The reduction in headline consumption would be neutralised if the expansion in the bus network was focussed on areas where the patronage response was likely to be higher than what is implied by the mean settings of the parameters, or social advantage from bus trips were higher than the Trigen distribution mean rates.

Table 4 Impact of changes in bus ownership: default cases (\$ million)

	Change from local to local ownership	Change from local to non-local ownership
Quarantined Impact – 2 percentage point margin reduction		
Government cost savings	0.8	0.8
Benefits from passenger trips	1.0	1.0
Net consumption gain	-0.2	-1.7
Non-quarantined Impact – 2 percentage point margin reduction		
Government cost savings	8.8	8.8(a)
Benefits from passenger trips	11.0	11.0(a)
Net consumption gain	-2.2	-3.9(a)
Quarantined Impact – 5 percentage point margin reduction		
Government cost savings	2.0	2.0
Benefits from passenger trips	2.4	2.4
Net consumption gain	-0.6	-1.4

Note: (a) Assumes all other contracts stay in local ownership

It would also be neutralised if the conversion rate setting was higher. For example, if the consumption conversion rate was set at its upper bound value of 0.35 instead of its mean value of 0.22, then the headline consumption loss would be zero for the 2 percentage point margin reduction and for the change to a local owner. A change for a non-local owner still leaves the headline consumption loss at -\$1.4 million.

For the non-quarantined case the cost saving would extend over the entire metropolitan route network. For the non-local ownership transfer case, the gains are assumed to be repeated from the other contracts which are assumed to stay in local ownership. That is, it sets a new benchmark for negotiations.

Clearly, from Table 4, in terms of the default case, if the lower margin outcome can be achieved without any other adverse consequences, then it is significantly more advantageous to achieve the outcome by change in ownership from local to local.

Finally the case of a change in contract ownership from local to local ownership that save costs always have at least a neutral, and most likely a positive, outcome on the economy if the Government uses the savings to increase government current expenditure. This is because the direct and indirect current government expenditure impact on consumption is likely to be greater than the impact of margin income, dollar for dollar, on consumption. For example, assuming that the (household) consumption multiplier of direct government consumption expenditure in Victoria is 0.35, then the expenditure of \$0.8 million on general public consumption expenditures would yield a total consumption benefit of \$1.1 million. This would offset the direct consumption loss for margin reduction for the 2 percentage point reduction case and transfer to local operators by a gain of 2 to 1. That is, a net gain in headline consumption of \$0.7 million.

For the case of a change in contract ownership from a local owner to a non-local owner even if all the cost savings are transferred into current government expenditure this will not make up from the direct transfer of the total margin income to non-local entities. The net loss in consumption would still be \$0.3 million, even if all the cost savings were allocated to government consumption expenditure rather than increased bus services.

In the executive summary the \$ million values given above are expressed as a ratio to the initial contract value of \$40 million.

The analysis of this section assumes that it is feasible to significantly reduce margins without damage done to the quality of bus services. What happens, however, if this is infeasible and any margin reduction below the 9 percent benchmark does result in deterioration to the quality of bus services?

8. Change of contract ownership from local to non-local owners: general cases

In contrast to the default cases, the general cases for change in contract ownership from local to non-local owners allows the values of r_0 , r_1 and r_2 to take non-zero values as specified by the probability distribution. As for the default case, two margin reduction cases are explored, namely:

- (i) a 2 percentage point reduction; and
- (ii) a 5 percentage point reduction.

8.1 Cost reductions

Figure 3(a) and Figure 3(b) show the impact on direct cost reduction. These figures show the net impact from equation (2). That is, the impact on r_1 .

Figure 3(a) shows that the cost reduction can vary between 1.0 to 5.2 percent for the 5 percent probability benchmark for the 2 percentage point margin reduction case and from Figure 3(b) the corresponding range is between 1.7 and 8.7 percent for the 5 percentage reduction case.

8.2 Net change in patronage

The distribution of the net change in trips is the sum of the trip change from the Government case of savings to expand the network and the change in trips because of cost reduction leading to a reduction in service quality.

For the 2 percentage point margin reduction case the range of net trip change at the 5 percent probability benchmark is between -0.1 to 0.04 million, while the range for the 5 percentage point margin reduction case is between -0.13 to 0.10 million, or a total variation of 230,000 trips. The high end of the range would occur when r_0 takes values near zero while the lower end outcomes, that is outcomes when the number of trips declines by values close to -0.13 million, would occur when r_1 takes values near the upper limit values of 0.10 from Figure 3(b).

What is of interest is that the mean of the trip change for the two cases are similar, that is, close to zero. This suggests the mean expected outcome is from whatever the positive benefit of cost savings from margin savings it is offset by loss of patronage from cost savings. However, there are possibilities, albeit for low levels of probability, for substantial net trip gains and substantial net trip losses.

8.3 Net social benefits from trip change

Figure 5(a) and Figure 5(b) show the net change in social benefits from the net change in trips. The profiles follow the profiles of Figures 4(a) and 4(b). The range in social benefits for the 2 percentage margin case is from -\$1.9 to \$0.7 million, while for the 5 percentage point case it is between -\$2.4 and \$2.1 million.

8.4 Headline consumption expenditure

Figures 6(a) and 6(b) show the impact on total headline consumption expenditure for the two margin reduction cases.

The range for the 2 percentage point reduction case is between -\$3.5 and -\$2.0 million (figure 6(a)). The range for the 5 percentage point case is between -\$4.2 and -\$2.0 million (figure 6(b)).

The two cases are close in range and mean outcomes. The reason for this is that the main damage is done in the substitution of a local owner for a non-local owner, irrespective of the margin decline. However, there will be some additional consumption losses for higher levels of margin reduction because of the increased intensity of the reduction in cost effect.

Figure 7 shows that the outcome for headline consumption, after the transfer to non-local ownership occurs, is most sensitive to the r_1 parameter and the impact of margin squeeze on the realisation of the potential. That is, to the extent costs and revenue standards decline and the impact of this on patronage or r_2 . This on reflection should not surprise. Any benefit from cost reduction is transferred out of Victoria and the loss of efficiency has flow on impacts for further consumption in Victoria.

Not unexpectedly, the general case outcome is significantly inferior to the default outcomes. This echoes the warnings from stakeholders that a switch to non-local owners in pursuit of margin reduction involves potential costs which are all too often ignored. However, as can be seen from the figures, the model output coverage to the default case outcomes is in terms of maximum/minimum outcomes.

Figure 3(a): Impact of change from local to non-local operator

- Cost reduction in eligible costs from contract change to non-local operator (r_1 parameter)
- 2 percentage point margin reduction

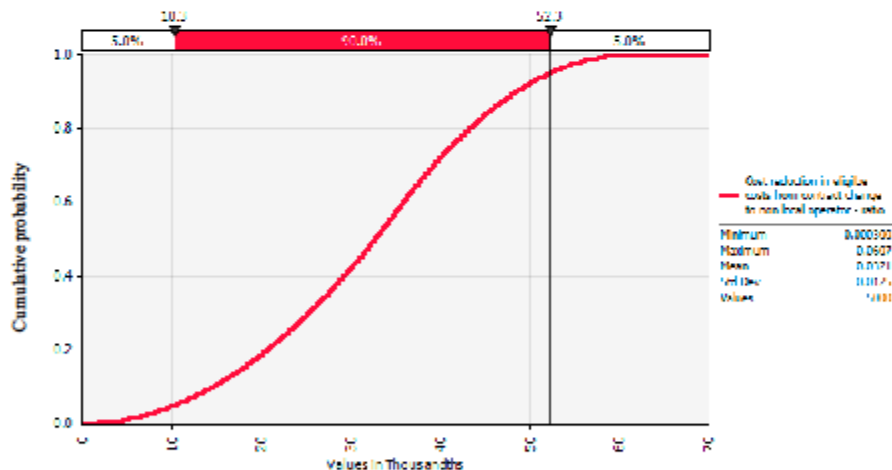


Figure 3(b): Impact of change from local to non-local operator

- Cost reduction in eligible costs from contract change to non-local operator (r_i parameter)
- 5 percentage point margin reduction

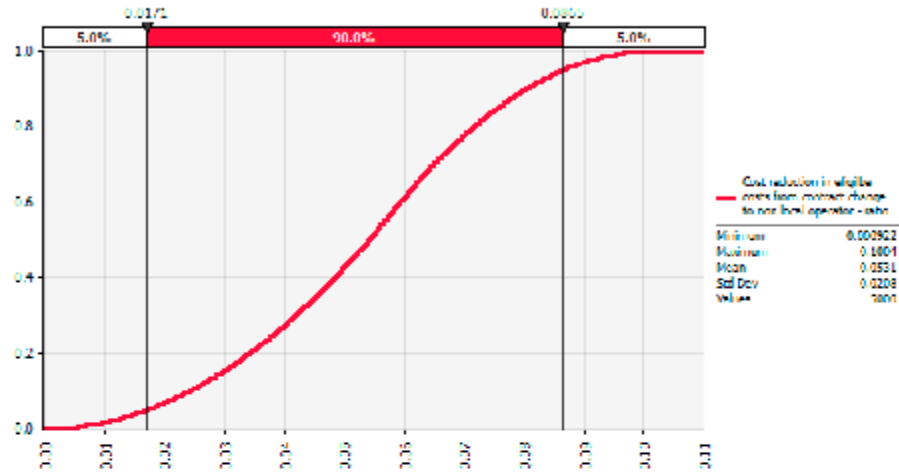


Figure 4(a): Impact of change from local to non-local operator

- Net change in passenger trips (million) - 2 percentage point margin reduction

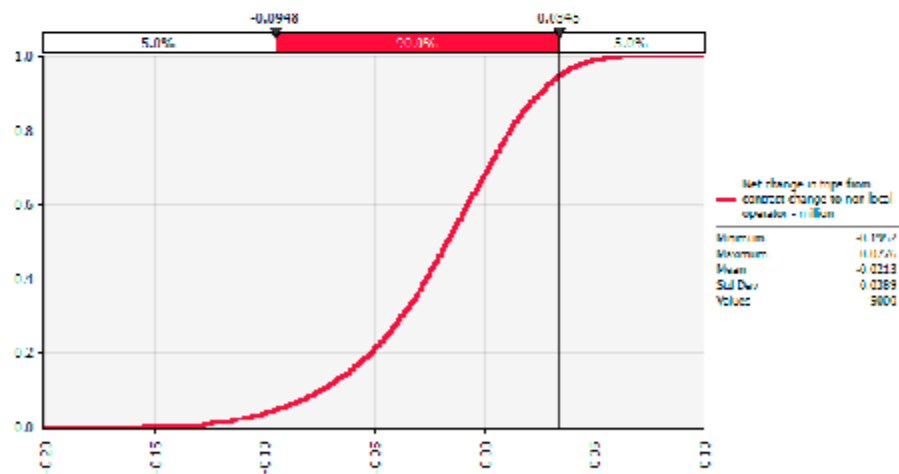


Figure 4(b): Impact of change from local to non-local operator –
Net change in trips (million) – 5 percentage point margin reduction

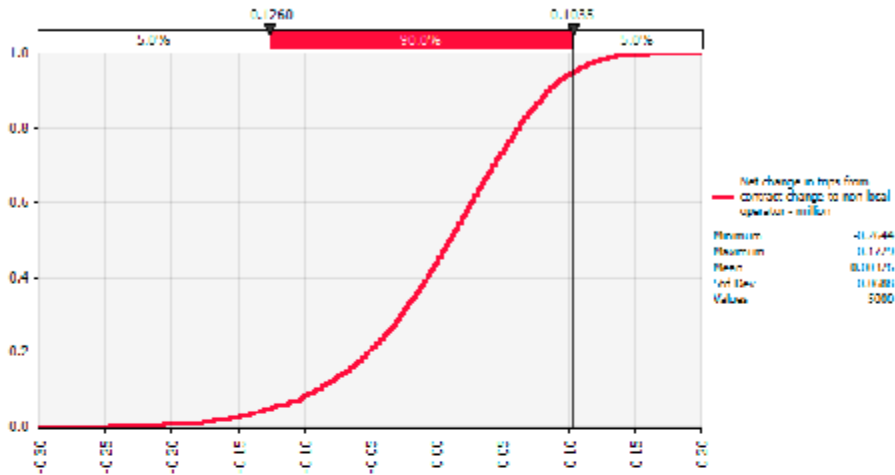


Figure 5(a): Impact of change from local to non-local operator –
Net social benefit (\$m) – 2 percentage point margin reduction

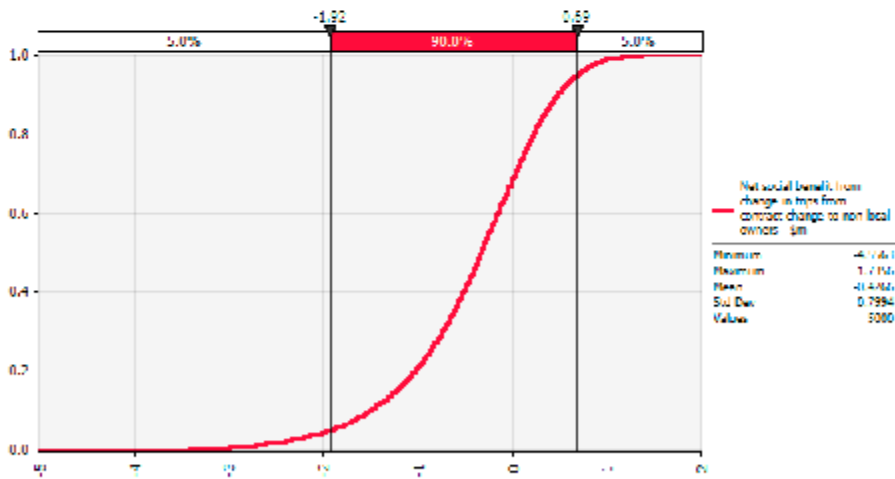


Figure 5(b): Impact of change from local to non-local operator –
Net social benefit (\$m) – 5 percentage point margin reduction

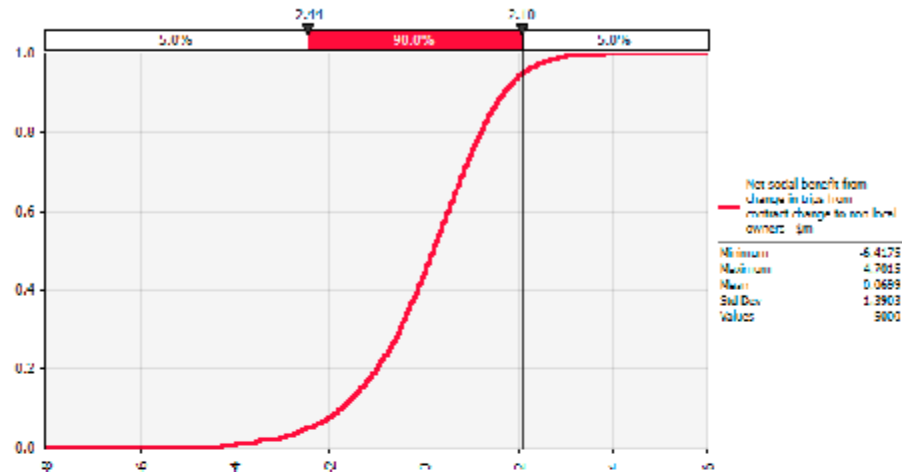


Figure 6(a): Impact of change from local to non-local operator –
Total headline consumption change (\$m) – 2 percentage point margin reduction

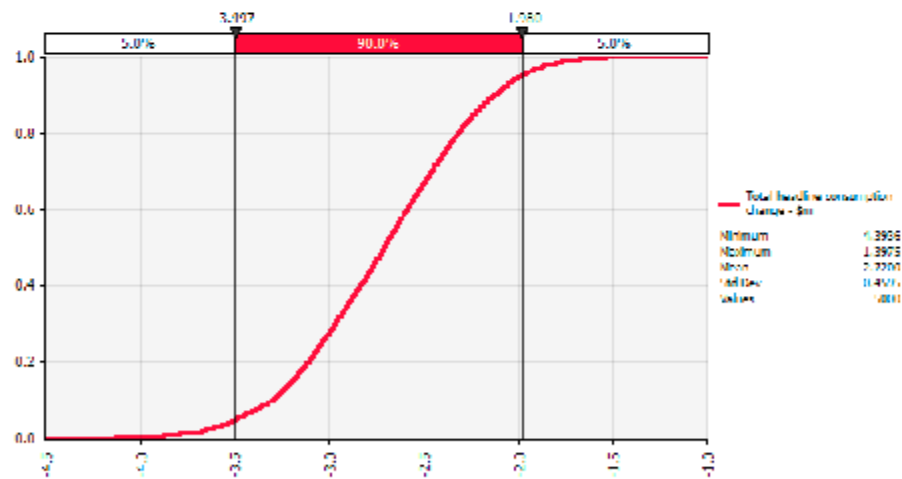


Figure 6(b): Impact of change from local to non-local operator –

Total headline consumption change (\$m) – 5 percentage point margin reduction

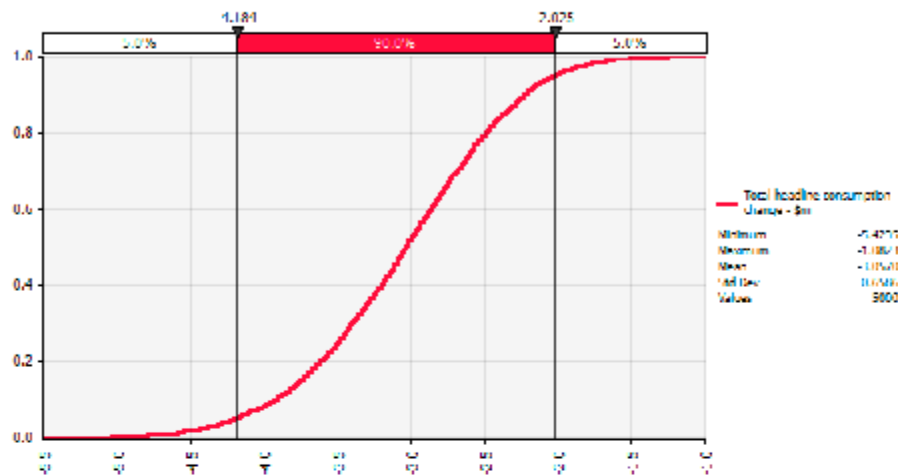
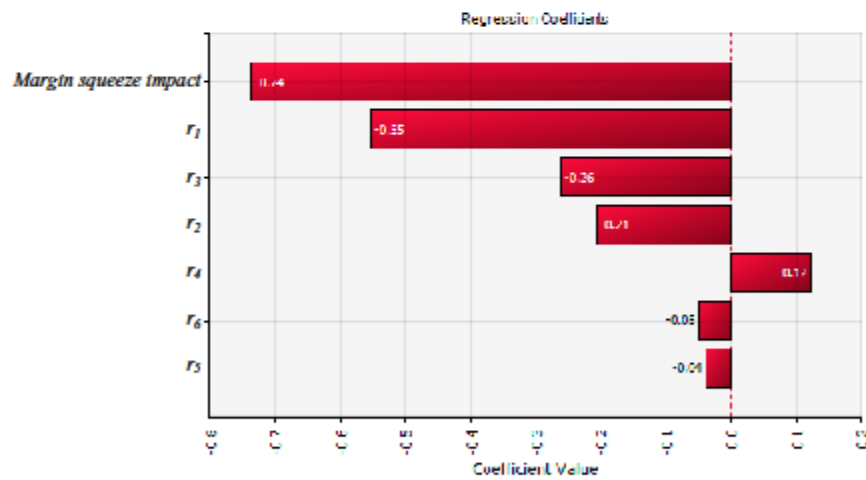


Figure 7: The sensitivity of total headline consumption change to parameters (\$m)





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12. Post Script

The writer notes he is a Doctoral Candidate at Monash University where he is writing a thesis that attempts to link governance with performance in the bus and coach industry. The thesis asks the question is the small family-based transport business the best governance model for public transport outcomes and is this model sustainable? Further, what is the role of the industry representative body for operators in promoting and maintaining the best outcomes for the most effective corporate governance model?

The thesis will test empirical research on the cultural characteristics and capability of small family bus businesses and large multinational bus businesses by firstly, undertaking a series of focus groups and interviews, then eventually a formal survey of operators. The cultural characteristics and capabilities of the family and multinational governance models will be detailed. The thesis will also show public transport outcomes, performance indicators and consequences of the governance models using the PESTEL model. An analysis of the various governance models will be presented via a SWOT in order to view any non-replicable characteristics that yield operators a competitive advantage. A comparison of international bus operator governance in Canada, New Zealand, South Africa, United Kingdom and Scandinavia will examine similarities and differences to Australia's bus governance models. This research will lead to new knowledge about the impact of the governance model on bus transport outcomes for all stakeholders including the travelling public. Government policy recommendations will arise from these findings.