East Coast Response to the ORR 'Retail Market Review'

Consultation on the potential impacts of regulation and industry arrangements and practices for ticket selling (September 2014)

31 October 2014

1. Introduction

East Coast operates 155 trains per day along the East Coast Main Line, connecting London with key cities including York, Leeds, Newcastle and Edinburgh. East Coast operates in a highly competitive market, with on-rail competition on the majority of the routes it operates, airline competition at Leeds, Edinburgh and Newcastle and the car providing an alternative with the M1 and A1 along much of the route. East Coast is predominantly a long distance rail operator with the vast majority of customers buying in advance, through a mix of channels. Purchases are discretionary – only 3% of revenue comes from Season Tickets.

2. Executive Summary

The rail market has grown considerably over recent times and the growth observed within the retail market does not suggest any significant issue within the third party retail market. In fact third party channels are growing more quickly than the overall market and particularly on longer distance routes are taking an increasing share. There are substantive differences between sectors within the Rail market though – for instance, the long distance sector and in particular East Coast, has a very different customer type, buying behaviour, product mix and channel mix than the overall industry. Third parties have a strong level of revenue performance in this sector and within East Coast.

East Coast believes that the current commission structure is balanced and equitable and compares favourably to other travel sectors. Over and above this East Coast recognises the value of third parties in generating incremental revenue growth and modal shift opportunity and has a range of rebate and corporate deals in place to leverage this - covering typically more than 50% of corporate sales.

East Coast has an objective to maximise commercial returns and applies different strategies to different retailing channels. East Coast discounts selected fares on their website (generally by 2%) as part of a wider drive to reduce prices and increase revenue in a channel which is mostly leisure based and has scope for journey generation. The discount scheme allows East Coast to establish a greater direct contact with its customers, which in turn provides an opportunity for East Coast to enhance customer service experience for its customers, for instance, by providing timely and relevant communications about booked services/products directly to the customers. Moreover, it also provides East Coast an opportunity to stimulate revenue and ultimately, delivering best value back to the taxpayer.

We welcome the opportunity to review the costs and benefits of the wider strategic issues identified by the review. Of particular interest would be a review of impartiality requirements (to enable simpler retail options), the removal of fares regulation on long distance routes (to free up commercial opportunity, improve crowding management and enable simpler retail) and the relaxation of Schedule 17 requirements to pass more control of hours to TOCs (to ensure balance between service and operating costs and enable reinvestment in alternative/self serve retail technology at stations).

3. East Coast Response

East Coast appreciates the opportunity to respond to this consultation and general subject matter.

East Coast supports the general views laid out in the ATOC response and where applicable answers below are directed to the ATOC paper. However, where East Coast believes that the answers require more detail or indeed East Coast has a different view to ATOC this will be outlined below. This paper is a written response further to the two face-to-face engagements which East Coast has conducted with the Office of Rail Regulation (ORR) between March and August 2015. East Coast would welcome any further opportunity to engage on this topic.

4. Section 2 – Rail Ticket Buying and Selling Practices

Q1: Is our description of the retail market for tickets and passenger buying behaviour correct? If not are there any relevant trends/issues we are missing?

The description covers all the basics but we believe under-represents 3 key trends:

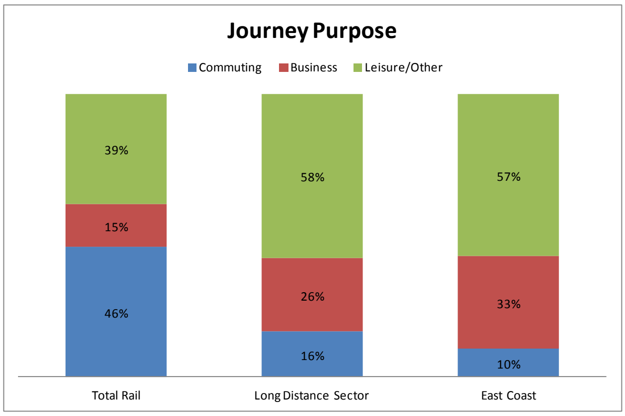
i) The likely fundamental shift in how people will search for journeys, buy tickets and fulfil those tickets over the next 10 years

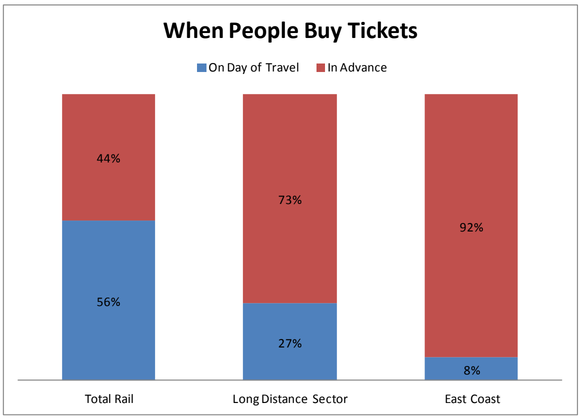
ii) The very real difference in retailing and passenger buying behaviour by market sector (i.e. long distance versus commuting)

iii) The growth in the TMC channel versus other channels

Taking the first point it should be noted that there will be demand from customers (given changes in the wider marketplace, particularly in retail and travel) and the facilitation of changes such as barcode ticketing and smartcard schemes. Both of these factors will inevitably lead to a much higher proportion of customers moving from traditional sales channels/ticketing methods to more digitally based options such as e/m tickets, smartcards, smart media etc. This in itself will lead to reduced retail costs and movements between channels (regardless of price).

The second point is around the fact that 'one size does not fit all'. The majority of the statistics and commentary within the consultation paper is around the total UK rail industry. However, this industry is made up of very different market types. The long distance sector (where East Coast predominantly operates) is very different to the total industry in terms of the customer profile, the booking profile of those customers, the channel mix of bookings and the ticket types sold.





Source: Q4 and Q10 of National Rail Passenger Survey Feb-Apr 2014

Within the long distance sector East Coast arguably already leads the way in terms of adoption of train specific Advance Purchase fares, the movement from stations to web sales and the growth of the TMC market.

Finally, turning to the issue of third party TMC growth it is clear that this channel has performed very well over time despite the concerns raised around commission levels, pricing parity and distribution of fares.

Q2: Have we appropriately captured the most significant changes to ticket retailing in the last 10 years or so? Do you consider that the pace and level of developments and changes have been appropriate in meeting passengers' changing needs?

Rail Products:

On a rail product front the pace and level of developments has generally been appropriate. Products are developed by TOCs either themselves, or by participating in industry wide developments such as the Two Together Railcard (2014) or Fares Simplification (2008). East Coast has a good track record of product innovation, for example :

1) The introduction of a mix and match single structure on the website for key flows (2011) – this resulted in a significant increase in the usage of the Super Off Peak Single fare and a more flexible mix and match offering for leisure customers.

2) The introduction of discounts aimed specifically at the car market (2010) – for small groups of 3-9 we offer a 25% discount when booking East Coast Advance fares online. This is also available within TMC's.

3) The introduction of the "Scottish Executive product" (2010) which was a direct response to corporates who wanted to take advantage of a First Class product on a long distance routes but had Standard only travel policies. This has been particularly successful in generating business travel and also encouraging modal shift.

4) The overhaul of tour operator fares (2013) – moving Superbreak (package operator account) from a broadly fixed price net product to an Advance Purchase model where they have access to a range of price points depending on the time of day, train etc. This is a much more flexible model and one which provides benefits for both customers (guaranteed seat reservation, lower prices in many instances) and East Coast (crowding levels more manageable).

5) The introduction of Carnet tickets (2009) which provides 5 return tickets for the price of 4. This is a substantial discount for buying 'in bulk' and the introduction was in response to customer demand within the business market.

Where we have had issues with developing products, it has been more due to constraints within the TSA (Ticketing and Settlement Agreement). One example was on the York-London route where East Coast compete directly with Grand Central, an Open Access operator, which offers considerably lower flexible fares. We wanted to compete on a more even basis but this required the insertion of a permanent East Coast only interavailable fare. The TSA restricts 'lead operators' in this respect as its only allows this for a temporary, promotional period. We sought an 'interavailability direction' to overcome this but unfortunately this was rejected on the 2 occasions on which approval was formally sought. The end result was that the York market was denied the opportunity of a cheaper East Coast dedicated Anytime fare.

Another example of the constraints is around the development of Advance Purchase fares. To extend the reach of these to 'on the day' of travel requires considerable 'hoops' to be jumped through, including TOC approval and DfT consultation. This was demonstrated by the Cross Country case study which the ORR mentions. The extension of Advance Purchase fares to 'on the day' effectively also blurs the boundaries between the Advance and walk-up ticket types – as such yet another reason to drop the out of date regulation around dedicated Standard Class walk-up fares.

Finally, and probably most importantly, fares regulation is the main inhibitor of change and a key reason for crowding at 'Off Peak' times as well as sub optimal revenue levels on certain routes. Relaxation of fares regulation on long distance services would enable true single leg fares across the board, and a true mix and match offer for all retailers at rates which are both customer friendly and commercially viable.

Ticket Fulfilment:

This has proved to be one of the most challenging issues for the industry (as well as East Coast) over the last few years. Despite some inroads into digital forms of ticketing on TOC specific fares and on certain markets there has been little in the way of wholesale/step change in this respect.

Ticket Retailing:

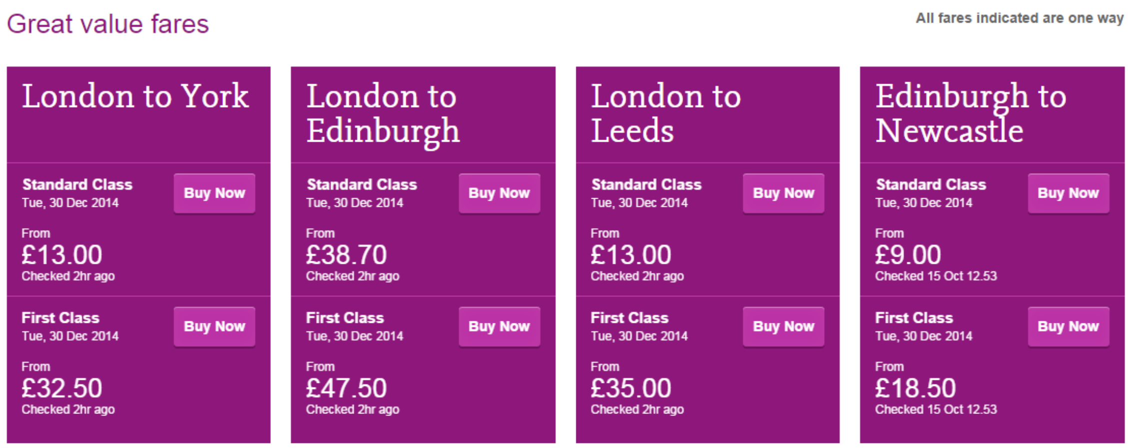
The EC website is the primarily selling channel for East Coast. Some innovations which East Coast have recently brought to this retail channel are:

a) Introduction of the Rewards Loyalty Programme

This programme was delivered in 2012 and marked a step change in TOC loyalty programmes by giving all the opportunity to join with a very low spend hurdle (£22). The scheme has been very successful in generating advocacy, loyalty and revenue and has in excess of 650k members.

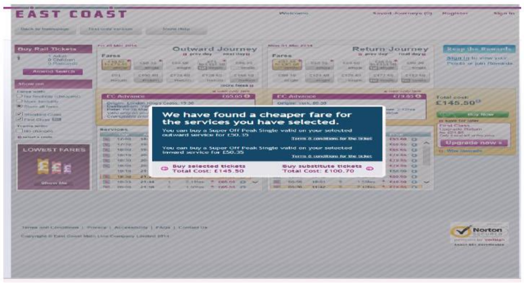
b) Live Fares Feed

Due to the restrictions in the reservations system (NRS), it isn't always easy/fast to indicate to customers when the cheapest fares, for their preferred journey, are available. It can also be frustrating for customers to see a "fares available from" message alongside advertised prices and then experience difficulty in finding train services with these fares. As such, EC has launched a live fares feed which can look at any given date in the booking horizon, across our key routes and then return the fare that is actually available in First and Standard Class at the date/time of that check. The fares feed is updated every time a customer searches for that journey on that date, so there is rarely a long gap between a last check and the fares shown. These fares are then promoted across the EC website, customer emails, search marketing activity and shortly also on TV adverts (which will be the first time this has been done by any company, not just rail, in the UK advertising market).



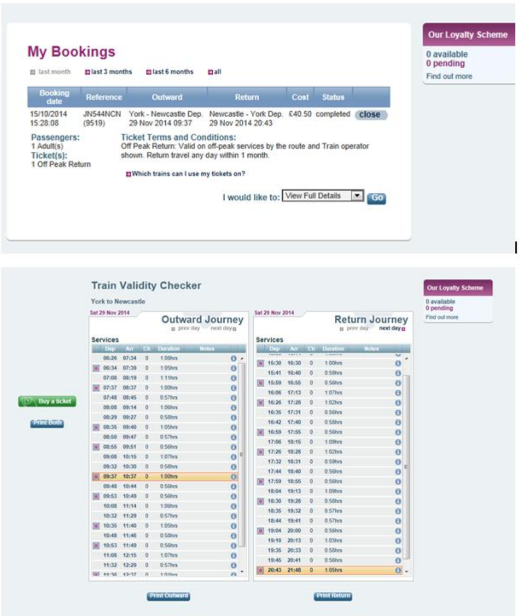
c) Automatic check for any cheaper return fares when a customer selects 2 single fares

This is a feature of the website which checks if anyone has 2 single fares in their basket but there is a cheaper return fare available. This helps protects customers from being sold a fare that may be unnecessary.



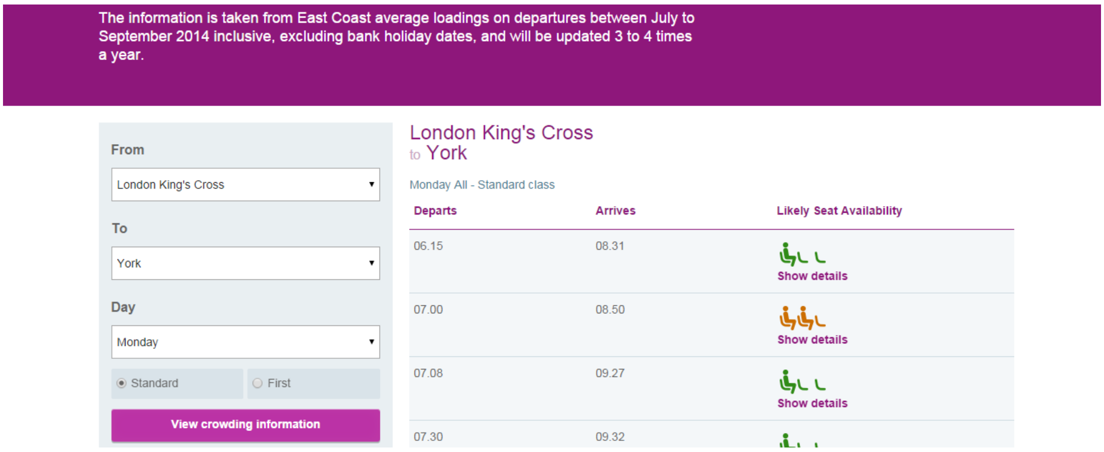
d) Validity Checking Tool

When booking a ticket, the East Coast website very clearly highlights which services are available and valid for travel on the ticket selected. Once purchased, if a customer wishes to make a change, it can be more difficult to work out which services a booked ticket is valid on. East Coast has therefore created a tool accessed via My Account for those booking online to check which services the ticket is valid on. Further, this capability will soon be available for all East Coast customers via the website, even if the ticket wasn't booked on eastcoast.co.uk. This tool will allow all customers to easily see which services are Peak, Off-Peak or Super Off-Peak.



e) Train 'busyness' tool

In order to help customers get a feel for how busy key routes are at different times of the day, East Coast has introduced an interactive tool to give an indication of this.



Over and above the developments highlighted above, East Coast continues to innovate and drive improvements. A key example of this is the imminent move to a 24 week booking horizon (from the traditional 12 weeks) on key routes where we compete with airlines (who enjoy longer booking horizons).

Q3: Are there any insights on passenger behaviour, market share and sales channels from other sectors that are worth considering?

Please refer to ATOC response.

5. Section 3 – Regulation and Industry Arrangements for Selling Tickets

Q4: Have we accurately described the ticket selling arrangements in respect to (i) retailers' incentives in selling tickets; (ii) retailers' obligations to facilitate an integrated, national network; (iii) retailers' governance arrangements; (iv) retailers' industry rules; and (v) retailers' industry processes and systems?

We would point to the ATOC response for this.

ATOC uses a number of criteria to set commission levels – this includes average transaction values, opportunities for other remuneration, benchmark rates and cost of sale. The current structure is deemed to be balanced and fair and in many ways more generous than other travel sectors (for example Eurostar or airlines where commission is 0%). Commission rates cannot sensibly be viewed on a standalone basis but rather in aggregate with other retailer remuneration – it should also be viewed in the context of the average transaction rate for that channel.

East Coast is open to alternative models for remuneration if a better model can be identified and the ramifications are fully considered.

6. Section 4 – Impact of Retailers incentives and obligations to facilitate integrated, national network

Q5: What are your views on the impact of the retailers' incentives in the way they sell tickets? To what extent do the incentives discussed herein impact retailers' approaches, and how do these differ by retailer type? From the point of view of a retailer, what factors have to be present to make the development of new products an attractive proposition?

Please refer to ATOC response.

Q6: What are your views on the impact of the impartiality obligation? What is your view on passengers' awareness of impartial retailing? How does the cost of impartial retailing impact passengers' services? How could this be addressed?

The need to offer the full range of fares to support impartiality drives complexity (as well as cost). East Coast strongly believes that a large proportion of passengers (in their most general sense) are unaware that TOC's are required to sell impartially and that they sell all services across the country.

As such, East Coast has long been an advocate of simpler retailing. This started with the initial move away from the industry standard 'trainline.com' B2C retail site to a newly designed website in 2006 in partnership with ATOS. This was the first step towards a change away from the traditional view of fares and one which over time has gathered industry and e-commerce field awards – for example a 5 star rating from 'Web User' magazine. Since introducing this change East Coast has continued to champion the concept of a simpler, single leg fares structure and has engaged with the Department for Transport on many occasions between 2007 and now, including most recently during the Fares and Ticketing Review. East Coast has a regular programme of MVT (Multi Variant Testing) to trial a variety of enhancements to the web booking process and improve the customer process. A trial of a simpler retail display has been recently conducted. This trial slimmed down the initial fare options to the dominant fares (i.e. Anytime, Off Peak and Advance Purchase) and only showed one way fares. It was conducted on enquiries for Newcastle or Leeds to/from London during a 2 week period in Summer 2014. The results are still being analysed and are not statistically significant at this stage – however there is some evidence that a simpler retailing display generates incremental bookings suggesting rail is more accessible to customers. This indicates that relaxing the requirements around impartiality and moving towards a more logical and simpler single leg structure could generate a higher level of conversion rate (particularly for new/infrequent customers) and ultimately revenue for the industry in the long run. We would recommend a deeper review of impartiality obligations as part of the review of 'network benefits' regulation.

Q7: With respect to split ticketing, what are your views? Are passengers appropriately safe-guarded against the risks attached to split ticketing? To what extent do industry processes and systems enable split ticketing to be developed by industry and used by passengers? Where are the issues and what could be done to address them?

Please refer to the ATOC response.

Q8: What are your views on the requirement on TOC's to create and retailers to sell inter-available and through tickets and to offer a timetabled, walk-up service? What are your views on the benefits passengers and TOCs derive from both? What challenges does this obligation give rise to, if any? Where are the issues and what could be done to address them?

There are 2 questions posed within this. The notion of a 'timetabled, walk-up service' is certainly one of rail's USP's over other modes. However, as per the statements made in the opening sections of this response, the review does not fully consider the different dynamics by market. Within long distance and specifically for East Coast the vast majority (92%) of journeys are booked before the day of travel (based on NRPS Q10, Feb-Apr 2014) and less than 1% actually buy onboard. 60% of these journeys are for Advance Purchase fares with the other 40% for open tickets (source: EC Customer Satisfaction Surveys, September 13-14). Passengers with an open ticket can avail themselves of the opportunity to use their ticket across many services. We would not advocate the removal of the 'walk-up' railway service.

Regarding the question of selling 'inter-available and through tickets' there are pros and cons as outlined in the consultation paper.

A further consideration in respect of inter-available tickets is that this in itself has been the main problem for the development of digital ticketing – be that barcode or smart. As inter-available tickets can be used across TOCs, any such ticket must also be valid and recognisable across these TOCs. Smartcards do not have visible displays of ticket details so need to be read and validated and each TOC must have the confidence that the card holds a valid permit to travel and is not being used fraudulently. Mobile barcode tickets do have visible displays of ticket details which is somewhat easier to manage across TOCs. For these and others reasons it was only in October 2014 that the first, small scale, trial of inter-available mobile barcode tickets went live. With TOC only tickets it is much easier and quicker to implement different forms of ticketing which meet customer needs.

In conclusion there are pros and cons to the issues outlined in this section and we would support any further review into inter-available and through ticketing.

Q9: With respect to having minimum obligations on TOCs to have their station ticket offices open, what are your views on the impact of these obligations on how the market can develop in line with passengers' needs?

East Coast retail costs from station operations (as a % of total retail costs) are over twice as high as the % of revenue generated in stations. This indicates that there is an imbalance and inefficiency that needs to be addressed. Consumers and retailers in many other retail sectors are benefiting from technological advancements to improve ease/convenience of purchase and ensure efficient cost management. In this context the constraints within schedule 17 of the TSA appear increasingly inappropriate and counter to both customer demand and the requirements to reduce industry costs (cf McNulty).

Please also refer to ATOC response.

Q10: With respect to TOCs being prohibited from charging fees, what are your views on the impact of this requirement? To what extent, if any, does this give rise to a distortive effect between TOCs and retailers?

Please refer to ATOC response

7. Section 5 – Impact of industry governance, rules, processes and systems

Q11: What are your views on the current form of industry governance? Are there any specific examples where the governance has enabled or limited retail innovation? Where necessary, how could industry governance be improved?

Please refer to ATOC response.

Q12: What are your views on the current form of industry rules? What benefits do they give rise to and how? Are there any specific aspects of industry rules that limit or dampen innovation in retail? How could they be addressed?

Please refer to ATOC response.

Q13: With respect to the third party retailers' arrangements, to what extent does the nature of their relationship with TOCs enable them to benefit passengers, including bringing about competition and innovation? How are the arrangements between the wholesale provider and the third party retailers in other sectors relevant to rail? What is the impact of third party retailers in rail not having access to a wholesale market/wholesale price? Do the industry governance, rules, processes and systems pose additional impacts for third party retailers that we have not captured?

East Coast has an objective to maximise revenue and does apply different strategies to different retail channels. Action is appropriate to each market place. Within the 'leisure' market or predominantly leisure channel such as eastcoast.co.uk price can be used as a lever to attract new customers and generate additional journeys. However within the 'business' market and TMC's a discount strategy would be abstractive in many instances. Therefore we work with TMC's to put in place appropriate incentives for them to encourage their customers to generate better value – for example First Class for Standard Class prices or rebate deal on volume/revenue targets.

Turning specifically to the web strategy of fare discounting. This is for 2 main reasons – firstly to drive channel shift from higher cost channels (predominantly station channels) to online channels and secondly to capture customer contact information to enhance customer service and generate higher levels of revenue. In line with the McNulty review East Coast is ensuring best value by driving costs down and revenue up. Our online discount policy works to the benefit of consumers, our business and, through its ability to maximise franchise value, the DfT. Direct customer details provide the opportunity for East Coast to inform customers about key service changes and updates as well as provide marketing messages to drive additional journeys, trade-up to First Class and so on. Such discounting is common practice within the travel industry and has become increasingly common across TOCs .

Currently East Coast discount Advance fares by 2% on www.eastcoast.co.uk and also has a 50% discount on the Super Off Peak Single fare on key routes when booked online. The website is a largely leisure based channel and represents a relatively 'safe' area to discount fares as in general this is revenue generative rather than revenue abstractive. Discounting is more abstractive in business based channels where there is less opportunity to stimulate additional trips and East Coast does not have a direct customer relationship to help grow sales. It is also noted that this kind of online discounting takes place in at least 3 other TOCs from 2 other owning groups (both as a percentage and as a fixed amount).

However, that said East Coast has a range of discounts in place with the TMC channel. We have deals currently in place with a range of corporate clients where they have access to significant discounts. Historically, there have been more but the decision was made to remove them due to poor performance and no increase in market share.

Typically we have bilateral deals in place with TMCs that account for over 50% of our corporate sales.

There are also a number of TMCs we account manage, through our Sales team, without having bilateral agreements in place. In addition, we offer special ITX (inclusive tour) rates to many Tour Operators – Superbreak is the largest account . East Coast has also trialled discounting on Super Off Peak Single fares with 2 major corporate clients for a 6 month period. The results were low usage and revenue abstractive and therefore this trial was discontinued. Alongside this East Coast has also extended its Rewards loyalty scheme to TMC's.

Moreover, East Coast believes that the discounting practice is compatible with the TSA and should this be restricted the end result would be a price increase for a substantial amount of customers.

It is worth noting that over time third party retail costs will decrease with the move away from CCST tickets to lower cost fulfilment methods such as mobile barcodes, e-tickets or smart cards. EC is working with third parties to help deliver this – e.g. expansion of 'print@home' e ticket functionality on EC Advance fares to Trainline.com and the offer of this functionality to all third parties.

Q14: What are your views on the current form of industry processes and systems? What benefits do they give rise to and how? Are there any specific aspects of industry processes that limit or dampen innovation in retail? Do these processes have other impacts, either causing problems or leading to benefits?

In summary there are certain areas which have restricted the level of innovation and choice within the retail environment – ticket structure simplification and digital ticket fulfilment. Although certain improvements have been made in these areas – most notably the introduction of the common fare descriptions in 2007 and and the development of print@home tickets, the developments have not been as far reaching or innovative as they could have been. The main reasons for this are restrictive and expensive legacy systems and outdated regulation. The TSA and fares regulation are covered elsewhere within our response. Regarding legacy systems there is (and has been) a high level of cost and significant timeframes involved in making substantive changes to the reservations system (NRS), the fares system or the ticket issuing system (TIS) front end systems. New developments within the Rail Settlement Plan Modernisation Programme to replace the fares system with a new more flexible 'Product Management System' and replace the reservations system will go a long way towards freeing up technical and commercial opportunities for development and innovation.

Q15: With respect to industry data, how does access to and quality of data manifest? What is the impact?

The central fares and reservation data is a strong positive for the rail industry and ensures that all channels interface with one central system and there is a high degree of accuracy for the quotation of fares. However, certain areas carry complexity – for example the description of restriction codes or the application of the routeing guide. In instances like this, different TIS can apply different logic and/or pull data from different sources – the end result can be inconsistent information for customers with respect to ticket types. For example thetrainline.com write their own 'short text' explanation of key fare T&C's which differs to the EC 'short text' and differs again to the more complicated full text as written in the fares manual. The move towards a new fares system (PMS) will help directly address this issue by providing a central source of information pertaining to fares for all retailers to draw from. This will generate consistent information across retail sites and also free up the potential for 'TIS-Lite' solutions in the future – lower cost, simpler front ends with complexity moved to the back end.

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