

THE AUDIT OFFICE

COMPETITIVE PRICING  
OF  
PUBLIC PASSENGER TRANSPORT  
  
SUMMARY REPORT

AUGUST 1992

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# 1

## INTRODUCTION

- 1.1 This report summarises the Audit Office's audit of the introduction of competitive pricing procedures for public passenger transport. It has been prepared to provide an overview of the performance of Transit New Zealand and Auckland, Wellington and Canterbury Regional Councils, being the agencies selected for review.
- 1.2 The full report published concurrently provides a detailed account of the audit, including our findings. The chapter references in section 2 of this summary report refer to chapters in the full report.

### Mandate

- 1.3 The audit was carried out under the authority of section 25(3) of the Public Finance Act 1977. It assessed the effectiveness and efficiency with which the new Competitive Pricing Procedures for public passenger transport were developed and subsequently implemented in July 1991.

### Audit Approach

- 1.4 Four organisations were chosen for examination. They were Transit New Zealand (Transit), the statutory agency responsible for developing the Competitive Pricing Procedures (CPPs), and three of the regional councils responsible for putting the CPPs into practice. They were Auckland, Wellington and Canterbury Regional Councils, which together spent 93% of all public passenger transport subsidy money in 1990-91. We examined how these organisations carried out their respective roles for the introduction of the new policy in July 1991.
- 1.5 Field work for the audit was carried out from December 1991 through to February 1992. All four organisations were visited, where documentation was reviewed and staff interviewed. In addition, we talked to passenger transport operators, and to consultants who had experience with public passenger transport in New Zealand.

### Audit Model

- 1.6 To evaluate the performance of the four organisations, we used the model illustrated on page 5, which identified key stages of the competitive pricing process.

### Background

- 1.7 Section 20 of the Transit New Zealand Act 1989 states that, after 30 June 1991, neither Transit nor any local authority may make any payment in respect of a passenger transport service unless the amount of that payment is determined by a Competitive Pricing Procedure.

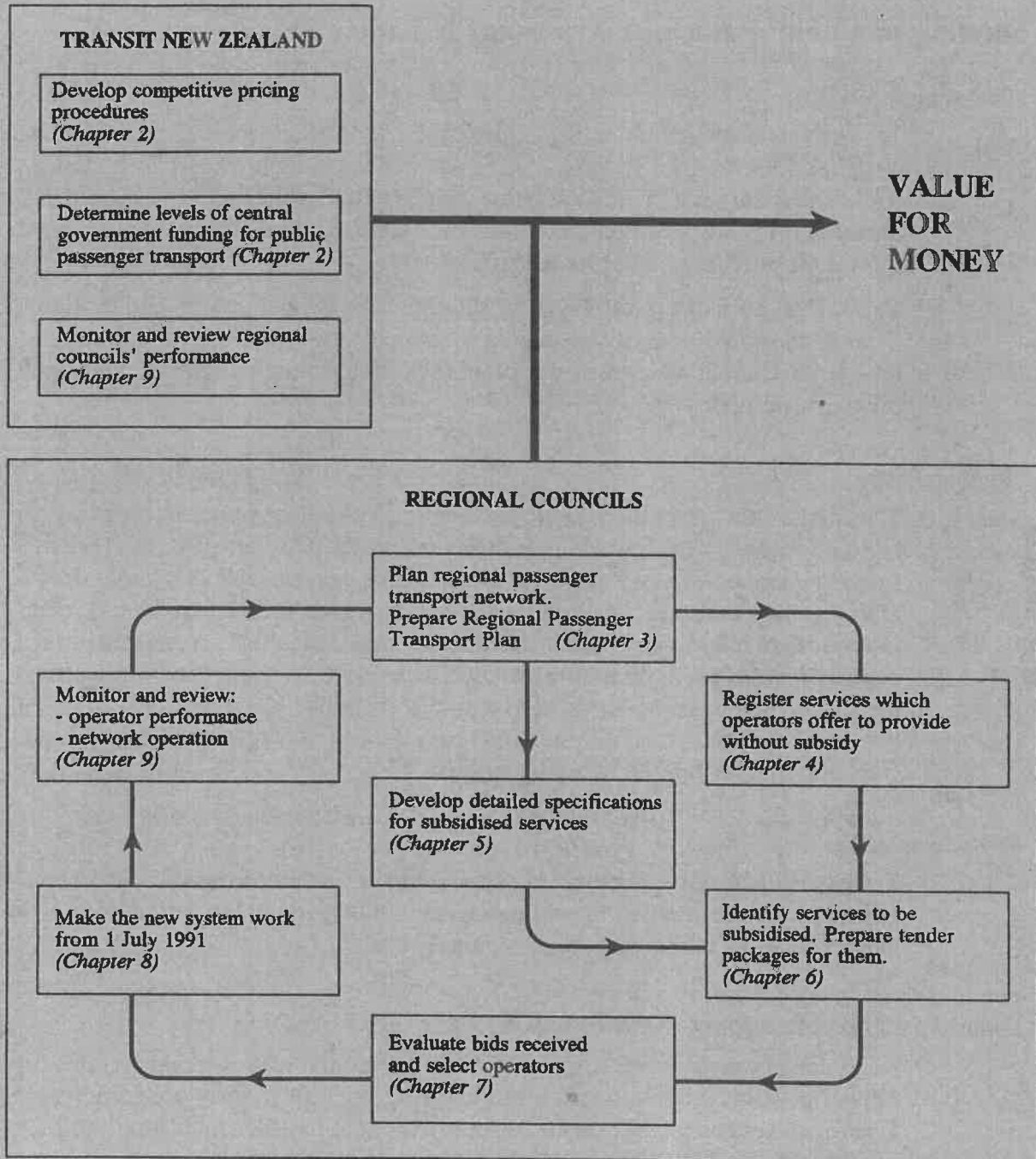
## INTRODUCTION

*1.8* The Competitive Pricing Procedures are a key element in the Government's reform of the transport sector. The aim of this particular provision is to ensure that regional councils secure their subsidised public passenger transport services at the best possible price. To achieve this, they must put the work out to competitive tender, using procedures approved by Transit.

*1.9* The Competitive Pricing Procedures were chosen for examination because:

- Over \$100 million was spent on public passenger transport services in 1990-91, funded by both central and local government.
- Public passenger transport is important in the lives of many people, providing some 125 million subsidised passenger journeys each year.
- The CPPs represent a significant element in the Government's reform of the transport sector. The reforms were designed to address shortcomings in the previous regime. There was no requirement for competition in the supply of services, and costs were not transparent.
- This was a new policy, and an evaluation of the first tendering round could provide useful lessons for future years.

## THE COMPETITIVE PRICING AUDIT MODEL



## RESULTS OF THE AUDIT

### Funding of Public Passenger Transport (Chapter 2)

#### *Development of CPPs*

- 2.1 Transit was responsible for developing the CPPs which the regional councils were required to use. In doing so, it drew on available expertise including consultancy services. Transit selected its consultant with care, and monitored progress. We are satisfied that Transit obtained value for money for the services it purchased from its consultant.
- 2.2 The CPPs were the product of a lengthy debate over issues and options. Transit consulted widely with regional councils and the transport industry to produce a manual which was workable for the three councils whose tendering practices we reviewed.

#### *Funding Policy*

- 2.3 Transit has the responsibility for allocating central government funding to regional councils for public passenger transport. Our analysis of Transit's subsidisation policy and funding mechanisms revealed shortcomings in its ability to account for the road user funds which it spends on passenger transport. While we recognise that there are difficulties in establishing a subsidy justification policy, the absence of a sound rationale has implications for the involvement of central government in public passenger transport. At the present time, it is not possible to establish whether public passenger transport is over-funded or under-funded.

#### *Recommendations*

- 2.4 Transit should give priority to developing a sound rationale for central government's contribution to public passenger transport, and to determining how much should be allocated to each regional council.

### Planning the Transport Network (Chapter 3)

- 2.5 Regional councils were responsible for designing the passenger transport networks which were to come into operation on 1 July. They are responsible also for the ongoing planning of transport services in order to ensure that they continue to meet the needs of their regions.
- 2.6 Canterbury Regional Council did a commendable job in planning for the new regime on 1 July 1991. The council reviewed its network and actively sought the views of the public about its policies and the services it was proposing to provide.

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- 2.7 Wellington Regional Council also did substantial research to support its detailed network planning, and developed a Regional Passenger Transport Plan and published detailed service specifications.
- 2.8 Auckland Regional Council lacked studies to assist it with detailed service level planning and so adopted its existing network. Public input was sought indirectly through the local community boards.
- 2.9 None of the councils had all the information necessary for longer-term planning. However, in each case, they were working on obtaining it. We recognise that the planning modelling essential to achieving this is still a developing area.

### *Recommendations*

- 2.10 **Regional councils need to consult regularly with those who are using public passenger transport about future transport policies and services, as well as with the general public. To address broader regional needs, councils should collect the necessary information for medium-term and long-term transport planning.**

### **Commercial Services (Chapter 4)**

- 2.11 The transport reforms anticipated that operators would be willing to run some services without subsidy; that is, on a commercial basis. This would reduce subsidy expenditure, and councils would then call tenders for the remaining services. Thus, it is in the regional councils' interests to encourage operators to provide such services. While the councils' ability to influence the level of commercial services is limited, the policies which they adopt can make this option more or less attractive to operators.
- 2.12 In the three councils examined, the proportion of commercial services was small, and they typically mirrored existing service patterns. In Wellington, where some commercial services conflicted with the council's requirements, the council carried out analysis to justify its subsequent intervention in the market.

### *Recommendations*

- 2.13 **Regional councils should explore opportunities to encourage operators to run services without subsidy. They must be willing to respond flexibly to initiatives taken by the market, particularly if more commercial services are registered in the future.**

### **Developing Service Specifications (Chapter 5)**

- 2.14 To translate plans and policies into a working transport system, each council had to develop explicit service requirements. This involved, for example, setting fares, deciding how often services should run, and calculating how many people needed to be carried on each trip. This required councils to have

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information about current and potential passenger needs. Services had to encourage patronage without creating excessive costs.

- 2.15 To a large extent, Canterbury and Wellington Regional Councils based their service specifications on research. They sought to introduce improvements to the existing system to make it more attractive to users, in the most efficient manner. Although we found some shortcomings in their performance, they were largely successful in this endeavour.
- 2.16 Auckland Regional Council placed considerable importance on avoiding any changes to the transport system, in order to avoid disruption to travellers and consequent loss of patronage. However, the council was aware that the existing system was inappropriate and that patronage was declining. Consequently, the council missed the opportunity to introduce, through the service specifications, any of the necessary changes which it had itself identified as desirable. This approach may have been successful in minimising the immediate impact on passengers, but it does nothing to address the continuing long-term problem of declining patronage.
- 2.17 None of the three councils gave the attention to fares which we had expected, given their importance in influencing subsidy levels and patronage. All three councils used existing fare levels as the starting point, without knowing whether these were appropriate.

### *Recommendation*

- 2.18 **Regional councils should develop fare structures which balance the objectives of recovering costs and encouraging patronage.**

### **Designing the Individual Tender Packages (Chapter 6)**

- 2.19 Having developed service specifications, regional councils faced the decision of how best to tender out the work. This required them to split up the network into tender packages. The size and the content of each tender package, or Request for Tender (RFT), could affect the outcome and costs of the tendering process.
- 2.20 We expected councils to design RFTs to:
- Benefit from operator efficiencies;
  - Encourage competition; and
  - Accommodate the needs of users.
- 2.21 All councils took steps to encourage competition by identifying times of low demand and tendering those services out as separate RFTs. Some further



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opportunities were forgone where councils packaged RFTs to limit the number of operators on particular routes.

### *Recommendation*

- 2.22 In packaging tenders, councils should balance the need to maintain an integrated transport network with the benefits of allowing the most cost-effective operators to bid for services.

### **Evaluation of Bids and Selection of Operators (Chapter 7)**

- 2.23 Having received the operators' bids, the councils faced the task of evaluating them and selecting the best offers. There were certain circumstances where councils could intervene in the tendering process to influence the outcome. These were where there was only one bidder or where the prices were, in their view, too high.
- 2.24 A directive issued by the Minister of Transport also allowed councils, if they chose, to give a price preference to existing operators and to offer extended contract periods.

### *Results of the Tendering Process in the Canterbury Region*

- 2.25 From our analysis of Canterbury Regional Council's management of the tendering process, we are satisfied that the council used the devices at its disposal in seeking to secure services at the least cost. It was able to reduce original bids by retendering and negotiation.
- 2.26 The council met the 1 July 1991 deadline for putting in place its planned new services and fare structures.
- 2.27 The subsidy paid in Canterbury in 1990-91 was \$14.8 million. The subsidy identified at 1 July 1991 was \$10 million, representing a saving of \$4.8 million or 32%.
- 2.28 Canterbury Regional Council was successful in attracting increased competition and innovation in the provision of services, with mini-buses obtaining work on low patronage services.
- 2.29 The introduction of the new competitive tendering process imposed costs on the ratepayers of Christchurch and Timaru, where the municipally-owned bus companies failed to retain their existing levels of work. In the financial year ended 30 June 1991, Christchurch ratepayers had to bear costs of \$18 million for the resulting redundancies and asset write-downs.

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- 2.30 In Timaru, the district council was able to offset costs by selling its fleet to the successful bidder. Christchurch City Council was able to recover only about \$400,000 of its losses, through the sale of its surplus buses.

### *Results of the Tendering Process in the Wellington Region*

- 2.31 Wellington Regional Council applied pressure on operators in the Hutt Valley by re-opening highly-priced tenders there. However, a lack of documentation meant we were unable to ascertain the effect of this action on the final contract prices.
- 2.32 The time available to the council to re-tender and negotiate was very limited. Consequently, the council did not test prices in those cases where there was only one bid for a service. The council was therefore unable to ensure that it had minimised the costs of these services.
- 2.33 The council completed the tendering process and set up the required services by 1 July. New services were introduced, and existing services modified.
- 2.34 The tendering process allowed some new entrants to gain contracts, and produced innovations through the use of mini-buses to service lower-capacity routes. In the Hutt Valley, more than one company now operates on some routes, providing a mix of commercial and subsidised services. This was the sort of outcome expected from the Government's policy.
- 2.35 The subsidy saving identified at 1 July 1991 was \$6 million, a reduction of 16% over the funding of \$37.5 million required in the previous year. \$2.1 million of the saving related to rail services. The total subsidy cost for the new network at 1 July 1991 was \$31.5 million.
- 2.36 Wellington City Council began rationalising its municipal bus operations in advance of the tendering process, to remain competitive. It succeeded in obtaining the desired contracts during the tendering round. However, the restructuring resulted in redundancy payments of \$3 million, and fixed asset and inventory write-downs of \$33 million for the 1990-91 year. These costs, which were an outcome of the CPP process, have to be borne by the ratepayers of Wellington.

### *Results of the Tendering Process in the Auckland Region*

- 2.37 After the tender results had been announced, the council was told by the Yellow Bus Company, the largest operator in the region, that it would not be financially viable under the contract durations it had been awarded. To meet the company's concerns, the council extended \$17 million worth of contracts by up to two years.
- 2.38 The council ensured the survival of the company and the continuation of the services which it was providing. However, the true costs of this are hidden by the way in which the council chose to achieve those objectives. The valuable

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concessions given to the company were at the expense of competition in the Auckland region.

- 2.39 The council reduced the costs of four minor services and vetted the quality of service offered in some others. However, the vast majority of the services received no detailed scrutiny, despite information available to the council that there were inefficiencies present.
- 2.40 The tendering process was completed on time and services were in place for 1 July. The council has retained the existing level of services and these will operate for a minimum of three years, when the first contracts come up for renewal. Through its support of the Yellow Bus Company, the council avoided the restructuring costs faced by municipal bus operators in the other regions.
- 2.41 Operators generally retained the services they were running previously, and did not expand into new areas or areas held by other operators. As in other regions, there were some new entrants, including taxi operators.
- 2.42 The saving in subsidy costs identified by the council at 1 July 1991 was \$3.6 million, a reduction of 7.5% over the previous year's cost of \$48 million.

### *Recommendation*

- 2.43 **Regional councils should make use of all opportunities to test tender prices. This is particularly important where a single operator dominates the market or where competition for services is weak.**

### **Making the New System Work (Chapter 8)**

- 2.44 In the period up to 1 July 1991, regional councils designed their passenger transport networks and contracted operators to provide the necessary services. 1 July marked the day on which the transport systems created by the councils began operating. It was their responsibility to ensure that this transition was successful.
- 2.45 Further, they had to ensure that the transport services they were funding continued to meet the needs of travellers and maximised the value obtained from the public money used to subsidise them.
- 2.46 There are three key areas where regional councils have a role in the ongoing operation of their passenger transport systems:
- *Promotion and Publicity*  
Promoting public passenger transport as a desirable mode of travel, and providing specific details about services is essential to a successful passenger transport system;
  - *Amenities for Travellers*  
Users of public passenger transport need amenities such as bus shelters and timetable displays; and

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- *Service Adjustment and Co-ordination*

Changes to the transport system (for example, new services, amended timetables, and new fare structures) require overall management.

2.47 Canterbury and Wellington Regional Councils take an active role in promoting individual transport services as well as public passenger transport in general. These councils serve as a focal point for the public. They also take responsibility for making ongoing adjustments to the system to meet user requirements.

2.48 Auckland Regional Council provided public information about the 1 July changes. However, it plays a very limited part in the ongoing promotion and operation of its network. The potential consequences of this approach are a system which fails to meet user needs and thus exacerbates the decline in patronage.

### *Recommendation*

2.49 **Regional councils should take responsibility for the ongoing operation of their transport networks; where necessary, in conjunction with other local authorities and operators.**

## **Monitoring and Review (Chapter 9)**

2.50 Running the public transport networks in the three regions will cost more than \$85 million of public money in 1991-92. It is essential that regional councils and Transit protect this investment by monitoring and reviewing transport services and the way in which they are provided. They can also use this information to improve services in the future.

### *Regional Councils*

2.51 We consider it essential that regional councils monitor and review in three areas:

- *Operator Performance*

Operators of subsidised services are contracted to provide a certain quantity and quality of service. Councils should ensure that these contractual obligations are met.

- *Patronage*

Councils need to know how many people are using services. For example, falling patronage may indicate traveller dissatisfaction or changing needs. This may require councils to make service changes or, where necessary, to consider whether services should be discontinued.

- *Service Suitability*

Current services need to remain appropriate and future demands need to be anticipated. Councils should obtain and analyse the necessary information to achieve this.

## RESULTS OF THE AUDIT

- 2.52 Canterbury and Wellington Regional Councils are putting considerable effort and resources into ensuring that operators perform satisfactorily. Auckland Regional Council is not obtaining the information necessary to adequately evaluate the performance of its contractors.
- 2.53 None of the three councils is maintaining its operator performance material in a way which will allow trends to be established. This means that they will find it difficult to identify patterns of complaints or the longer-term patterns of individual operator behaviour.
- 2.54 No council monitored the effects of the 1 July changes on patronage. Without this information, they could not establish whether the changes were successful. Canterbury and Wellington Regional Councils are now building up their knowledge of current patronage levels.
- 2.55 None of the three councils was successful in ensuring that all operators complied with requirements to provide patronage information. They had also done little analysis on the reports they did receive.
- 2.56 Canterbury and Wellington Regional Councils had set in place systems to identify and make necessary service improvements. Auckland had yet to begin work in this area.

### *Recommendations*

- 2.57 **Regional councils must give a priority to obtaining patronage information so they can ensure that their services match needs.**
- 2.58 **Councils also need to ensure that they collect the necessary information for reviewing services and monitoring the performance of operators. The information must be maintained in a way which allows them to use it for managing their networks.**

### *Transit*

- 2.59 The key objective of the CPPs was to enable Transit and regional councils to procure subsidised public passenger transport services in the most efficient way, through competition among potential suppliers. In carrying out its functions, Transit was required also to have regard to the overall goal of maximising national economic and social benefits. We therefore expected Transit to have reviewed the outcomes of the tendering process in each region against specific performance targets to establish whether those objectives had been met.
- 2.60 Transit has set in place mechanisms to review and monitor certain procedures and processes within its areas of responsibility. However, it does not review

whether the funding which goes to public passenger transport is being spent effectively and efficiently.

**Recommendation**

- 2.61 Transit should develop performance measures which enable it to evaluate whether it obtains value for money from its contribution to public passenger transport in the regions.

**A Special Case:**

**Wellington Rail and Trolleybus Services (Chapter 10)**

- 2.62 Wellington Regional Council had identified the rail and trolleybus services as essential components of the region's passenger transport system. It was successful in safeguarding these modes and thus obtaining the network it set out to achieve. In doing so, it avoided the problems which it believed would be caused if the rail and the trolleybuses were unable to survive the competitive tendering process.
- 2.63 The council will pay a total of \$17.2 million to preserve the rail network for 1991-92. This compares with a subsidy figure for 1990-91 of \$19.3 million, representing a saving of \$2.1 million.
- 2.64 There were two costs to the council from securing the rail services:
- Services which would have been run without cost to regional ratepayers were declined; and
  - A \$10 million infrastructure subsidy was paid to NZ Rail.
- 2.65 The council's commitment to protecting rail led to an environmental policy being applied without evidence of the likely detrimental effects of using an alternative mode.
- 2.66 The council did not analyse how the fixed costs of the rail infrastructure related to the costs of operating individual rail services. Without this information, the council could not be sure that it was not paying too much to support rail.
- 2.67 The protection of the regional rail network was achieved through negotiations which the council failed to control. This gave the rail operator the strategic opportunity to influence the outcome of the tendering process. In taking this approach, the council failed to promote a commitment to competition, even where survival of the rail structure had been assured and no additional protection was necessary.
- 2.68 Although the infrastructure subsidy therefore proved effective in securing rail services for the region, we are not satisfied that it was negotiated in such a way as to ensure that it obtained the most cost-effective outcome for the region.
- 2.69 The council also made a special subsidy payment to meet the infrastructure costs of Wellington's trolleybus network. It used a competitive process to test

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the price which it paid for the trolleybus infrastructure subsidy. This gave the council an assurance that the price was reasonable.

- 2.70 However, costs and benefits to the ratepayer of protecting Wellington's trolleybus network are not clear. The regional council did not relate the infrastructure subsidy to individual trolleybus services to ensure that it was not subsidising services which the operator was able to run commercially. In our view, therefore, the council failed to manage the process to ensure that it secured the trolleybus services for the least cost.

### *Recommendations*

- 2.71 **Wellington Regional Council should take a more active role to identify and secure benefits for the region from the rail and trolleybus networks, and test subsidy costs in order to better protect the interests of ratepayers, road users and the travelling public.**

## OVERALL CONCLUSIONS

- 3.1 It is not possible to calculate the net benefits of introducing the Competitive Pricing Procedures. The information which the councils collected under the old system does not allow comparison, and not all effects are quantifiable.
- 3.2 Benefits we identified were:
- The total amount of subsidy money being paid out for passenger transport services by the three councils for 1991-92 is some \$14 million lower than it was for 1990-91;
  - Services which were previously subsidised are now provided commercially, without public funding; and
  - Municipal bus operators have changed their operations to become more competitive.
- 3.3 We also identified a number of other outcomes.
- 3.4 The reforms created restructuring costs for ratepayers in Canterbury and Wellington, where municipal operators lost contracts. These costs totalled \$53 million in the year to 30 June 1991.
- 3.5 As no comprehensive patronage surveys have been conducted since 1 July 1991, the effect of the reforms on users of public passenger transport remains unknown. It is essential to establish this, since the transport system exists to meet the needs of passengers.
- 3.6 There were two situations where regional councils failed to identify the true costs and benefits of their decisions. These were:
- Auckland Regional Council's support of the Yellow Bus Company; and
  - Wellington Regional Council's application of its environmental policy to protect the rail and trolleybus networks.
- 3.7 The three regional councils we visited faced an enormous administrative task in preparing for 1 July 1991. We would like to acknowledge this, and commend them for completing the task within the limited time available. Regional councils will not face an effort of the same magnitude in the future, since all subsequent tenders will be carried out on a staggered basis. Their work may become more complex, though, if competition increases, as instanced by the situation faced by Wellington Regional Council in the Hutt Valley.
- 3.8 We found that regional councils have different views of their roles in the new passenger transport regime.
- 3.9 Auckland Regional Council placed reliance on operators for running the network. Canterbury and Wellington Regional Councils saw their responsibilities more widely, and took an active part in the ongoing operation of their systems.



## OVERALL CONCLUSIONS

- 3.10 Canterbury and Wellington Regional Councils saw the reforms as an opportunity to introduce change. They undertook research to identify regional needs, and from the results developed appropriate service specifications. Auckland Regional Council made a conscious decision to limit change as far as possible. It argued the need both to avoid disruption to the travelling public and to secure the survival of the Yellow Bus Company. The council's decision has simply deferred the impact of the transport reforms.
- 3.11 Competition was a key objective of the CPPs and the reforms generally. All three regions were successful in encouraging new operators to enter the market and in reducing subsidy costs. However, Auckland and Wellington Regional Councils took decisions which effectively inhibited competition:
- In Wellington, the political decision to protect rail led to the cheaper option of buses being rejected on certain routes. This policy also resulted in some \$10 million of funding being removed from the competitive process, in order to support rail. As a result of its preference for rail, the council did not explore opportunities for buses. These might have offered greater benefits to users or a price advantage.
  - Auckland Regional Council, in electing to use the longest possible contract periods locked in the existing network for at least three more years. The rationale for this decision and the final choice of contract periods were explicitly designed to protect the Yellow Bus Company from the effects of competition.

### Management of Public Passenger Transport in the Future

- 3.12 There are a number of areas where, in our view, Transit and regional councils need to direct their efforts in the future.
- 3.13 A key priority for Transit, if it is to fulfil its statutory responsibilities, is to decide how best to use taxes collected from road users to support public passenger transport. Transit has yet to develop a defensible policy for subsidising passenger transport and to devise funding mechanisms which would enable it to know how its contribution to regional passenger transport is spent.
- 3.14 Within the constraints of Government policy, Transit is responsible for making choices about how much money the Government should spend on roading, passenger transport and other land transport activities. As long as central government and ratepayers accept that there is a relationship between public transport and the amount of money spent on roading, there will be an urgent need for Transit, regional councils, or both, to develop a means of making the choices required.
- 3.15 Compiling detailed information about patronage is essential for regional councils to ensure that they support only those services which continue to meet the travel requirements of passengers and ratepayers. Only by reviewing routes and timetables can councils know where subsidies can be used most effectively

## OVERALL CONCLUSIONS

and efficiently in the interests of users. This must be accompanied by research to establish the emerging transport needs of the region and the demand for new services to meet those needs.

- 3.16 Regional councils must review service specifications, such as fares and vehicle features, to ensure that there is a balance between subsidy costs and the needs of the travelling public.
- 3.17 There is a need for regional councils to actively pursue strategies to maximise opportunities for competition and thereby maximise subsidy savings. These include grouping services in the tendering process so as to attract bids from a variety of operators, and establishing accurate benchmarks for evaluating service costs. The tendering process saw few major services contested. Where services are not contested, regional councils need to test prices in order to obtain the best result for the region.
- 3.18 Transit and regional councils are both supporting public passenger transport out of public funds. This carries with it the obligation to monitor and review how that money is spent. There is only limited scrutiny of how regional councils are using the funds collected and distributed by Transit. All regional councils need to take an ongoing interest in the system and its operation. More generally, they must continually review how services are being used and, where necessary, make changes to accommodate the changing requirements of the travelling public and to maximise value from the subsidy paid.