

Bills Committee on Rail Merger Bill
Follow-up to meeting on 14 November 2006

(a) Details of previous cases whereby railway corporations, bus companies or green minibus operators set their individual fares at rates different from the overall fare adjustment rates

The two railway corporations and most of the franchised bus companies last increased their fares in 1997. We have made a comparison based on available information concerning their fare adjustments in the 5-year period between 1993 and 1997. Paragraphs 2 – 10 summarise our findings.

Franchised bus fares

2. Routes of franchised bus companies are grouped into different route groups which are subject to their respective fare scale. Individual routes within the same route group are subject to the maximum fare levels set for different ranges of route distance. The fares of individual routes within the same distance range are normally adjusted by the rate approved for that distance range, but there would also be cases the fares of some of these individual routes may be adjusted by different rates, subject to:

- (i) the adjusted fare cannot exceed the maximum fare level prescribed for that distance range; and
- (ii) the weighted average rate of fare adjustment of all individual routes must equal to the approved overall average fare adjustment rate.

3. The following table sets out the range of deviation of adjustment rates of individual fare scales of three franchised bus companies¹ between 1993 and 1997:

Table A

Franchised bus company	Year	Overall fare increase rate	Deviation from overall fare increase rate	
			Over (+)	Under (-)
KMB	1993	11.2%	+5.9%	-6.2%
	1994	12.9%	+4.7%	-4.2%

¹ They are the Kowloon Motor Bus Company (1933) Limited (KMB), China Motor Bus Company Limited (CMB) and Citybus Limited (CTB).

	1995	7.0%	+2.2%	-7.0%
	1996	3.6%	+8.2%	-3.6%
	1997	7.0%	+2.1%	-7.0%
CMB	1993	13.0%	+3.4%	-3.1%
	1994	9.8%	+9.3%	-8.7%
	1995	No fare adjustment		
	1996	10.4%	+5.4%	-5.6%
	1997	8.0%	+3.5%	-1.5%
CTB	1993	No fare adjustment		
	1994	13.4%	+4.8%	-2.3%
	1995	No fare adjustment		
	1996	9.6%	+1.7%	-2.9%
	1997	6.0%	+1.5%	-1.8%

Note: Figures rounded to one decimal place.

4. According to available information on the actual adjustment rates to individual bus routes in the same period, there were some cases where the deviation from the overall approved fare adjustment rate was close to or exceeded 10 percentage points. The following are examples concerning KMB bus routes:

- (i) In 1993, the fare increase rate of KMB route no. 71B² (Tai Po Central – Fu Heng) deviated from the overall fare increase rate by +31.6 percentage points
- (ii) In 1994, the fare increase rate of KMB route no. 203E³ (Fu Shan – Jordan Ferry) deviated from the overall fare increase rate by –12.9 percentage points.

5. Table A and the above examples explain that flexibility for adjustment rates to individual fares is not unique to the railway corporations. Both the franchised bus companies and the railway corporations operate in a competitive market in Hong Kong with the presence of other public transport operators, and they all need to be allowed certain flexibility to respond to market changes.

Railway fares

6. The following table sets out the range of deviation of adjustment rates of individual fares of the two railway corporations between 1993 and 1997 based on information provided by them:

² The fare increased from \$0.7 to \$1.

³ There was no change in the fare level.

Table B

Railway corporation	Year	Overall fare increase rate	Deviation from overall fare increase rate	
			Over (+)	Under (-)
MTRC	1993	9.0%	+11.0%	-3.1%
	1994	7.1%	+6.1%	-7.1%
	1995	7.8%	+8.9%	-7.8%
	1996	6.9%	+13.1%	-6.9%
	1997	5.5%	+1.9%	-5.5%
KCRC	1993	7.3%	+17.7%	-7.3%
	1994	No fare adjustment		
	1995	6.8%	+18.2%	-6.8%
	1996	6.8%	+26.5%	-6.8%
	1997	6.2%	+13.8%	-6.2%

7. Apart from the reason of market changes, the following will help explain the specific cases mentioned in Table B where the individual fare adjustment rates deviated from the overall fare adjustment rate by more than 10 percentage points. In future, MergeCo will be subject to more stringent restriction as the proposed Fare Adjustment Mechanism (FAM) will limit its flexibility to deviation of no more than 10 percentage points from the overall adjustment rate:

- (i) In 1993, the rate of fare adjustment of certain MTR concessionary single-ride fares which increased from \$2.5 to \$3.0 deviated from the overall fare adjustment rate of 9% by +11 percentage points.
- (ii) In 1996, the rate of fare adjustment of certain other MTR concessionary single-ride fares which increased from \$5 to \$6 deviated from the overall fare adjustment rate of 6.9% by +13.1 percentage points.
- (iii) In 1993, the rate of fare adjustment of certain KCR concessionary stored value fares and concessionary single-ride fares which increased from \$2 to \$2.5 deviated from the overall fare adjustment rate of 7.3% by +17.7 percentage points.
- (iv) In 1995, the rate of fare adjustment of certain other KCR concessionary stored value fares which increased from \$2 to \$2.5 deviated from the overall fare adjustment rate of 6.8% by +18.2 percentage points.
- (v) In 1996, the rate of fare adjustment of certain other KCR concessionary stored value fares and concessionary single-ride fares which increased from \$1.5 to \$2 deviated from the overall fare adjustment rate of 6.8% by +26.5 percentage points.
- (vi) In 1997, the rate of fare adjustment of certain other KCR concessionary stored value fares and concessionary single-ride fares which increased from

\$2.5 to \$3 deviated from the overall fare adjustment rate of 6.2% by +13.8 percentage points.

8. According to further information from MTR Corporation Limited (MTRCL) concerning their fare increase exercise in 1987, whilst they implemented an overall fare increase of 6.7% in that year, at the same time they also reduced some of the individual fares along the sections between Tsuen Wan and Lai King, between Kowloon Tong and Choi Hung and between North Point and Wanchai from \$2.5 to \$2.2 having regard to the introduction of / changes to sectional fares offered by other road-based public transport operators. The reduction of these individual fares represented a –18.7 percentage points deviation from the overall fare increase rate of 6.7% in that year. Similar reduction of individual MTR fares happened in 1989 when, in response to introduction of new express bus routes operating along the Island Eastern Corridor, the fares along some sections of the Island Line were reduced from \$2.7 to \$2.5, which represented a –16.7 percentage points deviation from the overall fare increase rate of 9.3% in that year.

9. In the case of railway fare adjustments in future, MTRCL is requesting limited flexibility that would enable MergeCo to react to changing market conditions. The range of ± 10 percentage points from the overall fare adjustment rate under the FAM has already greatly limited MergeCo's ability to adjust individual fares as compared to fare autonomy the two railway corporations presently have. The FAM itself has already ensured MergeCo would not obtain additional financial benefits even if it decided to exercise flexibility in adjusting individual fares at different rates within the permitted range, as the application of different adjustment rates to different individual fares under the FAM must be revenue neutral. Further, MergeCo is required to obtain certifications from two independent experts regarding the details of individual fare adjustments to ensure compliance with the FAM before the fare adjustments could take effect.

Green minibus (GMB) fares

10. Many GMB routes are operated on an individual basis and therefore we have not researched into the past fare adjustment records of GMB fare adjustments for the purpose of this analysis. It is relevant to note, however, that since the operating environment pertaining to different GMB routes may differ and the financial performance of individual GMB operators are different, it is likely that the fares of individual GMB routes were and would be adjusted by different rates. The provision of limited flexibility to MergeCo in individual fare adjustments would enable MergeCo to respond to future market changes including fare adjustments of GMB service as well as introduction of new GMB service in areas

where GMB service is a competitor of the railway service.

(b) Details of synergies of the rail merger and the basis of calculation

11. Synergies of the rail merger were identified and estimated via a review conducted jointly by MTRCL and Kowloon-Canton Railway Corporation (KCRC), supported by a management consultant. Each functional area common to both corporations was examined in a 3-step process:

Step 1 – Activity Analysis

- Comparison of functions and activities
- Comparison of key performance items
- Identification of best practices

Step 2 – Synergy Calculation

- Bottom up calculation of manpower requirements for each activity
- Revenue, non-staff cost and capex synergies calculated in absolute or percentage terms (Note: Purely for synergy assessment purpose, it was assumed that synergy could be fully realized at the time of the assessment)
- Calculation of implementation costs

Step 3 – Ramp up

- Time scale required for implementation worked out
- Ramp up to full synergy determined based on timescale for implementation and associated capital expenditure required

12. Based on the above approach, it was estimated that when all synergies are fully realized, they would amount to about \$450 million per annum net of recurring implementation costs.

13. The majority of synergies identified would come from the following three areas:

- Transfer of best practice and operations synergies (about \$160 million per annum⁴), for example:
 - Improved scheduling of engineering work
 - Implementation of total station operation
 - Implementation of group station management

⁴ Further breakdown of synergies amount is not available because synergies may come from overlapping activities and it is not appropriate to artificially apportion the estimated amount into each and every different activity.

- Combining operations at interchange stations
 - Combining Customer Service Centres and ticket offices
 - Centralising maintenance of electronic components
 - Improved energy management
 - Reorganisation of stores
- Procurement (about \$140 million per annum⁴), for example:
 - Contract bundling in respect of cash handling, station cleaning, catering, spares and IT equipment
 - Wider implementation of e-tendering
 - Increased alternative sourcing of items
 - Review and rationalisation of specifications
 - Increased volume of procurement of spares
 - Consolidating insurance
- Support functions (about \$150 million per annum⁴), for example:
 - Streamlining of overlapping functions
 - Reduction of overheads
 - Combining of training facilities
 - Reduction in annual reporting
 - Consolidating and integrating IT systems and equipment
 - Consolidating financial processes
 - Reduction in representation required at industry groups and meetings
 - Reorganisation of transport planning
 - Consolidation of marketing costs
 - Integration of customer service hotlines