Pre-seen analysis
T Railways

Note: The enclosed document in no way indicates what is likely to be examined in the un-seen information on exam day.

Contents

- Pre-seen analysis of T Railways
- E3 Tips and Guidance
- F3 Tips and Guidance
- P3 Tips and Guidance
- News articles about the railway industry

Exam Timetable

<table>
<thead>
<tr>
<th>May 2013 Exam sitting</th>
<th>Tuesday 21 May</th>
<th>Wednesday 22 May</th>
<th>Thursday 23 May</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morning session</td>
<td>E3 Enterprise Strategy</td>
<td>P3 Performance Strategy</td>
<td>F3 Financial Strategy</td>
</tr>
<tr>
<td>9:10am to 12:30pm</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Pre-seen analysis of T Railways

Background

- Country T landlocked and outside the Eurozone.
- Currency T$
- T railways nationalised 1975
- Since 1998 T Railways (Holding company and Board) became the holding company of three wholly owned subsidiaries
  - T City-Link (TCL) – passenger services
  - T Freight Railways (TFR) – freight services
  - T Property and Track Services (TPTS) – track, property, policing and related services

The activities of T Railways

- TCL – 1800 passenger rail services per day within country T. Fewer services on Sundays. Electric network with international connections, most trains now electric. Recent road improvements have led to some lines being discontinued due to fall in demand.

- TFR – 600 freight services a day excluding national public holidays only. Haulage services e.g. coal, petrol, steel, concrete, cars and retail goods. Most of the trains ‘old diesels’, but recent investment in a number of electric trains for environmental purposes.
  - TFR accounts for 40% of group revenue.
  - Freight haulage market share within county T is 10%.
  - 80% of haulage being by road which is a major concern to government because of congestion and the harm to economic productivity.
  - TFR has benefited from road congestion e.g. 25% increase in freight haulage over the last 15 years.

- TPTS – ‘other services’ including track maintenance and upgrades.
  - 200 railways stations
  - Retail concessions and own cafes
  - 11 maintenance depots
T Railways organisational structure

- Role culture and classical system of rational planning
- Ownership by government
- Chairman of T Railways reports directly to government civil servants e.g. formal annual and ad-hoc meetings.

Rail regulator

Rail regulator to provide ‘independent review of T Railway activities’, it makes direct recommendations to the Minister of Transport, on all issues. Their role is ‘to ensure rail services are delivered in Country T in a safe and efficient manner’. Its aims are ‘provision of efficient services, satisfaction of rail users and the improvement of safety for staff and passengers. Also monitoring carbon emissions from rail transport.

T Railways Chairman recently said...

“T Railways is committed to providing an excellent service to its customers and work is ongoing to improve our time keeping. Investment in improving railway stations is continuing and accessibility to railway services is increasing with new car parks being built at many stations in the network. Other service amenities are being improved such as better access ramps for disabled customers and the levelling of the height of platforms at many stations so that customers can access and alight from trains without having to take a large step up or down to the platform. This will reduce the incidence of accidents which occur at stations where the platform infrastructure was developed for a bygone era of railway carriages.”

T Railways strategic objectives

- To deliver reliable, safe and punctual rail services to customers efficiently and cost effectively thereby helping to achieve economic growth in Country T by reducing congestion on its roads;
- To continually reduce its level of carbon emissions to help provide an environmentally friendly transport infrastructure.
T Railways financial objectives

- T Railways should at least cover its operating costs from the revenue it earns;
- T Railways should provide value for money.

Financial data for T railways

- Prepares its accounts according to international accounting standards.
- Policy of not revaluing non-current assets.
- Head office overhead allocated and apportioned to its three subsidiaries.

<table>
<thead>
<tr>
<th></th>
<th>Revenue (T$ m)</th>
<th>Operating cost (T$ m)</th>
<th>Profit (T$ m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TCL</td>
<td>680</td>
<td>630</td>
<td>50</td>
</tr>
<tr>
<td>TFR</td>
<td>516</td>
<td>494</td>
<td>22</td>
</tr>
<tr>
<td>TPTS</td>
<td>95</td>
<td>80</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td><strong>1291</strong></td>
<td><strong>1204</strong></td>
<td><strong>87</strong></td>
</tr>
</tbody>
</table>
The total operating cost for TPTS was T$842 million in 2012, this was after the allocation and apportionment of head office overhead.

All operating cost of TPTS, except that relating to its revenue of T$80 million (above), allocated and apportioned to the other two subsidiaries, e.g. T$762 million (T$842m - T$80 m) allocated and apportioned to the other two subsidiaries.
Financing T railways

- The government of T Country invested T$100 million in 1975 as share capital.
- Any deficit by T Railways is guaranteed by the government by additional revenue funding e.g. this is not a loan.
- The government also providing a loan facility to finance capital expenditure e.g. long-term loan recognised (currently T$1800m, page 7 pre-seen). No fixed repayment date and fixed interest of 4% per annum.
- T Railways is now seeking wider sources of finance e.g. banks and commercial lenders.

Key performance indicators (KPIs)

Examples relating to TCL

- National customer surveys
- Customer complaints reported

Examples relating to TFR

- Capacity utilisation e.g. actual ÷ available load, each journey.
- Punctuality e.g. number of trains on time ÷ total journeys.
- Carbon emissions e.g. Kg CO$_2$ ÷ tonnes transported x by distance travelled (Km).

Examples relating to TPTS

- Number of delays per month due to signal failures
- Number of complaints per month relating to station cleanliness.

Health and safety

T Railways concentrates a great deal of effort on the management of particular risks such as Signals Passed at Danger (SPAD) and customer and staff injuries.

T Railways has a Safety Committee which meets regularly and monitors performance against its annual safety targets agreed with the Ministry of Transport.
Examples of the KPIs relating to safety which are used

- The number of customer movement accidents per million passenger kilometres e.g. accidents caused due to the motion of trains.
- The number of customer non-movement accidents per million passenger journeys e.g. slips and falls while on T Railways’ property.
- The number of accidents or injuries sustained by staff per million kilometres travelled.

The KPIs reported in T Railways’ annual report which accompanies its financial statements.

Environmental considerations

- The transport industry’s carbon emissions are responsible for between 20% and 25% of all carbon emissions in Country T.
- T Railways is increasing its efforts to reduce its levels of carbon emissions e.g. committed to reducing its carbon emissions by a third between now and 2015.
- All TCL and TFR drivers receive ‘eco-driving’ training on an on going basis.
- TPTS is progressing work on making stations and depots energy efficient by improving lighting and heating systems including the use of ‘intelligent lighting’.
- All three subsidiaries are keen to reduce waste and to increase the amount of waste they recycle. Target set by the T Railways Board of recycling 85% of T Railways’ total waste by 2015.

Development of T railways

The T Railways Board is constantly seeking ways of generating additional sources of revenue. Some ideas under consideration include:

- Structural changes such as running the three subsidiaries as completely separate entities.
- Expansion of the network.
- Diversifying the portfolio through operating other forms of transport.
• Outsourcing some or all of the current provision of passenger, freight, track, property or retail related services or privatising parts of the business.

The Government has considered privatising the whole of T Railways but so far has been wary of the ‘British experience’. However, possible privatisation of T Railways continues to be discussed within Government and Country T’s Prime Minister has never ruled it out.
E3 Tips and Guidance

Specific tips for section A – T Railways

Questions could either be ‘focused on the group’ e.g. profitability/non-financial performance analysis and advice about product/divisional portfolio, or based on ‘one division only’ e.g. one division and strategic option/investment/NPV to consider.

- Evaluation of the suitability of T railways current organisational structure/culture e.g. evaluation of structural changes such as running the three subsidiaries as completely separate entities. All operating cost of TPTS, except that relating to its revenue is allocated and apportioned to the other two subsidiaries, perhaps further profitability analysis of each division given ‘cost drivers’ and other ways of allocating and apportioning TPTS and group overhead.

T Railways existing organisational structure

- Role culture and classical system of rational planning
- Ownership by government e.g. bureaucratic
- Chairman of T Railways reports directly to government civil servants e.g. formal annual and ad-hoc meetings.

- Construction of an incremental profit forecast/or NPV for expansion of new products/markets e.g. Expansion of the network. Evaluation of whether this option provides a minimum financial return and is consistent with other principles such as ethics and Corporate Social Responsibility.
- Financial calculations could be based on passenger rail services/freight services per day within country T driving contribution, fixed cost and high initial financial outlay. Or investment in ‘other services’ including track maintenance and upgrades.
- An evaluation of T railways financial performance using financial and non-financial information provided e.g. ratio analysis or balanced scorecard review of performance.
• Explain alternative approaches that can be used by the Board of Directors or manager of a division in general, to manage conflicting objectives between stakeholders, given a strategic option in the un-seen information.

• Recommend to the Board using an appropriate model (for example, the Boston Consulting Group Portfolio Matrix/Ansoff/Porter's generic strategies), future strategies for each of T railways current and potential business segments e.g. Diversifying the portfolio through operating other forms of transport could be another option to consider on the day.

• Value for money (VFM – 3 Es) framework for performance measurement applied to T Railways, or a division.

• Evaluation of outsourcing some or all of the current provision of passenger, freight, track, property or retail related services or privatising parts of the business.

• “Possible privatisation of T Railways continues to be discussed within Government and Country T’s Prime Minister has never ruled it out”.

• Questions could include discussing why T railways mission statement or objectives might change because of a change in ownership?

• Discussion of the relevance of the style of strategy currently in use by T railways. Perhaps advice to the Board of other alternative approaches to strategy, given a possible change in ownership. Advice the Board of Directors of DP of another approach to forming strategy which would be most suitable for its organisation’s changed circumstances as a privatised company.

• Recommend, with reasons, four Critical Success Factors (CSFs) which would be appropriate given a change in ownership.

• Lewin's three-step model of change to assist the staff to make the transition to the new privatised model.

• Recommend, giving your reasons, which competitive strategy B should follow in future, in each of Country T's business sectors. Using Porter's model of generic competitive strategies/Ansoff in your answer.
**F3 Tips and Guidance**

For F3 it is important to understand the strategic objectives and financial objectives

**Financial objectives for T Railways**

The Government’s aim and the T Railways Board’s main financial objectives are that:

(i) T Railways should at least cover its operating costs from the revenue it earns;
(ii) T Railways should provide value for money.

**Strategic objectives for T Railways**

(i) To deliver reliable, safe and punctual rail services to customers efficiently and cost effectively thereby helping to achieve economic growth in Country T by reducing congestion on its roads;
(ii) To continually reduce its level of carbon emissions to help provide an environmentally friendly transport infrastructure.

**Development of T Railways**

The T Railways Board is constantly seeking ways of generating additional sources of revenue. Consideration is being given to a number of possible initiatives. Some ideas under consideration include:

- Structural changes such as splitting T Railways up into its constituent parts and running the three subsidiaries as completely separate entities;
- expansion of the network;
- diversifying the portfolio through operating other forms of transport;
- outsourcing some or all of the current provision of passenger, freight, track, property or retail related services or privatising parts of the business.
F3 section A exam questions focus is on options available to the company which meet both the strategic and financial objectives. The possible initiatives mentioned in the pre-seen are the possible options that will require evaluation in F3.

**F3 May 2013 and September 2013 exam paper predictions for T Railways:**

The T Railways Board is constantly seeking ways of generating additional sources of revenue. The considerations mentioned above could lead to the following numerical questions being examined:

**Numerical aspects**

- **Business valuation.** The main methods of valuation would be required (net assets, dividend valuation model, earnings based, discounted cash flows). Foreign exchange rates will be an aspect, so forecast future exchange rates and discounting cash flows using the various exchange rates forecast could be examined.

- **Investment appraisal.** Various projects may be undertaken. The relevant cash flows will need to be discounted using the appropriate discount rate (perhaps calculation of WACC or using CAPM – ungearing and gearing betas). The difficulty in establishing a suitable discount rate for a public sector organisation may be examined as the cost of capital structure is based on funding by the government.

- **Financing.** T railways funding needs are met by the government so this may not be an issue. However during times of economic downturn and austerity measures, the government may not have enough funds available. Perhaps one of the subsidiaries may be floated on the stock market and privatised?

- **Lease versus buy.** With the structural changes forecasted, leasing assets may be viable and cheaper option then purchasing outright.

- **Forecasting financial statements** incorporating the forecast data. Additional forecast data will be given to see the impact on the income statement, statement of financial position and cash flow statement. The need for financing will be highlighted here. Key ratios can be calculated from the forecast data to assess the affect on performance and financial position.

- **Efficient management of working capital** can release cash flows which enable the company to release cash for any financing short falls in the future. However as funding is provided by the government this may not be an important issue.
Discussion aspects

- The various types of financing available and their advantages / disadvantages.
- Project control and implementation.
- Role of treasury department and other organisations in terms of raising long term finance.
- The impact of efficient market hypothesis and share price if privatised.
- The impact on the public and other stakeholders with the particular course of action taken.
- Incorporating real options in investment appraisal.
- The use of appropriate discount rates (WACC, CAPM) in public sector organisations.
- Identifying the major risks (PEST analysis).
- The impact on the 3 key financial management policies (investment, financing and dividend) and their interaction with each other.

Whatever the numerical aspects of the question are, you must discuss whether the objectives will be met and the impact on the strategic aims.

Previous questions papers November 2012 and March 2013, deal with a similar government owned organisation for section A.
P3 Tips and Guidance

Exchange risk

The GBP is weaker than compared to the EUR when exchanging T$. Therefore if the nationalised rail industry of country T wanted to buy in replacement rolling stock or track it would be currently more expensive to source these from the Eurozone, however this is subject to changes in the exchange rate which may in the future make the GBP exchange more favourable for T.

Nationalised industry risk

It is always perhaps more difficult for a government to run a company in an industry as they do not have the expertise and knowledge to make it successful. There is a risk that the government are running it inefficiently and the country as whole maybe more successful if it was run by private companies.

Private company risk

There is a risk that the private company, if given the chance to run the railways, will run it to the benefit of the shareholders and not to the other stakeholders, such as the public. They may cut services which are not profitable because they are not in demand but this may severe vital links from remote locations across the country.

Environmental risk

The unseen may look at the impact that the infrastructure changes may have on the environment and whether or not the targets set by the Board of T Railway of reducing its carbon emissions by a third by 2015 are realistic. There may also be environmental issues with the disposal of old diesel locomotives.

Governance risk

There may be issues with the lack of non-executives on the T Railways Board leading to decisions being which may not be in the interests of T Railways as a whole. If in the unseen there is mention of non-executives they may not be independent.
**Strategic planning risk**

The Board of T Railways takes a formal and bureaucratic approach to planning the strategy of T Railways. There is a risk that the Board take a reactive approach to events impacting the railway industry. The rational planning approach does not allow for more frequent ad-hoc revisions of the strategy which may be necessary to keep up changes that were unexpected.

**Rail regulator risk**

The rail regulator is appointed by the Government which means that there is a risk that he may act for the interest of the government rather than for the interest of the railway business as whole. Public confidence in the rail regulator may be low if they suspect that he is acting for the Government rather than for the public at large.

**Objectives risk**

T Railways has many objectives that it wants to meet. There is a risk that some may not be met and it depends on the specifics of the objectives that bind them. For example the level of punctual trains maybe achieved if the rate is set very low rather than very high.

Some objectives may conflict with others and therefore it needs to be decided which objectives have priority over others. For example customers may have to pay higher fares if they wanted to make trains safer by carrying out more checks or buying more modern carriages.
Outsourcing risk

The Railways Board is looking to outsource some or all of the current provision of passenger, freight, track, property or retail services. The following are risks to outsourcing:

- Loss of strategic control over key activities.
- Risk to the security of your key products (coca cola formula).
- Loss of competitive advantage.
- They do not understand your needs as well as you do.
- Locked into a contract you would rather not have (becomes costly and time consuming to sort out).
- Outsourcing companies have their own priorities which may conflict with that of the customers e.g. timetabling.
- Loss of internal expertise.