A critical analysis of the PTOG Funding and Industry Survey on the Impact of Cost Pressures

Presentation: SABOA CONFERENCE 2022

09 JUNE 2022

MAN BUILDING = NASREC EXPO CENTRE

SABOA

Southern African Bus Operators Association

voice of the bus & coach industry

Industry overview

- Since 2009, the subsidy payment to bus operators have been via the Public Transport Operations Grant (PTOG) as published annually in the Division of Revenue Act (DORA).
- This grant is viewed by National Treasury as a supplementary grant with the expectation that provinces would "top up" their provincial allocations to meet the relevant escalation formulas embedded in the interim, tendered and negotiated contracts.
- This has not happened except for three provinces that traditionally operated "homeland" services. The PTOG caps the annual kilometres of operators and contract costs may not exceed the allocated amount in the PTOG.
- SABOA has made many presentations to the DoT and Treasury to increase the grant **(this year the PTOG de-escalates by -0,4%)** or to ensure that the grant is more in line with the relevant escalation formulae in the respective contracts.
- This has had some success. It is estimated by SABOA that since 2009 the cumulative deficit of the PTOG compared to the expected increase in the subsidy amount - when using the interim contract escalation formula as a proxy for the three types of contracts - **is in the order of R3,6 billion**.

Industry overview

- The Bus and Coach industry comprises of the following sub-sectors:
  - Contracted provincial commuter bus transport
  - Private (corporate) bus services
  - Municipal bus services
  - Scholar bus services (mostly SMME operators)
  - BRT services
  - Long distance interprovincial services
  - Tour/charter services
  - Cross-border services

Industry overview

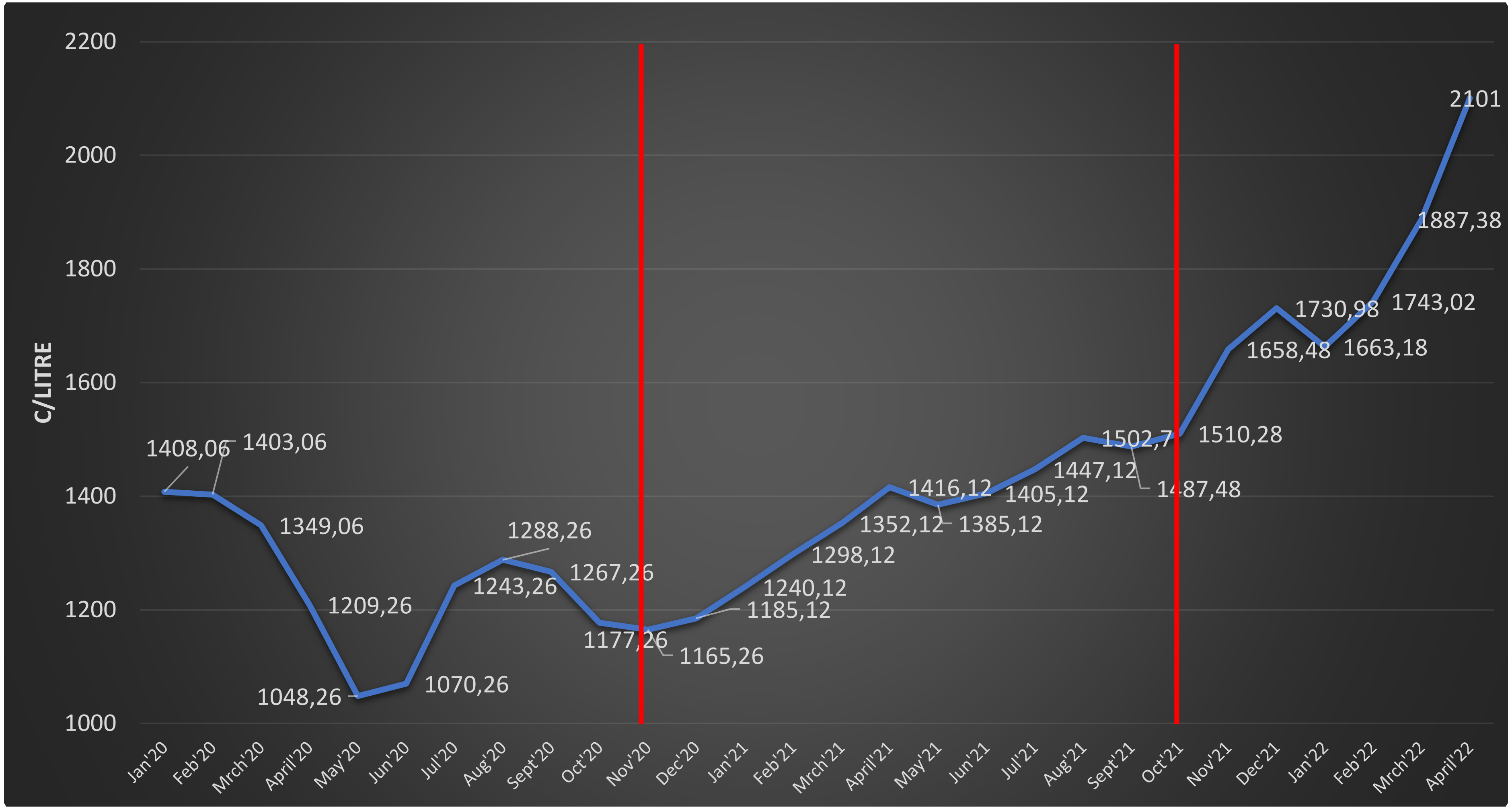
- In 1997, Interim contracts (ICs) were concluded with all subsidized bus operators as a transitional measure to full contracting within three years. The subsidy was based on a passenger subsidy linked to distance travelled and socio-economic circumstances of passengers.
- Approximately 120 Tendered (TCs) and Negotiated (NCs) contracts were concluded between 1997 and 2001 after which the system came to a halt mainly due to funding issues.
- All Tendered and Negotiated contracts are kilometre-based contracts.
- In 2009,with the introduction of the PTOG, all remaining ICs were converted to kilometre-based contracts and the contract kilometres "capped". All tendered and negotiated contracts were also capped and contract expenses were not allowed to exceed the annual PTOG determined by National Treasury in the DORA
- Since 2009 the industry cost escalation has been "de-linked" from agreed escalation formulas in the ICs, TCs and NCs as National Treasury determined the annual grant.
- Treasury expects provinces to "bridge the financial gap" between agreed escalation formulas and the PTOG.
- Only three provinces that historically operated "homeland services" make financial contributions namely (Northwest, Eastern Cape and Limpopo).
- The following table is a comparison of the annual PTOG increase compared to industry wage increases, CPI, diesel and the agreed IC escalation percentages (as a proxy for TCs and NCs increases). Blocks in red indicate respective percentages that are higher than the PTOG percentage increase and the blocks in green where the PTOG percentage exceeds the particular percentage increase.

Comparing the escalations of ICs, PTOG, CPI, Labour and Diesel

Year	INTERIM CONTRACT ESCALATION PERCENTAGE (WHAT OPERATORS SHOULD HAVE RECEIVED)	ACTUAL (PTOG) PERCENTAGE ALLOCATION (WHAT OPERATORS ACTUALLY RECEIVED)	AVERAGE HEADLINE % CPI INCREASE/YR	ANNUAL WAGE PERCENTAGE INCREASES IN BARGANING UNIT	ANNUAL AVERAGE WHOLESALE DIESEL PRICE PERCENTAGE INCREASES (REEF PRICING) DECEMBER Y/Y
2009/10 (Introduction of the PTOG)	11.0	-6.0	7.1	11.0	-16.93
2010/11	2.0	5.1	4.3	10.0	8.1
2011/12	6.8	5.0	5.0	9.0	37.89
2012/13	9.9	3.1	5.6	8.5	8.59
2013/14	5.9	5.5	5.7	10.0	10.19
2014/15	6.8	6.2	6.1	9.5	1.28
2015/16	3.3	2.2	4.6	9.0	-17.48
2016/17	3.0	9.3	6.4	8.2	1.94
2017/18	6.6	6.0	5.3	9.0	17.51
2018/19	5.64	3.2	4.5	9.0	9.5
2019/20	7.28	5.6	4.1	8.0	-0.9
2020/21	4.16	6.7	3.3	6.0	-14.5
2021/22	1.94	5.5	4.5	4.0	43.7
2022/23	9.14 (Est)	**-0.43**	5.7 (April'22)	6.0 (Eff April'22)	17,0 (April'22)

Source: IC contract escalation clause; DORA, STATSSA, SABEA and Dept of Energy

Wholesale price of Diesel (Inland)



From November 2020 the price of diesel has continuously increased with a significant acceleration from about October 2021

Source: Dept of Energy/SAPIA

Cost increases in the bus industry

- The cost structure of bus companies have changed fundamentally over the years since ICs were concluded in 1997:
  - Fuel is now about 30% of TOC
  - Labour comprises about 40% of TOC
  - Whilst these two large cost elements make up 70% of a bus company's costs, the remaining 30% of costs are generally escalated at the applicable CPI.

- The wholesale price of diesel increased by **43.7%** (Dec '21 year-on-year) resulting in a TOC increase for diesel alone of **13.1%** (The PTOG increased by 5,5% in 2021/22).
- In April 2022 the **diesel price** had already increased by **17%** increasing industry TOC by **5,1%** for 2022.
- By end May this had risen to over **5,5%** is expected to rise further at end June.
- The **labour cost** increase in 2022/23 was settled at **6%** (averting a possible strike), therefore at 40% of TOC the cost increase for bus companies on labour alone is **1,8%.**
- **CPI** is hedging around **5,9%**. This may translate into an industry TOC increase of around **1,7%** or higher.

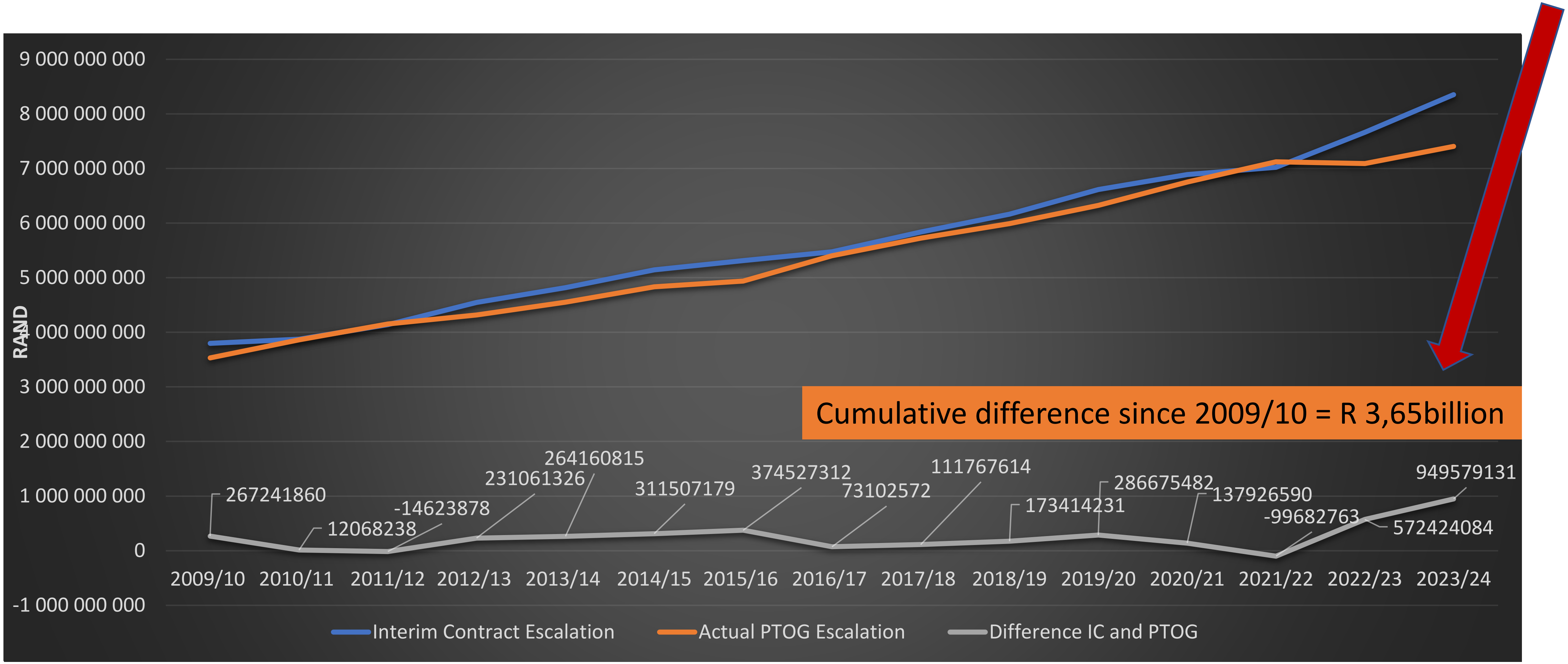
Cost increases in the bus industry

- When adding the percentage increase of labour, diesel (April '22) and CPI, the impact **in 2022 on TOC is already 8,6%**.
- This needs to be viewed in the context of the PTOG increase of **-0,43%** and the impact of the 2021 **43,7%** increase in the price of diesel (Dec '21 year-on-year) and a further **17%** increase in diesel to April 2022.
- According to StatsSA (P0141), the Transport Cost Index increased by **14,7%** (April year-on-year).
- You can see from the impacts shown here that the commuter bus industry is experiencing this type of cost pressure.
- **The impact of the -0,43% increase in the PTOG means that government is not assisting the industry at all in dealing with these increases.**
- The industry cannot absorb these costs and ultimately will have to decide on passing costs onto or recovering costs from passenger fares.
- Commuters generally resist resist above-inflation increases or multiple increases in one year.

Summary of cost changes

Cost element	Percentage change	PTOG percentage provision for 2022/23
StatsSA Transport Cost Index (April year-on-year)	14,7%	
Diesel increase (Dec year-on-year)	43,7%	-0,43%
Labour cost increase (est.) (negotiations incomplete)	6%	
CPI for 2022 (est.)	5,8%	
Diesel increase (April '22 vs Dec '21)	17,0%	

Comparing the Interim Contract escalation to the actual PTOG increase over the period 2009 to 2024: Cumulative difference



WHAT DO WE DO????

- A most difficult conundrum for experts, policy makers, regulators and stakeholders indeed:

- The conundrum of:
- HOW IS THE BUS INDUSTRY SURVIVING AMIDST THESE SERIOUS FUNDING CONSTRAINTS AND INCREASING COST PRESSURES?
- This is answered somewhat by the data extracted from a **SURVEY OF INDUSTRY** operating within the PTOG funding.
- The survey was taken post a high level engagement with the NDOT and the Acting DG.
- Using the survey monkey platform all operators were requested to complete the survey on the basis of aggregating the data for an industry view.
- The data will be made available in detail post meeting and follow up with the NDOT and Treasury, but the slides that follow reflect a high-level summary extract from the findings.

Industry Sector overview = PTOG

- This sub-sector is the contracted provincial commuter bus transport
  - There are approximately 6353 buses that operated 225 million revenue kms in 2019/20.
  - It was funded via the PTOG included in DORA to the value of R6 billion in 2019/20.
  - This subsidy funds: Interim contracts (68% of contracts last concluded in 1997); Tendered contracts (28% of subsidy budget with last tendered contract awarded in 2001) and Negotiated contracts (4% of subsidy budget).
  - All contracts are net-cost contracts meaning the operator takes all the cost and revenue risks of operations.
  - The average subsidy per passenger was R 22.21 and revenue per km operated R 26.76.
  - This represents 270m subsidized passenger trips for the period.
  - On average the industry employs 2.1 people per bus.

Source: Industry stats – DORA (2019/20)

SABOA INDUSTRY SURVEY

- **Twenty-four** operators completed the questionnaire.
- These operators operated a total of **5243 buses**. According to the PTOG notes in the DORA for 2022/23, audited results recorded that the PTOG subsidy was applied to **6170 buses** in the country (Division of Revenue Bill, 2022: 199).
- The response rate – based on the number of buses, is therefore **85%** (5243 buses less 189 non-subsidised buses dedicated to non-subsidised services).
- Only **927** buses not accounted for amongst the respondents to the questionnaire.

SABOA INDUSTRY SURVEY: BUS FLEET

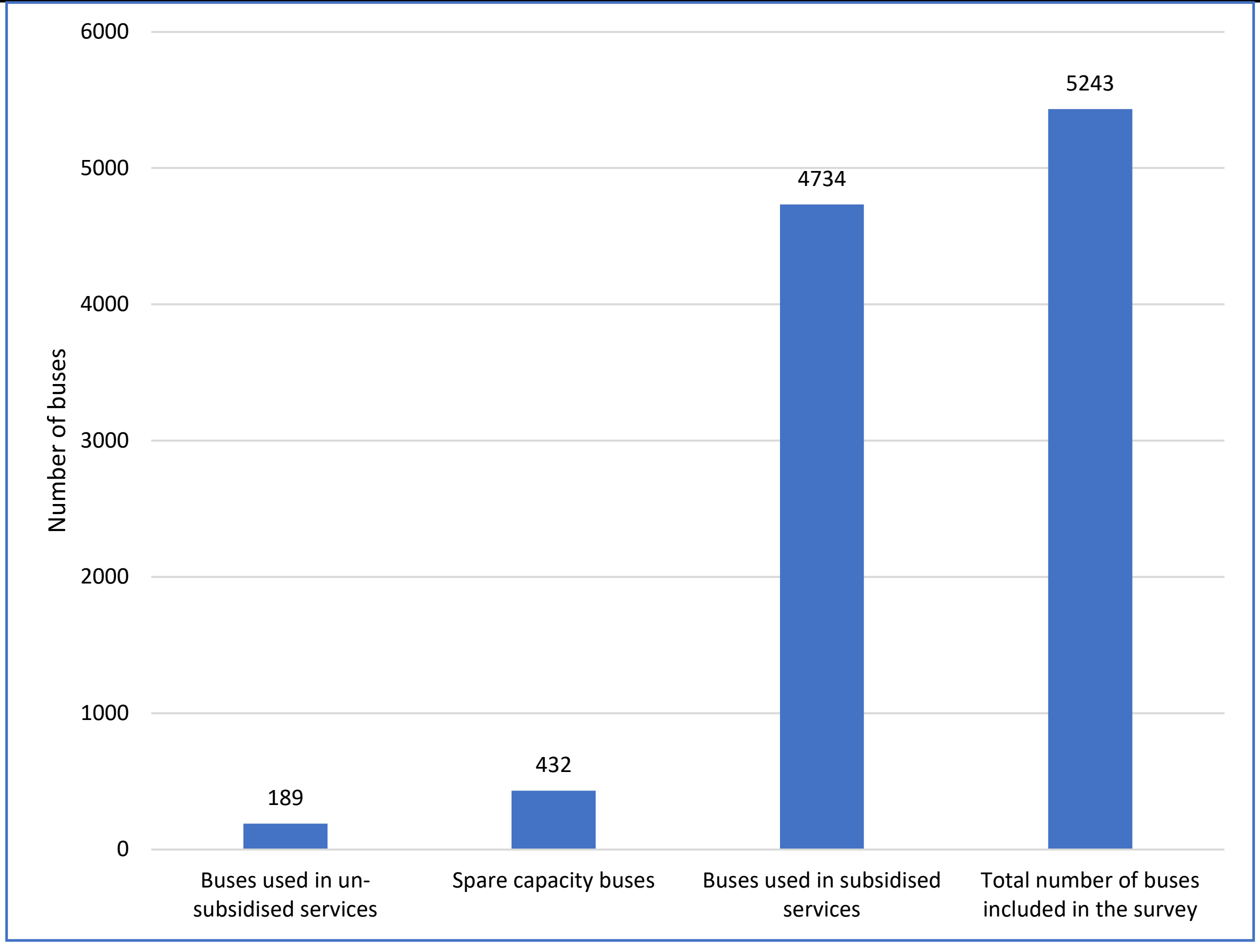


Figure 1 depicts the characteristics of the fleet.
A total of 4734 buses are used for subsidised services with a **standby fleet of 432 buses or 9,1%** of the active fleet.
Respondents operated 189 dedicated buses on **non-subsidised services.**

Figure 1: Number of buses included in the survey
Source: SABOA INDUSTRY SURVEY – MAY 2022

SABOA INDUSTRY SURVEY: BUS FLEET AGE

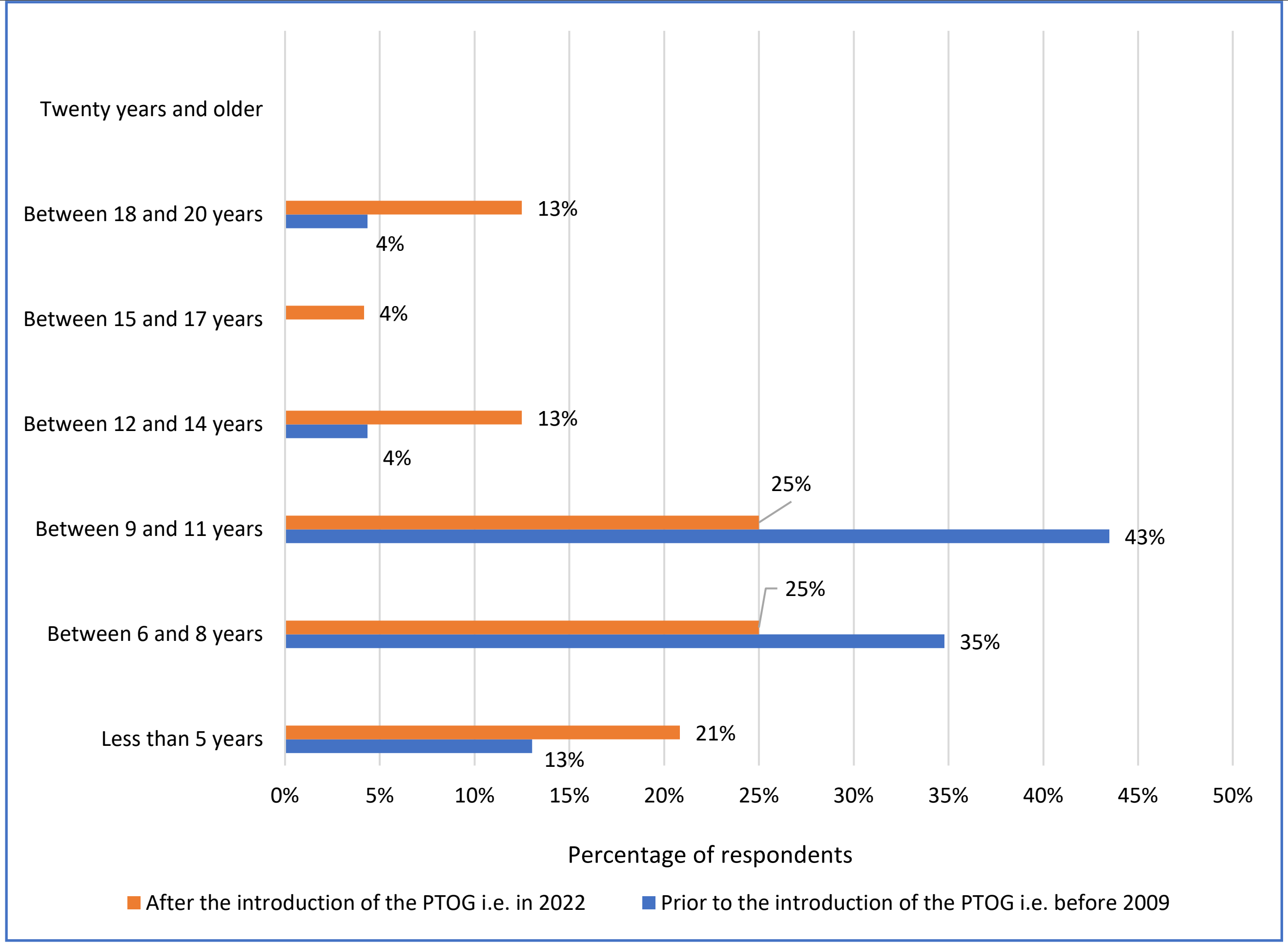


Figure 2: Fleet age before and after the introduction of the PTOG

Source: SABOA INDUSTRY SURVEY – MAY 2022

Prior to the introduction of the PTOG, 91% of respondents reported that their fleets were less than 12 years old compared to 71% of respondents currently.

After the introduction of the PTOG, 30% of respondents reported that their fleets were now 12 years and older whereas prior to the introduction of PTOG this figure was only 8%.

Significantly, 13% of respondents reported that their fleets were on average between 18 and 20 years old.

It is evident that the current funding model and constraints have had a major impact on fleet renewal, higher operating costs (due to the older fleet) as well as less reliable services (due to more frequent breakdowns of older buses).

SABOA INDUSTRY SURVEY:CONTRACT COMPLIANCE

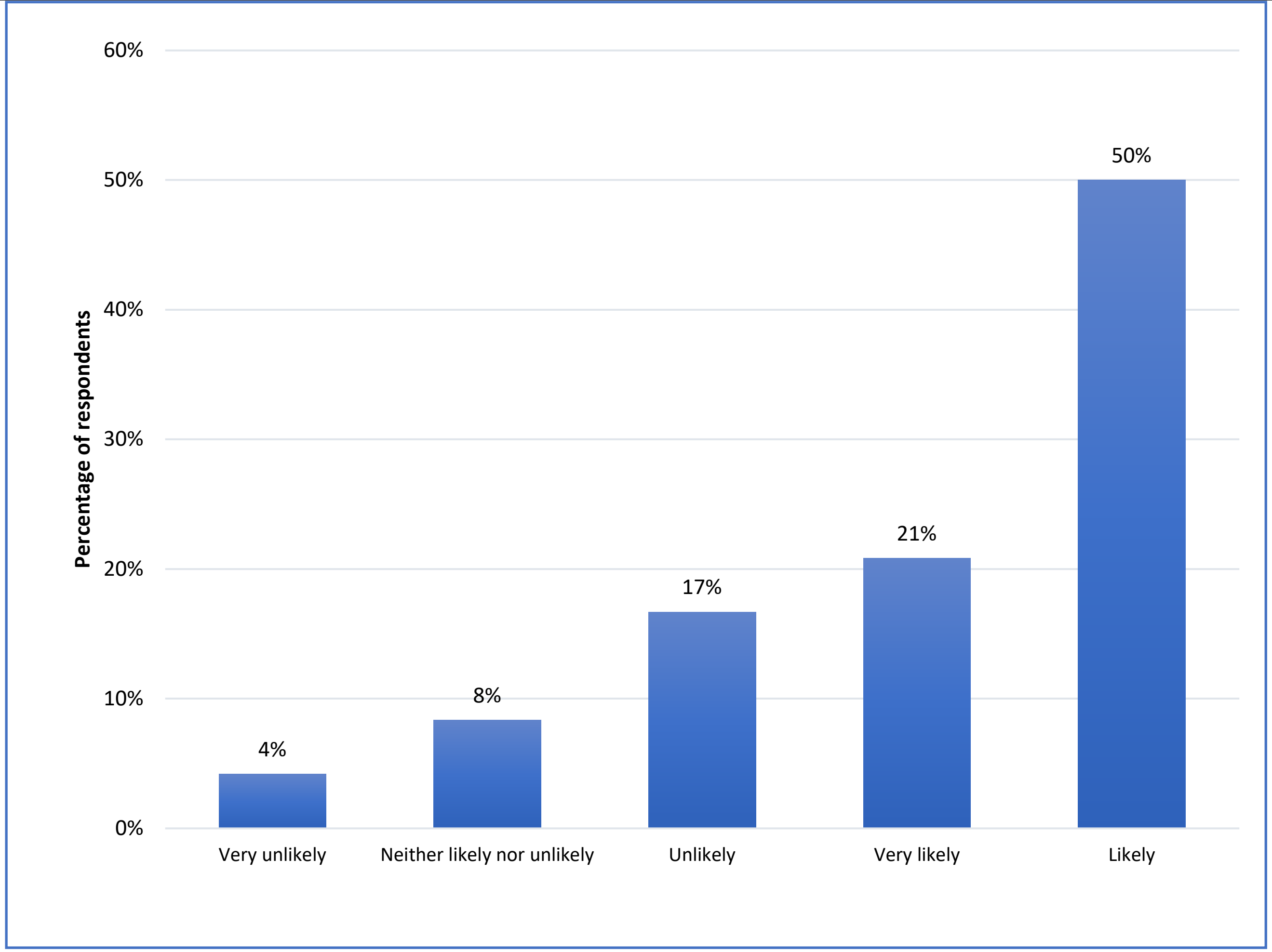


Figure 3: Ability to comply with contractual conditions

Source: SABOA INDUSTRY SURVEY – MAY 2022

It is concerning that only 21% of respondents believed they were "very likely" to comply with their contracting conditions.

Most respondents (50%) mentioned "likely" as their response to the question.

Conversely, 29% of respondents mentioned that they were unlikely to meet their contracting conditions.

Influencing factors around contractual compliance could be financing issues as the constrained PTOG escalations result in cash flow issues.

Operators are unable to recover these shortfalls from the fare box, thus affecting their compliance rates with their contracting conditions, poor operating conditions, policy uncertainty impacting on long term investment strategies in fleets.

SABOA INDUSTRY SURVEY:CONTRACT CONDITIONS

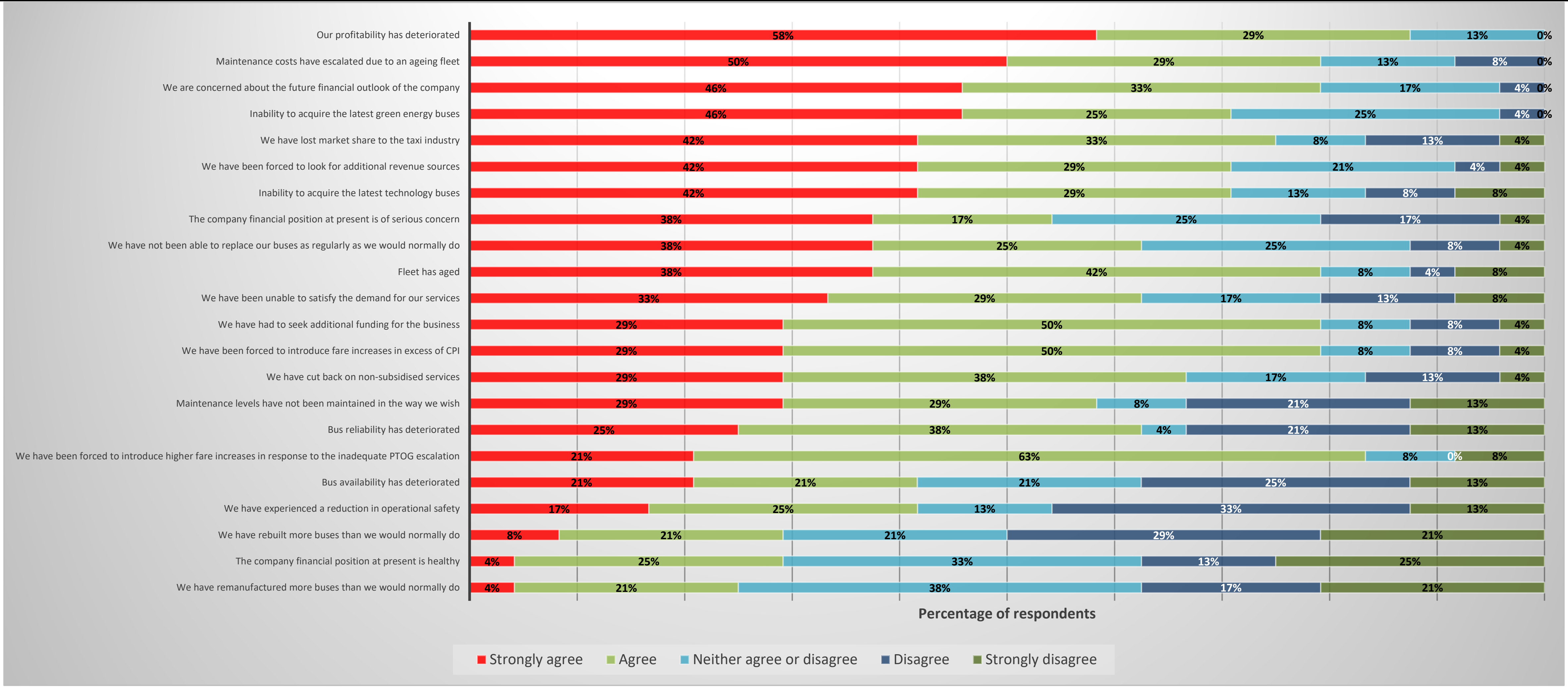


Figure 4: Impact of PTOG on the industry

Source: SABOA INDUSTRY SURVEY – MAY 2022

SABOA INDUSTRY SURVEY: MAJOR CONCERNS

Area of concern (ranked based on "strongly agreed "responses)	"Strongly agree" (%) responses	"Agree" (%) responses	Total responses
1. A deterioration in profitability	58	29	87%
2. An escalation in maintenance costs due to an ageing fleet	50	29	79%
3. Concern about the future financial outlook of the company	46	33	79%
4. Inability to acquire the latest green energy buses	46	25	71%
5. Lost market share to the taxi industry	42	33	75%
6. Being forced to look for additional revenue sources	42	29	71%
7. Inability to acquire the latest technology buses	42	29	71%
8. Serious concern about the financial position of the company	38	17	55%
9. Inability to replace buses as is regularly required	38	25	63%
10. The bus fleet has aged	38	42	80%

Table 1: Ability to comply with contractual conditions

Source: SABOA INDUSTRY SURVEY – MAY 2022

SABOA INDUSTRY SURVEY: EFFICIENCIES

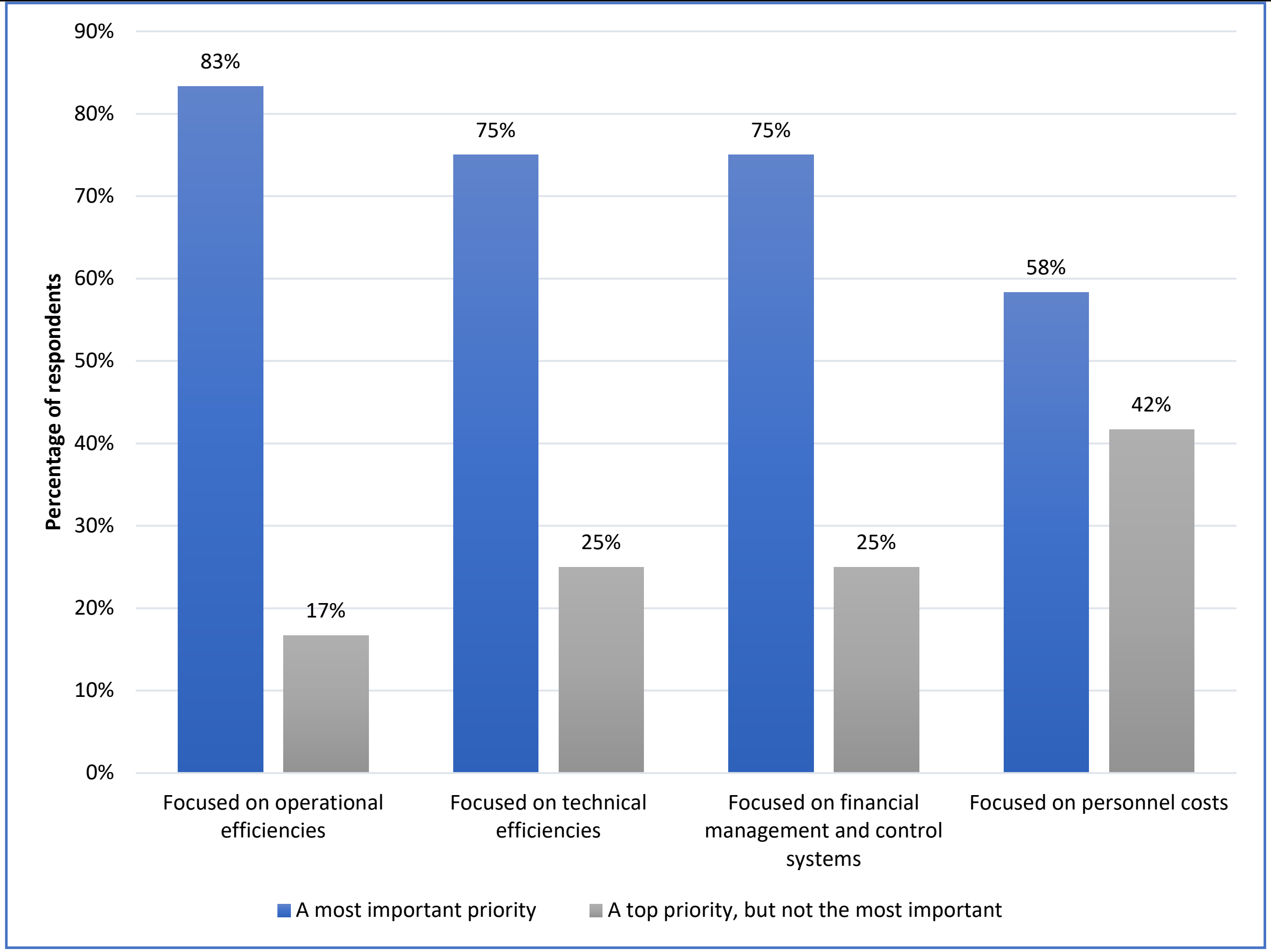


Figure 5: Areas of focus for efficiency improvements

Source: SABOA INDUSTRY SURVEY – MAY 2022

It is evident from this information that:

- **most attention (viewed as a "most important priority") has been focused on operational improvements (83%),**
- **followed by technical and financial management and control systems (75% respectively) and lastly on personnel costs (58%).**
- **Initiatives related to each of these four areas were taken to a deeper level – which is being aggregated even further.**
- **Clearly the industry views cutting of personnel costs as the ultimate last resort in contribution towards efficiency improvements.**

SABOA INDUSTRY SURVEY: FUTURE EFFICIENCIES

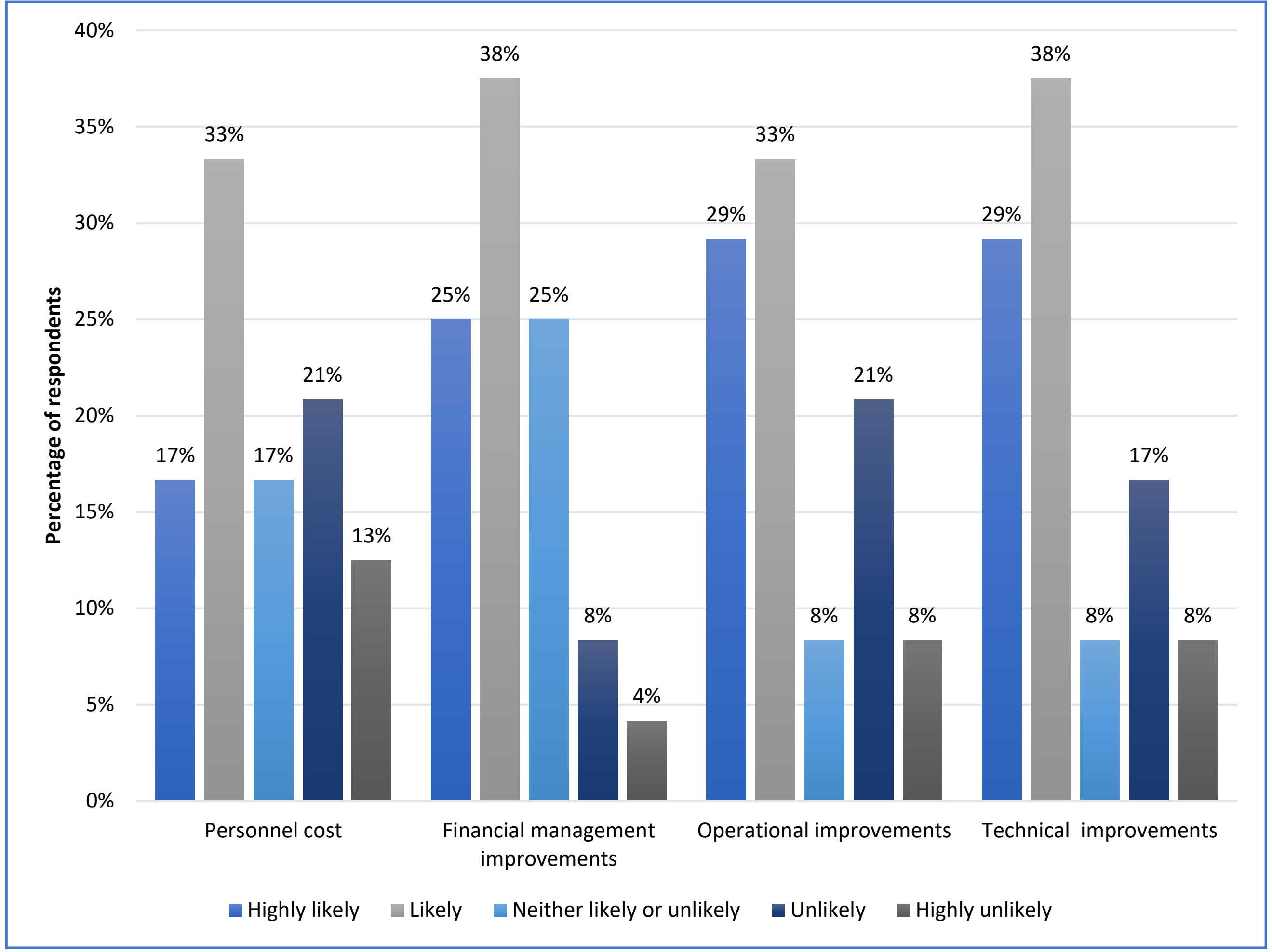


Figure 6: Potential for further efficiency gains

Source: SABOA INDUSTRY SURVEY – MAY 2022

It is interesting to note that respondents believed further efficiency gains were "likely" in all four areas of personnel costs, financial management, operational and technical improvements (a 33%-38% likelihood).

This is despite the initiatives that have already been implemented in the four areas.

The magnitude (incrementality vs substantiality) of these potential improvements were not established.

In contrast, respondents indicated that further efficiency improvements were highly unlikely: personnel cost (13%), financial management (4%), operational management (8%) and technical areas (8%).

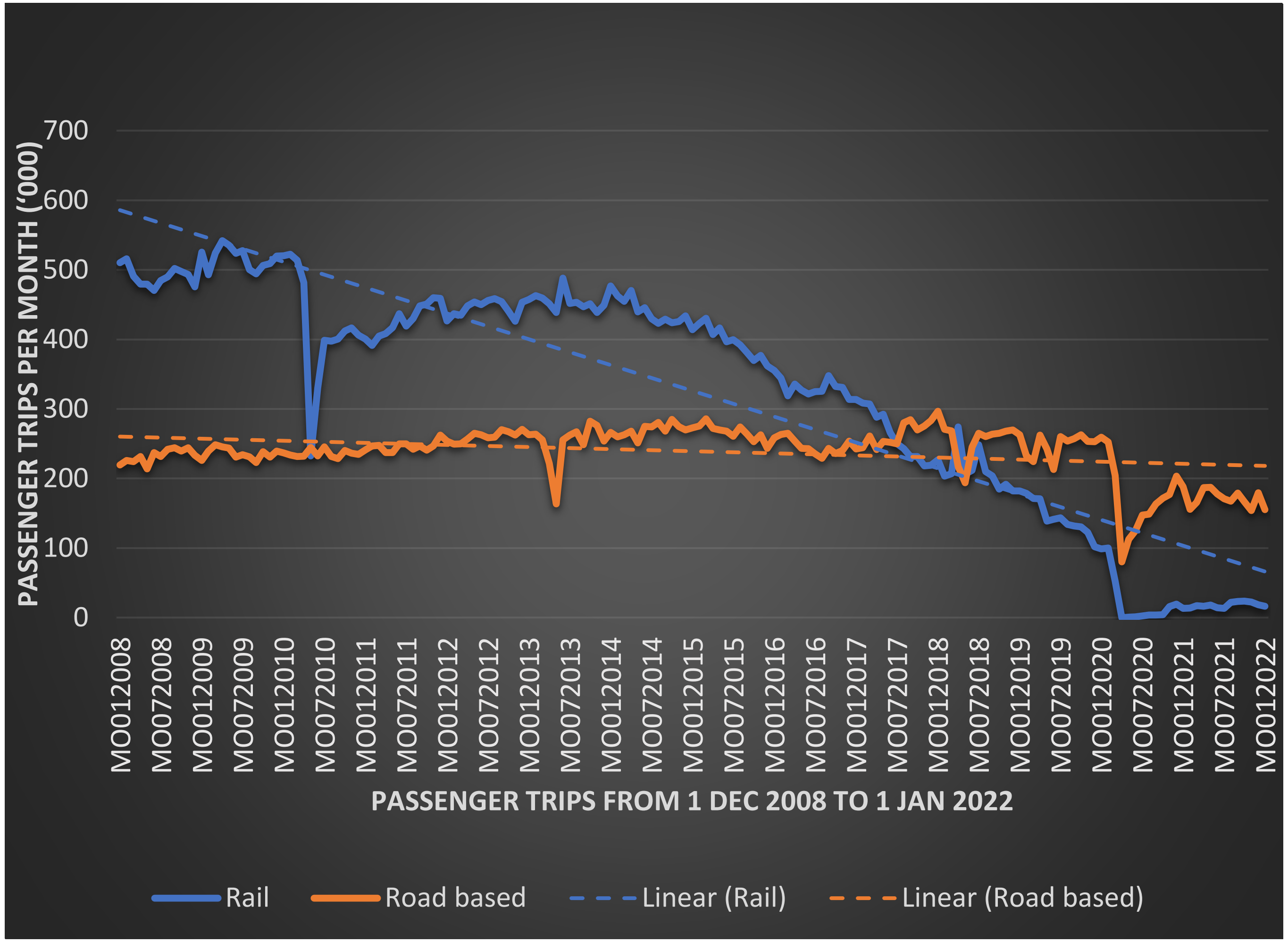
Survey Summary

- To conclude, it is evident from the survey results that the industry has introduced wide-ranging efficiency improvements across the main functional areas of businesses.
- These improvements have assisted companies to cope with, amongst other, the normal business environmental uncertainties but also the unpredictability and inadequacy of one of its main revenue streams – the PTOG.
- It is evident that the industry is on the back foot with a decline in profitability and there is a serious concern about the future financial outlook.
- The bus fleet is ageing, becoming less reliable and requiring increasing maintenance.
- The industry is also forced to introduce higher than normal fare increases due to the growing gap between costs and funding, which over time may result in a reduction in service quality ultimately impacting bus commuters directly.
- The lack of adequate funding has also resulted in many areas not being served by buses – even where demand does exist. This feeds to a market that become “captured” by the taxi industry.

Impact of the insufficient PTOG escalation and DORA conditions since 2009 on the industry

- The cumulative difference between the IC escalation and the PTOG at the end of FY 2023/24 is estimated to be R 3,65billion. This has had a major impact on the industry:
  - The industry has been "capped" in terms of the kilometres it may claim as the annual PTOG grant to provinces may not be exceeded.
  - The industry cannot expand its services in line with passenger demand. Passengers are unsatisfied with the range and scope of services as reported in the three national household travel surveys (NHTS, 2003, 2013 and 2021).
  - Companies have been battling to operate profitably and had to cut back on numerous expenses to maintain services, for example, the cutting back of social services proved by companies (i.e. non-subsidized), negatively affect the passengers.
  - Companies have had to implement significant fare increases to remain viable with high levels of passenger resistance. At present passengers will have great difficulty in accepting additional fare increases based on the high cost of diesel.
  - Companies have experienced continuous cash flow issues that impact on maintenance programmes, bus replacement programmes, high average fleet age, reliability of operations and general quality of service.
- The Competition Commission in its Market Enquiry into the Land Based Public Transport Sector reported that the *"allocation of bus subsidies does not adequately consider challenges and costs incurred by bus operators…"* (Main Report Page 12, Par 34).

Passenger trips: Commuter rail and Commuter bus



- The industry has not fully recovered since the start of the COVID-19 pandemic, but expectations are that the demand for commuter bus transport will increase due to the high fuel price.
- Since the PTOG was instituted in 2009 the bus industry has not been allowed to add additional routes/services due to the DORA cap. This is unfair as the industry cannot provide the services that the public demands (see the comments in the NHTS '21).
- The minibus-taxi industry has grown its market share at the expense of the bus industry **(See the NHTS surveys of 2003, 2013 and 2021)**.
- The commuter bus industry is currently the only reliable scheduled "formal" mode of transport that has a national presence in urban, semi-urban and rural areas

*Scope of StatsSA survey available on the website

Source: StatsSA (P7162 reports)

URGENT ENGAGEMENT NEEDED

- The industry urges the Department of Transport to urgently review the negative PTOG grant for 2022/23 as well as address the systemic under-funding of the industry.
- The industry and the commuting passengers deserve a better deal and support from government.
- Commuter rail is virtually non-existent – bus transport remains the only viable formalised and regulated mode of transport at present.
- The approach sought for the review of public transport funding must an urgent and collaborative one, positioned before or in line with the mid term budget review.
- SABOA will prioritise the engagement with both NDOT and Treasury, using the detailed aggregated survey results as a basis and measure for urgent action.

THANK YOU

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