

MODELS AND IMPLICATIONS FOR INDUSTRY COMPENSATION IN THE RESTRUCTURING OF PUBLIC TRANSPORT IN SOUTH AFRICA

C VON DER HEYDEN, E HASTINGS and N LEITNER

Pegasys Strategy and Development (Pty) Ltd, 4 Church Square, Spin Street, Cape Town,
8001

Tel: 021 461 5476; Email: info@pegasys.co.za

ABSTRACT

The concept of compensating existing public transport operators for the detrimental impact of the roll-out of large-scale, publicly funded IPTNs on their businesses is valid. However, the general approach to compensation adopted by South Africa to date is not financially viable and has serious implications for future developments. Different compensation models that look to align operators' success, financial and otherwise, with that of the new system they are incorporated into, must be considered and adopted going forward to ensure the sustainability of the country's public transport transformation programme.

INTRODUCTION

The informal public transport industry in South Africa, predominantly comprised of minibus taxis, currently forms the core of public transport services available to and utilised by the majority of the country's population. The minibus taxi industry has grown and evolved since the 1970's in response to a demand brought about by rising urbanisation, South Africa's unique spatial development policies of governments pre-1994, and a lack of viable alternatives. Today, the industry is heavily relied upon by the bulk of commuters, who have come to depend on the wide availability, flexibility and relative affordability of such services to access economic and social opportunities. It is now estimated that around 60-70% of South African commuters use minibus taxis as their primary mode of transport (Venter, 2013; Govender & Allopi, 2006; Statistics SA, 2014)

Nevertheless, from 1994 the South African government has placed significant emphasis on reforming the industry through various approaches, with the intent of improving the reliability, affordability, safety and efficiency of the system. A relatively recent focus has been on the implementation of integrated (rapid) public transport networks (IPTNs). Inspired by the successful examples of this approach elsewhere in the world, particularly South America, national government is using the development of such systems to leverage transformation in the informal public transport industry. Since the middle of the previous decade, South Africa has invested billions of Rands in establishing IPTNs throughout the country, with networks at various stages of completion in 13 cities, and many more in the early planning stages.

A not insubstantial portion of this investment to date has been allocated towards the compensation of existing operators within the informal industry, who are typically directly financially remunerated for relinquishing their legal right to operate within the sphere of the new system. Going forward, however, there are concerns around the viability and affordability of such an approach. This paper explores the concept of compensation – what it is, who is compensated, and why. It follows with a brief look at where and how compensation has been paid to date in South Africa (and abroad), examines the implications of continuing along the current trajectory, and considers the key issues at hand. In conclusion, it proposes a number of alternative approaches to improve sustainability, for further deliberation.

THE CONCEPT AND APPLICATION OF COMPENSATION IN SOUTH AFRICA

Background

The existing informal public transport industry in South Africa consists of numerous and varied participants that can be broadly divided into two groups, those that directly offer a public transport service, and those who indirectly support or service the industry and its market.

Whilst the goal of the South African government is to transform the existing public transport industry into a modern, efficient and consolidated service to the public, the impact of such on these groups could potentially be catastrophic, due to a loss of business and livelihoods. Hence careful consideration has been given to how the various existing industry participants can be fairly accommodated and empowered in the transformed system.

Of the two broad groups that comprise the existing public transport industry, it is undoubtedly that which directly offers a public transport service to the general public that, if disregarded, will be hardest hit by the introduction of IPTN services. While indirect employees and businesses may have success in finding a similar role in the new system, or adapting to other markets, public transport providers are effectively replaced by a public sector-funded, high quality alternative. Typically, drivers and other direct employees in the existing industry (eg. fare collectors, rank marshals, etc.) are provided with employment opportunities in the new system. However, an employment opportunity in isolation is likely insufficient recompense for operators that own established revenue-generating businesses with vehicles and valid operating licences.

Origin and Purpose of Compensation

The South African minibus taxi industry is often hailed as an entrepreneurial and broad-based economic empowerment success story (Ndebele, 2010; Vadi, 2013). Self-funded citizens have created businesses that provide much needed public transport services to large, oft-neglected portions of society, in turn generating a livelihood for themselves, and directly and indirectly supporting thousands of others. If this livelihood is to be negatively impacted by new IPTN services, a case could be made that owner operators should be compensated for their loss of business and income. From a government perspective, to improve uptake and increase the likelihood of success of its IPTN systems, it would be prudent to compensate the operators for relinquishing their business, and bring them into the new system as willing participants. This would reduce competition, and decrease the possibility or impact of protest and similar actions.

Hence, industry compensation can be broadly defined as the reparations made by Government to existing (and affected) legal owner operators, in exchange for their economic rights (to generate an income through a valid operating licence and business). Moreover, in many cases, Government's transformation aim is to have (at least a portion of) the compensated operators become shareholders in the newly established operating companies.

For brevity's sake, it should be noted that this paper largely concentrates on the minibus taxi and unsubsidised bus operators. These parties comprise the majority of South Africa's existing public transport industry, and stand to be the worst affected by the roll-out of IPTNs across the country.

Legislation and Objectives

National legislation and policy is in support of the concept of compensation to operators in return for them relinquishing their existing businesses (economic rights) impacted by the roll-out of integrated public transport networks. National intent is that operators, particularly minibus taxi operators, should not financially be worse off under a transformed system. To this end, the National Department of Transport and National Treasury have introduced the Public Transport Network Operations Grant (PTNOG), intended for cities and municipalities implementing IPTNs, that can be used, amongst other things, to fund "...compensation for the economic rights of existing operators" (Division of Revenue Bill, 2014).

Beyond the broad nature of compensation as economic recompense, the concept has a number of objectives which are key to the introduction of a consolidated and transformed system. Each party in the new system, including government (representing the general public), and the industry (the affected operators) has its own objectives related to compensation:

- **Government** (compensation paid to)
 - Facilitate the consolidation and transformation of the existing public transport system into a more efficient and more inclusive system, that is sustainable over the long term
 - Ensure affected operators are financially no worse off under the new system
 - Ensure acceptance (approval) of new system from majority of existing industry
 - Retain and build on broad-based black economic empowerment characteristics of existing industry
 - Limit competition to the new system
- **Industry** (recompense for)
 - Relinquishing familiar business and livelihood (economic rights)
 - Taking on risk in the new system
 - Ensuring financial security over the long term

Overview of Existing Compensation Models in South Africa

The four systems briefly explored here are those that are most advanced in South Africa with respect to compensation negotiations, and have either implemented, or are close to implementation of, their compensation models. Hence they not only provide an overview of the characteristics of approaches developed to date, but also offer critical insight into the various issues for consideration around the concept of compensation.

MyCiti (City of Cape Town)

MyCiti is the City of Cape Town's integrated rapid public transport system. It started first formal services in May 2011, and the City continues to roll out numerous routes.

After consideration, the City chose an approach whereby existing (minibus taxi) operators eligible to receive compensation, would receive a once-off lump sum cash payment in exchange for their affected operating licence and vehicle. The operators then had the option to leave the industry, or invest part of all of their compensation in the new VOCs to become shareholders (City of Cape Town, 2012).

The compensation offered as part of the first services rolled out by the City was based on an estimation of the value of the operators' wholly or partially subsumed business. Based on this methodology, the City and the operators negotiated an average compensation value of R500,000 per operating licence (excluding a scrapping allowance per vehicle relinquished) (Springleer, 2013).

Rea Vaya (City of Johannesburg)

Rea Vaya is the City of Johannesburg's integrated rapid transport network. First services started in August 2009, with multiple phases still to be rolled out. The City has entered into compensation agreements with the first set of minibus taxi operators affected by the initial phase of services.

The City agreed to pay compensation to eligible operators at an amount of R5,500 per month per relinquished licence/route, for a period of up to four years (escalated annually). The approach was based on a shareholder model, where each operator was to be equally recompensed, and each was required to become a shareholder in the new VOC (the proceeds from scrapping their vehicle were to be used to purchase shareholding). The City's direct payment works out at a gross total of R264,000 (before escalation) per operator over the maximum four years (City of Johannesburg, 2013).

The monthly payments from the City are to continue until the dividends generated by the VOC through profitable operations are sufficient to replace the direct payments. The City is remunerating the VOC for services rendered at rates to allow it to generate sufficient profit to consistently pay out such dividends to operator-shareholders once established. Assuming the City continues to finance this exact amount indirectly through the VOC operational payments, each licence will earn an additional R528,000 (before escalation) to the end of the twelve-year operational contract, for a total of R792,000 per licence paid out over the 12 years.

Go George (George Municipality)

The Go George IPTN is close to implementation, with first services expected to be rolled out in 2014. Planning and negotiations are still underway in support of this intended implementation.

A compensation agreement was reached with industry representatives in 2013. All minibus taxi (and unsubsidised bus) operators, with valid operating licences, operating on routes to be subsumed by Go George services, were identified as eligible for compensation. George Municipality has based its compensation model on the value of the affected operator businesses that will, in effect, be replaced by the new system. It has adopted a sliding payment scale mechanism for direct payments, affecting operators with more than one affected operating licence. An operator's first relinquished licence receives the maximum amount, and every subsequent licence handed over entitles the holder to a lesser payment. Using this approach, the average compensation value is approximately R260,000 per licence in total (before escalation).

The municipality has provided operators with two options with regards to their compensation. The first is to receive a lump-sum payment upfront and leave the new system. The second is to use part of their compensation payment to purchase shares in the newly formed VOC. These shareholders will then receive their compensation in monthly stipends, paid out over five years. The municipality also supplemented the compensation package for those operators who became shareholders, by incorporating the value of company dividends, capital appreciation of shareholding, and employment offer. In this way, it sought to reduce the value of the direct monetary payment component (George Municipality, 2013)

Libhongolethu (Nelson Mandela Bay Municipality)

Libhongolethu is the Nelson Mandela Bay Municipality's integrated public transport system. It began limited pilot operations in January 2013, with plans to formalise the pilot routes and roll out additional phases over the next decade. An interim compensation arrangement has been entered into to facilitate operations on the pilot routes.

The affected operators on the pilot routes have surrendered their minibus taxi vehicles, and are receiving a monthly compensation payment of R6,500 per vehicle. Outside of the pilot routes, a memorandum of understanding signed between the municipality and industry in May 2010, agreed to operators' demands of a "profit guarantee" of R8,000 per month per taxi in compensation, for twelve years. This would equate to a gross total value of R1.152 million (before escalation) per licence over the period (Nelson Mandela Bay Municipality, 2013)

The Approach Outside of South Africa

In contrast to South Africa, well known examples of public transport transformation elsewhere in the developing world have infrequently embraced the concept of recompensing existing operators with direct monetary payments in "exchange" for their businesses, whilst incorporating them into the new system. Although local contexts differ, broadly speaking all of these projects share the same *modus operandi* as their South African counterparts – restructure a public transport system dominated by many smaller, private paratransit operators, into a more regulated, consolidated and efficient service offering.

In Bogotá, Columbia, the TransMilenio project sought to establish formalised and integrated rapid bus transport networks in the city. In establishing the new system, consolidated operating companies were formed and awarded operating concessions, with the shareholders determined by a competitive bid process. Existing operators received preferential treatment in this process, and in becoming shareholders were guaranteed a cash flow to replace that generated by their previous business. No additional monetary compensation was offered (Salazar Ferro et al, 2013).

In Curitiba, Brazil, a similar process was followed, with informal operators "forced" to consolidate into a significantly smaller number of formalised operating companies. Each formalised company then received a concession agreement and licence to operate in a particular corridor, generating a profit to replace (and to improve on) previous earnings. No additional monetary compensation was offered.

A “lite” bus rapid transport system was implemented in Lagos, Nigeria in 2008, with existing mini and midibus operators fully included in the transition process. Much like Bogotá and Curitiba, the operators became shareholders in the new operating entity, and retain and improve upon their livelihoods in this manner (Zimmerman & Agarwal).

The Mexico City, Mexico bus rapid transit system is one that does share some similarities with its South African counterparts. Each operator was required to forfeit their route authorisations and concessions, and join together to create new consolidated operating companies per main corridor. Operators were provided with a financial incentive for scrapping their old vehicles, which was to go towards the purchase of new vehicles. The balance had to be provided by the company. The City entered into negotiations with operators with regards to agreement on profit figures for their existing businesses. The City then guaranteed that, should profits from operations not be sufficient to meet this amount, it would make up the difference (Flores-dewey & Zegras, 2012).

THE IMPLICATIONS OF THE CURRENT APPROACH TO COMPENSATION IN SOUTH AFRICA

Based on the existing approaches to compensation so far employed in South Africa, the concept of compensation is treated as a ring-fenced issue, separate to the benefits derived from integration into the new system. Affected operators are negotiating for and typically receiving direct monetary payments that in reality often exceed the value of their underlying business, as government effectively pays a premium to expedite negotiations and the roll-out of new services. In South Africa, this is viewed as the compensation necessary for loss of income

The Cost of the Current Trajectory

The implications of this approach, where the country makes large compensation payments based on agreements that neglect the financial benefits of becoming a stakeholder in a transformed system, are significant.

It is estimated that there are approximately 150,000 minibus taxis currently operating in South Africa (Venter, 2013). Only a fraction of operators have so far been compensated as part of their involvement in IPTNs. Utilising the figures from the four approaches reviewed earlier, to transform the entire country, consisting of 150,000 vehicles, would cost the Government anything from R39 billion all the way up to a staggering R173 billion in present (not adjusted for inflation) terms just for compensation. This figure does not include private bus services currently operating in the country, which would also need to be considered in the transformation process.

To put this range of numbers in perspective, consider National Treasury's and the Department of Transport's current budget for the implementation of IPTNs in South Africa. All-in, the department has approximately R5 to 6 billion a year to disperse in grant allocations to the various cities and municipalities to aid in the implementation and operation of these transformed services. Cities have a significant reliance on these grants to help finance infrastructure development, vehicle fleet procurement, and planning and establishment costs, amongst others. Only a proportion is allocated towards compensation. If it is crudely assumed that even 20% of this R5 billion goes towards compensation (and it is likely less), it would take Government over 170 years to fully finance compensation payments for the entire country. This of course assumes the number of 150,000 vehicles remains static over this 170 year period.

The Long Term Repercussions

The obvious longer term implication and conclusion is simply this: South Africa cannot afford the current approach taken with regards to compensation. It is unaffordable to the fiscus, and moreover, the country is effectively "paying double" given that it is also financing the establishment and operating costs of the new IPTN systems, a significant part of which accrues to the operator shareholder in the form of dividends, capital value and salaries.

Over the short term, the current approach is also setting a precedent which will become more and more difficult to extricate from. Operator negotiations in many parts of the country, for systems in development, are already heavily influenced by the type and quantum of compensation payments already made elsewhere. Given that the compensation issue is the central and most difficult one faced in negotiations, continuing down this road will inevitably lead, in the next few years, to the stalled development of many IPTN systems, and with that the wasted time and resources to get to that point.

KEY CONSIDERATIONS AND ALTERNATIVE APPROACHES

It is clear that the current approach to compensation is not feasible over the longer term for the country as a whole. Continuing with the status quo will eventually see a small number of over-capitalised “first mover” cities operating world-class public transport systems (but struggling to expand), whilst the remainder of the country will be unchanged. More efficient methods of fairly (for all parties) recompensing operators for their lost business must be investigated and embraced.

A key consideration in assessing more viable alternatives in compensating operators, is the reality that significant value exists in the wider transformed system, in which affected operators by design become stakeholders. To date, this value has been hugely discounted or altogether neglected in considering an operator’s compensation package.

Typically, as part of the transformative and empowerment mandates of these newly-developed systems, operators become role-players in several sub-systems. Whilst at the very least government has pushed for operators to become shareholders in the transformed vehicle operating companies that provide the new services, there has also been movement towards incorporating existing industry in value chain opportunities throughout system development, implementation and operations. Through these opportunities, operators have exposure to employment options, a share in the profits, and the underlying capital value of the shareholding. With Government entering into long-term contracts (12 years in the case of the operating company) and investing significant resources into these systems to ensure their success, coupled with a lack of competition, the inherent value in these opportunities is enormous.

Yet very little of this value that will accrue to operators, if any, is taken into account when considering compensation. Instead, compensation has largely taken the form of direct payments from government, or variations of such. Operators affected by MyCiti had to use some or all of their compensation to purchase shareholding in the operating companies, but at a price significantly discounted from its true value. Rea Vaya operators will receive the majority of their compensation in the form of dividends from the operating company, but this has been facilitated by the payment of an inflated profit margin to the company by government for rendering the services. In short then, affected operators are receiving a negotiated (and oftentimes above fair value) settlement in cash for the value of their subsumed business, and then on top of this they are receiving the full upside of their exposure to value in the rest of the system.

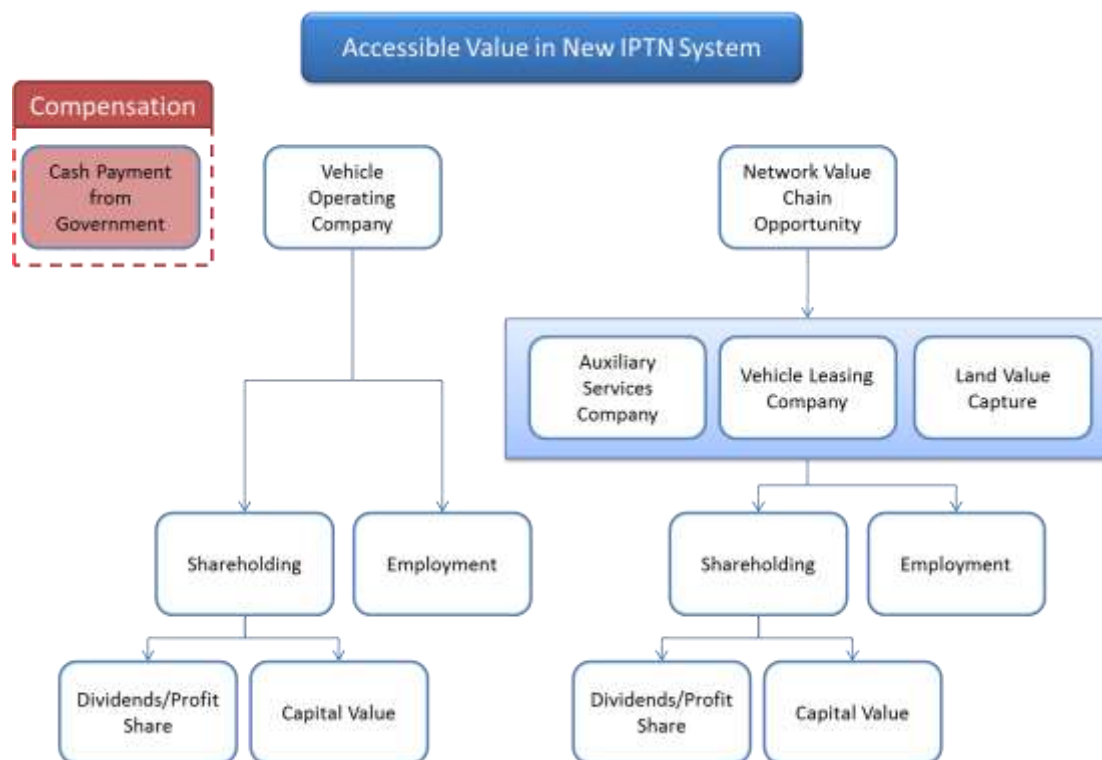


Figure 1 Areas of Value to be Realised by Affected Operators in Transformed IPTN System, In Addition to Compensation

Compensation as a Package

On the basis of the above considerations, the logical way forward is for government to begin assessing the accessible value in the full system in present terms, and incorporating it into its compensation offer to operators. This will diminish upfront expenditure on compensation in the form of cash, and tap into previously neglected areas of value, ultimately drastically reducing the country’s cost of compensation.

An added benefit of this packaged approach is the ability to “mix and match” the components that form the overall compensation package. A common problem in compensation approaches to date are the rigid “one-size-must-fit-all” offers made to a diverse industry of individuals desiring different outcomes, making it very difficult to get buy in from the collective. With a package, the value of certain components in the offer can be increased or decreased, included or excluded, to best suit the circumstances of the individual. This will ultimately result in a smoother path through negotiations to a united agreement.

Finally, this approach begins to talk to true empowerment, with the success of the operators, both in a personal and financial capacity, aligned with that of the system they become shareholders in and employees of. By moving away from an approach where operators are compensated with large amounts of money upfront (with incorporation into the new system a secondary and often peripheral thought), in the package approach the emphasis is very much on integrating operators into the new system and its long-term empowerment benefits.

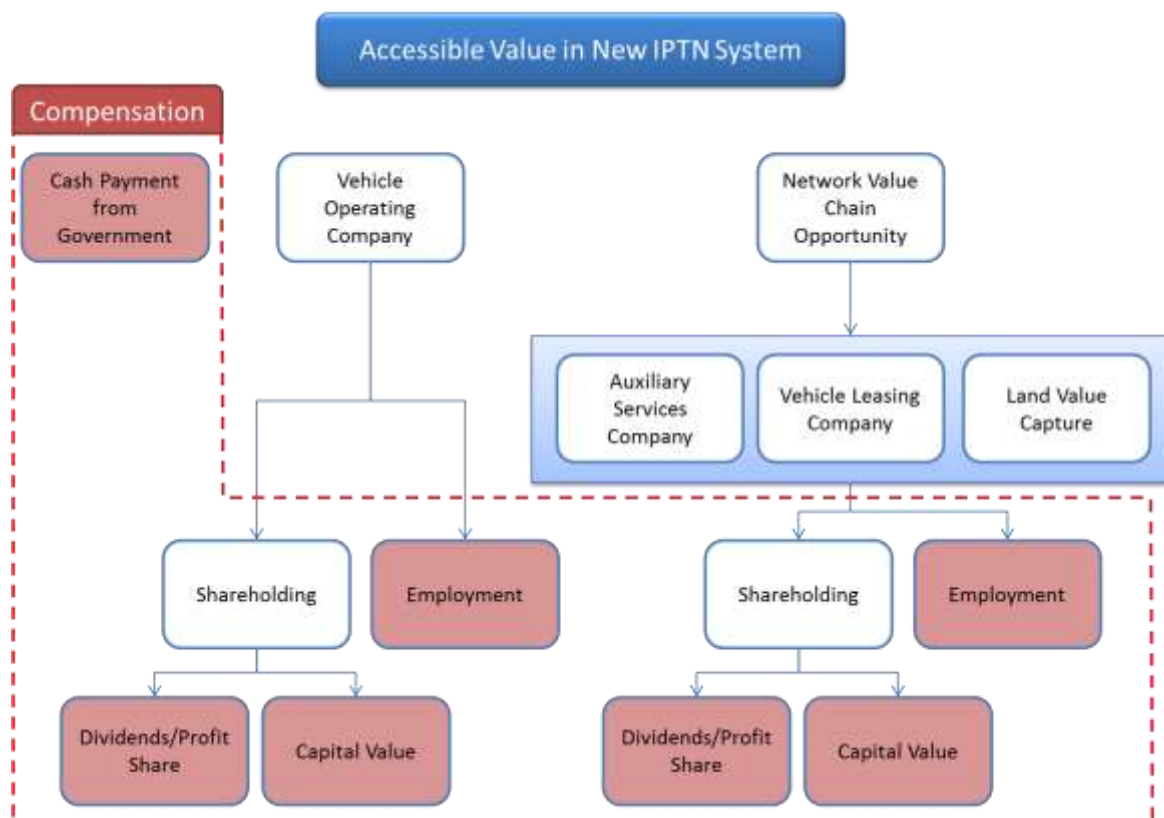


Figure 2 Areas of Accessible Value Incorporated into Compensation Package to Affected Operators in Transformed IPTN System

Implementation Challenges

The current perception of compensation (one very much reinforced by government's general approach to date) is one of "cash-in-pocket". The switch over to a package approach, which begins to incorporate other value opportunities that are not so immediately "visible" as a cash payment, will not be easy and will not be quick.

The largest and most difficult challenge lies in shifting this entrenched perception, predominantly amongst industry, but also to a certain extent within government. Due to the perceived uncertainties (and often a lack of understanding) around shareholding and cash streams such as dividends, it is likely that initially the industry will heavily discount the value of such as a component in the compensation package. George Municipality has, as previously described, adopted the compensation package approach in its negotiations with affected operators, with limited success. Whilst operators who have chosen to become shareholders in the new system have accepted the package, the non-cash components have been valued at less than their true worth.

In changing this perception, a number of initiatives are required, not least of which is educating industry of the benefits and upside to becoming stakeholders in the new system. Unfortunately, this is a time-consuming process, and to date government has rather sought to expedite implementation in its desire to see services proffered to the public as quickly as possible (at an inevitable cost). If the package approach is to be a success, government (and the general public) may need to be more patient (and steadfast) in its approach, looking beyond potential short-term gains towards long-term financial and transformational sustainability.

Secondly, successful implementation of the package approach to compensation in specific instances can play a powerful role in driving the change in perception country-wide, as the tangible benefits can be observed by industry. The challenge lies in gaining the initial traction in the first systems to espouse such an approach. To ensure the best chance of success, the approach requires a country-wide adoption, with national government taking the lead in driving acceptance. Systems looking to implement a package approach can be undermined by other cities still offering a direct cash payment.

In parallel to adopting the package approach in compensation negotiations with industry operators, government should also investigate ways of capturing the true value and upside inherent in the system being implemented, particularly if industry insists on discounting such value below market worth. This may provide government with an opportunity to realise this long-term value upfront, and utilise generated funds to pay compensation or in another part of the new system's development, ultimately lowering total cost.

Moving Away from Compensation

The final consideration which is briefly contemplated in this paper (but the expansion thereon another topic altogether), is whether South Africa should move away from the need for compensation. Even the approaches deliberated above, whilst alleviating the financial impact over the coming years, will likely not allow the country the financial ability to compensate the majority of existing operators in the move towards a nationwide transformed public transport system. Instead, the concept of improving and transforming the existing public transport system in incremental steps (rather than a "big-bang" approach), whilst allowing operators to continue providing services using their existing licences (and perhaps assets), should be carefully considered.

By nature then, this approach would progressively improve the quality, reliability and efficiency of the current system without the need to pay compensation to the operator. The likelihood is that, over time, as the system is slowly transformed, even if the operator moves away from operating off his or her individual licence and towards operating off the licences of a consolidated service provider, having experienced the benefits (financial and otherwise) of being a primary stakeholder in the transformed system, the requirement for compensation will fall away at least partially.

CONCLUSION

The concept of compensation is valid. Without it, the roll out of large and heavily funded integrated public transport systems would have a catastrophic socio-economic impact on the numerous small, paratransit operators that have made up the majority of South Africa's public transport service offering for the last half a century.

However, the country's current general compensation model is financially inefficient and, in the longer term, unviable. Implementing government entities have, to date, been willing to pay out large amounts of monetary compensation that far exceed the real worth of the businesses they are replacing, for the simple reason of wanting to expedite proceedings. In turn, the existing industry around the country has observed this precedent and adapted their negotiation tactics to match. The bottom line, however, is that this current path is unaffordable to South Africa, and, unless the approach is altered, will result in large parts of the country's public transport sector being left untransformed when funding is exhausted.

The alternative is for government to adopt a package approach to compensation, by properly assessing the value that will accrue to operators as shareholders and employees in the new system, and incorporating this value into the compensation package. Currently, the majority of this value becomes financial upside to the operator shareholders, who in addition walk away with generous compensation payments. By reducing the direct cash component, and bringing the value of dividends, share capital and salaries from numerous value chain opportunities into the compensation package, government not only saves itself money (hence making compensation significantly more affordable), but truly empowers operators by aligning their interests with that of the new system.

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