CASE STUDY

Queensland Rail: QR Ltd (QR)
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QR is currently Australia’s largest national rail freight operator and an internationally competitive freight business. It has achieved this success whilst remaining in government ownership and with a strong union presence through strategic decisions on competition and investment, and the formation of alliances. Recently, in response to the impact of the global financial crisis on its public finances, the Queensland Government has announced plans to privatise parts of the company, giving rise to a major protest campaign from unions, the media, the public and some coal companies. This case raises a number of key questions regarding strategy in government business settings.

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Australia is an extremely large continent, larger than either the United States or Western Europe but with a relatively small population. Consequently it has fallen to state governments to provide the major transport and communication infrastructure, because private enterprise found the task uneconomic, especially as the population was very scattered across the nation. Another factor is the Australian belief, embedded in the nation’s value system, that every citizen is entitled to the same standard of public services wherever they may live; a very costly goal for governments to deliver. Establishment of railways in the nineteenth century faced all of these challenges.

QR began as a colonial style railway with the first train travelling from Ipswich to Grandchester on 1 July 1865. Queensland has always been the most decentralised state in Australia, the capital city Brisbane accounting for less than half the population of the state and the remainder scattered across vast distances between many provincial centres. So the railways were a major element in opening up of the vast frontier. Indeed, the railways were seen as the key element of land settlement policy. The Queensland track was built to a gauge of only three foot six inches (i.e. a narrow gauge), rather than the standard gauge of four foot eight inches, to save costs in the construction, and the railway remained the single largest cost item in the government’s budget throughout the nineteenth century. Indeed the wages of all public servants often depended on the financial situation of the railways.

Over time a number of community service obligations were forced upon QR including concessional freight rates for particular commodities or regions, concessions to some passengers such as pensioners and school children, and free travel for politicians for life.

Organisational change has been a constant theme. QR has been through several institutional forms. It began as a government department operating under its own piece of legislation (The Railways Act). In 1991 QR began the commercialisation process with the creation of an independent Board of Directors (non-executive), appointed by the government to set strategic direction. In 1995 the entity was corporatised as a statutory Government Owned Corporation (GOC), and on 1 July became a company GOC which is very close to a corporations law company, with two ministers as shareholders, namely the State Treasurer and the Minister responsible for Transport.

In government ownership QR has always confronted the classical governance dilemma of trying to run as a business but also remain a service to the public. The main issue being how to maintain an ‘arm’s length’ relationship with its owner, the Queensland Government. The role of the Board has never been clear – it formulates strategic directions without the actual power to implement them. The government then notes them as recommendations from the QR Board but retains the power to decide these matters. In reality this results in a ‘disconnect’ between strategic planning and execution. QR is required to pay an annual dividend to the government, which is set in a rather arbitrary fashion depending on annual results. It must receive government approval for its capital raising activities – a delicate aspect since competitive strategies in rail require large outlays on track and rolling stock. For most of its existence it has been subject to the full array of public sector...
accountability, including Auditor-General, Parliamentary Committee scrutiny, and Freedom of Information. In its corporate forms QR’s Board has been comprised of people with business expertise, but the discretionary areas for the Board have been somewhat limited, with the Government retaining control over most aspects. QR has always been highly unionised, which has caused tensions regarding the introduction of modern business practices and has been a major force in keeping the railway in public ownership.

However, the dominant policy matter has been the need to cross-subsidise an unprofitable passenger network (especially in the urban areas), from profitable freight operations especially haulage of coal. QR is also subject to regulation of its network access prices, often a source of tension. The same regulator, the Queensland Competition Authority, also oversees the ports, which have become bottlenecks in recent times, hindering QR’s own freight haulage operations.

So, in summary, QR has a Board of non-executives, two shareholder ministers, service agreements with the State government, a requirement to pay a dividend, funded Community Service Obligations, and reports to a regulatory and accountability regime. It has six operating divisions:

- QR National – coal and bulk logistics, transport and general freight business
- Passenger Services – community, long distance and tourist passenger networks
- Network Access-managers of the Queensland railway network including access to it and operations on it
- Infrastructure Services – construction, maintenance and management of the rail network
- Rolling Stock and Component Services – manufacture, heavy repair and overhaul of most of QR’s rolling stock fleet
- Shared Services – internal and business support across QR operations.¹

In the last part of the twentieth century, as a result of sweeping national reforms to Australian Competition Policy, the ‘business areas’ of the public sector lost the traditional ‘shield of the crown’ and were forced to engage in open competition, including payment of full taxes, total transparency, and a requirement to provide third party access to its infrastructure. This had a major impact on the Australian railways which would now face competition from private freight companies that had to be given access to the track for their rolling stock at competitive prices.

Rather than take a defensive stance, QR took strategic advantage of this situation and won contracts in other Australian states (e.g. coal contracts in the Hunter Valley of NSW), and overseas in competition with private bidders. This was quite an achievement for an organisation with a longstanding public service culture. A large part of the credit is given to the entrepreneurial skills of the CEO of the time, Bob Scheuber, who had a long career in QR having worked his way up the ladder. He had always retained his union membership, and the trust he had generated with the staff was considered to have been a vital factor in being able to introduce the new corporate and strategic focus, which did require some job cutting. It was also a key aspect of his leadership of a railway with the usual run of accidents which affect railways the world over. Scheuber has commented that in his major media appearances during such crises he regarded the interviews as a key avenue for communicating to his own workforce, just as much as to the public.

In 2006, QR signalled a more commercial future with the appointment of a former CEO of BHP, John Prescott, as Chairman. In 2007, leading steel company executive Lance Hockridge (formerly of BlueScope and BHP which are giant international mining companies and steelmakers), was appointed CEO to replace Bob Scheuber whose contract had expired.

QR’s success has been aided by a set of strategic partnerships it has formed with linked operators in the transport and logistics supply chain. It has also had active Corporate Social Responsibility programmes with several community, not for profit organisations, and is the major sponsor of the ‘Queensland Reds’, the state’s rugby union team.

In 2008, in a shock announcement, the State Labour government revealed that the global financial crisis had made a major dent in the State’s finances: so much so that Queensland lost its longstanding Triple A credit rating and was facing intense difficulties in raising loans in the face of already mounting debt levels. In response to this crisis the government announced a privatisation programme which would include government forests, ports, and parts of QR including its freight division and coal network. This produced a public outcry since privatisation had not even been mentioned during the election campaign. The unions immediately mounted a major protest campaign against privatisation in general but especially at the proposals for QR. This campaign gathered intensity and was backed by substantial media commentary, particularly when it became obvious that the government had not carefully thought through the privatisation goals or process and its likely ramifications.

Business generally welcomed the privatisation moves, citing various reasons why rail freight should be in private hands. The debate, it was argued, was about who is the best owner of QR’s freight business: the government or the private sector; not an argument about individual managers but about structures and governance. Do we want QR’s freight business owned by a government,
which has a complex array of political and policy objectives, or do we want it owned by an entity with only a commercial focus?

Three reasons for privatisation advanced were:

1. The freight business is capital intensive and it is extremely important that the required investments are made to transport Queensland’s growing coal exports. A commercial entity that is well capitalised will generally invest when it sees sufficient demand for the services, but a government owner must weigh the more immediate political benefits of investing instead in possibly schools or hospitals.

2. It is more difficult for a government to run QR efficiently given that it is constantly lobbied by customers, unions and other stakeholders making demands that they would not do to a private operator.

3. QR needs to be responsive to commercial opportunities and such decisions regarding one customer, who might be prepared to pay, should not have to pass through a political filter.

On the other hand, a group of leading economists attacked the privatisation plan saying that the measures of costing and expected return had overstated the financial returns given the costs of dressing up the assets for sale, and undervalued the dividend stream that would have kept flowing to the government if the asset remained in public ownership. The coal industry expressed concerns at the plan to sell both QR track and rolling stock as one entity (i.e., an integrated operator like the Class 1 railways in the USA) which they claimed might lead to anticompetitive pricing and access decisions that would create inefficiencies and delay upgrades. The argument effectively complained that this would amount to replacing a public monopoly with a private one.

QR itself conducted a study of rail privatisations around the world and was unimpressed by experiences in Britain and New Zealand, but regarded Canadian experience more favourably. The British experience was believed to have brought some benefits, including possibly lower rail fares than might have been the case otherwise, but it also seemed that crowded trains, allegations of profiteering by the multitude of new rail service providers, paralysing crashes, and endless political friction had led to a bigger British government subsidy than had been the case when rail was in full British government ownership. Many argued that the splitting of the UK’s train operating services from the track – i.e., above-rail assets (e.g., rolling stock such as locomotives and carriages) from below-rail assets (e.g., ownership of the track itself and responsibility for its maintenance) – was the source of many of the problems, because it led to a multitude of small train operators squabbling over access to lines that were controlled by a company that had no financial incentive to maintain or improve the infrastructure.

The main Australian competitor group to QR, Asciano, which operates the Pacific National group, an above-rail operator, expressed concerns to the competition regulator that the sale of a vertically integrated QR would give it incentives to discriminate against above-rail competitors.

As the debate wore on it became clear that the government had not taken many of these factors into account, especially the question of which body would have responsibility for track maintenance. Some 5000 workers in QR currently have this responsibility. It was not clear what the interface between the newly privatised parts of QR and the rest would be, and particularly why a government would continue to subsidise one part but not the other. The actual valuation of the assets and their split was another very difficult task. Moreover, QR had an enviable safety record, a reputation for good technical excellence, a sound customer/commercial balance, and sense of corporate responsibility; the damage which could be done to the brand needed to be considered.

In the event the government responded to union and public concerns about ownership by announcing that the sale of QR’s freight operations and coal network would be by a public flotation, with parcels of shares reserved for QR staff and preferential access to shares for the Queensland public. (The government is offering QR National employees $1000\(^1\) worth of free shares, and an additional $4000 worth on a discounted basis.) The government would also retain a 25–40 per cent initial shareholding which would be sold down over time. The Rollingstock Workshops, which services the freight rolling stock, and the track maintenance staff who build new track or maintain current track will be included in the new privatised freight entity called ‘QR National’. Therefore QR National is currently planned to be a fully integrated freight operator and track owner.

With the split of freight from passenger operations, the plan also creates a new entity called Queensland Rail which will be a passenger business offering the suite of passenger services that QR currently provides. This new passenger Queensland Rail will stay in government ownership.

There are a number of key questions raised by the case. Is it possible for a government owned business to operate strategically and in an entrepreneurial manner given the political context in which it has to function? Is risk taking compatible with public sector accountability regimes?

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\(^1\) $1000 Australian dollars = £605 or €666 or $915.
such an entity maintain a truly 'arm's length' relationship with its government owner to facilitate day to day business decision making? What are the potential advantages and disadvantages of the privatisation of an acknowledged successful government business enterprise? Is there a case, in the transport and infrastructure sectors, for maintaining government ownership of networks and only privatising the value-added components? What can a government achieve, in the public interest, through public ownership, that it cannot achieve by privatisation plus regulation?

References: