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RETRACK

REorganization of Transport networks by advanced RAIL freight Concepts

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Outline of Business Plan

1 Introduction

The RETRACK Deliverable 3.2 presents outcomes of research work carried out under WP3.1, 3.2, and 3.3 which outline the important elements of business plan that the RETRACK operators may use for establishment of strong market position in the European rail freight transfer.

The work, performed by the Institute of Transport Economics of Oslo, Norway, responds to strong willingness of the RETRACK train operators expressed during professional discussions to base their train service provision system on internationally effective collaboration and highly competitive solutions. Several elements of business plan are reviewed below, so that the RETRACK partners may consider them and select those which they deem pertinent and useful for their needs.

2 Strategic Rationale for Alliance between the RETRACK Train Operators

Strategic alliances are collaborative ventures among sovereign firms inclined to pursue common goals where capital, expertise and market coverage are joined to achieve collective commercial gains. As these are scarce resources, the risk arising from commitment of these assets must be carefully managed. Since international supply of rail freight transport requires movement of cargo across several country territories, train operators joint their efforts to transfer loads through the subsequent national networks. This is required because network incompatibilities, regulatory diversity and operational disparities make the risk arising from rail freight supply along the trans-European corridors too large to be borne by one single rail carrier. Therefore, contributions of several partners are required for international provision of rail freight service. An alliance will be called “strategic” when it produces a competitive advantage for its all participants, and the end-users of its services.

Two generic alliance forms could be distinguished, equity and non-equity, both creatures of contract. Equity arrangements represented by joint ventures involve joint stock companies that often, but not always, are integrated financially by equity swaps among their owners. Non-equity alliances apply much looser governance modes and often exploit complementary skills and market domains for expanding the geographical freight movement, and/or management of subcontracting operations. They may also involve partial standardization of partners' contributions. Empirical evidence shows that a non-equity alliance can sometimes evolve into formal joint venture with proprietary capital holdings. The collaboration between the RETRACK operators falls into the second category of alliance arrangements because of the lack of current indication of any capital involvement.

In rail transport industry, as elsewhere, firms enter into alliances to achieve economies of scale, scope and density, save on capital outlays, draw on complementary expertise, share risk, and obtain the resources necessary to expand more quickly than would otherwise be possible. These factors also appear to be important for the RETRACK train operators, whose volitional collaborative agreement seems to involve equipment pooling and integration of

individual service provision networks for spreading the capital costs and realizing the economies of scale.

It is often argued that an intrinsic feature of an alliance is its temporary character. The very notion of an alliance denotes an arrangement whose *raison d'être* is task-specific, action-oriented and time-limited. Although, the duration of the RETRACK operators' venture is not yet decided, the temporary aspect of partners' collaboration is important for the viability of their strategic future. If the RETRACK partners want that their consortium becomes a highly recognisable vehicle for European provision of rail freight service, then they may need to consider not only a long-term affiliation, but also institutionalization of their venture.

3 Collaboration as a Means of Creating Competitive Advantage

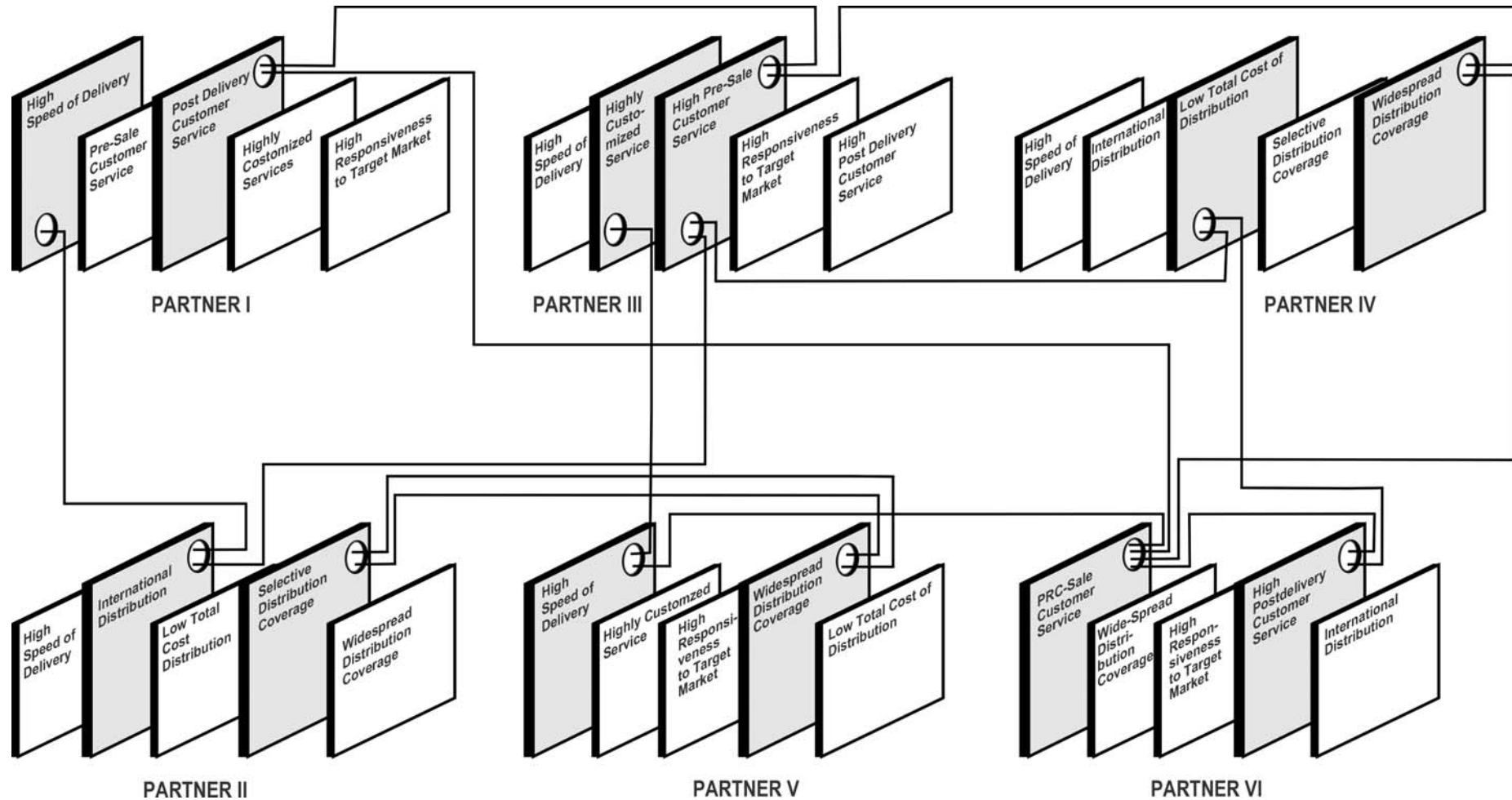
Despite the myriad of differences dividing the RETRACK operators with regard to preferred modes of functioning, decision-making, and market service, partners may need to agree on their alliance mission pretty soon. After that initial stage is passed and an alliance mission has been determined, the next step is to work for its implementation. The major practical tasks may include development of an operational plan for the alliance, that is, what the alliance is intended to become and how it is supposed to function, based on the combined, time-distributed contributions of its partners.

Such joint efforts may need to consider the following issues: How do the partners view market potentials? Whom do they see as key customers, competitors and/or future collaborators? How do the alliance partners want to compete? What is the worst case scenario for achieving the planned international scale of the RETRACK operations and revenue levels? What competitive advantages will the alliance create for the partners and what should be done to make this happen? In short, how viable is the alliance strategic idea when translated into an applied business plan?

At this stage the partners may also need to consider what strategic effect the combining of their individual capabilities and operational bases will have on each of them and on the alliance as a whole. The partners will see the alliance as a viable strategic opportunity only if it produces benefits for each of them separately, but also for the entire group.

By plotting the different service capabilities of six nominal partners, the figure below shows how, by combining its different partners' strengths, an alliance can consolidate itself, thereby enhancing the competitive advantage for each participant and the competitive standing of the entire venture. This illustration may motivate the RETRACK partners to conduct the similar assessments in order to verify the competitive substance of their venture.

Figure 1: An Analytical Model of Alliance’s Competitive Synergy Produced from Linking-up Partner’ Individual Capabilities.



As indicated above, two or more partners can combine their capabilities to produce economies of scope, scale, and density by integrating different elements of their operative strengths. For example, by jointly moving freight across several national territories, partners may create a considerable competitive advantage, and distance themselves from competitors operating in a similar manner, but on a smaller scale. In addition, critical human resources may be better utilized by serving a larger market with broader scale of operations and good local knowledge of multiple customers.

Benefits may also come to partners who combine highly customized services with low total cost of service provision. Operationally, gains can be realized by sharing the fixed investment, overhead costs, and production facilities among various service lines, which are complementary and do not compete with each other. For those service lines and territories that overlap or run in parallel, market re-alignment and/or re-configuration of the network design may produce the scale advantage. The latter may lead to a more specific segmentation of a larger market and the supply of highly cost-effective, comprehensive range of services, with the different offerings complementing each other. Most important, however, combining each partner's strengths vis-à-vis the customers results in a stronger ability to serve European-level customers.

Other benefits come to partners with international operational skills and bases who collaborate with those who offer a low total cost of transport and broad feeder network. For example, if one company that controls access to large freight repositories, which is necessary for supporting inter-regional train operations, wants to expand its service to international scale, it can do so by investing in its own train network in each targeted country. Since doing so might outstrip the firm's resources, the firm forges a strategic alliance with partners who already serve the national markets in a given region. The mutual gains of this type of strategic partnering stem from geographical service expansion and standardization of service quality in international market. The latter might become an attractive competitive feature for manufacturers or marketers of global products, who might be seeking a suitable third party to outsource the international freight movement between the several geographical regions.

Another gain accruing from collaboration materializes in securing of steady sourcing. This is based on the fact that partners in different markets might have large production capacity in place before they enter an alliance, but because of limited freight volumes within their national markets, they cannot effectively utilize these assets. If the partners are not direct competitors, access to a larger freight repository could afford them greater utilization of their load carrying investments, and broaden their customer appeal by allowing them to offer a wider range of service. Collaboration with other alliance members increases the minimum level of freight to be distributed by each individual partner, and by so doing also produces the economies of scale for their venture.

Different configurations of collaborative venturing may require different types of contributions, which are realized through increases in scale, scope, and/or density, and their combinations. Gains can accumulate because of access to new markets, other operational networks, and the fact that partners are now sharing the risk, saving on costs, saving time, and expanding market coverage.

Each party should assess how these prospective benefits fit into its own competitive posture and satisfy its strategic goals. Thus, it is necessary at the early phase of alliance implementation to establish a clear and open vision of the prospective strategic match, which

the partners seek to achieve. This involves determining what strategic intents each partner wants to realize and reconcile these with those of their alliance counterparts through assessment of the scope, scale, and time in which the expected gains should materialize. The competitive advantage of the alliance must also be understood from a unified point of view, so that each partner can estimate the scope of its inputs and their timing for attainment of collective goals.

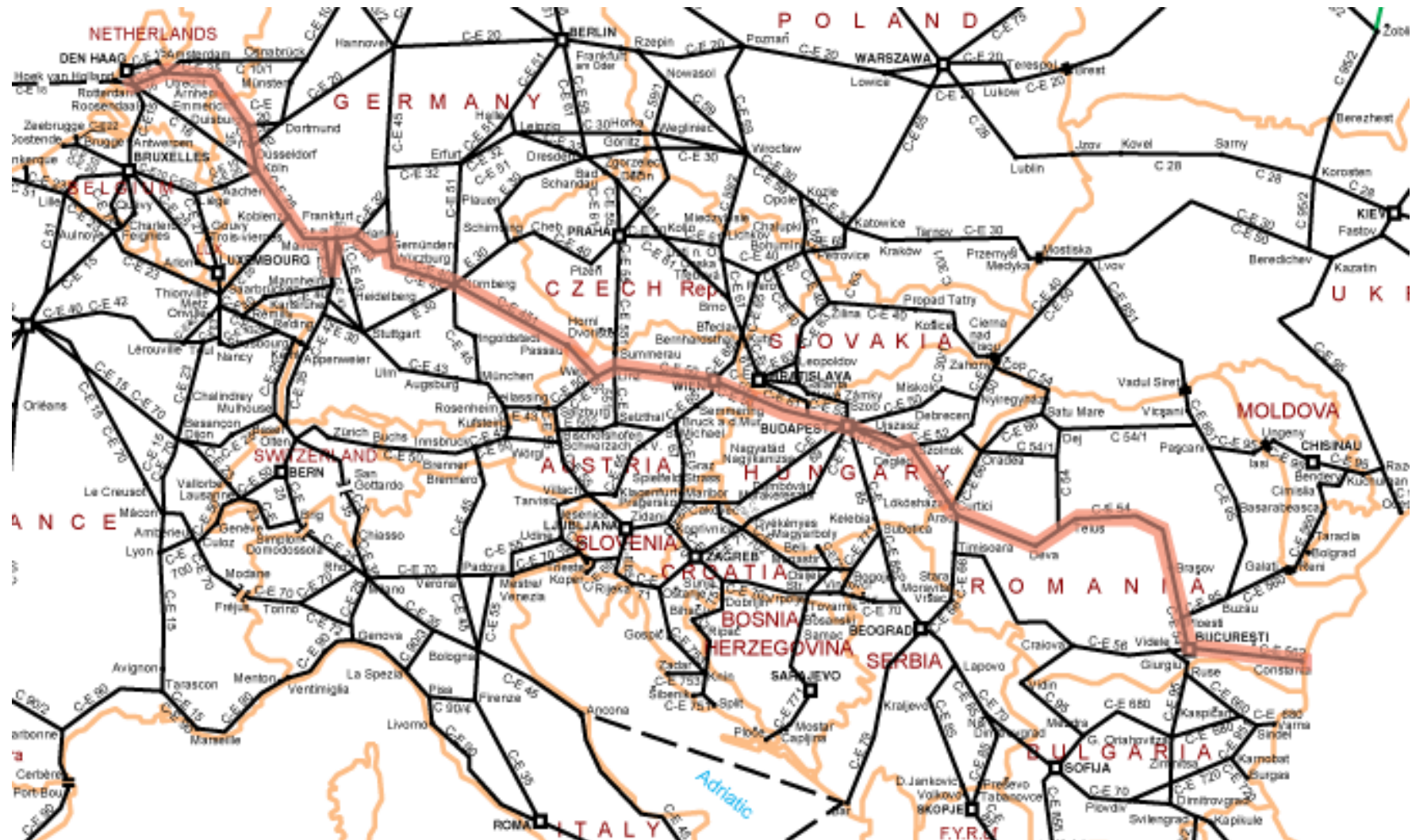
In short, to achieve a strategic and operational match and reap the benefits of the alliance membership, parties have to agree on coordination modes for their actions, which will guide joint service provision. Only a specifically coordination strategy will enable the strategic alliance to become competitive and operationally efficient. Whatever the subject of the collaboration, the management representing each member firm must ensure that operational integration is specified within the areas where partners collaborate. This must be manifested in a joint plan, which needs to be drawn before partners start the actual service provision.

If one partner's service supply operations in one part of the market are to be combined with service provision by other partners in other territories, then it is necessary for all parties to be certain of the intersect points where one party's function ends and the other's begins. Here, the business plan should specify precisely the types of tasks, operations, and roles to be performed individually, as distinct from those performed in concert. The strategic points at which individual providers' services are joined and the scope of joint performance must be clearly defined and the inputs carefully measured. Figure 2 provides the overview of the network which the partners aim to use for moving the freight in integrated fashion along the Rotterdam- Constantia corridor.

In order to draw an integration plan for service provision, each segment of this network has to be investigated with regards to who is to operate a given stretch, what kinds of responsibility this party acquires, how these responsibilities are going to be reimbursed, what is the maximum cost level that partners can charge on each other for sequential freight transfer, what quality level is required along the entire haulage and, who is going to collect the customer payments for the combined RETRACK service.



Figure 2: Rail Corridor Served by the RETRACK Train Operators



Consequently, partners involved in the process of planning their collaboration may need to ask themselves the following questions: What resources contributed by each partner are relevant and available over the short and long terms? What are each partner's attitudes toward long-term collaboration? How might this collaboration evolve over time without conflicting too much with the strategic concerns of either party? These considerations also involve operational and tactical issues, and the assessment of individual sacrifices and rules for benefit distribution. In addition, partners must work out clearly delineated ground rules not only for carrying out standard tasks, but also for handling unusual or emergency situations.

Issues, which require jointly agreed solutions, may include insurance for damage, returns, complaints, and the terms of record keeping. In addition, partners should reach a basic consensus on how to tackle situations when a common contract guarantees a service level to another partner's customers which is beyond the quality standard provided by the first partner(s). Consensus should also be reached on how to handle orders for customers' continued replenishment and how to reimburse costs incurred by operations that cut across several partners' service provision territories.

By agreeing on the content of joint tasks and the procedures for their performance, partners lay down the foundation for a relationship, which is different from a typical transaction-based business-to-business encounter. Alliance collaboration should be based on awareness that partnership-style relationships involve mutual tolerance, long-term vision, sharing of benefits and burdens, joint operational and strategic planning, and exchange of detailed operational information. Thus, partners must be able to access each other's internal boundaries and use each other's proprietary assets for collective benefit creation.

However, achieving consensus on task involvement may be hampered or at least delayed by the diversity of the partners' operational models and their incongruent expectations of future gains. Realistic planning of alliance work cannot be completed without assessing the others' contributions and gains. During this assessment process, overestimation of sacrifices and over-blown expectations of alliance benefits may generate resentment on the part of some members and reluctance to sacrifice autonomy. Consequently, inconsistent assessments of individual inputs and outputs may thwart the implementation process or even generate relational conflict. Such conflict may arise from disparate expectations of other partners' conduct, the anticipations of what the others should contribute, how they should behave in performance of joint tasks and to what benefits they are entitled.

In order to prevent this from happening, partners may need to start building a joint competitive advantage.

4 Elements of Joint Competitive Advantage

4.1 Business Models for RETRACK Operators

The RETRACK operators may need to consider making a soon decision related to which business model they want to apply for development and organisation of business links with their customers, and what implications this choice will have for their internal relationships.

Business models define what service level the RETRACK operators offer, what cargo segment they target, and what kind of business bonds they establish with shippers and/or logistics service providers (LSPs). One type of business links with RETRACK clients could be a long-term, blanket contract chartering a large part of the RETRACK collective loading

capacity on, say, the entire Rotterdam-Constantia corridor. Another may involve several small, short-term spot contracts for freight transfer over shorter corridor segments, i.e., between Ludvigshafen in Germany and Budapest, Hungary, or between Constantia in Romania and Vienna in Austria.

Since supply of international rail transport requires collective efforts of several carriers performing physical transfer of freight from origin in one country to destination in another, each company in such a cluster may have at least one role. Yet, depending on the internal organisation of the carrier network, different functions may also be performed by the same company. Usually, the network companies operate at four functional layers:

- First layer: A leader of a given transport chain or a network integrator
- Second layer: strategic partner(s)
- Third layer: operative partners
- Fourth layer: supporting partners

The leader of the RETRACK network has the powers and the responsibility for:

1. Setting the level of service quality along the entire corridor and/or on the corridor segments served by different sub-groups of the RETRACK operators.
2. Negotiating and concluding the contracts with clients on behalf of the entire venture.
3. Agreeing the freight transit rates that the RETRACK operators offer for particular type/scope of freight transit, and auxiliary services supplied by supporting partners and/or subcontracts such as terminal operators.
4. Collecting payments from customers on behalf of the RETRACK consortium.
5. Crediting and reimbursing the RETRACK partners and/or subcontractors for their shares of service provisions.
6. Carrying of economic risks for shared corridor operations and RETRACK fulfilment of contractual obligations.

The strategic partner(s) within the RETRACK network have the powers and the responsibility for:

1. Marketing of RETRACK services to different clients in countries of RETRACK operational coverage.
2. Devising new service offering that are customised to transport-freight market segments.
3. Acquiring legal obligations on behalf of the RETRACK consortium as regards purchases and/or chartering of rolling stock and/or locomotives, ICT solutions and other auxiliary inputs required for operations of the entire group.
4. Drawing of strategic plans for business expansion and/or standardisation of service quality among the RETRACK operators.

The operative partners perform mainly rail haulage. Yet, apart from largely functional contributions, these partners may participate in strategic decision-making when the RETRACK strategic objectives involve expansion of geographical markets, acquisition or lease of new rolling stock, and/or application of specific expertise which they control.

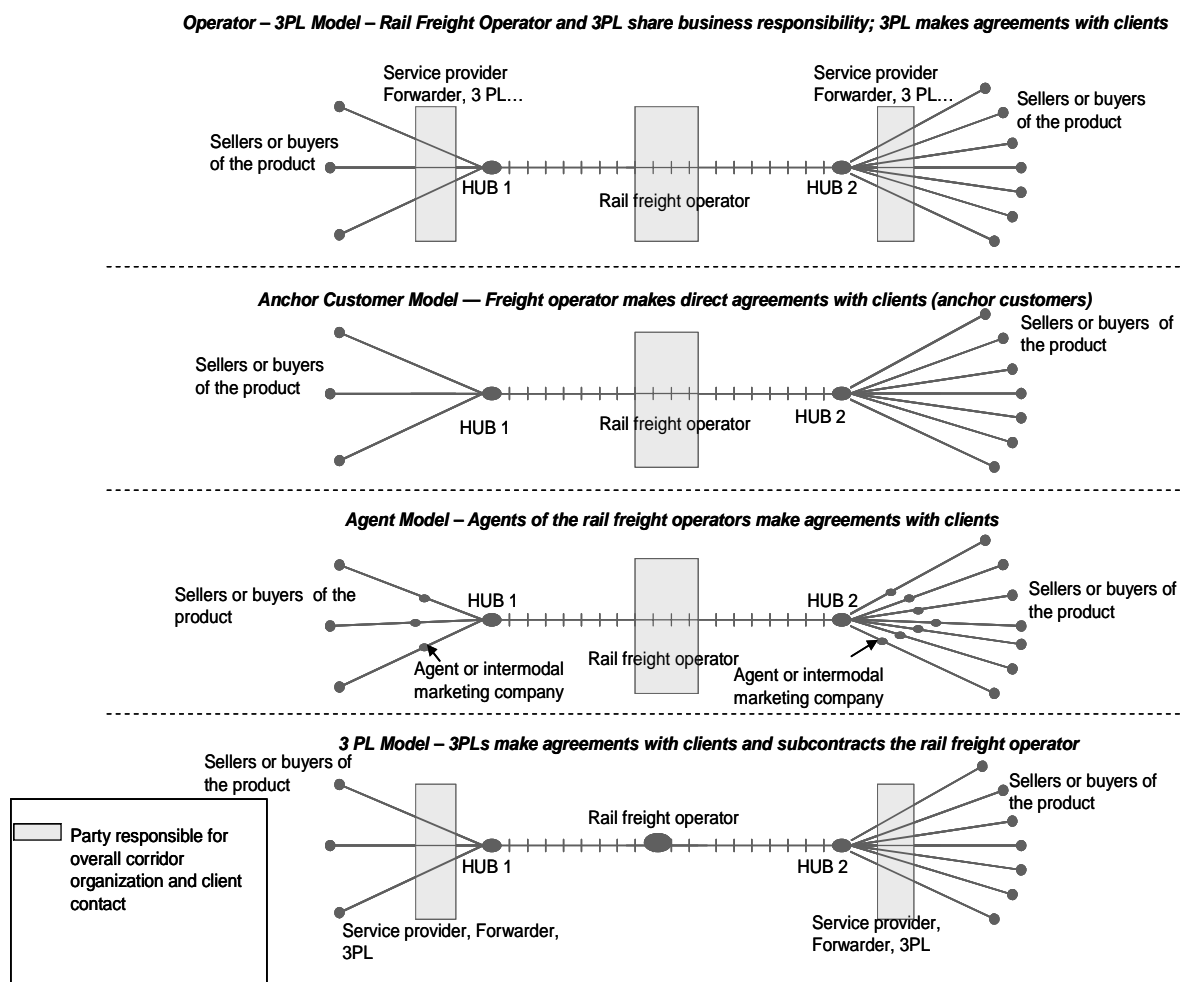
Finally, the supporting partners involve suppliers of ICT systems and other auxiliary inputs needed for proper execution of the RETRACK consortium’s commercial goals

The figure below presents four different business models in which RETRACK operators may assume different positions and perform different functions vis-à-vis three classes of customers.

1. A Freight/train Operator-3PL Model
2. An Anchor Customer Model
3. An Agent Model, and
4. A 3PL/4 PL Model

Each of these models puts different requirements on the leader of the RETRACK consortium as regards management of risk arising from the venture’s contractual obligations, supply of required service quality, and returns on capital engaged.

Figure 3: Four Business Models



Model 1: Train Operator & a 3 PL Provider

In this business model one train operator sells and/or leases the load carrying capacity of the entire consortium to a 3PL provider, who in turn concludes contract(s) with shippers,

consignors and/or other end-users. Division of roles in this working arrangement is pretty straightforward: train operator(s) perform long haul between single-modal and/or inter-modal hubs while the LSPs negotiate with clients the conditions of sales and the levels of quality.

Model 2: Anchor Customer

In Anchor Customer Model one train operator leads a network of rail carriers providing transport services, concludes contracts with buyers (shippers or consignors) without any intermediaries, and organises freight movement between international origins and destinations. Anchor customer is a large client who ships frequently large freight volumes along a given corridor, and buys and/or charters considerable part of the RETRACK operators' load carrying capacity. This model is highly prevalent in traditional railway segments where carriage capacity is sold to limited number of large buyers who ship trainloads and/or block trains with unitised, non-unitise bulk, steel, and/or paper rolls.

Model 3: Agent Model

In the Agent Model, the rail freight operators offer services through intermediaries such as brokers and/or inter-modal marketing companies who sell the load carrying capacity to international clients against fast commission. This model is a modification of the previous one; train operator(s) move freight along a given corridor while agents sell the load transfer capacity either on particular corridor segments or along the entire Rotterdam-Constantia pipeline.

Model 4: A 3 PL and/or 4 PL Supplier Model

In the 3PL Model, the LSP concludes all sales of combined logistics and transportation service. A train operator is just one of the subcontractors who provide line-haul between hubs and/or inland origins and destinations. A given LSP either cooperates with other LSPs within a given corridor, or competes. If they cooperate, only few operators will run trains along this corridor. If they compete, many

other freight operators are involved, and a fierce intra-rail competition emerges.

A preliminary discussion with RETRACK operators suggests that the Anchor Customer Model is of some interest. The benefit of this solution is that it reduces the risks of empty haulage because loading capacity could be pre-ordered. However, a drawback is that price becomes the main competitive criterion for transport buyers who easily compare the costs of similar service offered by different carriers or their consortia. In case when a given train carries homogenous cargo or just few cargo categories, and/or when dispatches are destined to small number of receivers, there is no much need for advanced ICT solutions, and information about freight in motion and after arrival can be provided by a lock driver equipped with mobile phone. This may considerably reduce the cost of service provision and, improve the RETRACK carriers' competitive standing (at least during the first phase of the consortium's business life).

4.2 Cost Model

Another action important for the building of RETRACK venture's competitiveness involves drawing the business plan for provision of profitable and competitively robust rail freight services.

The issue of sustainable competitive advantage is closely related to operational efficiency and the introduction of common operations standards that become an important building

block of the RETRACK quality and its marketing hallmark. As these issues touch on managerial and operational differences between the partners, they need to be resolved in structured and systematic manners. Therefore, the below section deals with how the partners may need to compensate each other for services they provided under RETRACK trademark.

Transfer pricing, or the reimbursement for services rendered to traffic passing through the partners' service territory, is a key issue that the alliance has to deal with in the management of international operations. Resolution of this issue in an economically sound manner is imperative to improving operational efficiency of all alliance partners, and the cornerstone of an incentive system that will enhance the amount of business transacted between the partners.

One indicator of operational efficiency is the cost of joint service provision allowing the attainment of profit in given market conditions. Since the alliance's partners will transfer freight between international origins and destinations, the efficiency of one party's performance affected the economic results of the others. Because this issue may frustrate the inter-partner relations, it calls for fair, sincere and principle-based settlement.

Division of costs is the most important element in every contract for service provision. The parties must know not only who does what, but also how the resulting costs should be divided. In most cases the fact that a party must do something means that it must also bear the resulting costs, unless otherwise agreed. But there are many exceptions, and uncertainties arise with regard to services performed on the part of other parties in territories distant to the domicile of the party that issued the order. In addition, difficulties arise with respect to division of costs whenever additional expenses are caused by unexpected events, such as when a cargo requires additional handling and/or when the price/costs level for the same type of service varies across different national and/or regional markets.

Therefore, a cost model is proposed that the RETRACK partner may apply to assess the economic and financial fundamentals of their service provision.

It is proposed that this value judgement consists of five analytical stages:

1. Estimation of operating expenses related to supply of rail freight service between Rotterdam and Constantia, and development of cost model incorporating all operations and/or equipment used by trains carrying wagons and/or inter-modal units
2. Estimation of revenues covering expenses generated by supply of the above rail services with yields from transfer of different commodity categories and/or haulage of inter-modal units that brake-even at different expense/revenue levels
3. Development of financial model balancing expenses and revenues related to different levels of service quality, and carriage of different commodities and load carrying units
4. Estimation of short, medium and long-term parameters for business models securing access to different goods repositories through different types of relationships with clients
5. Synthesis of results from the above partial estimates and development of algorithms calculating operational and marketing feasibility of RETRACK service supply.

Below we present the model components and the relationships between these elements based on the following operational assumptions

1. The RETRACK operators run a block train with fixed number of load carrying units. This train is there after called the RETRACK SHUTTLE TRAIN (RST), and
2. The RST has a fixed timetable for freight movement between, say, Rotterdam and Budapest (i.e., no stops on route other than border crossings).

The cost model will calculate the break-even by dividing the total variable expenses by the net revenue generated by the sales of the RST freight carrying capacity reduced by the discounts and/or special prices as compared with published tariffs. The following three types of costs are considered as expenses arising from production of international train service:

Variable Costs:

- Infrastructure usage fees (IF)
- Electrical/Diesel power (EL)
- Technical inspection (TI)
- Labour costs for handling, marshalling,
 - loading, unloading, coupling/uncoupling of wagons and/
 - or Inter-modal Transport Units (ITUs), technical tests and
 - train operations (WA)

Direct fixed costs:

- Depreciation of wagons, ITUs and engines (D)
- Interest rates on loans or lease rents for rolling
 - stocks and/or engines (IR)
- Insurance of rolling stock, personnel and auxiliary
 - equipment (IN)
- Installation of information system for on-line
 - monitoring of train movement and positioning of freight
 - in motion, and depreciation/ amortisation of ICT
 - hardware and software (IS)

Fixed indirect costs:

- Sales and marketing staff, marketing, administration and
 - coordination functions (A+S)
- Depreciation of fixed capital outlays other than rolling,
 - i.e., buildings, office equipment, etc) (CD)

Other operational parameters impacting on direct variable costs and the revenue levels include:

1. Transit time, i.e., number of train hours on one-way trip between Rotterdam and Budapest which also defines the needs for train operating personnel, rolling stock, engines, and supporting services (TT)
2. Amount of pay-tonnes carried (NT)
3. Frequency of RST service per week (WF)

Since revenues should offset operational expenses, the following definition of net revenues is used for assessment of economic viability of the RETRACK services:

Net Revenues will be composed of tariffs multiplied by the amount of wagon pay-tonnes (or ITUs) and subtracted by discounts and/or special rates offered to customers, which are different from the maximum profit tariffs (R).

Consequently, assessment of the RST's economic viability will involve the following three sequential calculations:

$$\text{Costs} = (\text{WA} + \text{TI}) * \text{TT} + (\text{D} + \text{IR} + \text{IN} + \text{IS}) + (\text{IF} + \text{FL} + \text{SS} + \text{WA} + \text{TI}) + \% * (\text{A} + \text{S} + \text{SD}) \quad \text{WF}$$

$$\text{Net Revenue} = (\text{TT} * \text{NT}) * \text{WF} - (\text{R} * \text{NT}) * \text{WF}$$

$$\text{BEP} = \text{Operating Costs} / \text{Net Revenue}$$

The break-even point calculates the ratio between the operating costs and the revenue that, hopefully, will always be positive.

4.3 Operational Efficiency of RETRACK Consortium

The above cost model may help the RETRACK partners to assess the levels of their costs and expenses, and by so doing reveal

the competitive gaps and/or advantages between themselves and their rivals. However, the competitive strength of the entire alliance will depend not only on individual partner's cost levels, but also on the operational efficiency and cost-effectiveness of the entire RETRACK venture's collective performance. This underscores a need for the RETRACK operators to devise and agree on a settlement code for mutual reimbursement for services provided to customers located in markets covered by their alliance.

Such a system has to be based on the most competitive price benchmark for delivery of a given service quality, otherwise the RETRACK partners may risk overpaying each other and losing a competitive edge in relation to their own customers. Two solutions may be proposed. The first may involve a system of incentives for a continuous compression of operations costs, while another, a mutual disclosure of individual pricing structures under transactional settlements.

The incentive scheme is pretty harsh, because it requires exposure of freight rates and calculation algorithms that the RETRACK partners use currently and may reveal that some partners operate at substantially lower rates than others for the same operations in different national markets. Adding to the complexity may be the fact that one operator may use a formal quality control based on ISO standardization, while the others not. This discrepancy may become a source of difficulty with cost/quality standardisation because the same price level may pertain to different quality standards. These inter-partner differentials may hinder an economically sound transaction settlement.

Moreover, the different RETRACK partners may be exposed to different intensity and forms of competition in different geographical markets and/or service provision segments, and so their willingness to adhere to the least-cost pricing may vary.

Thus, the disparate efficiency levels and the different intensity of competitive pressures may erode the competitiveness of the entire alliance by inviting the individual partners to switch to outside suppliers operating in a more cost-effective manner.

In this situation, the only competitively sound solution seems to be basing the alliance pricing system on the variable costs of the most cost-effective operator. However, some serious drawbacks may be associated with this solution. These may cause that partners whose costs match and/or remain below the above benchmark will receive the full reimbursement, and

may thus profit from international service provision. Alternatively, those who operate at costs higher than the benchmark may lose money, as they will receive a fixed amount of compensation. Needless to say this proposition may be resisted by those who have most at stake, i.e., whose variable costs may vary but still, on average, exceed those of the remaining partners.

However, the adoption of the above scheme may also produce several positive outcomes for the RETRACK partners. The first is the awareness of the relative efficiency differences between the partners and the competitive gaps/gains between themselves and their rivals. Second, application of standardized reimbursement code based on a unitary tariff system for all routes served by the RETRACK alliance may solidify partners' commitment to keeping freight rates at promised (low) levels. Third, such a system may provide a baseline to which all partners could narrow down the cost variance within the agreed-upon time period.

Yet, given the fact that the RETRACK partners are still at a very early stage of their collaboration, and that the differences in cost levels reflect the variance in their firms' operational efficiency as well as the heterogeneity of market conditions, the adoption of one uniform system may not be immediately feasible. However, it may serve as a long-term numerical goal for operational integration of partners' performance and quality standardization.

The settlement conditions reviewed below provide the RETRACK partners with some ideas on how the members to other alliances supplying international rail freight transport resolved the issues which they also are facing. The business plan agreed-upon between these carriers envisage that all strategic and operational partners associated within this particular consortium decided to abide by the following procedure for settlement of mutual transactions:

1. All transactions are to be settled through an *ex post ante* reimbursement of operators for the services supplied to other partners during a given period of time.
2. The settlements are to be based on a benchmark fixed on the lowest variable cost of the most cost-effective operator among the alliance members or an outsider that prevails within a given market segment during the period of compensation.
3. The risk of utilisation of load carrying capacity is to be borne by the departing party. The latter will also pre-pay the remaining partners for services rendered under freight movement along a corridor located outside the shipping party's operations.
4. The clearance of inter-partner transactions for a given period of time is being effectuated via electronic invoice transfer and based on two alternative settlement codes, depending on the nature of the business. The first type of settlement is based on a fixed rate for a given service agreed-upon between the collaborating partners.¹ However, in the situation where multiple partners jointly supply haulage to one corporate customer, the inter-partner settlements are based on the contract which defines the volume of services to be provided within a given time period, and the desired quality of service delivery.

¹ One important aim for adopting this settlement scheme, apart from reimbursing the service suppliers, is to induce the partners to operate in the most cost-effective manner. The outcome sought is that the party producing services below the rate agreed for periodic settlement could retain the profits, whereas the party whose production costs exceeded this rate is to suffer losses. The latter should stimulate the loss-making party to improve its operational and/or financial efficiency.

5. All partners have to disclose to each other the detail accounts of their cost structure in order to identify the services that were priced higher than the benchmark.²
6. Partners who suffered losses on services provided to other partners had a right to compensation equal to 25% of losses incurred during a given transaction period, but no longer than over two subsequent settlement terms.
7. Partners who during two consecutive settlement terms did not reduce the level of operating costs are obligated to restructure and rationalize their operations. Moreover, they have to accept that other partners would buy the freight-carrying capacity and other freight-handling services on the routes they served from alternative sources during the time the re-structuring was to be completed, until the cost of service provision reached the competitive level.

This deal provides general incentives to reduce operating costs, and stimulates to purchases of larger traffic volumes and/or a broader range of services from the most efficient suppliers. If implemented by the RETRACK consortium, it may also stimulate towards growth in inter-partner trade, strengthen business links among the partners and increase the scope of mutual business dependence. Moreover, by demanding self-disclosure of operations costs, it may commit the less competitive parties to discipline their operational and financial performance, and forestalled opportunistic behaviour.

It may also allow those who lag on efficiency to rebuild their service provision system without the need to leave the alliance. An incentive that stimulates towards permanent compression of operations costs in line with the standards set by the most efficient rivals may keep the competitors at bay by making it very difficult to offer more cost-efficient transit within the alliance's market area. The above may create a long-term competitive advantage for the venture.

4.4 Formalisation of Collaboration between the RETRACK Partners

In order to create a solid competitive market foundation for their venture, the RETRACK partners may need to acquire a formal identity for their collaboration. Besides, operations as a "virtual" alliance may also be unsafe because of anti-trust implications.

Parties that collaborate with regard to market organization and/or price-setting without filing for the formal permit may be accused of anti-competitive collusion and indicted for unfair competitive behaviour by national competition authorities and, in the worst case, also by the European Court of Justice.³

Luckily, the European Commission recognized the need for alternative modes of collaboration between firms from different countries than just through mergers and acquisitions. One of them is non-equity venturing or consortia of sovereign partners amalgamating their efforts without capital investment toward the achievement of specific business goals.

A legal format of European Economic Interest grouping is reviewed below so that the RETRACK partners may consider its applicability for formalising their collaboration.

² This provision is practical importance for strengthening inter-partner trust and identifying systemic inefficiencies in partners' procedures and standards.

³ Such a threat may arise when (if) a large European rail operator competing with RETRACK partners on the same international corridor lodges a complaint to DG Competition accusing the latter for unfair rivalry in the same market segment.

In acknowledgement of the need for non-equity international collaboration, the Commission of European Communities has drafted a provision for a legal format of the European Economic Interest Grouping (EEIG). The EEIG's statutory purpose is to facilitate "cross-border co-operation of a nature similar to partnerships or joint ventures ... and to make possible co-operation among businesses ... subjected to legislation of different [EU] Member States". The statutory provision also specified that "the EEIG is different from a company mainly by the virtue of its purpose".

The purpose of the EEIG was stated in Article 3 of the Regulation 2137/85/EEC published by the European Economic Community Council on establishment of a new trans-national company structure. Such a company could be established in order: "to facilitate or develop the economic activities of its members and improve or increase the results of those activities; its purpose is not to make profit for itself. Its activity must be related to the economic activities of its members and must not be more than ancillary to those activities. The grouping may not as a general rule be used as a basis for activities that are not connected to the existing activities. Typically, an EEIG may provide for its members joint purchase offices, joint sales offices or joint research and development".

In the view of the above, EEIG may be provide a suitable blueprint for formalization of collaboration between the RETRACK partners and the business carried out by their alliance. This suitability is further enhanced by the EEIG's simple management structure and limited legal impacts on other business areas of partner firms. The contents of these terms are reviewed below.

Membership in the EEIG is extended to companies and (other) legal entities which have their registered office and/or central administration in an (EU) Member State or natural persons who carry out any industrial, commercial, craft or agricultural activity within the Community.

Management of the EEIG consortium is vested with "the members acting collectively, and the manager or managers". However, a stipulation has also been added that a specific contract signed by the parties could allow establishment of other managerial solutions equipped with powers defined differently. Actual performance of the management function is to be conducted by one or more natural persons appointed by the formation contract or by a decision of the group members. However, another stipulation was added that the members of the grouping had supreme authority (over the manager), and could therefore make any kind of decision for the purpose of achieving the EEIG objectives.

Still another important provision is submitted by a paragraph stating that "there is no statutory requirement that a certain capital should be contributed to form the EEIG". The freedom to decide whether capital should be contributed is left to the members. This is very convenient because it means that no financial investments are needed beyond the funds necessary to design the trademark and a logo, and register them in the countries of EEIG operations.

The EEIG's formal powers with regard to its members are restricted by the following statements:

"A group may not:

- exercise, directly or indirectly, power or supervision over its members' activities or over the activities of another undertaking,

- directly or indirectly, on any basis whatsoever, hold shares of any kind in a member undertaking; the holding of shares in another undertaking shall be possible only in so far as it is necessary for the achievement of the grouping's objectives and if done on its members' behalf".

These two statements are crucial. They restrict the consortium's decision-making to subject-matters related to management of the EEIG, and introduce a borderline separating the RETRACK commercial interests from other business areas within the founder firms. Moreover, restrictions on mutual shareholding may suit well the RETRACK partners, as none of them (so far) voiced any desires to acquire proprietary stakes in others' interests. So the above articles restrict the EEIG's legal impact to management of the RETRACK consortium affairs only and therefore to exclusion of other matters of partner operations from its regulatory purview.

The EEIG may also provide a legal framework for the Articles of Association, which need to be devised and adopted by the RETRACK partners in order to formalise the RETRACK rail service provision. The Articles of Association may define the hierarchical managerial structure, the scope of its executive powers with regard to decision-making, plus the extent of contractual obligations among the alliance members. The RETRACK partners may also use the EEIG legal provision to register the trademark of their venture, thereby transforming the private (informal) contractual arrangement into a private unlimited liability company. This company may also serve as marketing outfit, and a backstage for the RETRACK joint sales office.

Thus, the main contribution of the EEIG organization to RETRACK alliance may be "... to develop, promote and facilitate long-term cooperation among the EEIG members in order to create and strengthen a network among the members within the international railway business, and particularly in provision of international freight transfer along the Rotterdam-Constantia Corridor".

In order to fulfil the above, the RETRACK alliance members may need to commit themselves to:

- "Work actively in order to develop, promote and facilitate cooperation with other members in order to provide the best possible platform for the EEIG, and create and strengthen the network mentioned,
- Work towards creating and strengthening business relationship among the members by supporting the work performed by the EEIG,
- Observe full confidentiality (both during and after the period of membership) with respect to all the information provided or made available by members to other members insofar as such information was of a confidential nature".

Typically, but not necessarily, the EEIG's organizational hierarchy is composed of three structures: The General Assembly of all members, the Board of Directors, and the Manager. Each level commands a different understanding of decision-making, but builds on power prerogatives assigned to a preceding hierarchical ladder. The idea is that in order to work efficiently together for optimum performance, the three components of the managerial system had to interact in an interfaced manner. The broadest scope of nominal powers is assigned to the General Assembly, which has the authority to:

- alter the objective of the EEG
- alter the number of votes allotted to each member
- alter the contribution of every member or by some members to the EEIG financing
- alter any other obligation of a member
- admit new members or Associated Members

The Board of Directors possess the more specific strategic and executive powers to:

- - Develop the strategies and business of EEIG, as well as supervise the Manager, and
- - Appoint and remove the Manager.

Moreover, the Board of Directors has the powers to launch several standing committees or project tasks manned by functional experts from the founders and/or associated partner firms in order to deal with the following integration issues:

- Marketing of the alliance's services,
- Application of commercial technology;
- Development of systemised products;
- Legal matters

Finally, the position of Manager is equipped with powers and obligations needed for:

- Proper execution of the decisions of the General Assembly and the Board of Directors
- Preparation of the meetings of the General Assembly and the Board of Directors
- Operation of the EEIG business
- Reporting on an ongoing basis to the members of the business activities of the EEIG
- Entitlement to any action required to discharge the above duties and responsibilities.

During the first stage of integration between the RETRACK partners, the Board of Directors may get collectively involved in design and implementation of common operations standards. However, after the first sequence in the RETRACK alliance is successfully passed, the board may assume more strategic duties related to advancement of the content and the scope of RETRACK venture's collaboration. These may involve standardisation of the RETRACK operators' service performance either through adoption of ISO benchmark or franchise contract.

5 Summary

Deliverable 3.2 reviewed several components of the RETRACK business plan that collectively may help the venture to establish strong market position in international rail freight transfer.

First, the strategic rationale for non-equity alliance between the RETRACK partners was discussed. It emphasised the importance of long-term working relationships and formalization of the RETRACK collaborative affiliation.

Second, the creation of joint competitive advantage was addressed in order to enhance the RETRACK partners' awareness about a plethora of competitive opportunities arising from collaborative bonding of individual expertise, market coverage and service production assets.

Third, four elements of joint competitive advantage have been reviewed, with an aim to provide input to RETRACK partners for taking informed choices of competitive strategy and effective competition measures. These involved:

1. Four business models from which the RETRACK train operators may choose those that best define the customer-service segments they want to target, and solidify business relationships with clients shipping large and stable goods volumes.
2. Cost model that allows the RETRACK operators to estimate operational expenses and revenues from the sales of load carrying capacity at different stretches of corridors served.
3. Settlement code for cost-effective reimbursement of RETRACK partners for haulage provided to joint customers, and
4. The suitability of legal vehicle of European Economic Interest Grouping for formalizing the RETRACK partners' collaboration in the form of unlimited liability company without any capital investment.

Although the subject matters discussed here are presented in sequential fashion, the attainment of the RETRACK strong competitive advantage will require several concurrent actions and decisions. This means that several issues which involve different spheres of alliance as a whole and individual partner operations have to be resolved simultaneously.

One practical suggestion may involve inclusion of network integrator function into powers and responsibilities of the RETRACK EEIG manager so that this person may represent the RETRACK interests vis-à-vis the actual and potential clients.

Another proposal may refer to defining as soon as possible the strategic and operational duties of the RETRACK Board of Directors as regards development of standardized service, its sales and marketing.