VR Group: State ownership steering and purchases of passenger services

VR Group is a logistics and transport enterprise that operates rail services and supplementary trucking services and also provides track construction and maintenance services. In 2010 it had a net turnover of about 1.4 billion euros, with person-years averaging 11,950 and a balance sheet total of about 1.7 billion euros. The parent company, VR-Group Ltd, is fully owned by the Finnish state and comes under the purview of the Ownership Steering Department in the Prime Minister's Office.

The audit focused on the ownership steering of VR-Group Ltd and purchases of passenger services from VR by the state.

The Ownership Steering Department is an expert body that is responsible for the ownership steering of state-owned companies operating on market terms. It reports directly to the minister in charge of state ownership steering but administratively is part of the Prime Minister's Office.

The state purchases passenger services on railway lines where traffic otherwise would not be worth operating or could not be financed with customer revenues alone. The Ministry of Transport and Communications purchases passenger services from VR.

Ownership steering

The Ownership Steering Department's basic functions are the formulation of ownership strategy and related analysis and monitoring to support it. The formulation of ownership strategy consists of evaluations and decisions concerning the state's role and activities as owner, while analysis and monitoring build up the expertise regarding specific companies and industries that is needed in formulating strategy.

The task of the department's analysis and monitoring function is to produce information on the financial development of each com-

pany or group to support ownership steering. Evaluating the ownership steering of VR requires long-term and systematic monitoring and analysis together with the production of information on financial analyses and ownership strategy for the Government. On the basis of the audit the Ownership Steering Department has fulfilled this task.

The objective of ownership steering is to achieve the best possible financial result at any given time, which is evaluated on the basis of profitability and long-term growth in shareholder value. In the five-year period 2005-2009 the economic value added (EVA) generated by VR declined, but measured in terms of net profit, return on investment and return on equity profitability remained positive. In its profit and loss account VR Group has recorded a profit each year since its incorporation at the beginning of 1995. Whether or not results have been adequate is something that is up to the Government to decide. On the basis of the audit the Ownership Steering Department is able to produce essential information on profitability and shareholder value to support decision-making in this respect.

The basic ownership strategy for VR-Group Ltd that was issued on 26 November 2008 was a response to the 2007 Government Programme, which called for ownership strategies to be clarified for state-owned companies. It took some time to formulate, but the current basic ownership strategy together with the timely ownership strategy reviews that are presented to the Cabinet Committee on Economic Policy and a tripartite agreement reached by the Ownership Steering Department, VR Group and the Ministry of Transport and Communications form a comprehensive whole. The National Audit Office nevertheless considers that the owner's numerical objectives regarding the company's profit and balance sheet condition should be presented more clearly and precisely as part of the ownership strategy for the company.

The audit also examined two decision-making processes that appeared troublesome and exceptional from the viewpoint of ownership steering: 1) a decision by the state to procure 20 double-decker sleeping cars in 2008, despite opposition from the board of directors and management, at a cost of about 70 million euros and 2) a decision by the board of directors to provide financing from VR's own funds to allow VR-Track to proceed with an infrastructure project at a cost of 40 million euros in 2009 and 40 million euros in 2010.

On the basis of this examination, first of all the National Audit Office considers that under the guise of business activities VR's funds have been used as an instrument of regional and other support policy. The Government should not interfere directly in VR's rolling stock investments or their amount and scheduling. This is important to ensure the transparency that is required in state-owned companies' activities and the market-based nature of VR's business operations. It is also crucially important from the viewpoint of the company's operating conditions and the credibility of ownership steering.

Secondly, in view of requirements concerning the transparency of the state budget economy and state-owned companies' activities, the separation of the state's and VR's spending and the fair treatment of enterprises by the state, the National Audit Office considers it important to avoid any situation in which a market-based company that is fully owned by the state can provide or must provide financing for the state-owned rail network from its own funds on the basis of a decision by its governing bodies.

Passenger services purchased by the state

The objective in purchasing passenger services from VR through the state budget at a cost of about 43 million euros a year is to achieve a higher service level and share of rail transport compared with the situation if VR managed traffic purely on market terms. In the opinion of the National Audit Office, it is important to keep in mind the supplementary nature of these services, which can only be financed and maintained if commercially profitable traffic remains sufficient in scope and density. It should also be recognised more clearly that the goal is not simply to maintain existing passenger services but to ensure passenger services that cannot be operated profitably but are regarded as important on social policy grounds.

The National Audit Office considers that the present purchasing agreement system is functional in itself, but promoting the system's social effectiveness and operational efficiency would benefit from occasionally using "budget base zero". This means that instead of starting with historical choices, it would be necessary to begin with a clean slate and conclude new purchasing agreements according to current priorities and criteria regarding the basic service level as well as customers' needs.

The obligations in current purchasing agreements are risk-free in the sense that the state is not exposed to unforeseen charges and will not have to pay unnecessary charges if VR's customer revenues increase. According to agreements, calculated costs for individual services are subtracted from customer revenues (ticket sales) and the state compensates VR for any shortfall up to an agreed ceiling.

The National Audit Office considers that in purchasing passenger services more attention should be paid to their mass transport nature. Rail services cannot and should not be purchased with the aim of serving everyone or providing door-to-door service. This must be remembered particularly when it comes to purchasing services that are least profitable, have the fewest passengers and are most expensive for the state in terms of compensation per passenger.

In purchases of passenger services the basic service level receives top priority. The ministry also purchases higher-level services on transport policy grounds, however. In the opinion of the National Audit Office, specifying the basic service level supports and allows the implementation of an effective purchasing policy. From the viewpoint of the state, the payer of subsidies, the basic service level in public transport is achieved if demand is satisfied by at least one mode of transport. The objective should not be for rail transport to achieve the basic service level. What matters is the entire public transport system. The state's transport policy objectives may also be conflicting to some extent with each other or with the basic service level objective. It is possible that the basic service level alone is not sufficient to promote rail transport's modal share. Promoting the use of public transport may include raising the share of rail transport, but this may erode other the share of other modes of public transport and for example fail to reduce private motoring as intended. Prioritising purchases of passenger services in the rail sector is not enough. Before and in parallel with this, priorities must be set among different modes of transport so that the mode of transport that is best suited for different passenger volumes and travel densities along with any subsidies can be implemented as effectively as possible.