

Using PESTEL to design effective strategies

Introduction

When people think of rail travel they think of trains. They do not think about the **infrastructure** of the train network. This consists of countless bridges, viaducts, embankments, cuttings and tunnels. Independent companies built the first railways in the 19th century. From midnight on 31st December 1947 the government took control of the railway industry and British Rail ran it. In 1994 the railway industry was **privatised** and its services **franchised** to train operating companies such as Virgin and First Group. Responsibility for the infrastructure passed to a new plc called Railtrack. In 2002, the government transferred the assets and business of Railtrack to a new **not-for-dividend** company – Network Rail.

When Network Rail was created it needed to invest in the tracks and services. Since 2002, it has made many improvements. For example, in 2005 it replaced or repaired over 700 miles of rail.

Network Rail is a company limited by guarantee with a board of directors but no shares or shareholders. Instead, it has unpaid **stakeholder** 'members' who check standards of **corporate governance** and monitor performance.

Strategy and the external environment

The external environment is the context in which a business operates. This takes in various factors including those outside its control, for example, laws or standards. Each factor can have an effect on the business – positive or negative –and so companies make plans and strategies to try to anticipate these effects. If a company does not plan for external environment changes or ignores them, then it may miss opportunities to grow or suffer setbacks, for example, losing business to a competitor.

Every business strategy is designed to meet objectives and achieve targets. Ordinary firms must add value and reward shareholders. Failure to make an adequate **return on capital** can lead to the collapse of a firm or takeover by a competitor. Network Rail is required by its members to add value. This can be in money terms or as other benefits. If Network Rail does not make a profit, then less money will be available to improve the services.

Network Rail's 5-year plan includes targets such as reducing operating costs by £53 million by 2008/9. It re-invests its profits and has special responsibilities to satisfy the needs of its key stakeholders:

- The travelling public. They want reliable train services with safety as a top priority.
- The train operating companies. They want fair treatment and effectiveness in giving value-for-money.
- The government. It has three expectations:
 - ensuring the highest safety standards
 - getting value for the taxpayers' money
 - seeing its investment in railways meet national transport needs.

Profit-orientated businesses measure success in terms of costs and profits. Network Rail shares these priorities but also considers **social costs and benefits**.

CURRICULUM TOPICS

- PESTEL
- External environment
- Strategy
- External influences
- Objectives and Planning



GLOSSARY

Infrastructure: the assets whose shared use enables firms to operate effectively e.g. roads, bridges, power supply.

Privatised: the process of selling state-owned business to the private sector.

Franchised: businesses that are based upon the name, logos and trading methods of an existing organisation.

Not-for-dividend: not for profit.

Stakeholder: an organisation or group of people affected directly by the activities of a business.

Corporate governance: the process of high level control of an organisation.

Return on capital: the level of profits arising from the resources invested in the business.

Social costs and benefits: sources of cost or value that do not appear in business accounts but are experienced by society.





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GLOSSARY

PESTEL analysis:

drawing together the external forces affecting a business including political, economic, social, technological, environmental and legal factors.

Environmental

scanning: the research and assessment of proposed changes in PESTEL issues.

SWOT analysis:

identification and evaluation of the strengths and weaknesses inside a firm and the opportunities and threats in its external environment.

Monopoly: when there is only one firm in the market or when a large firm has a significant share of a market (e.g. 25% or more).

These affect the wider community and include costs of noise pollution or additional road use. Social benefits include regenerating derelict land or increasing trackside safety, for example, keeping fencing in good repair or increasing use of security CCTV. Balancing the costs of providing the social benefits against the need to maintain its profits is not easy!

The **PESTEL analysis** is a standard way of **environmental scanning**. It groups together the factors which managers must be aware of and plan for. PESTEL analyses external influences affecting a business. It stands for

Political - the current and potential influences from political pressures

Economic - the impact of local, national and world economy

Social - the ways in which changes in society affect the organisation

Technological - the effect of new and emerging technology

Environmental - local, national and world environmental issues

Legal factors - the effect of legislation in both the UK and other countries.

Successful managers need an all-round view of their environment for decision-making.

Network Rail uses PESTEL analysis to draw attention to each of the key external environmental factors. This allows managers to identify links or inter-dependencies between them. More particularly, PESTEL highlights both opportunities and threats likely to affect Network Rail.

These become the external input to a **SWOT analysis** that aids the strategy-making process.

Network Rail also needs to be aware of its competitors. Although it is the only company that owns the railway track (and therefore has a legal **monopoly**), the market for travel is highly competitive. Other forms of travel, e.g. bus, plane, car, are sources of both threat and opportunity. One opportunity, for example, is that car users may find it cheaper to travel by train because of high petrol costs.

Political and Economic forces

Political

Railways have always been a political issue. In the 1960s, as car ownership increased, rail use dwindled and many lines closed. Government money has kept parts of the network operating. Further cuts to services would save money but increase social hardship and affect the environment by putting more cars on the road. Investing more in the railways would deliver social and environmental benefits but at the cost of the taxpayer's money.

Safety is also political. Serious rail crashes at Paddington (1999) and Hatfield (2000) raised concern over proper funding of maintenance and safety. Railtrack was held accountable for the accidents and as a consequence, it faced large costs in the form of penalties and compensation payments. It was against this difficult background that Network Rail was formed in 2002.

Economic

In economic terms, Network Rail receives income from two main sources:

- the train operating companies who pay for track access
- the Government that pays fixed amounts as part of a five year plan.

Network Rail operates with the same financial discipline as any large company. The company does not pay dividends but does aim to make a profit. It has normal business pressures to boost income and reduce costs. Profits are used to cut debt and most importantly, to invest in the rail infrastructure.

The following table shows how much Network Rail is putting into investment for 2006:

	2006 £million
Revenue	3,837
Operating Profit	480
Net Debt	18,238
Capital investment	3,151





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It has a clear instruction from the Department for Transport to improve operating efficiency. **Unit costs** – for example, the cost of replacing one mile of track – have been driven down by 22% since 2002. The target is 30%. Journey performance is equally under pressure. Delays are down 28% since 2002 and 86% of passenger trains now run on time. The target is 90%.

Network Rail is part of a closely regulated environment and is directly answerable to:

- its members who scrutinise its performance
- the Office of the Rail Regulator (ORR) which sets the charges for track access
- the Department of Transport which decides on the extent and timing of government funding.

The economy is a vital element in Network Rail's environment. Economic growth generates greater demand for rail travel. More jobs mean more commuting. Business expansion means more business travel. Rising incomes mean more leisure journeys by rail. An economic downturn would put all these factors into reverse.

Since the mid-1990s the UK economy has enjoyed a long boom with **GDP** up by 40% over ten years. Network Rail has enjoyed rising revenues from the train operators. However, more passengers and higher ticket sales have stretched operating capacity to the limit. It has invested in major projects to reduce delays, eliminate bottlenecks and raise permitted line speeds. The company works closely with train operators to improve reliability and offer more routes.

Social and Technological factors

Social

The rail network covers most parts of the country. This means that Network Rail has an important and sensitive relationship with the public. Nearly five million people live close to rail tracks, so noise needs careful control.

Network Rail aims to develop a positive image or **brand**. Persuading the public that rail travel is a real alternative to car use is vital. Individual rail companies build a local identity to increase usage.

Network Rail is a national company but also has a local impact. It is a huge national employer and has 32,000 staff in widely varying roles. It employs more engineers than any other organisation, running the largest engineering training programme in the UK. Progress in Network Rail's strategy depends on attracting talented and committed employees.

Safety is a particularly pressing issue. Trespass on the railway and misuse of level crossings are key causes of accidents. Network Rail has a major role to play in educating the public – especially children – about the dangers of the rail environment.

Technological

Network Rail has used advanced technology to cut costs, improve performance, such as running to time, and implement higher levels of safety. These are all key objectives which Network Rail has achieved recently. The cost of such investment is currently over £3 billion each year. These funds pay for improvements to track, signalling, and safety performance (for example, in detecting broken rails).

The need to adopt the best technology and to innovate continuously is urgent due to a history of low investment. Investment was poor in the British Rail era and inadequate during the Railtrack years. Today users expect good performance, so by investing money in new technology Network Rail is closing the investment 'gap' and can meet the rising expectations of its customers.

Environmental and Legal issues

Environmental

The greatest non-financial benefit of railways is environmental. Rail travel is much more energy-efficient than travel by road or air. For example, it is estimated that a car journey is six times more polluting than a similar distance by rail. Unlike roads, railways make few new demands on land and release lower levels of carbon dioxide.

GLOSSARY

Unit costs: total costs divided by output; the cost of producing one item of output.

GDP (Gross Domestic Product): a nation's wealth.

Brand: trade name; a name given to a product or service.





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GLOSSARY

Continuous improvement:

the constant effort to reduce waste, increase response time and improve quality.

Total Quality Management:

a management system designed to eliminate defects and meet customer requirements first time every time.

Fiscal: relating to the treasury or government finances and expenditure.



In keeping with its green credentials, Network Rail takes its environmental responsibilities seriously. For example, it buys wood for the rail tracks from forests which are properly managed and renewable. Railways are sometimes called 'nature's corridors' and Network Rail is responsible for the UK's largest number of Sites of Special Scientific Interest (SSSIs) alongside or near the tracks. Protecting these areas helps wildlife conservation, which in turn brings social benefits to Network Rail in terms of its public image.

The valuation of rail's environmental advantage is highly political. Network Rail is committed to helping the public understand the positive contribution rail travel makes to the environment. Public attitudes and political goodwill influence how much money and support for projects Network Rail receives.

Legal

Network Rail has to comply with a very wide range of legislation. Company law and the terms of its not-for-dividend structure are only the start. As a huge property owner, Network Rail deals with firms and households throughout the UK. It is a large national employer needing skilled and committed staff. Compliance with employment laws is particularly important. It owns all stations on the UK rail network and manages the largest. Consequently, it aims to provide facilities that meet the needs of all passengers. This includes those with disabilities, under the terms of the Disability Discrimination Act (DDA) 1995.

Health and safety legislation affects almost all of Network Rail's activities. New legal requirements reflect political pressures arising from changing social attitudes. Railways have always offered one of the safest ways to travel and continue to seek to improve their record on safety. For Network Rail this reflects its culture of **continuous improvement** and **total quality management**. 'Raising the bar' is at the heart of the company's mission to provide a safe, reliable and efficient railway fit for the 21st century.

Conclusion

Organisations make strategy to fulfil their corporate objectives. These arise from the aims and influences of their stakeholders. A business organisation adds value by ensuring that total costs are exceeded by corresponding increases in value. Network Rail is committed to adding value but some of its costs and benefits are social rather than financial. So as well as meeting its **fiscal** targets, Network Rail has to meet non-financial performance indicators such as safety in operations.

PESTEL analysis is essential to Network Rail in working to understand and meet the expectations of stakeholders. It uses PESTEL in its strategy-making and this is a key to its success in recent years.

Questions

1. What is the purpose of a PESTEL analysis?
2. Explain why it is important for Network Rail to monitor its external influences.
3. What are the main challenges that Network Rail has to plan for?
4. Evaluate the success of Network Rail's strategies using examples from the study.



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