

Non-rail Business of Swedish State Railways

Cooperation between Parent SJ and Subsidiaries

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Background

Swedish State Railways (SJ) is State-owned but operates on fully commercial conditions just like a private company. It is organized into a Group with SJ as the parent. Railway operations are organized by the parent, while non-rail business is run mainly by the subsidiaries.

The essential organizational structure is shown in Figure 1.

The Management group consists of the Director General and President, as well as Directors in charge of:

- Accounting, Finance and Planning
- Personnel
- Communications and Corporate Image
- Corporate Planning and Strategic Development
- Passenger Transport Division
- Freight Transport Division
- Mechanical Engineering Division
- Real Estate Division

SJ's non-rail business is largely based on its historical heritage. When private railways were nationalized around World War II, SJ became the owner of non-rail business in the form of limited companies. There is also an intentional strategy to operate—if appropriate—supportive and complementary services in the form of limited companies.

The SJ Group

The parent of the SJ Group is a public enterprise; the subsidiaries are limited companies. To minimize barriers inherent in the different forms of association—*inter alia* from a taxation point of view—SJ has created the wholly-owned AB Swedcarrier as a holding company for these subsidiaries.

The subsidiary group comprises AB Swedcarrier, with its wholly-owned subsidiaries SJ Invest AB, FAB SweRE,

SwedeRail AB, AB Trafikrestauranger, AB Svelast, CombiTrans Sweden AB, Rail Combi AB, SweFerry AB, TGOJ AB and SweMaint AB, as well as the part-owned company Sve Rail Italia AB.

Rail traffic is the core business of the SJ Group activities. Railway operations are concentrated on SJ.

The subsidiaries' various businesses are naturally complementary and supportive of the core business. The Group operations are handled by five business sectors: Passenger Transport, Freight Transport, Ferry Traffic, Mechanical Engineering, and Real Estate Management. Figure 2 summarizes the different units of the SJ Group and shows to what business sector they belong.

The historical heritage has occasionally led to competition between the limited companies and the core business of the SJ parent. In addition, uncontrolled competition has occurred between different companies within the SJ Group. The

Swedish Parliament has decided that the SJ Group shall continue to concentrate its activities on business-orientated development of railway operations and the activities of the Group that do not contribute to this should be discontinued.

Following the parliamentary decision, during the past few years, the SJ management has restructured the activities of the SJ Group, by merging similar operations into the same entity. One example is the ferry services. Previously, these services were operated partly by some subsidiaries according to different cooperation agreements, and partly by the parent. However, by 1991, the Group's entire ferry service was concentrated in SweFerry AB. At the same time, maintenance service was restructured so as to give the heavy overhaul of rolling stock to the subsidiaries TGOJ AB and SweMaint AB, while the Mechanical Engineering Division of the parent took responsibility for light maintenance.

Figure 1 The SJ Group

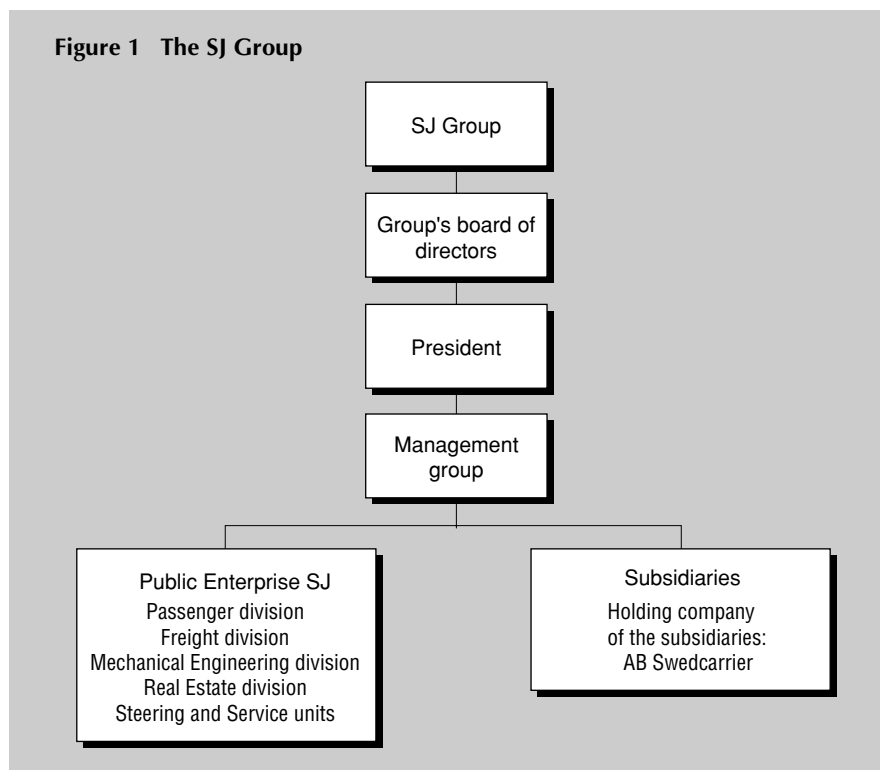


Figure 2 Units of SJ Group

Passenger Transport	Freight Transport	Ferry Traffic	Rolling-stock Maintenance	Real Estate Management	Other
Passenger Division, Parent Entity	Freight Division, Parent Entity		Mechanical Engineering Division, Parent Entity	Real Estate Division, Parent Entity	Other Units, Parent Entity
Swebus AB	AB Svelast	SweFerry AB	TGOJ AB		AB Swedcarrier Parent Company
AB Trafikrestauranger	CombiTrans Sweden AB		SweMaint AB		SJ Invest AB
	Rail Combi AB				FAB SweRe
	Sve Rail Italia AB				SwedeRail AB

Figures for operating revenue and number of employees refer to 1995. Operating revenue is US\$ million.

The SJ Group		SwedeRail AB		SweFerry AB	
Operating revenue	2,560	Consultant using SJs and Swedish National Rail Administrations railway knowhow as base		International ferry service on routes between Sweden and foreign ports	
Number of employees	24,850	Operating revenue	3	Number of employees	171
The Parent—SJ		Number of employees	16	TGOJ AB	
Operating revenue	1,760	AB Trafikrestauranger		Heavy rolling stock maintenance and major repairs; maintenance of replacement components; rebuilding of rail vehicles; traffic operations in close cooperation with SJ	
Number of employees	14,220	Catering with train on-board service and station restaurants		Operating revenue	145
• Passenger division		Operating revenue	86	Number of employees	1,140
Operating revenue	910	Number of employees	1,023	SweMaint AB	
Number of employees	5,300	AB Svelast		Freight wagon maintenance and repairs; replacement components and wheel set maintenance	
• Freight Transport division		Haulage and terminal operations with local and regional distribution and warehousing		Operating revenue	21
Operating revenue	770	Operating revenue	46	Number of employees	93
Number of employees	3,820	Number of employees	499	Swebus AB	
• Mechanical engineering division		CombiTrans Sweden AB		Bus and coach transport in cooperation with transport authorities, companies and organisations; company sold in 1996	
Operating revenue	220	Total logistics concepts with rail, trucks and intermodal transport as base		Operating revenue	474
Number of employees	2,200	Operating revenue	99	Number of employees	6,200
• Real Estate division		Number of employees	86	SJ Invest AB	
Operating revenue	130	Rail Combi AB		In-house finance	
Number of employees	240	Transport services involving removable load carriers between terminals in Sweden		Operating revenue	8
AB Swedcarrier		Operating revenue	76	Number of employees	16
Holding company of the subsidiary group		Number of employees	168	FAB SweRe	
Operating revenue	94	Sve Rail Italia		In-house insurance	
Number of employees	166	Concepts for transport between Sweden and Italy; equally owned by SJ and the Italian Railway Company, FS Spa		Operating revenue	2
SJ Invest AB		Operating revenue	73	Number of employees	1
Number of employees	16	Number of employees	10		

In the same way, activities competing with or not directly supporting the core business have been discontinued.

The winding-up of such activities has been carried out partly by successive sales or close-downs of operations within the parent and the subsidiaries, and partly by selling companies in their entirety. Examples of the latter are the sale of AB ASG, Sweden's biggest trucking company in 1995, and the sale of Swebus AB, the biggest bus and coach company in Northern Europe, in 1996.

Strategic Resources

One reason for producing Group support services is that synergism with other activities enables SJ to provide support products or services at very competitive prices. However, the main reason is that support is strategic in the sense that it is an essential prerequisite of the core business and that there are only one or very few possible producers in the marketplace. In the search for strategic resources, there is a choice between self production and long-term agreements with a monopoly operator. If SJ did not have its own resources, it could easily become dependent leading to disadvantageous agreements.

Control of Subsidiaries in SJ Group

Even if there are no clear dividing lines, it is nevertheless meaningful to separate operational control of subsidiaries from financial control.

Operational control

Operational control is very much focused on business with important synergism with the Division businesses, or businesses that could compete with core business in the divisions. A Marketing Board has been created in the freight traffic sector of the SJ Group as a special body for controlling cooperation and competition. The operational control also focuses on support of an imperfect internal market; for example, the products offered by TGOJ AB and SweMaint AB.

Formal operational control is performed by the company board chaired by a representative of SJ's Management Group. Very often, one or two other members of the Management Group are on the board as well.

Informal control is, of course, exercised by SJ's Management Group and is often channelled through the head of the relevant Division or the Director of Finance.

Financial control

Railway operations are by their very nature process-oriented and call for good coordination of planning of different undertakings. This is true whether the operations are carried out by the parent or by subsidiaries. The operations are capital intensive and many investments have a long life-cycle. The investments are usually irreversible; most fixed installations cannot be put to alternative use and the possibilities for selling rolling stock are very limited.

The basic principles of financial control within the Group are built on a combination of integration, cooperation and decentralization.

The need for integration and cooperation is met by a coordinated business plan and budget process in which special emphasis is laid on capital expenditure plans and major investment decisions are taken by the Management Group or the Groups of directors. The financial function is centralized.

The possibilities of close customer contacts and efficient business activities are utilized by decentralized control of current activities, for which both subsidiaries and parent Divisions take full bottom-line responsibility within the framework of adopted business plans and budgets.



Ferry between Sweden and Denmark—SweFerry AB



(SJ) On-board service—AB Trafikrestauranger

AB Swedcarrier—the holding company of the Group, SJ Invest AB—the internal financial company, and FAB SweRe—the internal insurance company, comprise SJ Management's joint body for financial control.

Financial objectives

In defining the financial objectives for the controlled entities, the principles regarding the subsidiaries are very similar to those for the parent Divisions. The Divisions are classified according to whether they operate in the external market, or have a supporting mission. The business of the subsidiaries is classified in the same way. Subsidiaries can have a supporting mission. Examples are TGOJ AB, SweMaint AB and AB Trafikrestauranger. TGOJ AB and SweMaint AB support rail operations by heavy overhauls and repairs, as well as by maintenance of wheel sets and spare parts. AB Trafikrestauranger supports passenger service by on-board catering and operating station restaurants.

The subsidiaries can also work in the market in cooperation with the rail business by using the Divisions as sub-contractors. For example, Rail Combi AB is producing and selling the railway component of combined transport to haulage firms and to forwarding and shipping agents. It then buys the rail transit transport from SJ's Passenger or Freight Divisions. The Passenger Division supplying rail transit for combined transport depends on the availability of passenger locomotives at night which are suitable to the somewhat lighter but swifter freight traffic that combined transport forms.

The subsidiaries may also operate in the market with individual businesses in relation to cooperation within the SJ Group. A prerequisite of developing such activities is that there must be obvious synergistic effects with the business connected to the railway operations.

As shown by the outline in Figure 3, SJ

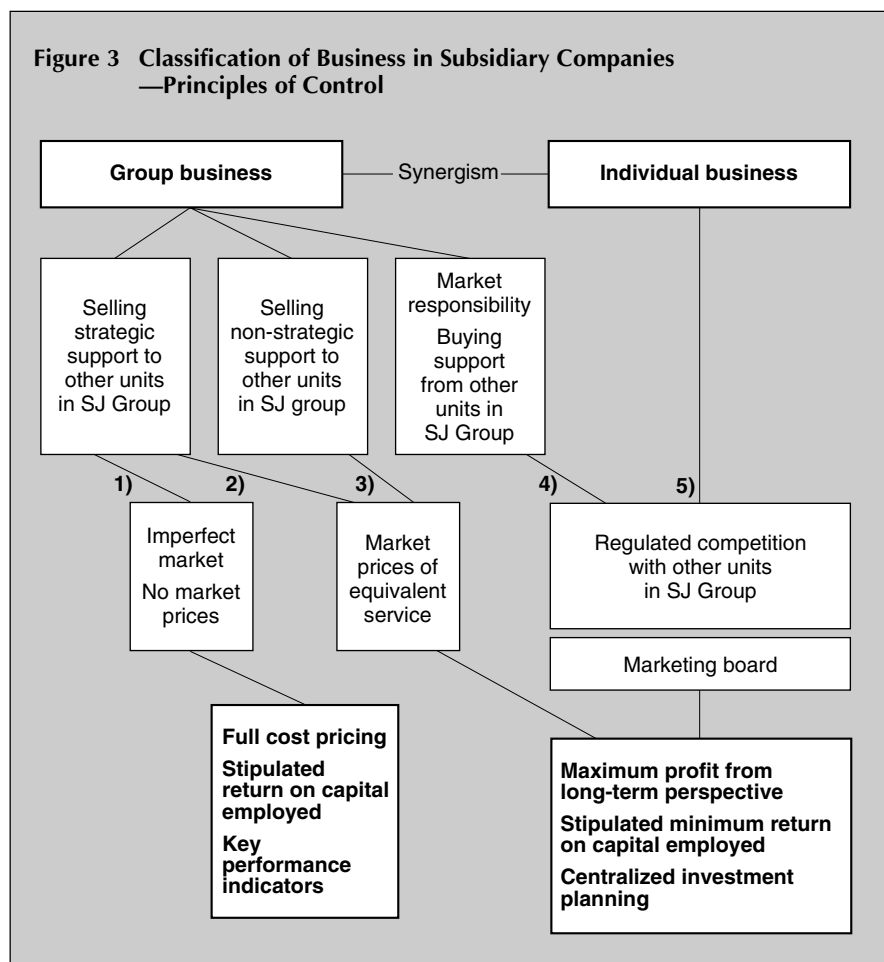
draws a distinction between the subsidiaries' five roles:

- Supporting strategic products/services furnished where there are no market prices
- Supporting strategic business performed where there are market prices for the same or similar products or services
- Supporting non-strategic business and, consequently, carried out in competition with external contractors
- Business carried out with responsibility for the market, in which case, other units within the SJ Group act as sub-contractors
- Business carried out in the market without cooperation with other units within

the SJ Group but having sufficient synergistic effects to operate within the Group

The dividing line for the principles of financial control is drawn between the sectors with or without market-adjusted prices.

To classify the activities in order to choose a control model, the activity of each subdivision of each company is analyzed separately. Consequently, the financial control model varies between different parts of the same company. A good example is the business of AB Trafikrestauranger; its on-board service is classified as case 1, while ground-based catering and station restaurants are classified as cases 2 and 5, respectively.



Financial control model without market-adjusted prices

Supporting business in an imperfect internal market must be controlled in detail with regulated pricing and Key Performance Indicators.

SJ has chosen a production-cost pricing model, where the price level produces a stipulated return on capital. Cross subsidies between different products/services must not be used.

To safeguard development of the company's internal efficiency (productivity) there is follow-up using Key Performance Indicators.

Financial control model with market-adjusted prices

Business in the market or in supporting business where there are market prices for equivalent services can be controlled financially by traditional objectives.

SJ has chosen to target maximum income but with a stipulated minimum return on capital.

The purpose of this line of thinking is to determine a common capital cost within the entire SJ Group. However, there are some individual adjustments of the required return on capital.

For some companies, SwedeRail AB for example, return on capital is not a meaningful indicator. Instead, in this case, SJ uses the net margin.

Further Development of Subsidiary Control

The subsidiary control described here works well on the whole and cooperation between subsidiaries and parent is secured. Information channels are kept short through participation of the company chairperson and often one or two other members of SJ's Management Group. Nevertheless, in some cases, the fact that the legal organization does not concur with the operational control can cause problems. For obvious reasons, this has



Terminal for combined transport—Rail Combi AB

(SJ)

occurred mainly in the freight transport sector, where several units operate within overlapping market segments. The Marketing Board has turned out to be a good instrument for cooperation between the Group's freight transport units but a lot more needs doing.

The development tends towards a con-

cept of considering the parent's Freight Division and subsidiaries within the freight sector as a Sub-Group. The financial and operational control within this Sub-Group can be coordinated by using informally consolidated accounts for this Sub-Group, paralleling the legal accounts. ■



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