competition. Competition is important because it increases the probability of the industry being efficient. Allocative Efficiency is achieved when the Marginal Cost is equal to Average Revenue, meaning that cost of production is at the value at which consumers value the good or services and that scarce resources are allocated to produce the goods and services we most need and want, maximising consumer satisfaction. However, because the firms are in the Private Sector, the domination of the Profit Motive as firms' objectives mean that Allocative Efficiency is not achieved. Firms will charge higher prices in order to increase their total revenue in the hope of increasing their profit, therefore the and, as the demand curve (Average Revenue curve) is downward sloping, the increased prices result in decreased demand (a shift along the curve towards the left) and therefore there are consumers who want and need to buy rail tickets who are unable to do so. Rail companies charge high prices, especially during peak travel, taking advantage of the inelastic nature of peak-time demand, and thus consumer satisfaction is not maximised. Productive Efficiency is achieved when the Average Cost (AC) curve cuts the Marginal Cost (MC) curve in the short run. This is because the MC curve always cuts the AC curve at its lowest point: beyond this point, because of diminishing returns, the increase in MC will drag up the AC. As a result of the Profit Motive, and the need to satisfy shareholders by paying high dividends, there is a substantial lack of investment by TOCs, even though investment has increased, resulting in Productive Efficiency and Dynamic Efficiency not being achieved. Moreover, because franchise contracts are limited in duration, rail operators do not want to invest as there is a significant risk that they will lose the franchise at the end of the contract and their successor will benefit from their investment, not them. Furthermore, because the TOCs with specific franchises are effectively monopolies, they are not forced to offer the lowest possible price to consumers in order to increase their market share, this not only leads to higher prices and thus a lack of Allocative Efficiency but reduced investment as they have less incentive to keep costs low. In the long run TOCs are also less efficient because the railway is a natural monopoly that has been divided up into franchises and TOCs are less able to benefit from economies of scale. For example, managerial economies of scale, as each company has to employ specialists such as for marketing, mean they are unable to operate at their Minimum Efficient Scale. Therefore the rail companies have higher average costs in both the long and short run; the lack of competitive pressure and contestability results in the rail market operating inefficiently.

What's more, the Government still has to pay an annual subsidy to TOCs, first because there has been a significant lack of investment, as previously explained, and secondly because the Private Sector TOCs do not take into account Positive Externalities: this second point, coupled with the Profit Motive, means that many loss-making routes would not be in service in the absence of Government subsidies. The TOCs do not operate in accordance with the Welfare Motive and, since the Government holds the view that the railway is an essential