



Customer engagement in the UK water sector – how the latest price review changed the game, reflections on the experience and what the future holds

Giles Stevens, Director  
7 August 2015

# Background – the water industry in England and Wales

**In 1989:**

Privatisation **c.40** regional vertically integrated monopolies

**Today:**

We regulate 34 licensed companies:

10 regional monopoly water and sewerage companies

9 local water only monopoly companies

5 new appointees

10 water supply licensees

**Successes:**

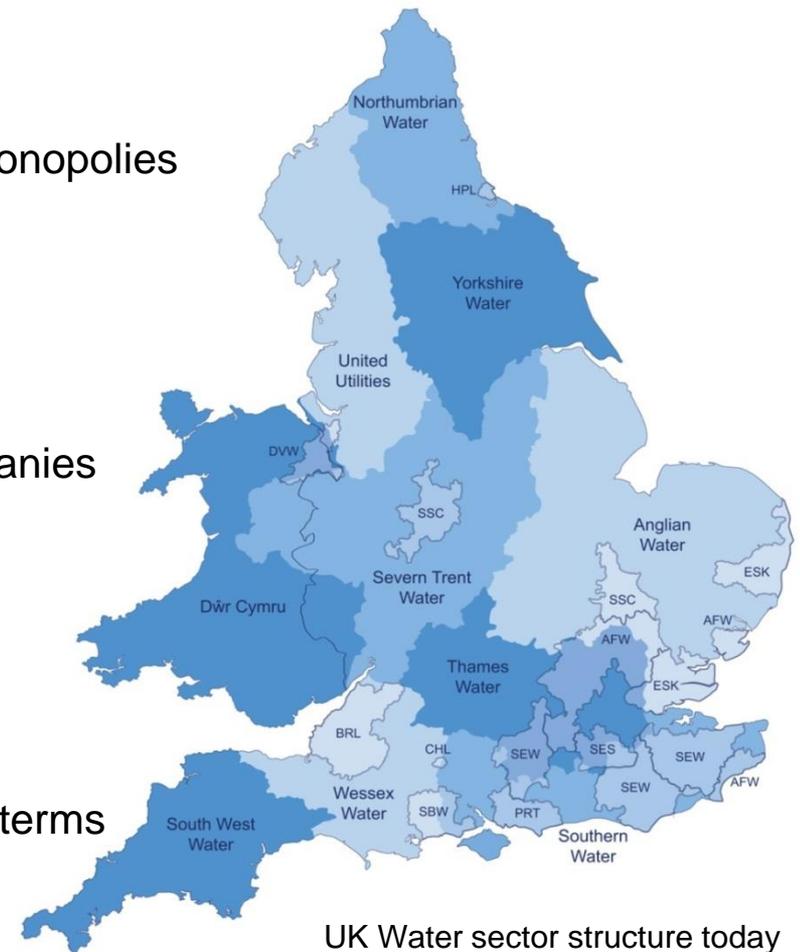
Private sector investment – **>£125 billion** in real terms

Better and more **stable infrastructure**

Improved standards of **service**

Greater **environmental** and **drinking water compliance**

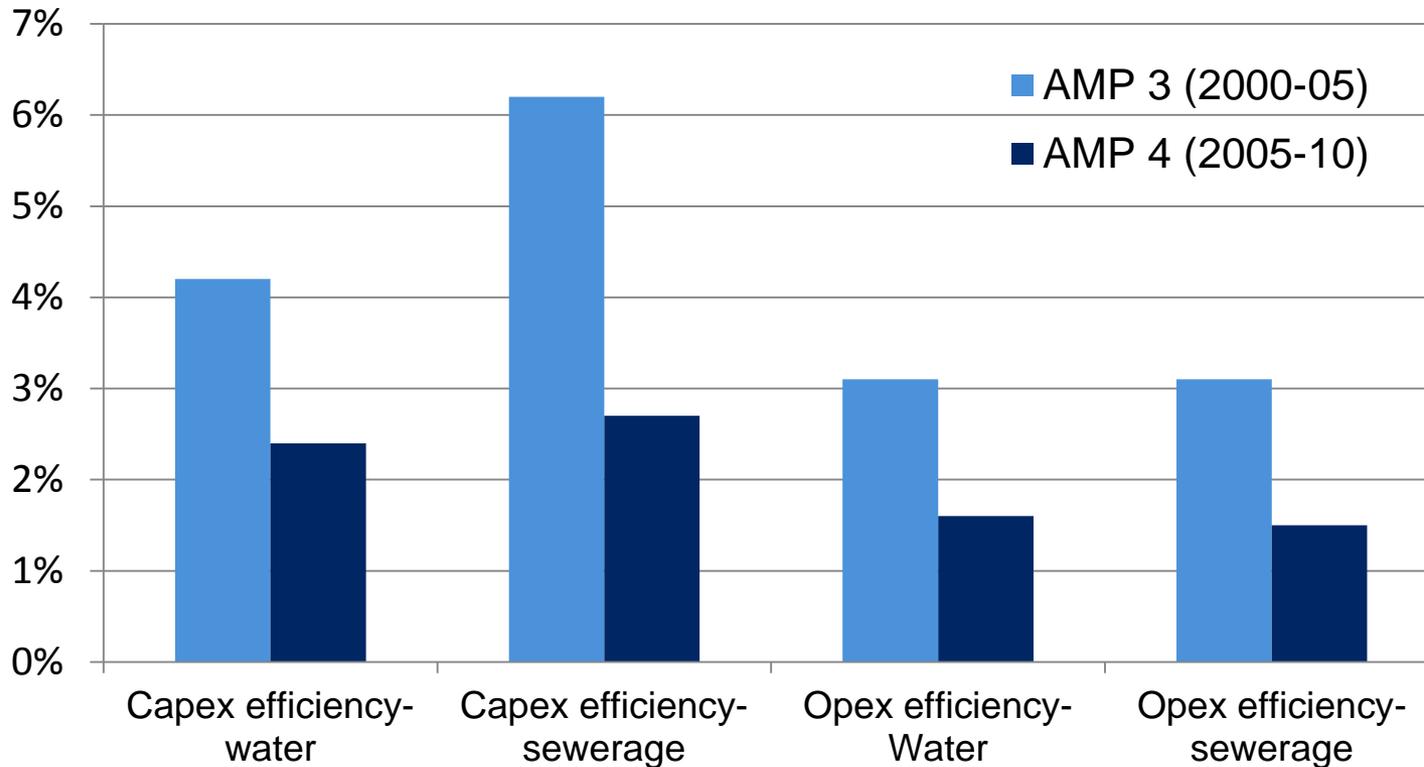
Consumer **bills 30% lower** thanks to economic regulation



UK Water sector structure today

# Efficiency gains were diminishing

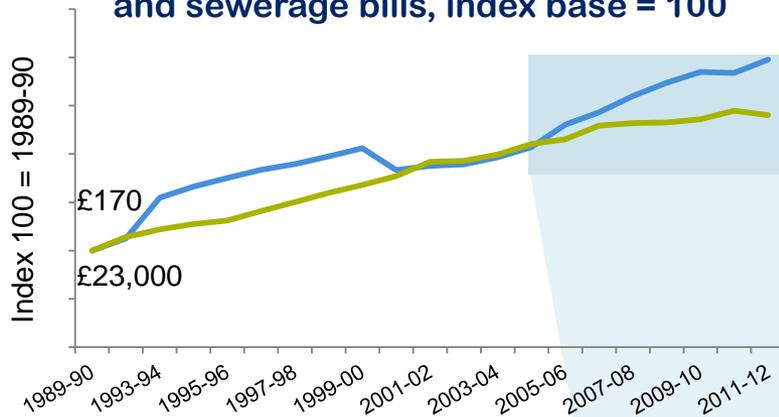
% cost efficiency gains from comparative regulation AMP 3 versus AMP 4



Source: Ofwat future price limits impact assessment, 2011

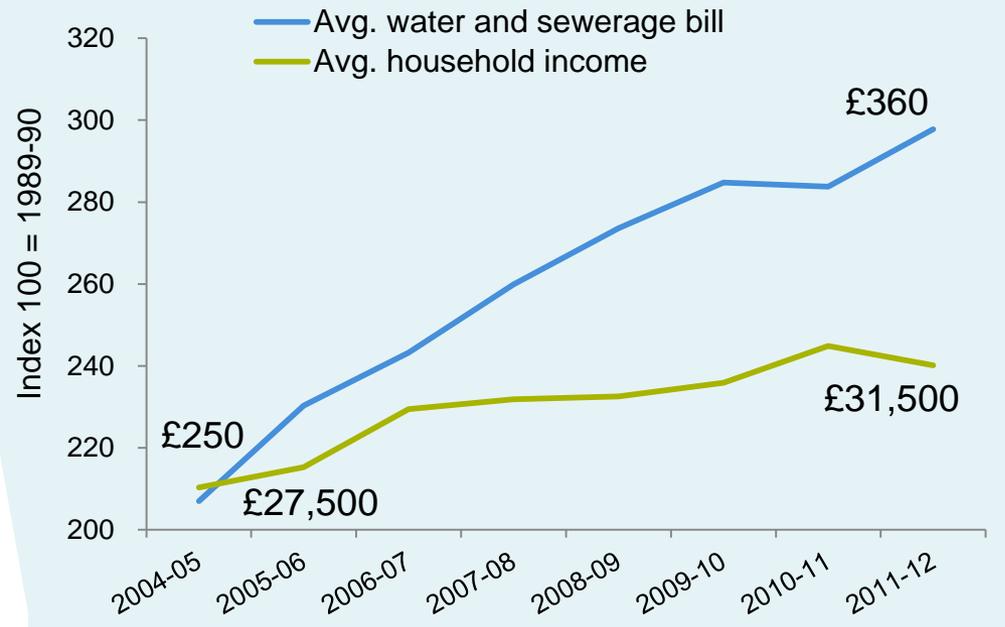
# Economic context

Average household income vs. average water and sewerage bills, index base = 100



Since 2004 price review...

Incomes increased by 14%  
Combined bills increased by more than 40%



# Key changes for PR14

**Goodbye** Ofwat setting companies' plans

**Hello** company ownership of business plans

**Goodbye** outputs for regulators

**Hello** outcomes for customers

**Goodbye** capex bias

**Hello** totex

**Goodbye** regulation of integrated business

**Hello** wholesale/retail split

**Goodbye** forced one-stop-shop

**Hello** choice for business customers

# Delivered more for customers

The results of our price review mean customers in England and Wales will get more from their water companies while paying less for services over the next five years.

Companies' plans for delivering water and wastewater services are driven by what their customers, the environment and society want, now and in the future. This means that companies have promised to deliver more for their customers.

## More

**£44 billion investment** in improving services, improving resilience and protecting the environment. This equals an average of £2,000 of investment for every household over the next five years



**522 tailored performance commitments**

developed with customers to deliver a high-quality service – with rewards and penalties on the companies to incentivise success

**50 beaches** with improved water quality for bathing

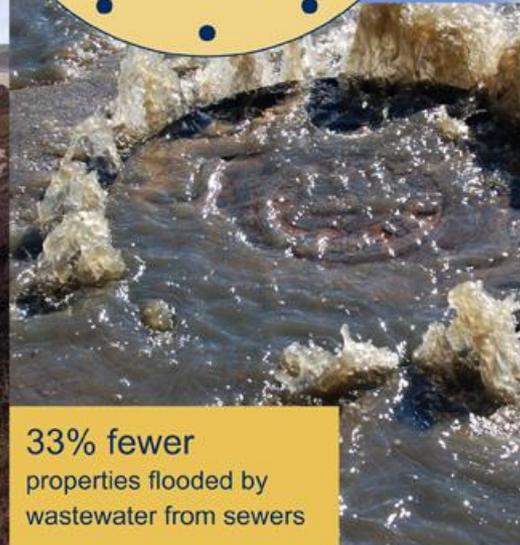


**1 million more people** receiving assistance through schemes to help them with paying their bill



**32% reduction** in the time interruptions affect the supply of water

**370 million litres of water** saved each day by tackling leakage and promoting efficiency



**33% fewer** properties flooded by wastewater from sewers



## For less

**5% average drop** in water bills over the next five years

6

Trust in water

# PR14 key milestones



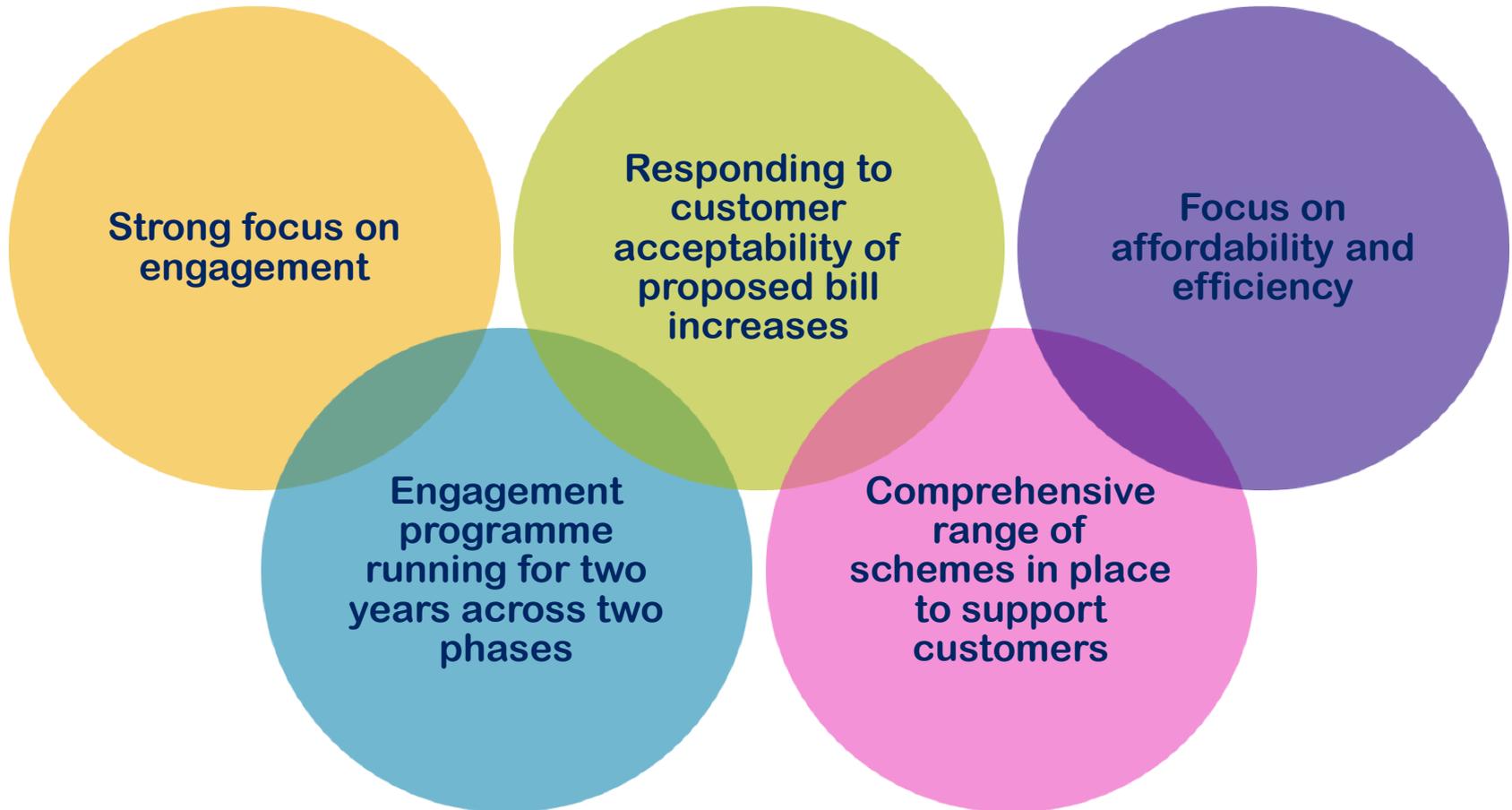
## Movements in totex

December business plans	£45.7 bn
June business plans	£45.8 bn
Draft determination	£43.6 bn
Final determination	£44.3 bn
Total reduction in totex over the review	-£1.4 bn

## Movements in revenues

December business plans	£56.9 bn
June business plans	£56.7 bn
Draft determination	£54.4 bn
Final determination	£55.4 bn
Total reduction in revenue over the review	-£1.6bn

# What did this change mean for a company ?



# The difference from a regulator's perspective



**More than a quarter of a million customers engaged**

**“Even more scope for customer engagement”**

Water company CEO – Utility Week

“...we have seen a real change in approach, which will benefit customers...CCGs have made an important and significant contribution” – Ofwat

**“Biggest customer engagement exercise in company’s history”**

– Water company websites

**19 CCGs, 12 CCG Chairs and over 164 unique stakeholder groups represented on CCGs**

**“...brought out the best in two companies: South West Water and Affinity Water... have come up with business plans that manage to supply water and reduce bills by 7 per cent and 11 percent respectively”**

– The Times

**“It’s all about the customer stupid!”** – Utility Week

**“Seismic shift in culture... in the water sector”** – Utility Week

**“We had some tough conversations at board level”**

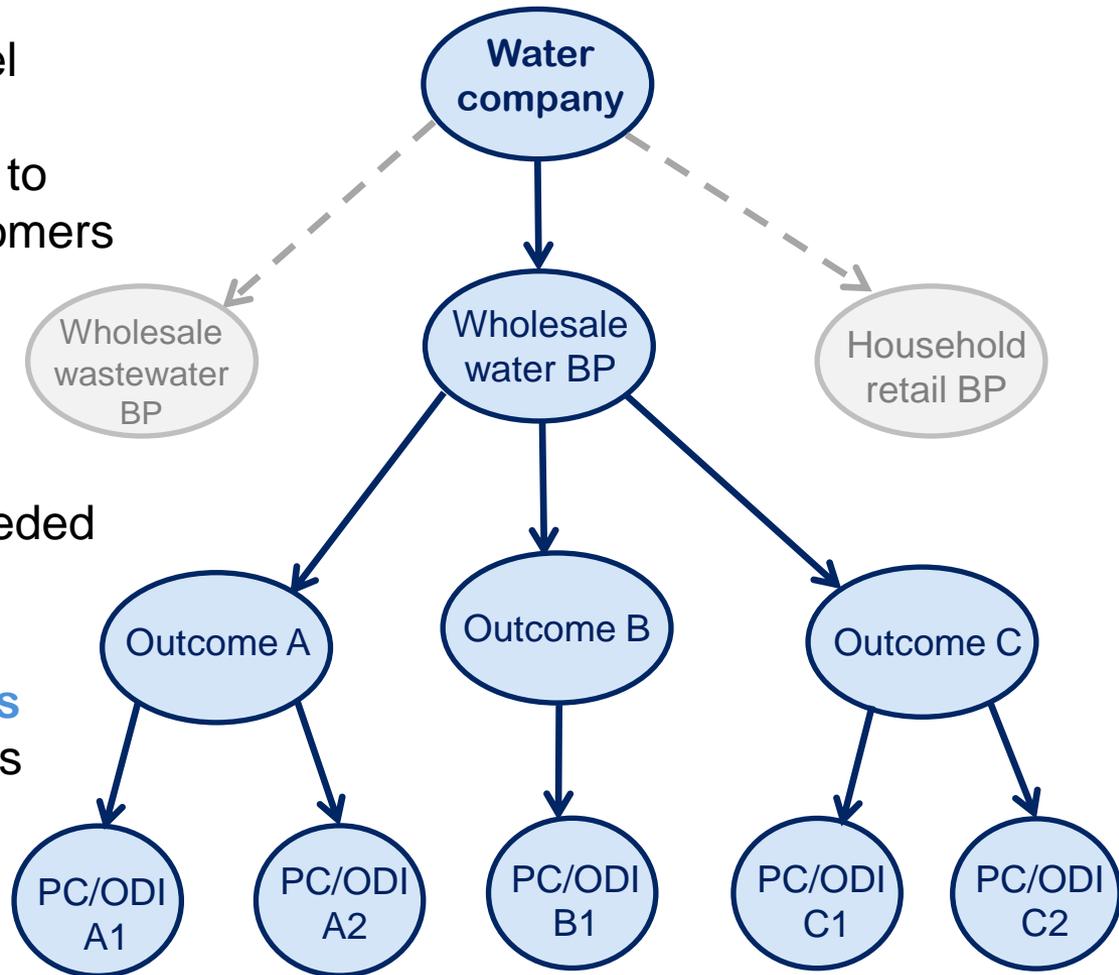
CCG chair – Utility Week

# What are outcomes?

**Outcomes** are the higher level objectives that company activities/outputs are intended to achieve – the things that customers and society value

**Performance commitments** (PCs) measure the direct and tangible products/activities needed to achieve outcomes

**Outcome delivery incentives** (ODIs) – rewards and penalties that may be financial, reputational or procedural



# Innovation in outcome delivery incentives

## Affinity Water

**“Making sure our customers have enough water, while leaving more water in the environment”**

**Example performance commitment: Reduced average water use**

In response to customer feedback, Affinity Water has committed to reducing demand between 2015 and 2020 through metering and a water efficiency programme. It has also committed to using water more efficiently, including a 14% cut in leakage by 2020

## Severn Trent Water

**“We will ensure water is always there when you need it”**

**Example performance commitment: Delivering the outcome of the Birmingham resilience scheme**

Severn Trent Water has committed to delivering a major scheme to improve Birmingham resilience – the Elan Valley Aqueduct. The success of the scheme in terms of delivering resilience to customers will be assessed by measuring the capacity delivered by the project. A penalty will be applied in proportion to any shortfall in capacity delivered

## Anglian Water

**“A flourishing environment”**

**Example performance commitment: Beaches with ‘excellent’ water quality**

Anglian Water has committed to increasing the percentage of its beaches with ‘excellent’ water quality as defined under the EU’s revised Bathing Water Directive from 58% to 67%

## South West Water

**“Protecting the environment”**

**Example performance commitment: The number of acres of farmland under revised management to deliver environmental outcomes and the number of farms where a plan has been agreed to benefit the Environment**

South West Water’s ‘Upstream thinking programme’ will see an increase in farming methods that take into account the needs of local water catchments (‘catchment management’) – more than doubling the number of farms involved (from 650 to 1,400)

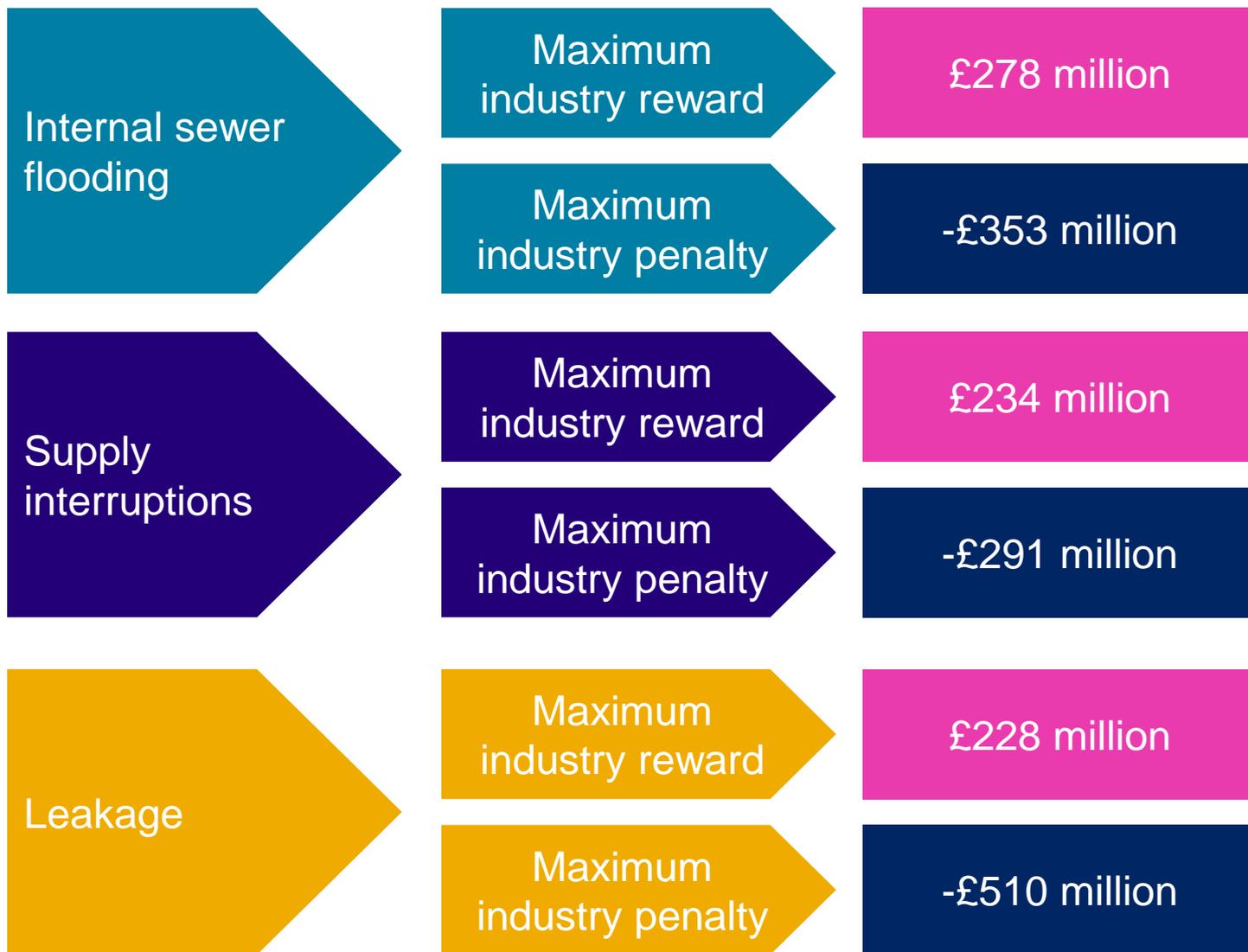
# Outcomes – summary of approach

Companies submitted their business plans in December 2013. We applied 18 risk-based review tests to their outcomes, performance commitments and ODIs on issues such as:

- the **quality of their customer engagement**
- whether the commitments were set at the **economic level**
- whether the financial incentives **reflected costs and/or willingness to pay**

171	Outcomes
522	Performance commitments
316	Financial ODIs
206	Reputational ODIs
144	Penalty-only ODIs
172	Reward and penalty ODIs

# Outcome delivery incentives: some stats



# Outcomes – the journey

Placed emphasis firmly on customer engagement and tasking companies to work with CCGs to develop outcomes and incentives

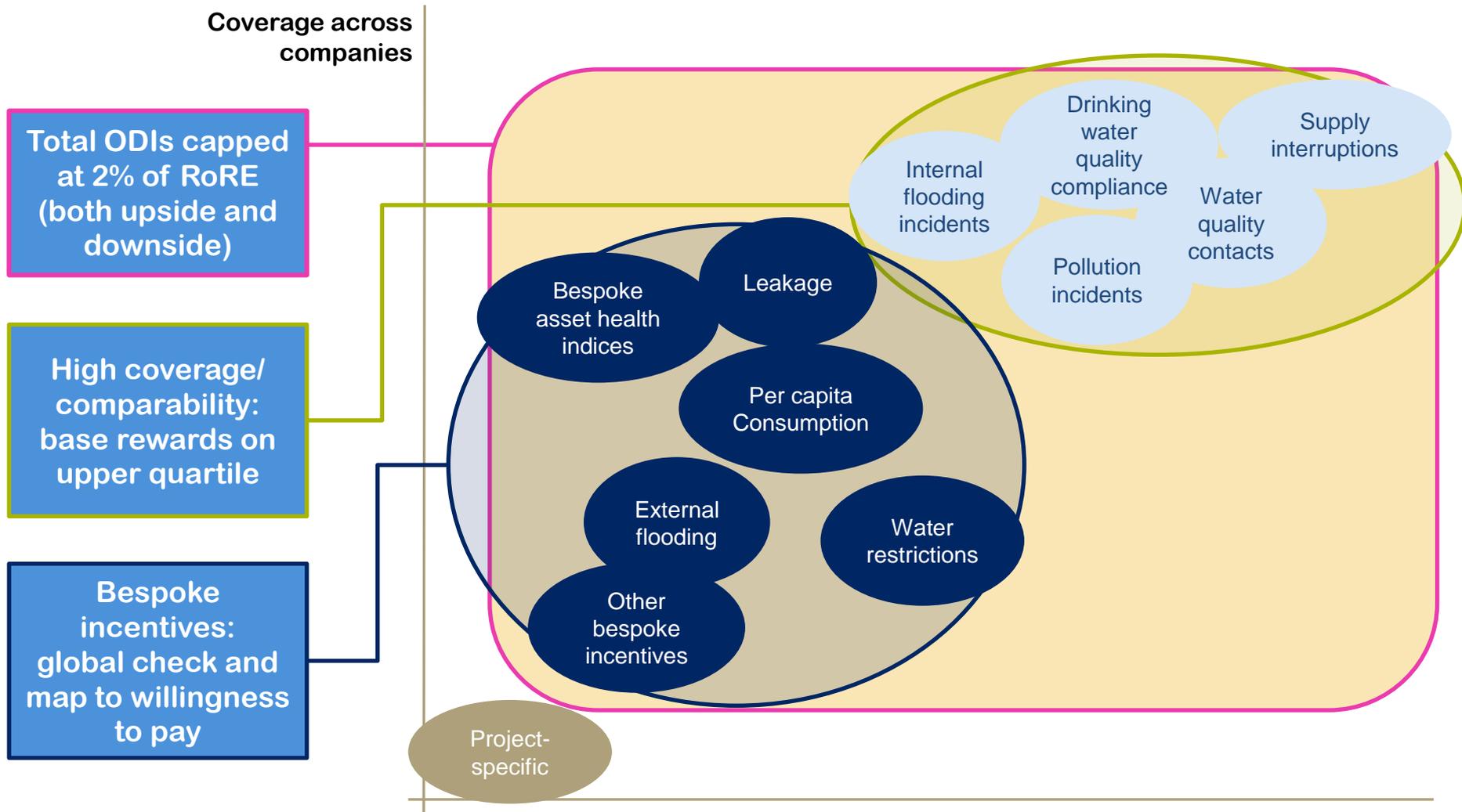
## So why did we have to intervene?

**Learning** – outcomes were new, a step beyond previous regulatory approaches and so all those involved – including us – had to learn

**Information** – process revealed much better information about performance and relative strengths and weaknesses, but later on

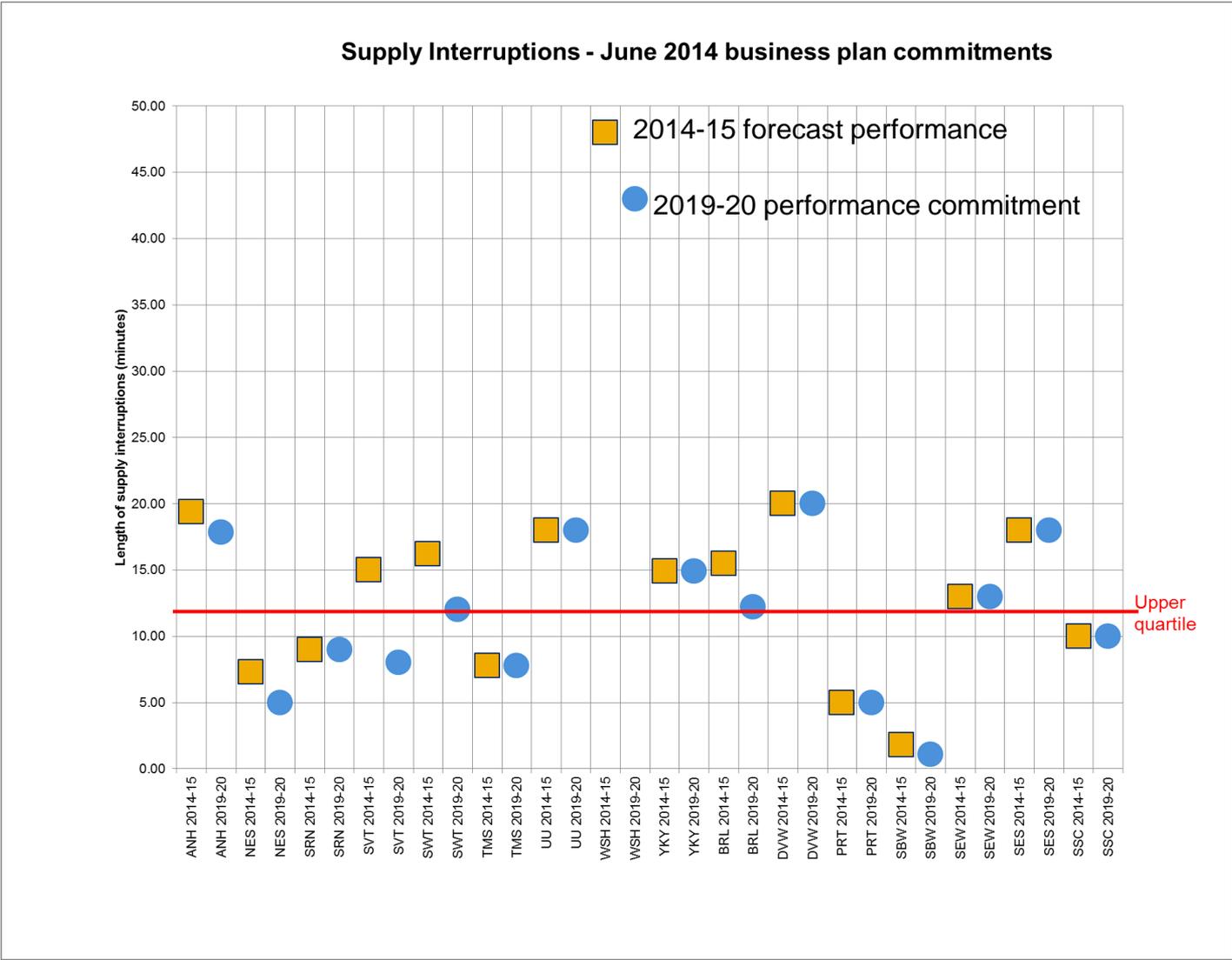
**Protection** – protection of customers remains of fundamental importance.

# Outcome – three global interventions

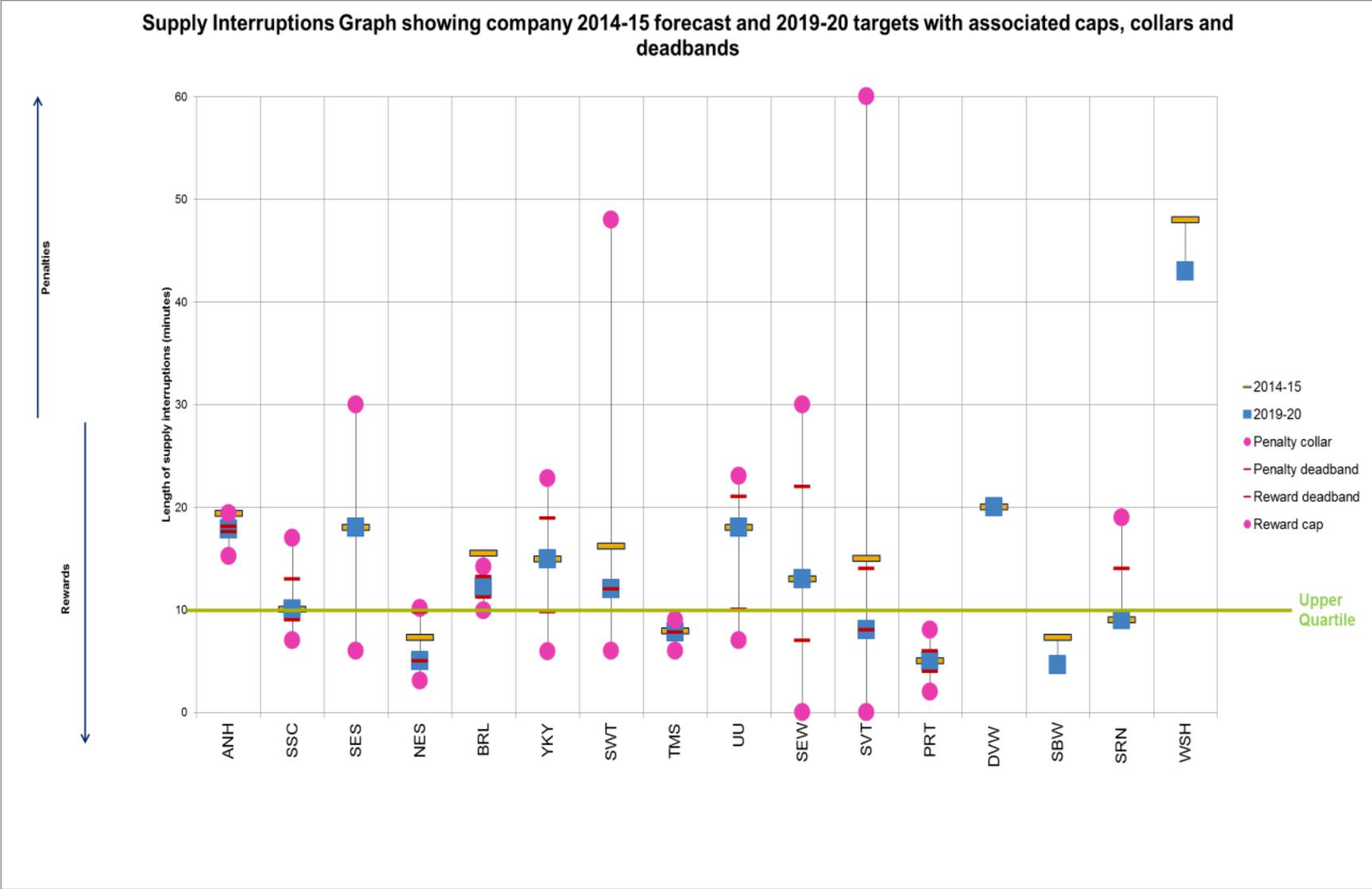


Comparability of outcomes

# Illustration of the challenges – supply interruptions

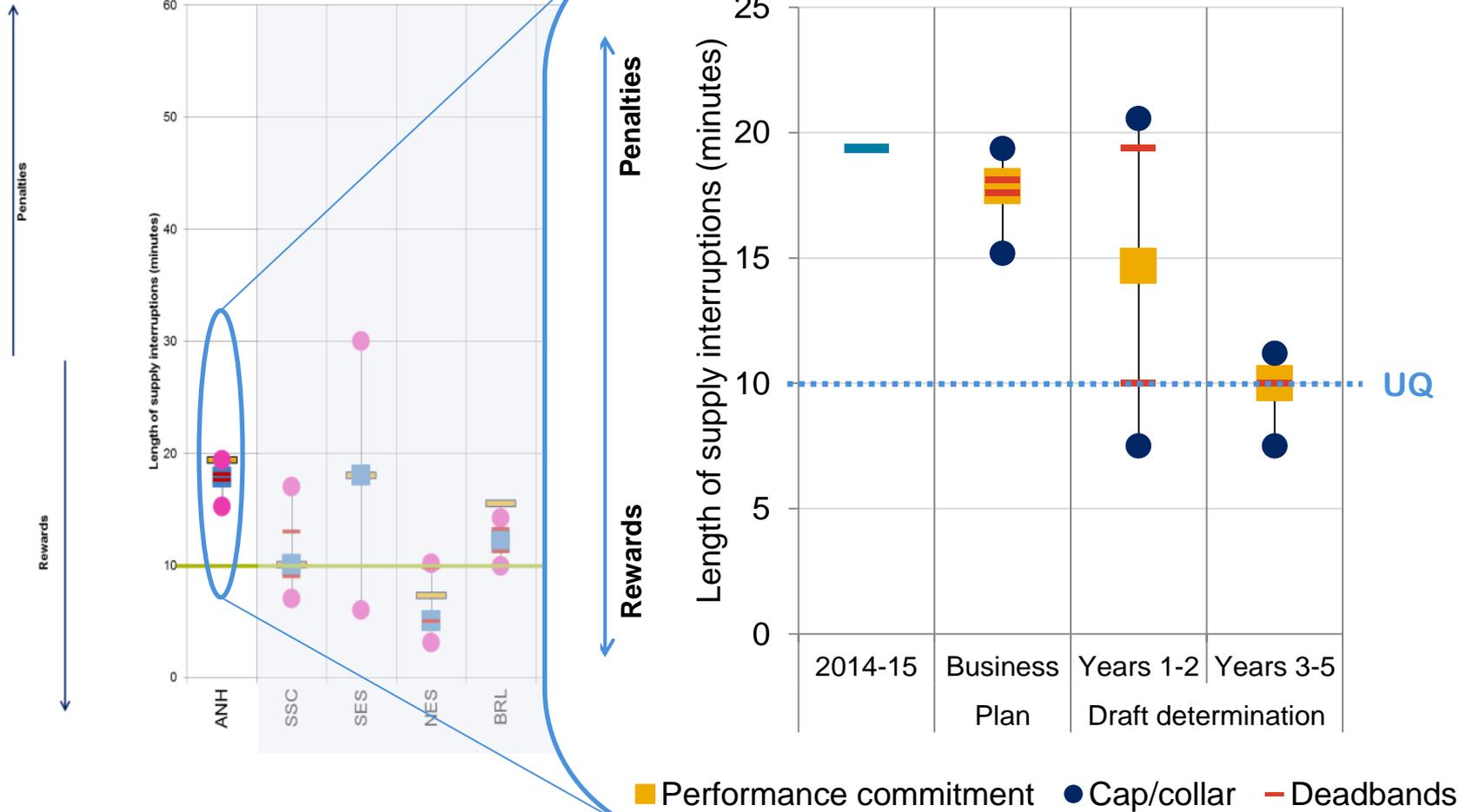


# Supply interruptions – the end results

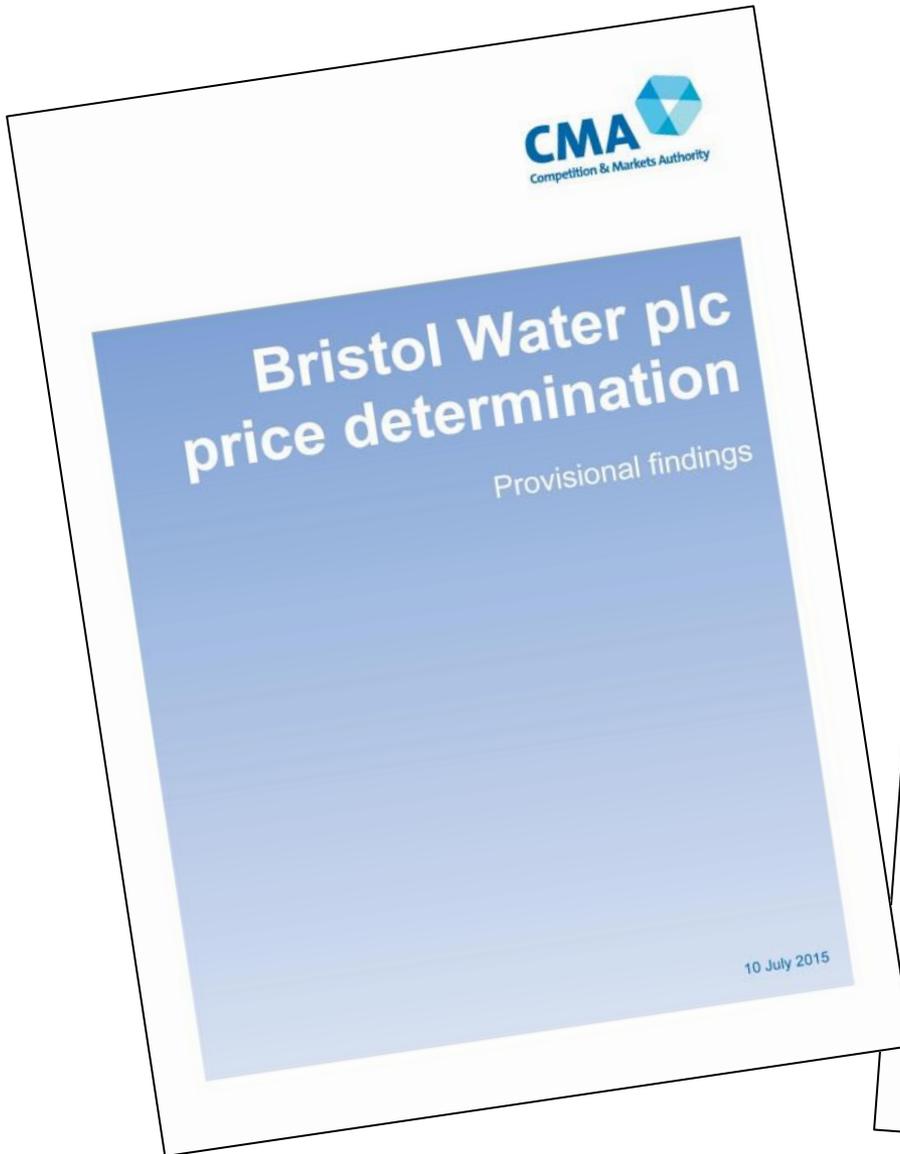


# Implementing the horizontal checks – a worked example

Supply Interruptions Graph showing company 2014-15 forecast and 2019-20 targets with associated caps, collars and



# Lessons learned/postscript



# We are reflecting on the successes of the CCG process



Quality of the **engagement higher than ever** before and resulted in higher quality business plans

**Challenge from CCGs** resulted in revisions to companies approach to customer engagement and to changes in business plan proposals

Demonstrates the important role of CCGs in **raising the quality of business plans** and providing us with assurance about the level and quality of customer engagement undertaken by companies

Allowed for **better integration of stakeholders** which meant that companies' plans were generally more rounded and captured the different trade-offs associated with their decisions

Photo © Highways Agency

## We are also reflecting on the lessons we will take forward

We did not set prescriptive guidance on how customer engagement should be undertaken – some companies and CCGs **enjoyed the flexibility but others found it challenging**

Sometimes translated into a very **wide remit for CCGs**, for example some delving more deeply into engineering and finance matters

We **changed our expectations about the CCG role through the process**. We asked companies to use the CCGs at the end to look again at PCs and ODIs – went beyond the challenge and assurance that we had originally envisaged



Photo © Highways Agency

# The future – towards Water 2020



Trust in water

Why customer engagement is important and how it may need to change in the face of other changes going on in the sector such as the reforms being introduced through the new legislation

**How customer engagement might evolve** in circumstances:

- where customers do not have choice
- where customers have a choice
- between wholesale and end customers
- between different service providers

**How can the quality of customer engagement be improved;**  
drive a more ongoing and dynamic process?

Role of Consumer Challenge Groups and the Consumer Advisory Panel in future price reviews and the Welsh Water forum

# Outcomes – key questions

How our approach to outcomes might need to evolve in light of the learning from PR14 and the experience we gain in the next five years, including:

- how we could have outcomes that **span multiple price controls**
- how we strike a balance between **common and bespoke outcomes**
- how we make outcomes work across disaggregated price controls

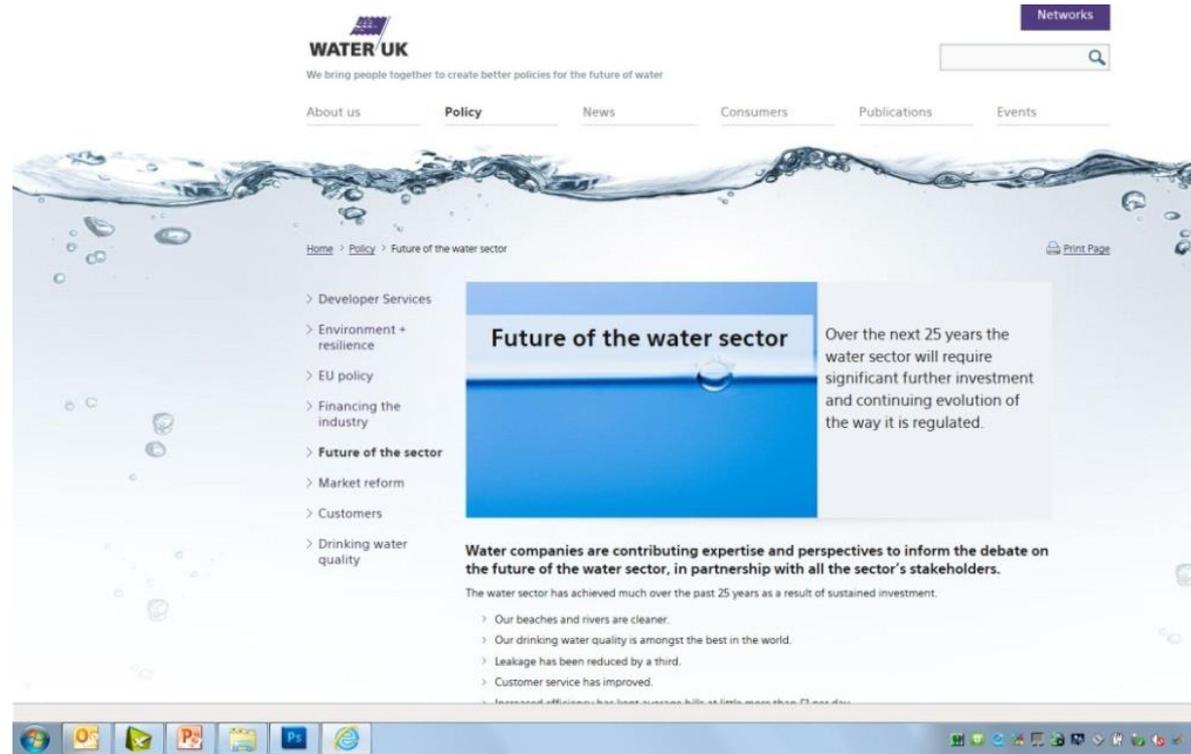
How we might alter the approach to Outcome Delivery Incentives, including, for example, changing the strength of these incentives, their structure, form and the cap and collar arrangements?

How to address the **asymmetry of rewards and penalties**, and ensuring **sufficient value is at risk**?

How we might go about **encouraging genuine two-way conversation** with customers to involve them more in the delivery of services in a way that might improve trust and confidence in the sector and deliver better overall outcomes?

Open review and partnership working essential...

...critical that we do PR14 lessons learned review with the aim to build on momentum



*[Market place of ideas – future of the water sector](#), hosted by Water UK, July 2015*

# Conclusions

A **lot has been achieved** in relatively short period of time:

- Strong inertia has been overcome
- A step change in customers being at the heart of companies thinking
- Movement away from seeking to appease regulator
- A lot of innovation and customer influenced outcomes

Now a **time for reflection**

- PR14 model is a good platform, but not set in stone
- Must capitalise on momentum
- Not blinkered on alternatives

Observations:

- **Information critical**
- **Transparency powerful tool**
- **Companies very different attitudes to change**

If you have concerns about the above, **how and when to intervene?**

# Questions



[www.ofwat.gov.uk](http://www.ofwat.gov.uk)