
John Russell, Utility Week Water Customer Conference speech, 17 January 2018

An update on the vision for PR19

Good morning everyone.

I am John Russell, Ofwat's Senior Director of Strategy and Policy. Thank you for inviting me here to speak at today's water customer conference.

This is an important event for our sector because current and future customers are at the heart of Ofwat's long-term vision for the water and wastewater sector.

Many of you in this room will know that last month we published our final PR19 methodology which really emphasised the need for companies to deliver more of what matters to customers and our expectation that they should receive a great service, at least comparable to the service they get elsewhere. I hope not too many of you spent your Christmas breaks pouring over all 257 pages! You might have also seen we've kicked off an innovation channel on YouTube to accompany PR19 with interviews and visual features. If you haven't seen that I do recommend you go and check that out.

That document made it clear that in this price review excellence will be the new normal. Companies are going to have to go further than ever before to achieve exceptional status.

PR19 will be built around four key themes: great customer service, resilience, affordability and innovation.

These themes are deeply connected and closely linked to the priorities set out for us by both the UK and Welsh Governments in their Strategic Policy Statements.

So today, I am going to explain how Ofwat is putting customers firmly at the heart of its agenda and how we will continue to drive the sector to deliver the things that matter to customers in PR19.

Customers at the heart of what we do: engagement and service

It goes without saying that the water sector provides a vital public service on which all households depend.

Customers must be able to trust in their essential water and wastewater services and as a result, their expectations are high.

For instance, customers expect their services to be resilient for the long and short-term. They expect to receive great service, comparable to the service they receive in other sectors, not just in other utilities.

And they expect their bills to be affordable and represent value for money. The only way water companies will achieve all of this, is to find new and better ways of delivering their services.

Currently, the legitimacy of the water sector has found itself under increased public scrutiny. Complex ownership structures, recent infrastructure failures and the role of the private sector in provision of utility services have all been highlighted in the media in recent months.

All of these issues pose real challenges for the sector.

Ofwat has been talking about the challenge of customer legitimacy for some time now. However, in her final speech as Ofwat Chief Executive at the recent Moody's conference, Cathryn Ross said that we think that PR19 will provide a fantastic opportunity for the sector to rebuild lost trust and legitimacy.

Companies can meet the legitimacy challenge head on by going much further in putting customers at the heart of their business plans

Now this builds on a journey we have been on since PR14, which saw a step-change in engagement between customers and water companies. PR14 incentivised better customer engagement, putting the onus on companies to step up and own the relationships with their customers. Only through strong relationships will companies be able to know and understand their customer base and be able to deliver the outcomes, or the things that matter most, to their customers.

We are building on that foundation for PR19. PR19 will challenge companies on the quality of the service they provide to customers.

In PR14 we expected companies to use customer engagement to inform their decision making. For PR19 we expect companies to go further and develop their business plans through active customer participation.

Through this participation we expect companies to better understand what their customers want. This includes setting stretching performance commitments that reflect their customers' priorities. These will be accompanied by powerful reputational and financial outcome delivery incentives that will increase the incentives for companies to deliver those things that matter to customers and encourage improvements in efficiency.

Companies must have 14 common performance commitments, covering the issues that matter the most to customers. These include pollution incidents, improving resilience to drought and flooding and water consumption.

We expect companies to adopt ambitious leakage reduction commitments and have set them a number of challenges including whether they can reduce their leakage by at least 15% over the five years to 2025.

The companies consider this to be very challenging, but some have already signalled privately to us that they expect to be able to meet the 15% challenge and I welcome the example of Yorkshire Water who have committed publicly to reducing their leakage by 40% between now and 2025.

Each company has a customer challenge group (CCG) that will provide independent challenge to the company and provide independent assurance to us on: the quality of a company's customer engagement; and the degree to which this is reflected in its business plan.

For PR19 we are also developing C-MeX and D-MeX, new measures of residential customer experience and developer services customer experience, for PR19.

Both measures are incorporate financial and reputational incentives to challenge companies on the quality of their customer service and measure overall customer satisfaction.

Unlike its predecessor, SIM, C-MeX will link financial incentives to the performance level of the best performing companies in all sectors. This will prove especially impactful because we know that customers don't compare their water services with those provided by other water companies. C-MeX will take account of where water companies stand with regards to customer service in comparison to big players like John Lewis and Amazon, who are renowned for their excellent customer experience.

Developer services customers are also an important customer group and in the past they haven't always received the most seamless, efficient service from water companies. For that reason, for the first time, through D-MeX, PR19 will test the developer experience.

We will be designing pilots for C-MeX and D-MeX soon and running them later this year to ensure that the measures are sufficiently robust to use as financial incentive mechanisms, before 2020.

Resilience

Customer engagement should also underpin companies' approach to resilience.

Just a quick aside at this point - resilience is not a new concept to Ofwat. Even before we are given a statutory duty to forward resilience in the sector in the 2014 Water Act, it was always one of our top priorities. We've taken a broad view and consider 'resilience in the round'.

A resilient sector is one that is able to navigate its way effectively through operational, financial and corporate challenges. A well-run company with a strong corporate structure is one that can deliver an excellent service to customers.

Ofwat has always had our sights set on the long-term. We all know climate change, population growth and water resources are going to challenge the sector in the years, and decades, to come. We are focused on helping the sector to adapt and prepare for the future.

We also know that resilience matters to customers. At the end of the day, customers want a seamless, stress-free and resilient service. They want a resilient water and waste water service they can depend on for the long-term.

Clearly then, it is crucial that companies have the right infrastructure in place to deliver reliable and resilient water and waste water services. And for this reason, unsurprisingly we see a lot of emphasis from companies on capital expenditure to achieve a resilient network.

Now, maintaining and building infrastructure is clearly an essential part of providing resilient water and waste water services.

But, where capital infrastructure is required, we expect companies to have engaged with their customers and to have had honest and open conversations about the potential affordability impacts and have evidenced the most cost-effective options.

We have also been clear that there should be no trade-off between affordability and resilience. If a company is efficient they can achieve both - that's what we'll be expecting in PR19.

Customers must agree that the expenditure is necessary. Companies will only win this debate and be able to maintain legitimacy if their customers are engaged.

Affordability

This brings me to affordability, our third PR19 theme.

Customer satisfaction and ability to pay bills underpins trust and confidence in water and wastewater services. Affordability remains an issue for many customers, not only for those struggling to pay their bills.

PR19 will be about affordable bills for all; now and for the long-term and including for those struggling to pay. Our initial view of the cost of capital – based on market evidence – is 3.4% (on a real CPIH basis). In RPI terms it is 2.4%, which is a reduction of 1.3% from the 2014 price review. The effect of this change alone should lower bills of an average water and wastewater customer by about £15 to £25. But to keep bills low companies will also need to deliver a step change in efficiency. We think that making significant improvements in customer service, and in resilience, together with a lower WACC and subsequently lower bills, will achieve this.

We will hold companies to account by assessing business plans against an affordability test, and for the first time, an explicit test on how they are supporting vulnerable customers. The bar is high and the criteria will be tough. The test will take into account information provided to us not only by companies but also from other organisations such as customer challenge groups (CCGs). Companies will need to prove they have engaged with their customers on how they will address affordability and how they will improve their support to customers in circumstances that make them vulnerable, to ensure that they have taken account of customers' views in their proposals.

We will even go a step further to hold companies to account on vulnerability. The challenges posed by vulnerability show no sign of abating and improving additional support for customers today, will put companies in a better place to help those customers tomorrow.

Vulnerability can be transient so it is essential that companies do not take a one-size-fits-all approach. Only through strong engagement and relationships will companies understand their customer base and be able to do this. Each company must also make a bespoke performance commitment to its customers about

addressing vulnerability. Together our approach to addressing vulnerability will incentivise companies, financially and reputationally, to provide sensitive, tailored and flexible support for customers.

Innovation

I now want to move onto our fourth and final theme. Innovation.

I've already talked about how companies will need to ensure their networks are resilient as well as keeping bills low. Customers expect this.

To do both they will need to develop innovative and imaginative solutions. Therefore, innovation is at heart of the other three themes. In a way it is the glue that holds everything together.

In PR19, it will be innovation that separates the exceptional companies from the rest. Innovation will push companies to deliver for customers and drive them to put customers at the heart of their plans.

In PR14, a good quality plan was required to achieve enhanced status. This time that's not going to be enough.

The bar has been raised – for PR19 there is an explicit expectation of innovation. We will incentivise companies by rewarding exceptionally ambitious and innovative business plans and companies who deliver on their business plans.

So what do we mean by innovation?

When people think of innovation, it is often in the context of new technology. But innovation can be delivered through increased choice for customers and by new entrants bringing new ideas into a market. For example, the introduction of competition through the business market means there is pressure on companies to really deliver what customers want and need. This has created an incentive for companies to focus on using and developing new products to help win customers and differentiate themselves in the market.

Also, the fact that retailers can choose a business model that suits them – rather than a one size fits all approach that incumbents have to take, retailers can target their services to specific groups and specialise in those areas. They don't have to 'ok' at everything like incumbents – they can be excellent at one thing, if that one thing is what certain customers really want.

We cannot (and do not intend to!) predict how the business retail market will develop. It may develop in a number of different ways, depending on the preferences and behaviour of a wide range of market participants.

It is still early days but customers are already seeing benefits.

For example, Water Plus has signed a deal to supply water to all of Kwik Fit's 831 UK sites. Previously, each of the sites was serviced by its local water company, which meant the business had to deal with 22 different suppliers for billing and specific site issues. This deal has led to cost savings and reduced payment processing and administration time for the company.

Also, it can mean that existing products are now available more widely. For example, Anglian Water have offered their Active Water Management service available for business customers in its home region and in Scotland for a number of years now. This is a service that allows businesses to manage their water use. It alerts them to opportunities for reducing the amount of water, enabling them to make informed, proactive water management choices. It will also review water usage data, flagging up any instances of irregular consumption that may indicate inefficient practices, faulty equipment or leaks.

Now that the market is open to competition, this service is being offered to business customers in other regions too. We know that Betfred are using this service to monitor their water use and improve their efficiency, bringing financial savings of over £120,000 and a positive impact on the environment.

A number of organisations have chosen to take the self-supply route. Self-supply is where a customer buys water supply and wastewater services from the water company and provides their own retail services. This approach can drive down costs and control consumption for self-supply companies. Additionally, there is potential for greater innovation. Self-supply companies are active participants in the market and have a direct customer voice in discussions with the market operator.

Of course, innovation can also refer to better customer service and customer engagement or culture change with regards to achieving environmental resilience and water efficiency. This is where you can see our four themes really start to interlink, and successful companies will ensure that customers are at the centre of it all.

I'll give another example here. The difference between the water sector and other utilities is that customers sit in the centre of the value chain. By that I mean they not only drive the demand for water, they are an integral part of what goes **into** our system too.

Customers are not passive users of water services. Their actions can directly affect system resilience and subsequently, affordability. Wet wipes flushed down toilets, fat poured down sinks ... these are the kind of unwanted additions to our networks that end up costing water companies serious money in asset maintenance. Taking shorter showers or even just not letting the tap run while you brush your teeth, these can save water and reduce the cost of bills.

As a result, companies have a part to play in educating their customers to encourage action and customer behaviour change with regards to resilience and water efficiency.

Innovation can also mean using customer data effectively. Last year we published two important reports on this subject.

Our Unlocking the value in customer data report encouraged companies to make better use of the data they hold on their customers.

We think customer data can drive better customer service and satisfaction. It can provide the insight and intelligence companies need to understand the needs and preferences of their customer base, allowing them to offer the flexible and targeted support.

We followed that work by working with Ofgem, through the UKRN, on our Making better use of data to support vulnerable customers report. This set out expectations for water and energy companies to work together towards cross-sector, non-financial data sharing.

The free non-financial services, such as accessible bills and targeted support in an emergency, offered in both water and energy are very similar. If a customer requires support from their water company, it is likely they'll need the same support from their energy company, and vice versa. Sharing this information will help limit the need for customers to have the same, potentially stressful, conversation regarding their vulnerable circumstance on repeated occasions.

We're pleased to see that a lot of collaboration is already taking place. A joint working group, led by Water UK and the Energy Network Association, has been established and is working towards developing data sharing arrangements across the two sectors by 2020. Already, that group is making good progress.

Conclusion

I am going to bring all this together now.

PR19 is part of a journey that will build on the successes of PR14.

This time though, we're raising the bar on what we expect from companies. PR19 will challenge companies to really stretch themselves, driving innovation to deliver more for less for customers. We will reward those companies who set new standards for the sector.

In their business plans, companies will need to deliver against our four themes; great customer service, resilience, affordability and innovation.

But importantly they'll need to evidence that they've put customers at the very heart of those business plans and engaged with their customers in every aspect of their decision making.

Each of our themes will offer benefits for customers by driving forward the efficiency frontier so companies can deliver more for less and ensure resilient, reliable services for the long-term.