

# Severn Trent

Response to Ofwat's emerging strategy

30 July 2019

WONDERFUL ON TAP



# Response to Ofwat's emerging strategy

## Vision and challenges

The expectations of our customers are changing and it is critical that the water sector steps up to the challenge.

Today, we all expect the companies that serve us to be a positive influence in our lives, and to benefit the society we live in. For water companies this expectation is even more pronounced given our privileged position of providing a monopoly public service. We also recognise the scepticism amongst a significant proportion of society towards big business and the role 'private' companies have in providing essential services like water.

Given this context, and the 2019 price review coming to its natural conclusion, we think the timing is right for Ofwat to refresh its strategy by starting with the vision for the sector.

The three emerging aspirations<sup>1</sup> articulated in the vision are very much in line with our own views and those of our customers. Through our extensive customer engagement it is apparent that there is an expectation that we not only do the day job well but consider how we can add wider value to society and the environment through the broad reach of our services. This is why in AMP7 we are introducing new areas of focus that complement our core job and promote wider benefits – such as our Community Dividend, focus on social mobility and new green spaces performance commitments.

The challenges specified in achieving the vision<sup>2</sup> also strongly resonate with our own insight. Importantly, we think these are challenges that all stakeholders have a role in addressing – from Government and regulators through to companies. This combined approach is already evident in some areas today, like the long term water resource challenges whereby:

- we have worked with United Utilities to facilitate a strategic trade with Thames;
- the establishment of the Regulators' Alliance for Progressing Infrastructure Development (RAPID) will facilitate regulatory and Government coordination; and
- the decisions in PR19 provide the necessary resources and customer safeguards to make the trades a reality.

We also think that there is one additional challenge that should be acknowledged – intergenerational fairness. There is a natural tendency in society to discount the future with excessive focus on the present. This could be exacerbated by the significant challenges we face on affordability and legitimacy, which could lead to decisions that favour the short term at the expense of future generations of customers. We therefore think it's important that intergenerational fairness is explicitly called out as a challenge so that when designing the regulatory framework explicit consideration is given to the needs of future generations of customers and any trade-offs are acknowledged.

## Ofwat's emerging strategy

The regulatory framework is a critical enabler of the vision and how the sector can meet the challenges of the future. It is important that the design of the framework through to the detailed implementation (for example, via the price review) works in a way that delivers the vision in a coherent and consistent manner – as is occurring for strategic water trades.

Having reviewed the high-level vision of what should be retained and what should be evolved, we are very supportive, particularly of the importance attached to ODIs, customer engagement and the continued use of the regulatory capital value (RCV).

---

<sup>1</sup> Delivering everyday excellence; Stewardship for the future and Value for individuals and society

<sup>2</sup> Long term water resources; operational resilience; pressures on the natural environment; customers changing expectations; legitimacy; and affordability

What is particularly welcome in the emerging strategy is the recognition of the value of outcomes and ODIs that have aligned customer and investor interest. For Severn Trent this has helped promote a stronger service culture, leading to a step change in performance across key areas such as sewer flooding. Maintaining the use of incentives into the future will give Ofwat and companies the ability to more effectively drive service improvements in areas that customers value most highly.

We also strongly agree with the retention of customer engagement and the allowed return on the RCV. This underpins the legitimacy of the regime to customers and investors who ultimately fund the services that we require. Therefore maintaining this strong link is critical to meeting the challenges of the future.

### **Three shifts in regulation**

The emerging strategy also identified three shifts – *creating a better future; driving transformational change and encouraging public enterprises to deliver public value*. At face value all three shifts are very welcome and should play an important role in delivering the vision.

When seeking to create a *better future* we think it is right that the strategy defines long-term expectations. This will channel focus on those issues that are most important to customers. However, setting long-term expectations will only drive meaningful change if they are focused on a small number of areas and framed as outcomes. This is because change requires both resources and focused effort – hence targeting a small number of areas is likely to have a greater chance of success than having long term expectations across a broad range of measures.

Framing expectations in terms of outcomes is also critical for driving both innovation and collaboration. For example, a long-term aspiration of “healthy rivers” would support more collaboration with farmers and government agencies and deliver better outcomes for society than a simple focus on the impact of the water sector. However, it would also need appropriate provisions to ensure customers only pay their fair share.

Likewise, we support the emphasis on securing long-term water supplies and operational resilience. As we noted earlier, the emphasis on coordinated action to address water resource challenges is welcome and should drive a step change in this area. On operational resilience, we have extensively engaged with the Ofwat team on what information might be appropriate to collect and form a view on resilience. However, responding to the resilience challenges will not only require high quality data, it will require a better understanding of our own customers’ expectations, as well as flexibility in the regulatory framework to implement solutions that meet those needs. This could involve for example, additional funding to reflect higher maintenance activity levels, supported by multi-AMP ODIs to protect customers.

To drive *transformation change* Ofwat has noted that it could “take a fresh approach to how we report on company and the industry’s performance overall”. We recognise that done in the right way, this could be a powerful tool to promote the delivery of the vision. However this would require that any performance reporting is explicitly and equally tied to the three elements of the vision – everyday excellence; stewardship for the future and value for individuals and society. We also think that reporting should reflect the delivery of the PR19 commitments rather than any new standards, given that these have been developed following years of customer engagement and regulatory scrutiny. This could lead to a reporting framework similar to the EA 4-star system, albeit with scoring tailored to the three strands of the vision.

We also fully support the emphasis on innovation. The recent consultation on customer-funded interventions for driving innovation is very positive and we welcome the emphasis on collaborative approaches. We also recognise some of the challenges identified – particularly how to move at pace and scale to deliver real change. This is partly why we felt the need to go beyond existing innovation institutions and establish the World Water Innovation Fund to work with other like-minded global utilities at pace.

We also support the importance being given to customer relationships. As a customer-facing industry with some unique challenges, we need mature relationships with our customers so that we can understand and exceed their expectations.

Finally, as we noted earlier we are very supportive of the emphasis on social purpose and public value. And, we think that it's logical that companies should own the aspiration and for Ofwat to encourage them to do so. Our own engagement shows that customers today expect us to do more than just the day job – they expect us to make a broader societal contribution through the delivery of our services. As a pathfinder purposeful company we have made a start on this journey. Even as we take ownership of the aspiration for ourselves, driving a change in customer perceptions and enhancing legitimacy across England and Wales is going to require the entire sector to embrace the challenges of securing value for customers, communities and the environment. For this reason, we will formally be asking for a license change to build in social purpose.