



Ofwat's emerging strategy: Driving transformational innovation in the sector

An Ofwat consultation

1 Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory body representing the interests of domestic and business water and sewerage customers across England and Wales. We have four local committees in England and a committee for Wales.
- 1.2 We welcome the opportunity to comment on Ofwat's consultation on driving transformational innovation in the sector.

2 CCWater's perspective

- 2.1 Innovation, and the need for the water sector to increase this, has been a topic of much discussion for over a decade.
- 2.2 The Martin Cave review 2011¹ concluded that 'there is general agreement on the potential benefits of greater levels of innovation for customers and the environment and a recognition that such innovation should be supported through market mechanisms and regulation as appropriate'.
- 2.3 CCWater is very interested in the area of innovation. We think it is essential that the industry makes a step change in this area, not just in terms of outputs, but also a change to culture. The industry needs to constantly be looking for new and better ways to think and operate to better meet the expectations of the customers they serve.
- 2.4 We believe that innovation should not be viewed as an end by itself, but we do think that it helps overcome some of the significant challenges faced by the water sector including: climate change; aging assets; a growing population; and changing customer expectations.
- 2.5 CCWater's main focus in the area of innovation is where change makes a material positive impact on customers; for example, in areas such as service, environment improvements, affordability and vulnerability.
- 2.6 We welcome Ofwat's focus on the area of innovation and we support views expressed in this consultation in areas such as sharing information and collaboration.

3 Consultation questions

3.1 What are the main barriers to innovation in the sector and why?

- 3.1.1 We do not see any fundamental barriers to innovation in the water sector.
- 3.1.2 We believe that comparative measures used in the water sector can lead to innovation driving up performance. However, we recognise that the increasingly competitive nature of committing to upper quartile performance at regulatory

¹ <https://www.gov.uk/government/publications/competition-and-innovation-in-the-water-markets-cave-review>

price reviews can result in companies being less willing to share innovation/good practice.

3.1.3 There are a number of barriers to innovation perceived by companies. These include fear of failure (missing regulatory targets) and the lack of financial benefit to companies within a price review period. However, it is our view that neither of these should act as a fundamental blocker to innovation.

3.2 Do you think that the financial support cited in section three is required to stimulate innovation in the sector? If so, what do you believe is the appropriate amount of funding and why?

3.2.1 We do not believe that setting aside additional money for innovation is a necessary approach to encourage innovation across the water sector. In a competitive (non-monopoly) environment, companies would invest their profits to innovate to gain a competitive edge. We think this is the model that should be encouraged by Ofwat.

3.2.2 We believe that the consumer should be the primary focus for companies when promoting and trialling innovation. If all companies strive to meet their customers' needs and expectations, and the regulator calculates price limits correctly, then innovation should naturally follow.

3.2.3 We also believe that an increased regulatory incentive based on consumers' views could help further drive innovation. Ofwat's introduction of C-MeX (Customer Experience Performance Commitment) should be a positive step forward. It is our view that strengthening this incentive further would increase the focus on delivering for consumers, without picking winners, which could help to drive innovation in the most important areas. By aiming to mimic what competition does in other highly competitive sectors, this incentive could force companies to reflect on the different needs and expectations of residential customers and to better segment their customer base.

3.3 Do you agree that our proposed draft principles for additional financial support will effectively safeguard the interests of customers?

3.3.1 We have concerns over how Ofwat will assess 'true transformational innovation' against other types of innovation that, as stated by Ofwat, are already incentivised through the regulatory regime. If a transformation is required in the sector, which we believe is needed (especially in areas such as customers service, the environment and climate change), then it would have been preferable for that to be included directly within companies PR19 plans.

3.3.2 We think more thought is needed regarding how this additional funding fits in with Ofwat's Outcome Delivery Incentive regime (ODI's). There is a danger that all customers pay for an innovative project that leads to improvements in areas for companies, which mean they get further rewards. Customers then pay again for the improvement in performance through ODIs.

3.3.3 These proposals have been put forward late in the Price Review process so we want to make sure that this doesn't impact customer investment in other areas.

- 3.3.4 Ofwat have stated that customers have been at the heart of this Price Review; with the expectation of high quality and appropriate customer research shaping companies' business plans. As this initiative will have an impact on bills, has Ofwat done, or plan to do, research into customer's views on these proposals?
- 3.3.5 If this is to go ahead, as Ofwat has stated, we think it is important to have a mechanism in place which gives money back to customers if, for example, a project doesn't go ahead.
- 3.3.6 We question why customers ultimately have to pay for the funding. As we have already stated in a competitive market companies invest in innovation through their own profits in order to gain a competitive edge. This should be the same model in water.
- 3.4 What are your views on the collectively funded innovation competition model which we describe in section three? What other key considerations not highlighted should we take into account in designing/ implementing the competition?**
- 3.4.1 As described above we believe the current regulatory regime should be enough to drive innovation within the Water Industry.
- 3.4.2 However, if these proposals do go ahead, we want to see customer focused innovation featuring heavily in Ofwat's thinking when it establishes guidelines for any innovation competition.
- 3.4.3 We like Ofwat's "open by default" proposal. We think that all entries, to said competition, should be made public even if they are unsuccessful in gaining funding. This would allow others to gain learning and possibly build on ideas from others.
- 3.5 What are your views on the end-of-period innovation roll-out reward we describe in section three? What other key considerations not highlighted (e.g. whether it should be collectively funded or individually funded) should we take into account in designing/ implementing the reward?**
- 3.5.1 As already stated we don't think either of these customer funded options are necessary.
- 3.5.2 Out of the two options presented, this option (rewarding companies that have demonstrated the most successful roll-out of successful innovation to the benefit of customers during the 2020-25 period) seems to hold the least risks for customers.
- 3.5.3 We understand that this is in addition to the competition option you have already presented however, putting more focus on proven projects drives companies to fund more themselves. Ofwat could also have successful collaboration or co-ordination as part of the test process to gain the reward.

3.5.4 If either or both of these options are chosen, a regular review of effectiveness is essential to ensure customers' money is being well spent.

3.6 What other potential alternative mechanisms for funding/ rewarding innovation not discussed do you think we should be considering? Which financial support mechanism or combination of mechanisms should we introduce and why? What would be an appropriate split of available funding/ reward?

3.6.1 We believe that the regulatory framework should provide enough incentive to innovate without the need for additional funding. Ofwat needs to set the price limits at the correct level and incentivise companies to get service levels and priorities right. Companies will then need to innovate to deliver the promises they make to their customers.

3.6.2 Ofwat could use existing tools to encourage innovation. As detailed above, strengthening initiatives such as C-MeX in the water industry would focus companies and drive innovation in the areas most important to consumers.

3.6.3 Ofwat could further incentivise innovation by strengthening their innovation test as part of their price review methodology. For example, Ofwat could make it clear now that companies can only achieve fast track / exceptional status if they can evidence:

- Delivery of innovation during the AMP
- An open approach to sharing that innovation
- A culture of innovation within the company

This way innovation should be a priority within any company for the whole AMP if they are seeking Exceptional/Fast Track status at the next price review. Water customers do not have to pay for this and Ofwat do not have to "pick winners" on specific projects.

3.7 Do you think the potential industry activities discussed in section four could help drive innovation? Are there other activities not identified which you think the industry should be considering?

3.7.1 We believe capturing where innovation delivers benefits to consumers and disseminating this across the industry is essential. This is especially important in areas such as leakage that are clear priority areas for customers. As per our point above, sharing innovation and good practice could be made an explicit expectation, by the regulator, for companies at future price reviews. This could be included as a test within the business plan assessment (akin to the series of tests Ofwat are applying to plans at PR19). This would help break down any barriers to sharing innovation.

3.7.2 It is unclear whether these proposals go far enough to encourage collaboration or coordination. The combination of ODI's and this 'competition' to gain additional funding could potentially discourage collaboration and sharing ideas. As stated above, Ofwat needs to consider using collaboration as part of the test at the next Price Review or, if this fund goes ahead, make it mandatory for any application that is submitted.

3.7.3 We see value in the industry coming together to identify the biggest problems and find common innovative solutions, and we believe Ofwat should encourage a sector wide joint innovation strategy.

3.7.4 Some companies are already pressing ahead with initiatives, like the Severn Trent and United Utilities World Wide Innovation Fund, but it seems rather disjointed throughout the sector. Could Water UK play a role in facilitating this and getting everyone signed up to a common strategy? Ofwat could also be explicit on the customer-focused areas they would like to see innovation explored.

3.7.5 Ofwat's 'open-by-default' suggestion for certain types of data seems sensible. This could help with finding the biggest issues across the industry that require innovation. Data that is 'open-by-default' could also help with customer trust in the water sector.

3.8 Do you think the proposals in section five will help drive innovation? Are there other activities not identified which you think Ofwat should be considering?

3.8.1 Whilst we see value in Ofwat giving advice on regulation innovation, other sectors/organisations could be better placed to assist companies on innovation than the industry regulator.

3.8.2 Collaboration and coordination between regulators on innovation would be a very sensible and cost effective approach. However, we would not want to see all regulators converging on a similar approach that might not be the best approach in water. Instead, it would be better for all regulators to constantly seek new and better ways to encourage innovation and share their findings with each other in a peer review and or challenging way.

3.8.3 CCWater is keen to collaborate and help in the area of innovation and we look forward to hearing about ways that we can be involved in any future developments in this area.

Enquiries

Enquiries about this consultation response and requests for further information should be addressed to:

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