
south east water

Driving transformational innovation in the sector

South East Water response

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1. Introduction

This paper sets out South East Water's response to the consultation on 'Driving transformational innovation in the sector' issued by Ofwat in July 2019.

Any queries in relation to this document should be sent to

[REDACTED]

The following section provides a response to each of the questions raised in the consultation document.

1.1 Overall comments

We welcome the opportunity to contribute to this consultation. As recognised by Ofwat we have shown considerable innovation across a range of areas over recent years including the widespread use of customers satisfaction incentives at PR14, now adopted more widely by Ofwat, the targeting of customers by their values rather than treating all customers the same, our resilient customer approach as well as a number of more technical innovations all detailed in the innovation section of our Business Plan.

We had a number of incentives that drove us to innovate in this way – for many it was a reputational benefit, for some it provided clear cultural benefits within our company and for others it allowed us to meet some stretching targets for example in relation to discolouration contacts.

However we recognise there is always opportunity to do more and in some cases we felt constrained by the existing incentives and priorities that we believe are worthy of further consideration. On this basis, we welcome the addition of another layer of incentives that, if targeted in the right way, will incentivise tackling important long term challenges in particular via collaboration.

In the answers to the questions below we have made suggestions with regard to the promotion of innovation more generally in addition to the comments relating to the proposal itself.

We would be happy to attend any workshops that are held to explore the options in the consultation further.

2. Consultation response

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

In our experience, within the water sector, we have found the largest barrier to innovation is the lack of any headroom within the total expenditure (totex) allowances.

The list of essential investment, and uncontrollable costs increasingly absorbs a significant amount of companies' totex allowances and so experimental innovation needs to compete for resource and funds that might otherwise be needed on essential maintenance or statutory obligations.

This results in only relatively certain or inexpensive innovation being undertaken, risking the loss of opportunities that require a greater initial investment.

The second barrier relates to target setting – targets that are not foreseeable or require a step change with very little (1 or 2 years) warning of the change will likely restrict innovation. Faced with short run and stretching targets and associated high penalties, companies will likely react with a response that is centred on increasing activity that is already undertaken and proven to achieve the new target, as time is limited to develop alternatives, and failure of the target represents considerable financial and reputational jeopardy.

Conversely a stretching target that is known but begins further away (5 years) presents an opportunity to begin trying alternative approaches of meeting the new target without the initial jeopardy thereby promoting innovation. So we do not object to stretching targets as they are likely to contribute to the drive for innovation we object to the short run notice of these targets driven mainly by an immediate step change in regulatory focus as seen with the leakage target.

A current example of this within the water sector, is the requirement for companies to achieve at least a 15% reduction in leakage, starting almost immediately. Many companies are reacting to this by employing more loggers and staff on the ground to ensure the targets can be achieved. Whereas a 15% reduction that is assessed in 5 years' time would likely mean that companies would use the opportunity the extra time creates to develop alternative and innovative approaches, knowing that should new activities not achieve what is required there would still be the opportunity to meet the target in the more traditional way if necessary.

2.2 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?

The incentive that will be felt most strongly here is reputational. We believe the ‘winners’ of and award will value the reputational benefit more than the financial sum awarded. So the decision on funding levels should consider whether the sum proposed is significant enough to attract a strong associated reputational benefit but not too large as to be seen as a potential waste of customers money.

We believe the proposed approach seems to do this.

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

Yes – although inevitably the detailed design will be important and should be tested with multiple potential scenarios.

We believe the ‘big challenges’ referred to in the draft principles need defining and should be in line with the challenges that are being developed as part of Ofwat’s emerging strategy – please refer to our response to the strategy where we set out what we believe the main challenges are.

Consideration should also be given to how the fund will be allocated between water and wastewater, such that solutions are pursued for both services.

2.4 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?

We believe that the innovation competition model and appointment of the independent expert should be led by Ofwat rather than by companies. Companies will be competing for the innovation fund and therefore there may be a real or perceived conflict if companies are responsible for developing the framework.

In relation to the potential risk of double-funding we think further consideration should be given to attempting to try and avoid any potential double-funding as it would likely result in companies only focusing on projects for areas not covered by performance commitments for the innovation fund. This would be a perverse consequence as performance commitments are designed to reflect customers and environmental priorities and therefore a priority for innovation. We believe Ofwat should be open to innovation to achieve existing incentives as well as innovation in other areas.

Careful consideration should be given by Ofwat in the design of the competition model – in particular Ofwat should make it clear how it will assess innovation and what forms of innovation would attract the highest award.

We would expect projects that are collaborative and concentrating on future challenges (with little current incentives) would be sought and incentivised more within this framework than for areas where there are already strong incentives in place – e.g. customer satisfaction with the new C-MeX measure.

2.5 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?

This is an important step to ensure delivery of innovation is also a priority. We see no reason that a piece of innovation cannot attract both the in-year and end of period award. The same comment applies on potential double funding in this area as it does on the in-year approach.

Consideration should be given to how the innovation fund will be allocated between the in-year and end of period awards.

2.6 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?

As mentioned above the reputational element is strong but the whole innovation package needs considering. We believe the optimum package to incentivise innovation would comprise of the following:

- Stretching targets, with financial and reputational incentives, set in areas broad enough to capture all forms of innovation i.e. not just technical
- Targets that are well flagged and have sufficient time built in to allow innovation to be developed to meet the targets.
- The use of grants, awards etc. that act as much as a reputational tool than a significant funding element.
- Continually encouraging innovation by rewarding companies who innovate and not using a take turn approach to making awards.

- Focusing innovation awards on areas with weaker in built regulatory incentives in particular long term objectives.

2.7 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?

The approach and activities outlined in section four could be seen to be too prescriptive. We believe Ofwat should allow the industry and its supply chain to develop a range of activities in response to the full package of incentives.

2.8 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?

We support the proposals included in section five.

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