



South Staffs Water

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Dear Sir,

South Staffs Water response to 'Ofwat's emerging strategy: Driving transformational innovation in the sector'

We welcome the opportunity to respond to Ofwat's consultation on driving transformational innovation in the water sector. We agree that adopting innovative approaches is crucial to delivering long-term resilience and great service to customers at an affordable price, and that innovation is an important tool for meeting the strategic challenges facing the sector in a cost-effective and sustainable way. We also agree with Ofwat's definition that innovation is about more than just changes in technology, and that it encompasses the way we use our systems and processes to deliver a culture of innovation across our business.

That said, there are some areas of concern for us in Ofwat's approach, including what we consider to be a WaSC-centric focus to the consultation that does not consider the different circumstances of all the companies operating in the sector. As one of the four smaller WoCs, we recognise that there is more we need to do to embed a culture of innovation across all parts of our business. But we have made a start. For example, we have taken inspiration from leading companies and have opened a small innovation hub in our contact centre, which provides a space for our people to come together to solve problems and generate ideas.

In addition, through our [bid assessment framework](#), we have introduced a process to evaluate potential new innovation and/or technology options, which considers factors such as practicality, strategic fit, financial viability, environmental implications and customer impact. And in our [business plan for 2020 to 2025](#), we highlighted three sector-leading, innovative approaches that are moving our business forward, and that we think will deliver real benefits both for our customers and the sector as a whole – our community hub, our trenchless HydroSEAL leak-sealing technology and the functional separation of our household retail and wholesale activities, which will create a sharper focus on the role these activities play in delivering excellent services to customers.

Below, we detail our responses to the questions set out in the consultation.

Q1. What are the main barriers to innovation in the sector and why?

We consider that the regulatory cycle with its five-year payback challenge is one of the main barriers to innovation in the sector. This is because there is currently no incentive to collaborate with others on innovation and no guarantee of rewards if innovation is shared. In addition, the relative sizes of some of the companies in the sector – ourselves included – means that we do not always have the ability or resource to drive innovation in the supply chain. So the potential cost of failure could well be greater on the smaller companies, and we consider this is also a barrier to innovation. This is one of the reasons why we have introduced a new evaluation process within our bid assessment framework as outlined above.

We think that another barrier may be a cultural rather than a financial one. We believe that there needs to be more of a cultural shift, where people can feel able to speak up about their ideas – and be supported by the business in return. Severn Trent Water's BrightSparks crowdsourcing platform and annual Challenge Cup are good examples of people being empowered to bring innovative thinking to the business. Linked to this is the issue of resource and workload, and the need to find ways to encourage people to step back from their day jobs and think outside the box.

Q2. 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?

Q3. Do you agree that our proposed draft principles for additional financial support will effectively safeguard the interests of customers?

While we support Ofwat's proposal to make funds available to help stimulate innovation in the sector, we are concerned about whether the regulator has carried out any engagement with customers to see if they would be willing to pay more in their water and sewerage bills to support this. We are mindful of the extensive engagement we have carried out with our customers during PR19. Our plan for 2020 to 2025 has been shaped by our customers and reflects the things that are important to them – but we have not engaged specifically on the need for an additional innovation fund. We would ask Ofwat to demonstrate that its view of a £200 million fund is one that customers across the sector actively support.

We also think Ofwat should ensure that the funding is available to all companies, irrespective of their size. To that end, we would recommend limiting the maximum award per project to encourage a greater number of smaller-scale contributions rather than a very few large ones that would inevitably be dominated by the WaSCs.

We recognise what Ofwat is trying to achieve with its draft principles for additional financial support as a way of safeguarding customers' interests. But we are concerned about the potential requirement on us to fund a proportion of project costs to ensure risks are appropriately shared between customers and shareholders. This is not something we have factored into our plan for 2020 to 2025.

In addition, we are concerned about Ofwat's claw-back proposals in the event that projects are not progressed as we think this could restrict the number and types of innovation project put forward by companies. And we have concerns about the time-limited nature of the funds as this goes against Ofwat's drive for more long-term thinking by the sector.

Q4. What are your views on the collectively funded innovation competition model which we describe in section three? What other key consideration not highlighted should we take into account in designing/implementing the competition?

We also recognise what Ofwat is trying to achieve with its proposal for a collectively-funded competition as an effective way of driving innovation in the sector. But we think it is at odds with Ofwat's view that innovation should be the result of more collaboration across the sector – as currently happens with Wessex Water's EnTrade platform for creating markets to better facilitate long-term catchment management schemes, for example.

We are concerned that Ofwat's competition approach could drive the wrong behaviours and result in less, nor more, cross-sector working. To be effective, we think that applications should insist on a minimum level of collaboration between two or more water companies or a supply chain partner and more or more water companies (given that most innovation comes from the supply chain). In addition, all applications should include an assessment of the scale of the problem they are looking to solve and the market potential, and the evaluation assessment should include a consideration of the scalability and applicability of any solution to the sector as a whole.

In addition, Innovate UK, the government scheme for providing loans to small businesses to drive innovative change already has the infrastructure in place to administer and manage this sort of process. This would reduce the need to spend money on setting up new bureaucracy. Following Innovate UK best practice, the competition could then take the form of a series of specific themed rounds, which would serve to focus effort and minimise duplication. Including customer representatives (such as CCWater) in the evaluation process would help to ensure that the sector maintains the broad support of its customer base.

We would also ask Ofwat to provide more detail about the process behind this proposal. For example, about the cut-off for funding and about moving from innovation to roll-out and implementation.

Q5. 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 when designing/implementing the reward?

Q6. 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?

We support Ofwat's idea of an end-of-period innovation roll-out reward that would entitle successful companies to an additional revenue allowance at PR24. But we think that Ofwat would need to design the mechanism carefully to avoid any risk of companies being double funded. We also think that Ofwat would need to consider carefully how it will manage the risks around this approach, particularly as all the risk is with the collaboration parties for several years. This is when most innovation fails (usually because of cash constraints).

Our view is that a well-developed and rigorously tested mechanism would allow companies to deliver innovations outside of the constraints of their final determinations. We feel that the end-of-period roll out would work better for a smaller WoC, where resourcing innovation bids throughout the period could be a challenge.

Q7. Do you think the potential industry activities discussed in section four could help drive innovation? Are there any other activities not identified which you think the industry should be considering?

We support Ofwat's proposal to develop and publish a joint innovation strategy as a way of focusing the sector's efforts while encouraging transparency and engagement with the value chain and innovators. We also believe that cross-sector innovation with other utilities may accelerate or maximise the benefits where synergies exist. But we are disappointed that Ofwat has not recognised the work that UKWIR does in driving new research and innovation across the sector, preferring to focus instead on its proposal to establish a new centre of excellence as a way of delivering benefits to customers.

And, while we agree that opportunities exist to make better use of data, we are concerned about what an "open by default" approach would mean in practice – particularly the resource impact it would have for the smaller WoCs.

Q8. 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 Ofwat's proposals to consider a similar model to Ofgem's Innovation Link as a way of providing information advice to water companies that are interested in getting innovative ideas off the ground. In addition, we welcome the proposal for increased co-ordination across regulators in the sector.

We would be happy to discuss any aspect of this response in more detail.

Yours faithfully

Caroline Cooper
Director of Asset Management & Regulation
South Staffs Water (incorporating Cambridge Water)