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A discussion paper on public value in the water sector

Ofwat

About this document

This discussion paper sets out a brief update on Ofwat's latest thinking on public value, following a range of conversations with companies, and insights from annual reports and wider engagement. This is followed by our own reflections, and some thoughts on what this may mean for the sector and Ofwat's role going forward. Finally the paper sets out a number of specific questions for stakeholders to consider.

Responding to this discussion document

We would welcome any comments on this document. Please email them to strategy@ofwat.gov.uk or post them to:

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The closing date for responding to this discussion paper is 9 February 2021. If you wish to discuss any aspect of this paper, please contact Amit Kamal by email, or at strategy@ofwat.gov.uk.

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1. Background and context

In October 2019, Ofwat launched a new strategy; [Time to Act, Together](#). This set out our ambition for the sector – providing the very best service for customers; improving the environment; and improving life through water, both now and in the future – and the role that we intended to play in achieving it. We set out three strategic goals:

- To transform water companies' performance;
- To drive water companies to meet long-term challenges through increased collaboration and partnerships;
- For water companies to provide greater public value, delivering more for customers, society, and the environment.

We set out that to achieve these goals we would use all our existing regulatory tools and develop new ones, including building our influence, data and insight. We indicated that we wanted companies to look for ways to deliver more social and environmental value by conducting their core activities differently and provided some examples to stimulate the conversation:

- Using nature based solutions rather than hard infrastructure in water and wastewater treatment processes;
- Deciding to locate training facilities in deprived communities to stimulate local economic development.

Water companies have a clear socio-economic and environmental footprint as one of a handful of key long-term stakeholders in the areas they operate in, and the communities they are part of. They have a clear role to play in helping to address some of the main challenges society faces, with the Covid-19 pandemic being a recent example of the vital role water companies can play in supporting their communities and ensuring that vulnerable customers have access to support.

The essential nature of the services water companies provide naturally means that customers and stakeholders expect company decisions to be driven by a broad range of societal and environmental factors, as well as financial considerations. This is also reflected in the expectations set out for companies in the UK and Welsh governments' strategic policy and objectives statements for Ofwat.

Ofwat's strategy reflects this, as well as the view that there is scope for companies to have greater ambition in this area. More generally, evolving expectations of companies across the economy to deliver greater social and environmental value

means that water companies should expect to do more through their core water and wastewater services to keep pace.

Evolving societal expectations is a key factor that was also identified in a report we commissioned at the start of the year from Purpose Union and the Impact Institute, in order to gain a different, external perspective on how purpose and public value is reported in the water sector. [Their report](#), which we have published alongside this document, provides a useful wider perspective from those who specialise in helping organisations drive social purpose. This desktop research report provided key learnings and perspective early in 2020, so some content is no longer current, and their report should be viewed in this context.

Alongside this we have kept up to date with the work and insights of a range of other bodies and third parties, for example Sustainability First's [Fair for the Future](#) publications and their prior work looking at [board approaches to governance](#). We have also had a number of conversations with companies to get a better understanding of how public value is viewed and approached within the sector.

The next section of this paper sets out some of what we've learned from water companies including through a range of conversations, annual reports, and wider engagement. This is followed by our reflections, and what this may mean for us and our approach going forward, with a number of specific questions for stakeholders to consider.

2. Public value in the water sector

We recognise that public value is not a new concept for the water sector. The sector has a proud heritage and history and many companies characterise public service as “in their DNA”. More recent investment in water supply and sewerage infrastructure over the past 30 years has supported economic growth and maintained and improved public health and environmental outcomes. Companies have told us that staff motivation and satisfaction are in large part driven by companies’ public service ethos and their place in the local community. Many companies point to long-standing programmes that incorporate public value thinking.

Whilst public value is inherent in the core services water and wastewater companies deliver, we consider, and companies recognise, that they need to continue to challenge themselves to consider how they can create *more* public value, by delivering their core services differently. This has already led to a step change in activity in recent years.

For example, there is a growing focus on environmental and social impact through some of the key processes that drive company investment. This includes looking at the wider range of benefits that can be delivered through integrated water resources planning, where five multi-sector regional groups are now developing plans to balance supply and demand. These plans aim to deliver long term environmental improvements, improve resilience to drought and set out how the supply of water for people, business and other major water users will be managed over the next 25 years. These regional plans will be reflected in individual company Water Resource Management Plans (WRMP).

The Regulators’ Alliance for Progressing Infrastructure Development (RAPID), which involves Ofwat, the Environment Agency and the Drinking Water Inspectorate, aims to help ensure the regulatory framework supports the development of an effective combination of strategic water resource schemes as industry drives these initiatives forward and aims to optimise solutions.

Reform to the Water Industry National Environment Programme (WINEP) will mean that, for example, companies can pursue more or broader catchment management and nature based solutions to deliver multiple environmental and social outcomes.

As another example, all English water companies have signed up to a Public Interest Commitment with specific 2030 commitments on carbon, leakage, plastics, social

mobility and water poverty, and Water UK recently published its [Net Zero 2030 Routemap](#).

Companies in Wales operate within the framework of the [Water Strategy for Wales](#), which sets out key principles of sustainable development which aim to enhance the economic, social and environmental wellbeing of people and communities across Wales.

Companies have also drawn attention to the broad spectrum of activities they undertake which contribute to their communities – from educational activities, which can help future generations to understand the importance of water as a precious resource; to focused engagement with customers that have affordability concerns, which can provide a vital stepping-stone to wider support.

A key theme that has emerged from our conversations with companies is that they generally consider that the building blocks of our existing regulatory framework can and do accommodate the delivery of public value outcomes. The outcomes framework was regularly referred to in this regard, as an example of how the regulatory framework can align private interests with public value.

All companies we spoke to also told us about how they go further on public value in different areas, and in different ways. Companies often turned to what could be termed “enablers” to public value: conditions or frameworks that help companies focus on public value outcomes. These enablers can largely be grouped under the headings of:

- **governance and leadership;**
- **decision-making tools and frameworks;**
- **customer, community and stakeholder engagement; and**
- **reporting tools and frameworks.**

There is clearly overlap between the above categories, and they can be considered components of a wider culture that enables public value thinking to flourish and public value outcomes to be achieved.

From a **governance and leadership** perspective, some companies have told us they have implemented or are looking at changes to their Articles of Association to enshrine their purpose, whilst others have developed ‘social contracts’ with their customers and communities. At least one company has suggested that public value outcomes might be enshrined in a licence condition. Others have noted more formalised approaches with externally assessed outcomes, such as B-Corp

accreditation, or BSI standards in this area. Some companies also told us that they consider their approach to share ownership or sharing dividends, or more fundamentally their ownership structure, underpins a different relationship with their customers and communities, and thereby their ability to deliver greater public value.

As observed through our analysis of companies' activity in the context of our Board Leadership, Transparency and Governance principles, companies are also focusing on their purpose. A number of companies have highlighted the importance of scrutiny of public value at board or committee level; and some companies have highlighted to us that relevant committee structures are being refreshed or reconsidered to increase or formalise their focus on public value, including through an environmental, social and governance lens. Public value can of course be driven from the bottom up as well as top down, and we agree it is important to harness both. More generally, companies are starting to recognise the need for greater diversity not just in terms of its contribution to good decision-making, but also to reflect the communities they serve.

Several companies have drawn attention to the **decision-making tools and frameworks** they have adopted, and how these take account of and enable public value. There is a broad diversity of activity in this space, from companies embedding and exploring "multiple-capitals"¹ approaches to decision-making to those broadening the scope of cost-benefit analyses to consider social and environmental value. The adoption of these tools was also often referred to in the context of devolved decision-making and giving more flexibility for staff to consider wider impacts in their decision-making processes.

Companies also focused on their **customer, community and stakeholder engagement** activities, and the importance of these groups' perspectives in coming to a view on where to focus in terms of public value outcomes. Many reflected on the need to draw on, and balance, multiple stakeholder perspectives; and several times the question arose of whether and how companies understand peoples' views as citizens as well as their views as customers. This is something we are keen to continue to explore, as set out in the [PR24 customer engagement paper](#).

Companies have also been telling us about the extent to which new and existing **reporting tools and frameworks** can help them consider, recognise and communicate their public value impacts. Environmental, social and governance

¹ The term "capitals" refers broadly to any store of value that an organisation can use in the production of goods or services. Financial and manufactured capitals are the most commonly report on. "Multiple-capitals" approaches generally take a broader view by also considering intellectual, social, human and natural capital alongside these metrics.

(ESG) reporting is increasingly important to investors, and companies have told us that there is increasing market demand from some types of investors for companies that have a clear understanding, and track record, of environmental and social performance. The UK has announced its intention to make Task Force on Climate-related Financial Disclosures (TCFD)-aligned disclosures mandatory across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.

Within this context, many companies told us that they are able to tell a clear and positive story to their investor and wider stakeholder community, relying on existing reporting tools, including those based on our price control framework (such as performance commitments and outcome delivery incentives). It is clear that different companies articulate their narrative in different and bespoke ways, depending on the nature of their investors and their approach to investment in the sector.

3. Our reflections and approach going forward

Public value is a powerful construct rooted in Harvard Professor Mark Moore's 1995 work on creating public value, in the context of a public agency or enterprise. His concept of public value included three aspects: delivering services, achieving social outcomes and maintaining trust and legitimacy. Our approach is very much anchored in that concept, consistent with the water sector's general ethos of public service delivery, while also encompassing the potential to have a transformational impact by seizing the opportunities to deliver core services differently and embedding a culture of public value in the sector.

This reflects and builds on our work on corporate governance within the sector including our work on Board Leadership, Transparency and Governance; and on Back in Balance. Our strategy set out that companies will need to be run with a clear purpose, adding wider public value for customers and communities as well as for shareholders; and that a stronger focus on their public purpose could help water companies build greater legitimacy in the eyes of the public, enabling them to enlist the support of customers and other partners in tackling the challenges ahead.

There are a number of points that we consider important to draw out as we consider how best to develop our approach.

- First, Purpose Union have highlighted that a key component of any such activity is that it is authentic and transparent and that it has a demonstrable impact translating into tangible outcomes. We agree it is fundamental that companies 'walk the talk' and allow stakeholders to understand and scrutinise their public value activity by being open and honest about progress and learning.
- We are also conscious that "public value" isn't necessarily a term that resonates with the public and it will inevitably mean different things to different people. Our intention is not for the term to dominate, nor do we expect to see every social or environmental initiative badged as public value. It will be important for companies to find ways to ensure that their approach resonates with their various stakeholder communities and again, that it seen to be authentic, with other behaviours consistent with companies' public value narrative.
- We are clear that optimising solutions for the delivery of greater public value does not necessarily equate to greater cost to companies or customers. Delivering core services differently can entail innovative approaches that are

equally or more efficient; it can mean achieving multiple outcomes with single solutions, rather than with multiple and siloed solutions; and it can involve bringing other funding streams to bear, especially where outcomes benefit others beyond companies and their customers. The delivery of public value risks being undermined if customers can only see the benefit of greater public value through greater cost; and customer affordability considerations are an integral part of public value thinking.

- Finally, we are also mindful that a broad pursuit of public value objectives could have unintended and even adverse consequences. Our collective efforts should augment and reinforce companies' delivery of their essential purpose and core activities, and not lead to a loss of focus on these fundamentals. To date, companies have not raised lack of clarity or loss of focus as an issue in their work on public value, but we are alert to the possible risks in this respect, and are keen to explore this through our questions.

Since the launch of our strategy, we have been actively promoting our ambition for the sector on public value in a number of ways and encouraging companies to take ownership. For example in the context of our [innovation competitions](#), a key theme is testing new ways of conducting core activities to deliver public value. We have also highlighted that public value can play a role in water markets such as the markets for developer services and business retail: this is consistent with our vision for the [business retail market](#), in which market forces are harnessed to create value for society.

As we take the discussion forward more generally, we consider a useful way to look at public value is along the two dimensions of 1) the enablers and the enabling **culture** that support or embed public value in an organisation, and 2) the **outcomes** that make a tangible difference to customers, communities, and the environment. At this stage it's not clear whether a unifying or standardised framework for public value that encompasses both these dimensions is necessary (or even desirable).

In terms of **outcomes**, we have been careful not to define public value tightly, nor to suggest or direct specific public value outcomes which water companies should focus on at this stage. We are not necessarily best placed to identify the untapped public value that might be derived from delivering core services differently, especially given the premise that companies' customers, community and stakeholders should inform the public value choices and decisions companies make. Public value outcomes are also likely to be context-specific and need to be dynamic and evolve over time – including as societal expectations change, and in response to events.

We also recognise that a lot of ongoing work the sector is engaged in is already focused on identifying, defining and delivering public value outcomes. Earlier in this paper we referenced some of this, such as the ongoing work on water resources planning and WINEP. Companies have also told us that tools such as the customer measure of experience (C-MeX) can also have a helpful role to play in driving public value outcomes.

On **culture**, our research and conversations have crystallised the fundamental importance of an enabling culture as a precursor to delivering public value outcomes: a culture which, as we put in our strategy, ensures that “every part of the business and every business decision is seen as an opportunity to add value to society”. As discussed above, water companies and others have told us about a wide range of enabling activities that can be seen as components of such a culture. This is a space where many companies are exploring and learning and we can see there is more to do to make companies’ aspirations a reality. As noted above, we worked closely with the industry to refresh our Board Leadership, Transparency and Governance principles, and on a licence commitment to meet the underpinning objectives. These principles also reflect the importance of the alignment of values and culture with a company’s purpose, and transparency to engender trust and ensure accountability.

More broadly we observe that different companies are focusing on different enablers to further embed a culture with public value thinking at its core. For example, some companies told us that they are already adopting decision-making tools and frameworks that take account of public value, fitting them into existing processes, or actively considering how to deploy them across the full breadth of the business; whereas others are at an earlier stage. As is to be expected, we therefore also observed a spectrum in the articulation of:

- how the various enablers fit together to ensure public value thinking is infused throughout a company’s activities and actions;
- the golden thread between ambitions on public value and the impact of a company’s actions on the ground and across all parts of the business; and
- how the interests of different stakeholders are considered and aligned to achieve the greatest public value outcomes.

This is very much an ongoing journey, across all the enablers of governance; decision-making tools and frameworks; customer, community and stakeholder engagement; and reporting tools and frameworks.

We are keen to explore whether any of the enabling elements above is considered more fundamental than others, or if there is a hierarchy in terms of impact and

effectiveness. We also intend to consider further whether there are elements that could or should meaningfully apply to all companies in a standardised way; or whether a single overarching enabler could support and drive the delivery of public value across all water companies. Ultimately our ambition is for public value thinking to permeate the culture of the sector more deeply and systematically; and for the question to be asked at every meaningful point, whether core services can be delivered differently in a way that creates greater public value.

We have a range of tools at our disposal which could reinforce or supplement the current approach, and we think of our role as potentially operating across the spectrum of informing, enabling and/or incentivising a greater focus on, or greater delivery of, public value. This could range from bringing the sector together to share insight and learning, and identifying and highlighting (emerging) best practice; to promoting relevant common enablers; and considering if and how we can best encourage companies to better deliver public value through the price review process (as we also explore in our [PR24 launch document](#)). We are also considering, from a regulatory perspective, how we can be assured that progress continues to be made, and we remain open to considering whether, in time, there should be a more direct role for Ofwat through the regulatory framework.

4. Feedback and Questions

This is not a formal consultation, but we welcome stakeholders' views on the content of this discussion paper generally and in three areas in particular:

Scope and Ambition

- a) What factors – outside regulation – impact on water companies' ability to deliver 'optimal' public value outcomes when delivering their core services? What are the constraints to meeting ambitions in this area?
- b) What are the risks in the pursuit of greater public value; and what could companies, and/or Ofwat, do to mitigate these risks?
- c) In pursuit of better public value outcomes, to what extent should companies focus on an enabling culture that drives public value holistically; versus a more discrete, targeted approach?

Incentives and barriers

- d) How does the regulatory framework contribute to, or limit, companies' ability to deliver better public value outcomes?
- e) What role, if any, should the price review play in encouraging or incentivising companies' delivery of public value?

Understanding impact

- f) What are the markers of progress on public value, both in the context of enabling culture and outcomes?
- g) What role, if any, should Ofwat have in monitoring progress? How else can we, customers and other stakeholders be assured that genuine and meaningful progress continues to be made?

Other

- h) Is there anything else Ofwat should be considering in order to meet our objectives on public value?

**Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.**

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