Amit Kamal
Public Value
Ofwat
21 Bloomsbury St
Bloomsbury,
London WC1B 3HF

*Via email : strategy@ofwat.gov.uk*

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Dear Amit,

**Ref: Public Value in the Water Sector**

Thank you for the opportunity to respond to Ofwat discussion paper on public value in the water sector.

Purpose and public value are at the heart of Affinity Water's strategy and what we do on a day-to-day basis. In 2019, Affinity Water's Board defined the Company's purpose as providing high quality drinking water and taking care of the environment for our communities, now and for future generations. This followed extensive research with our customers and stakeholders to understand what they thought Affinity Water should do and what it should stand for.

Delivering public value beyond the private value that we create is clearly at the centre of the model envisaged in the Water Industry Act and is at the heart of our purpose. Affinity Water's history, starting with the public health of creating more resilient water supply, also highlights a long tradition of creating local town-based water sources and networks using private investment for public good. Folkestone and Dover Water Company dates back to the 1840s and was the first Company outside of Greater London that had public supply of water. In Chesham, the town borehole that we have closed to help the River Chess recently was drilled in the 1870s. These sources and networks were built to foster higher public health and prevent disease.

There are three areas that we would like to focus on from the discussion document: 1) scope and ambition; 2) incentives and barriers, and 3) measuring impact.

## Scope and Ambition

We think that the key to creating public value and to delivering the performance commitments in place in AMP7 are inherently dependent on reframing how we think about the problems we are trying to solve. Many problems require a collective endeavour. Governments, NGOs, companies, and community members all have essential roles to play, yet they work more often in opposition than in alignment.

A movement known as collective impact (introduced in 2011 by John Kania and Mark Kramer in the Stanford Social Innovation Review) has facilitated successful collaborations in the social sector, and it can guide companies' efforts to bring together the various actors in their ecosystems to catalyse change. This can create significant shared value.

Shared value results from policies and practices that contribute to competitive advantage while strengthening the communities in which a company operates. Companies can create shared value in three ways: by reconceiving products and markets; redefining productivity in the value chain and strengthening local clusters. All three require a sufficiently robust market ecosystem. A collective-impact approach may not always be needed for the first two activities, but it is always necessary at the cluster level.

Companies are accustomed to thinking of strategy in terms of the activities under their direct control. They recognise the importance of a broader market ecosystem, but research has focused on the ecosystem of competition among related companies rather than on the social factors that affect markets. However, every company that pursues shared value in the face of inhospitable market conditions will encounter barriers in its ecosystem. Misaligned government policies or informal rules often perpetuate existing gaps, and ingrained behaviours and cultural norms may prevent the adoption of new solutions. The further a company looks beyond its own value chain to the causes of failure — situations in which socioeconomic conditions prevent conventional business models from succeeding — the less control and perceived legitimacy it has, and the greater the cost, complexity, and time frame of change. These factors can keep companies from even contemplating an effort to alter the external context.

We are working on different models to protect the environment using community involvement to promote water saving and in turn protect the environment. In doing that, we have found that the benefits of protecting the environment have a very wide range of benefits to the wider public. For example, the intrinsic benefits to physical and mental health of engaging with a river could have a significant benefit to NHS Clinical Commissioning Groups through reduction of primary and secondary care costs. However, there are risks around undertaking this approach for a public utility. There is a strategic question about who should set the type and scale of public value that companies are aiming to work with.

**Incentives and barriers**

The regulatory framework provides for delivery of public value through the outcome-based approach. The extent to which companies go beyond that through the framework is an important question. We agree that there are ways in which companies' core businesses can be run to promote public value. For example, we have been looking at targeting recruitment and training in areas with low social mobility and/or high gini coefficients (a measure of inequality).

In many instances public value will aid the sector in delivering the performance commitments such as PCC. It is important that incentives that the price review framework creates do not work against public value by under valuing or not valuing outcomes that are in the wider public interest.

**Understanding impact**

HM Government's review of the framework for public value led by Sir Michael Barber gives useful guiderails in the area of both culture and outcomes. One of the strengths of the water sector, like the public sector, is its public spirited ethos. Public health and environmental improvement are core to the culture of the sector.

Traditional approaches to assessing public sector productivity have focused on measuring the quantity of inputs used and services provided to the public.

Affinity Water

Substantial progress has been made over the past decades in developing and refining these methodologies – the ONS have published a time series of total UK public service productivity dating back to 1997 – however limitations remain. For some public services, outputs remain stubbornly difficult to measure particularly when they are indirect outcomes. Defence is such an example, with outputs that are hard to define and measure, such as ‘peace and stability’. The challenge, therefore, becomes how to improve public sector productivity performance when it is difficult to define quite what this is.

Instead of seeking to quantify inputs and outputs and observe the relationship between them, the framework instead seeks to define everything that a public body should be doing in between to maximise the likelihood of delivering optimal value from the funding it receives. It sets out the activities that are required to turn public money in to policy outcomes, creating a set of criteria that can then be used to assess the extent to which those activities are taking place and, by extension, how likely it is that value is being maximised.

This replicates in many ways the outcomes-based approach taken in PR19. However, other approaches also exist. The Taxonomy for example is fostering more granular and detailed reporting on environmental, social and governance (ESG) aspects of companies’ activity. Alongside the reporting of Taskforce for Climate related Financial Disclosures (TCFD) becoming mandatory by the end of AMP7 this could give a form of standardised measure. Indeed, we are seeing growing appetite across the market. However, it is key that these metrics measure what matters and that they do not obscure or dilute indirect public value.

As the discussion document states public value is rooted in Harvard Professor Mark Moore’s 1995 Book. Moore was examining how a public agency or enterprise can create and measure additional value. His concept of public value included three aspects: delivering services, achieving social outcomes, and maintaining trust and legitimacy. It is therefore a powerful tool for building value and support for a wide range of stakeholders. However, that trust and legitimacy is not merely underpinned by metrics but has to be specific to each company.

I hope you find our comments helpful and I look forward to further dialogue with Ofwat on the role water companies can play to deliver greater public value.

Yours sincerely,

[redacted]

Stève Hervouet
**Director of Strategy and Regulation**

**cc.**
Jake Rigg, Director of Corporate Affairs, Affinity Water