

By email to: strategy@ofwat.gov.uk

Public Value
Ofwat
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Dear Ofwat

A discussion paper on public value in the water sector

We welcome the opportunity to continue our engagement with you on the importance of delivering our service in the public interest. We believe that there are benefits for all when businesses take the step to define their purpose in order to deliver public benefit.

Public "value"

Before responding in detail, we would like to comment on the concept of "public value". We note that this concept, as developed by Mark Moore, has greater resonance with entities in the public sector and wonder whether the three central elements of Moore's 'strategic triangle' are easily translated into the regulatory environment. This is particularly true in relation to the second leg of Moore's strategic triangle – (the 'authorising environment') given that any public value proposition can only be delivered when that proposition has been 'authorised'. It seems to us to be critical that the 'universe' of authorisers should be broadly defined such that it includes, as a minimum, those stakeholder groups defined in s172 of the Companies Act 2006. It would be a mistake for Ofwat to take on the role of the key "authoriser". We are worried that this could easily transpire the context of the business planning process and would be concerned if Ofwat was unwilling to allow investment sought by a company to deliver a "public value proposition" which had the universal support of the wider stakeholder community. Were that to be the case, the 'operating capacity' (being the third leg of Moore's strategic triangle and constituting "the means by which inputs are transformed into public value creating outputs") would not be made available to companies.



Therefore, we greatly prefer the term “public benefit”. We draw Ofwat’s attention to the concept of public benefit companies. This construct is widely understood in the United States and is beginning to gain traction in the UK. Note that a public benefit is not the same as a certified “B Corp”. A company which aims to deliver “public benefit” can be judged by assessing whether that organisation:

- is committed to creating public benefit and sustainable value in addition to generating profit (such that sustainability is an integral part of an organisation’s value proposition);
- is committed to considering the company’s impact on society and the environment in order to create long-term sustainable value for all stakeholders; and
- reports (at least annually and using a third party standard), to show their progress towards achieving social and environmental impact to their shareholders and the wider public.

We agree that it is important for companies to demonstrate that they have embedded wider value into their decision making. Delivering public benefit is not something that is done by one department or through individual projects, it is something that must be part of everyone’s role within the business. This is a view that our customers expressed to us in developing our Social Contract.

Our work to date

As you know we have embedded our commitment to operate in the public interest through the changes to our Articles of Association. We have also enshrined in our articles the need for directors to take decisions having regard to the needs of a wide range of stakeholders – including our communities and the environment in addition to considering the interests of our shareholders.

Our core purpose is articulated externally as “to bring environmental and social prosperity to the region we serve through our commitment to Love Every Drop”. We have underpinned this purpose by redefining our values so that every employee knows how they can “build trust”, “do the right thing” and be “always exploring”, in order to contribute to this aim. To facilitate this, we have also been developing our six capitals framework which is now used in our investment decision making process, helping us to understand how our decisions can deliver natural, social, people and intellectual capital alongside financial and manufactured.

Through these enabling factors and this six capitals framework we can ensure that when we make decisions and deliver our business plan objectives, we do so in a way that considers the opportunities for delivering wider public benefit. The aim in doing this is that we maximise the public benefit that we can deliver for our stakeholders directly and through the development of effective partnerships with other organisations to make best use of available funding. However, in exploring this we have also come to recognise that small increases in investment at the right time can often unlock greater public benefit for our stakeholders. Where this is in line with our customers priorities, particularly in terms of natural or social value, we believe there are opportunities for further discussion.

Looking forward

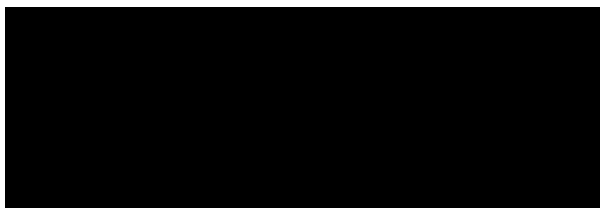
We agree with Ofwat that beneficial outcomes are best defined by each company in consultation and co-creation with their customers and communities. However, returning to our initial observations about public benefit corporations, we do see the value in a deeper conversation about the principles behind embedding purpose or public benefit within a business. This is why we are currently working closely with BSI on developing a new Publicly Accessible Specification on this subject. We feel that this is an area where the water sector could show strong leadership within the UK and beyond and we would welcome further discussions with you on this.

We agree that each company needs to define the metrics that are most material to them in tracking and demonstrating how a multi-capitals approach is influencing their decision making. However, there is merit in discussing if a broad framework and certain underlining data sources should be agreed, specifically to align use of these in certain strategic reports that are common across all companies. It would also be valuable to discuss how they may be considered in the preparation and execution of PR24.

We provide, as an annex to this letter, short responses to the specific questions posed in the discussion paper. We also note the clear linkages between this discussion paper and Ofwat's recent discussion paper on how best to reflect customers preferences in future price reviews.

We hope that this consultation marks the start of a deeper dialogue with companies on this complex subject, and we are willing to continue the conversation with Ofwat on this topic.

Yours sincerely



Darren Rice
Head of Policy and Regulatory Strategy

Annex – Specific question responses

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?

One of the key factors in delivering optimal public benefit is developing a trusted relationship with our customers, developing their understanding of issues, determining the way they rank priorities based on other demanding factors in their lives and their willingness to engage and take action. This is why meaningful, two-way customer engagement is so important, particularly on complex issues that demonstrate cumulative impacts over time, require early or phased interventions or require customer action or behavioural change to succeed. Resilience to climate change is an example of this; all our interactions through PR19 show that our customers are developing a much greater understanding of this, including identifying the difference between the direct impacts on their interaction with water and the indirect impacts of poor water planning in the landscape. Customers demonstrate a willingness to make changes themselves and want us to make the right interventions in a timely manner. In these discussions, we do not generally see a difference in the consideration of the actions required when they speak as a citizen or a customer.

However, we recognise that success relies on the customer/citizen mandate and this is why we have been co-creating a Social Contract and have placed so much focus on understanding the use of behavioural change theory. The Citizen/customer relationship is an area worthy of further investigation and is something we would be very happy to discuss with Ofwat to build a consensus of thinking towards PR24. Our work with the University of East Anglia, the Centre for Water Studies and the work of the 3Ss Group (Science, Society and Sustainability Research Group) or our connections with the Government Outcomes Lab at Oxford University would be interesting starting points. This is an area where Ofwat's recent discussion paper on reflecting customer preferences is mixed; it notes the future role of customers as citizens (which we support); but questions whether customers can meaningfully engage on complex subjects such as resilience. As we set out in our response to that paper, our experience is that customers can and are willing to engage. We consider it essential that in dealing with the creation of long term public benefit customers through the creation of a resilient region that customers are central to those discussions.

Another area critical to maximising our ability to deliver public benefit is cross-sector, collaboration and delivery at scale, in and across boundaries. We have seen the value in developing these collaborations whether it is large scale, long term water resource planning (such as Water Resources East), landscape scale integrated water management bringing together flood management, water resource potential and sustainable developments (Future Fens Programme) or maximising the ability to deliver enhanced Natural Capital (such as with Natural Capital East). Working across industry sectors, with

regulators, land managers and policy makers creates common frameworks, approaches and efficient processes that deliver coordinated activity that maximises delivery.

b) What are the risks in the pursuit of greater public value; and what could companies, and/or Ofwat, do to mitigate these risks?

Delivering public benefit has to be directly linked to the core purpose of the business if it is to succeed. If this is the case and is supported by processes that deliver meaningful engagement with customers, which influences and directs planning and decision making, then it should ensure that the approach is balanced and limits any risk. Our purpose and our social contract underline the fact that water is critical to the health and success of our customers, our community and our environment. At the core of our purpose to bring environmental and social prosperity to the region we serve, is the understanding that above all else we have to do the basics brilliantly, delivering excellent quality drinking water and treating used water to the standard that supports, not impacts the environment as it returns into the water cycle.

As we note above, it is our view that a company operating to deliver public benefit will succeed where it balances appropriately the interests of its key stakeholders (including shareholders who have a legitimate interest as investors in the business). A decision which generates returns for investors is still capable of benefiting a wider range of stakeholders where that "additional return" is then made available for reinvestment in the business.

In general, there is a risk that in the pursuit of greater public value that water customers' bills are used as the vehicle for collecting revenue for investment in creating public value that should otherwise be delivered through general taxation and wider Government actions.

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?

We believe that the successful delivery of public benefit comes from the understanding that everyone within the company contributes to it, whether that is for example understanding the implications on the customer in every decision you make or the implications to the race to net zero. So, developing and embedding a real purpose, connecting employees with the purpose through a set of values and the ability to make decisions with a view to that purpose are critical. We would agree that the absence of an enabling culture means that it is difficult for an organisation to "walk the talk".

That said, we do have some concerns regarding a mechanistic approach to assessing culture and we do not consider that a desktop review of annual reports (such as that undertaken by Purpose Union) is adequate for this purpose. We believe that an assessment of culture which is based on direct engagement with stakeholders to be far more robust. This might include, for example, the Glassdoor survey of Best Places to

Work which captures the views of employees (and in this regard we draw your attention to the fact that Anglian Water is consistently rated highly in the Glassdoor survey).

Other enabling measures such as the frameworks to support decision making, taking into account a wider set of parameters than just financial and regulatory, are also key – this is the basis for the development of our six capitals framework. We have already explained our belief that the relationship with customer is of paramount importance but we also believe that there must be transparency and accountability in terms of delivery. This is also why we are leading a project, with BSI and partners from a range of companies and Government departments, to develop a meta-framework for demonstrating how you embed purpose into business in a Publicly Accessible Specification. This project is in its formative stages but we would welcome further engagement with Ofwat.

The delivery of purpose and public benefit is a core consideration not something that can be delivered by one department or by individual projects.

Incentives and barriers

d) How does the regulatory framework contribute to, or limit, companies' ability to deliver better public value outcomes?

As we note above, there is little to be gained in challenging companies to deliver public benefit (such as long-term sustainable solutions) in circumstances where the regulatory framework is focussed on short term outcomes. For example, Ofwat has pointed to the role of innovation competitions as way of “testing new ways of conducting core activities to deliver public benefit”. However, we draw Ofwat’s attention to comments made by WICS in their recent methodology in which the Scottish regulator states that it “understands and accepts that innovative approaches are essential in driving long term customer benefits but require an acceptance that they will not always be effective in delivering the desired outcomes for customers and our environment. [Scottish Water] should not face a financial penalty if it is trying – through testing innovative solutions - to deliver the best outcomes for customers or our environment”.

The development of the PR24 regulatory framework provides an opportunity to better reflect public value and long term outcomes, reflecting on the PR19 lessons learned and wider reflections including those from the on-going CMA redetermination process.

As part of this, we also believe that Ofwat should take the opportunity to give high-quality customer evidence a much greater role in future price review decisions – not least as the sector has delivered a step-change in the quantity and quality of its customer engagement and so the evidence emerging from it is much stronger than in the past. This change has been recognised by Ofwat.

There is a risk that Ofwat may focus on alignment of engagement rather than alternative engagement approaches and thus dilutes the importance of customer views. We would encourage Ofwat to work with the sector to assess more fundamentally the full range of

engagement options and opportunities, including the approaches being explored in other utility sectors and in Scotland.

e) What role, if any, should the price review play in encouraging or incentivising companies' delivery of public value?

We agree that Ofwat should not try to define public benefit tightly, nor suggest or direct specific public benefit outcomes that water companies should focus on. However, we do agree that there could be valuable dialogue in a number of areas; the interplay between customer and citizen and also the framework and core data sets that can support a flexible but comparable approach to certain areas of multi capitals assessment, for example in the areas of social capital. We would welcome a collaborative approach to exploring these issues across the industry and with Ofwat, particularly in the development of processes relating to understanding the wider public benefit in business case proposals in PR24. We believe that the industry wide public interest commitment flagged by Ofwat (<https://www.water.org.uk/publication/public-interest-commitment/>) is a good example of what can be achieved without regulatory compulsion.

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?

We refer to our previous answers that highlight our commitment to a transparent third-party review of our progress towards achieving beneficial social and environmental impact. This includes our involvement approach to developing a PAS with BSI on this matter.

This is exploring exactly the issue of markers of progress on delivering purpose or public benefit in businesses. This issue and the value of this framework is not confined to our industry and there is great interest in developing it so that it is applicable to any business seeking to deliver a wider public purpose. By developing a standard with BSI, widely regarded for their rigour and independence, Ofwat, customers and stakeholders can have confidence in a company's commitment and progress in embedding these enabling factors, their delivery and transparent reporting. In the co-creation of our Social Contract with customers, BSI was recognised and trusted above other institutions in this market space. Other tools such as BITC's responsible business tracker also have an important role to play in monitoring progress.

Other

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

We refer again to opening comments regarding the concept of public value relative to public benefit. As a public body, public value may well have resonance for Ofwat. However, we believe that the concept of public benefit is better understood (both within the sector and beyond) and provides a clearer framework for progress in connection with the creation of sustainable value.