

PR24 and beyond: Reflecting customer preferences in future price reviews – a discussion paper

Severn Trent response

Executive summary

One of the key successes of recent price reviews is how they have pushed companies to make a step change in terms of the quantum and quality of the customer engagement we undertake. We have a stronger understanding of our customers and this is tangibly making a difference to our decision making, both at price reviews and on a daily basis. Many of these successes have been driven by the freedom for companies to innovate and explore different approaches – based on their circumstances – with a healthy degree of competition, examples of best practice highlighted by Ofwat and CCW, and challenge (provided by CCGs). We would like to see these successes retained and built upon at PR24 – and importantly we believe that this requires companies to remain accountable for the quality of our engagement and how we use it.

We recognise, however, that there have been challenges. And as we are on the whole supportive of Ofwat's direction of travel, we have focused our response on three challenges from PR19:

- ensuring customer insight is proportionate and appropriately used (and using new approaches);
- where the same type of research is used by companies, for the same purpose, understanding how differences in method make a difference to the results; and
- providing effective challenge and assurance.

Ensuring customer insight is proportionate and appropriately used

At PR19 there was much discussion about the different methods of research and insight gathering that could be used, and the need to be innovative. However, just as important as the method itself, is ensuring the right method is used in the right circumstances.

Big data, social media scraping and revealed preference all have an important role in price reviews – they tell us about how customers are acting and feeling today, and can show us trends to help predict how this could change in different circumstances. But qualitative, deliberative and stated preference approaches also have an appropriate role – particularly if we are asking customers about longer term issues, or we are expecting them to answer as a citizen (considering the contribution that their water company could make to society) rather than through the lens of their own service experience. More focus on the right method in the right circumstances, should mean that the level of insight undertaken is more proportionate – one of Ofwat's goals.

Ensuring comparability

One of the frustrations highlighted at PR19 was that ostensibly the same piece of research, designed to gather insight for the same purpose, could yield quite different results between companies. In part this may have been due to regional differences in customers' preferences, but innovation, different techniques and methods of presentation will also play a part. Triangulation and the use of multiple data points offered one way to help to mitigate this and provide more certainty about results.

We do not want to lose the scope for innovation and flexibility in our research – this helps us to improve and better understand our customers. However, we accept that at price reviews, there may be a limited number of circumstances where the comparability of results is the priority, and therefore some scope to undertake collaborative research or use an agreed methodology (i.e. willingness to pay for common performance commitments). In doing so, we need to recognise that we will lose multiple data points (that could be used for triangulation); and potentially accuracy (standardisation eliminates how method affects results, it doesn't necessarily get you closer to the 'truth'). Importantly

– all parties need to have confidence in the results (including companies' Boards if they are to approve plans). The practicalities of undertaking research at this scale, should also not be underestimated, so our preference would be to focus on defining a common methodology more clearly, rather than centralised procurement and implementation

Effective challenge and assurance

We think Ofwat should not mandate CCGs for PR24. There are other ways to deliver the roles they provided that could simplify the price review process and reduce the burden on our stakeholders.

CCGs had two roles during PR19 and PR14: to challenge companies to improve the quality of their customer engagement; and to provide independent assurance to Ofwat about the same issue. While many companies have cited the benefits of very detailed and committed CCG challenge on their plans, Ofwat has raised concerns about whether the assurance provided can be independent. It is a difficult balance to strike – particularly where CCGs are providing regular and embedded challenge.

PR24 is an opportunity to think about the two roles separately.

Now is the right time (rather than later in the AMP) for Ofwat to consider the extent of assurance it will need on companies' customer engagement, and who provides that assurance. On the question of the extent of assurance required, it is likely that, if some (albeit limited) research is undertaken collectively, then the profile of risk will change, and so too should the assurance required.

On the question of the assurance provider, Ofwat could instead look to companies' Boards – Boards are already required to provide statements regarding the quality of business plans (and our own Board sets a high bar for assurance). CCW as the statutory customer representative is another option - although conflicts can arise where CCW undertakes its own research which provides different messages, and this role should not compromise CCW's ability to provide an independent view on the outcome of price reviews.

The second role of CCGs is to challenge companies to improve their customer engagement, and many companies cite this as their key benefit. If the assurance role of CCGs is no longer required, then this would give companies the flexibility to invite challenge and advice in a way that works best for them. In our experience of CCGs at PR19, significant value was added, but the ask of members was considerable. We would like to move to a model that allows us to engage challenge and advice, but: i) recognises that this should complement rather than seek to duplicate the challenge provided by companies' Boards (and incentives within the regulatory framework); and ii) does not necessarily follow the traditional CCG set up. We believe the successes of CCGs could be built on by being more focused on the quality of customer engagement (attracting a depth of expertise in this areas, including CCW); adopting more agile working practices (reflecting that most companies now gather insight about customers on a weekly basis); and working to complement, (rather than duplicate) our on-going regulatory and stakeholder engagement.

Detailed responses to questions

We provide our detailed responses to questions below. In some instances, we have combined responses where questions are related.

Q1: Do you agree with the goals we have proposed for customer engagement at future price reviews? If not, why not?

Q2: Are there any other goals which you think we should have for customer engagement at future price reviews?

We support the goals proposed and believe they are a sensible development from PR19. We should not lose focus on the fact that the goals are a means to an end (rather than an end in themselves) i.e. to support an approach to engagement that that allows us all to have a better understanding of i) customers' individual needs, priorities and the value they place on their service; and ii) the extent to which and where they, as a citizen, want their water company (and in turn themselves through their bills) to contribute to society.

There are two goals that stand out compared to PR19.

Proportionality is important. A huge volume of research and engagement was undertaken at PR19, but both companies and regulators need to better challenge ourselves on the question of to what end. Achieving proportionality requires:

- understanding the right issues and questions to ask customers about (including from their perspective and the industry's);
- using the right tools to ask them; and
- building insight cumulatively over time (overlying new insight with existing insight, rather than starting anew).

On the first point, CCW's research with Blue Marble is helpful. Often companies have asked customers about issues that they would not expect to be consulted on or they find too difficult to answer. In a deliberative research project on long-term investment and green recovery conducted by Britain Thinks (October 2020), Severn Trent customers told us they are keen to be involved in Severn Trent's decision making in the future, especially about decisions that will have an impact on their own neighbourhood or their bill. However, most feel technical questions are best left to water company experts.

Using the right tools to engage with customers is something that our Water Forum (CCG) pushed us hard on at PR19. For example, revealed preference or operational data is highly valuable at helping us to identify scope for service improvement and how to shape behavioural change, but for issues including intergenerational fairness, and particularly those where we may be asking for a view as citizens, then stated preference and deliberative research have an important part to play.

Which tool is the right tool could also vary from company to company depending on its circumstances and its customer base. For example, Hafren Dyfrdwy has c.100,000 customers, very few of whom are members of online market research panels, compared to Severn Trent's 4.5m customer base. We may want to ask the same questions of each customer base, but there are circumstances in which the best approach to secure meaningful and representative insight, could be different for each company.

Achieving proportionality will also require building insight cumulatively over time – rather than starting from scratch at each price review. We have found that revisiting existing research, or combining it with new operational data or external data sources, can give fresh perspectives.

Promoting greater **collaboration** can be challenging, not least because a healthy degree of competition between companies to score well on IAP tests helped to drive the industry forward at PR19. That said, we believe there is certainly more scope for collaboration, in particular to reduce duplication where multiple stakeholders undertake similar research. It can also be achieved through greater information sharing – for example, companies are increasingly sharing existing research on customer preferences on supply/demand balances to complete the first iteration of regional water resource plans.

In our responses to questions 3 and 4, we discuss in more detail some of the challenges when collaboration requires standardisation.

Q3. Do you agree with the principle that in areas that are of common concern to all customers within a nation, evidence of customers' preferences should be generated in a consistent manner such that results are comparable? If so, why? If not, why not?

The answer to this question in large part depends on what the results are going to be used for:

- If they are to be used for regulatory purposes where information needs to be comparable, then yes, consistency is important.
- If the aim is to reduce duplication, and potentially exploit economies of scale, then yes consistency (and by inference a collaborative approach) would be beneficial.
- If the aim is to secure the most meaningful insight, then this could be compromised if a standardised approach is taken. Comparability in approach does not always get you closer to the 'truth'.

On the latter point it is important to recognise that:

- the same approach may work differently or be more or less appropriate depending on individual company circumstances (service definitions, increments of change in service standards, and to some extent sample sizes, all have different connotations for different companies);
- standardisation risks working to the 'lowest common denominator';
- consistency (and a collaborative approach) could lead to a loss of data points. At PR19 there was a large focus on triangulation, consistency could mean 'putting all our eggs in one basket'.

So, for example, in the case of willingness to pay for common PCs, taking a consistent approach would to some extent allow the industry to eliminate methodology as one factor as to why there are differences in willingness to pay values (which we understand is one reason why Ofwat is considering greater collaboration/consistency). It would not necessarily capture a more accurate suite of willingness to pay values for each company.

Q4. If we make use of collaborative nationwide research in future price reviews:

Which aspects of business plans do you think should fall within the scope of this research?

Notwithstanding the above, we believe there could be merit in exploring collaborative and consistent approaches to research in a small number of areas. We would not wish to see all research undertaken centrally as this could represent a significant step back from PR19 by:

- narrowing the scope of research undertaken;
- risk precluding wider sources of insight in business plan development e.g. operational data, customer contact data;
- compromise innovation;
- require insight to be gathered as one-off set pieces for price reviews (rather than continuously); and
- reduce company ownership of plans, particularly if the research is undertaken by other parties.

Given the above, we believe that the following warrant further consideration.

Understanding customer priorities and willingness to pay

We understand Ofwat's concern that companies can provide very different willingness to pay results, and it is likely that this is to some extent, due to differences in approach.

Before a decision is made about whether a collaborative or consistent approach should be taken, we believe there should be further consideration about how willingness to pay is used. In theory it: i) helps to identify customer priorities and an appropriate degree of stretch in targets; ii) informs companies' cost-benefit assessments; and iii) informs ODI incentives. In reality, where it has been used for ii) and iii) it is often used in conjunction with other insight and data, and where it is used for i) the same end could arguably be achieved with a simpler form of research.

Taking a more consistent approach – particularly to common PCs - would help to substantially rule out differences in method. It is also likely to be more cost effective and avoid duplication. But it would not necessarily solve the entire issue of comparability – especially where used for ODI incentive rates, if other data sources are also used.

As noted above, there will be some other drawbacks, notably the loss of data points, but also compromises to ensure that the approach reasonably works for each companies' circumstances. And the practicalities of designing and then deploying research at scale are likely to be challenging and complex.

Finally, it is important that all parties are comfortable with the approach. The outcome of this research could have an important bearing on the overall balance of risk and return in plans, for example. If companies' Boards are to provide a statement that their plans are high quality, they may seek assurance about centrally managed research if it is complex to undertake and impactful on plans.

Acceptability testing

Acceptability testing is challenging at price reviews - not least because companies spend years carefully undertaking different types of research on wide ranging issue from preferred contact

channels to intergenerational fairness, to iteratively develop nuanced plans, and then attempt to summarise these plans into a single piece of quantitative research.

Like willingness to pay, it is likely that differences in approach could lead to different levels of acceptability. If Ofwat wants to understand relative acceptability, then a nationwide approach to acceptability testing could be valuable. This is something that CCW already does to inform its draft determination response, and could be built on. But we would be concerned if this research is solely relied on to gauge how well plans meet customers' needs.

In each of the above, what 'consistency' means could require some thought, for example:

- Will companies be required to use a consistent method, or would all research be centrally procured?
- If data are to be captured to the same confidence level between companies, what does this imply for sample sizes?
- How do quotas need to vary to ensure they are representative?
- How do regional circumstances impact the most effective engagement method (for example, the absence of online panels in Hafren Dyfrdwy's area means that only telephone interviews or in person surveys are feasible, for others, different languages may be required to ensure research is accessible)?
- Could different service experiences lead to different results, or any 'atypical' operational conditions in different areas (for example, undertaking research while a company is experiencing an exceptional operational incident, could lead to atypical results)?
- While services could be defined consistently, would different increments of service change have different connotations? – this is likely to be most pronounced between larger and smaller companies.

Which organisations do you think should be involved in steering this research?

If the aim is for parties to have confidence in the results (and their comparability) then multiple parties will need to be involved including Ofwat, CCW and companies. There are two requirements that will be crucial for success:

- Experience and expertise in research. External advice could be sought, but most companies have dedicated research experts, and now three price reviews' worth of experience of designing research like willingness to pay.
- Ownership. If companies (and Boards) are required to use the outcome of the research in their plans then we must be able to shape its design.

Engaging all companies could be challenging (simply because of the numbers involved), but will be needed to meet both points above.

When should this research be undertaken?

Timing will be challenging, particularly is some collaborative willingness to pay is undertaken as it tends to be on the critical path for companies' business plan development, and other regulatory processes use it, for example water resource management plans.

This means companies will need early confirmation about what research would be collaboratively undertaken and when. In the case of willingness to pay, we expect to work on it this year (2021).

How should this research account for differences between England and Wales?

The key difference between 'England and Wales' is likely to be where policy direction places greater emphasis on different areas of service. This could in turn warrant different emphasis in some areas of research to reflect this.

Q5: To what extent do you think it would be necessary for us to provide guidance on customer engagement, assurance and other issues at future price reviews if we made – or did not make – use of collaborative nationwide engagement?

Q6: To the extent that you consider further guidance is necessary, what areas should this cover?

Q7: Are there other models which you think we should consider for providing assurance at future price reviews? If so, what are the benefits of these alternative approaches?

We think Ofwat should not mandate CCGs for PR24. There are other ways to deliver the roles they provided that could simplify the price review process and reduce the burden on our stakeholders.

Questions 5 to 7 consider two related, but slightly different points that are often conflated (in discussions about CCGs in particular):

- How can we provide assurance as to the quality of customer engagement/insight in business planning (and who should provide that assurance)?
- How can companies seek challenge and advice to deliver the best possible customer engagement/insight (and who should provide that advice)?

Companies (including us) often cite the challenge and advice provided by CCGs as a real benefit, whereas Ofwat has expressed concern about CCGs ability to provide independent assurance. And at times, the role of CCGs is likened to representing the views or interests of customers, when in practice they do not have this mandate.

PR24 is an opportunity to return to first principles, and we suggest separating the question of assurance from that of providing challenge and advice.

Assurance

Just like any other area of business planning or regulatory reporting, the extent to which assurance is required regarding customer engagement/insight should depend on:

- who the audience for assurance is (and why they need it); and
- the level of risk associated with the research or insight (which in turn will be a function of complexity/difficulty and how the research is to be used).

One of the fundamental reasons why CCGs were created was to provide Ofwat with independent assurance as to the quality of companies' customer engagement and the extent to which it is reflected in plans. Within the consultation, Ofwat has raised questions as to the independence of assurance that CCGs are able to provide, and has not suggested that these issues could be addressed in future.

If we move to a model where in a very small number of areas, insight is undertaken centrally or collaboratively - and which by their nature should carry greater risk as they are complex, play an important role in regulatory mechanisms and need to be comparable (ie, some areas of willingness to pay) - then in theory, the level and nature of assurance required should change.

Where any research is undertaken collaboratively, consideration needs to be given as to how all parties who have a legitimate interest in that research can be assured as to its quality (for example, Ofwat, other regulators and companies' Boards (the latter is particularly important if companies are to take ownership of the level of risk and return within their plans).

Where companies undertake their own bespoke research, or use their own operational data (both of which we envisage should still comprise the majority of customer insight used to develop business plans), like other areas of business planning, companies' Boards should provide assurance, on the basis of carefully planned, risk-based assurance programmes.

CCW could have a role in the above, however, we would not want to compromise its ability to represent customers on the basis of its own research or to independently challenge the outcomes of price reviews.

In any event, Ofwat as a recipient of assurance, should provide early clarity as to its expectations. However, we do not think Ofwat should be mandating who the assurance provider is. Instead this is an opportunity for innovation.

Advice and challenge

The second role of CCGs has been to provide companies with advice and challenge on their customer engagement, and at times, more widely on the development of their plans. It's in this role that companies often most strongly cite the benefit of CCGs, and certainly from our perspective we have valued on-going challenge.

In the future, we want to retain this form of challenge but find a more efficient way of achieving it – and if the role of CCGs in future is less about providing assurance to Ofwat, and more about advising and challenging companies, then companies should be given discretion to devise a model that best works for them and their customers.

In our circumstances, we believe the success of CCGs to date would be best built on by moving to a model that:

- **Is more focused** – particularly on the quality of customer engagement and attracting expertise in those areas, including from CCW.
- **Uses more agile working practices** – a success of PR19 was to encourage companies to develop insight continuously – this requires on-going challenge and advice, and we believe is less suited to the more formal Board style working practices that CCGs have necessarily adopted given their past assurance responsibilities.
- **Complements other engagement (but does not duplicate it)** – on-going regulatory and stakeholder engagement is a hugely important part of companies developing high quality plans.

This should be informed by sound customer engagement, but it seeks to address wider questions than the core role of CCGs – are we taking appropriate action to meet statutory obligations? Can we collaborate or work in partnership to find a more efficient way of achieving targets?

- **Complements companies' assurance and governance frameworks.** If the model above is adopted, evidence of on-going challenge and advice could be one component of companies' wider assurance frameworks.
- **Is informed by the expectations of Ofwat and CCW.** It is helpful for Ofwat and CCW to continue to provide guidance regarding their expectations for engagement and to highlight examples of good practice that they would like companies to explore.

Given the above, we believe there would be a number of issues to consider before introducing regional CCGs – at least under their existing role of providing assurance. That is not to say that we do not believe there is value in greater company collaboration and insight sharing at a regional level - our experience to date of regional water resource planning suggests that sharing insights could help to provide new and fresh perspectives and help all companies uncover more value from their insight. But we would argue that the goal of common planning should be sufficient to drive this.

Q8: To what extent do you think that the research techniques which have previously been used in the water sector are suitable to enable companies' business plans and our final determinations to reflect customer views? Do you think any particular approaches should be revisited?

Q9: Do you think that there are alternative approaches that we might usefully adopt in water, including those used in other sectors and potentially outside the area of economic regulation? If so, which techniques and why? If not, why not?

Q10: Are there any areas of the price review where the scope to solicit informed opinions from customers is intrinsically limited?

Q11: Do you think there are other ideas we should be considering for shaping customer engagement at future price reviews? If so, how would these ideas help deliver on the goals proposed in this paper?

As noted above, one of the main areas we developed with our CCG was using the right approach in the right circumstances – as opposed to just focusing on new approaches and techniques per se.

During a price review, and as part of the usual course of our business, we will be engaging with customers on multiple issues – some driven and revealed by customers as important to them, others will reflect the questions we need to ask to develop a high quality business plan.

Big data, social media scraping and revealed preference all have an important role in price reviews, but so too do qualitative, deliberative and stated preference approaches – particularly if we are asking customers about longer term issues, or we are expecting them to answer as a citizen rather than through the lens of their own service experience. And in this regard, we believe that there is scope for greater use of qualitative approaches (which can be overlooked as they do not offer the comfort of a statistically robust samples or a quantified answer) like citizens juries and expert panels – where we consider longer-term, directional issues.

As CCW's research has highlighted, it's also important that we do not seek to engage customers on issues that they believe should be the preserve of technical experts. For example, by focusing on issues that affect their service, their bill and local area at a more detailed level, while asking 'bigger picture' questions at a more principled level.