

**Ofwat – PR24 and beyond:
Reflecting customer
preferences in future
price reviews**

– a discussion paper

South East Water response

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South East Water
Rocfort Road
Snodland
Kent
ME6 5AH



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1. Introduction

This paper sets out South East Water's (SEW) response to Ofwat's PR24 and beyond: Reflecting customer preferences in future price reviews – a discussion paper published December 2020.

Any queries in relation to this document should be sent to:



Overall comments

Most companies get direct feedback from their customers through purchasing decisions and choices. We operate as a monopoly and therefore don't receive that direct feedback. That means that other forms of engagement with our customers are even more important than they are for companies that operate in direct competition environments. As a regional monopoly, we also have a very broad range of customers, including people from all backgrounds and income groups, and we have a particular imperative to ensure that we take account of the needs and preferences of vulnerable and disadvantaged groups.

Customer engagement is therefore central to how we operate, how we make decisions and how we are regulated.

Engagement has undoubtedly increased over recent years, and it has become an integral part of the way that we do business. Companies and stakeholders' willingness to keep this going beyond 'Business As Usual' engagement and a more light touch in planning engagement, has been damaged by the apparent lack of interest and overwriting of findings, by regulators and stakeholders. This is a real issue and it is imperative that the agreed approach is bought into by all parties, or the link between companies, customers and outcomes will never be achieved. In an ideal world research should all be done locally and reflected in business plans and price determinations. We understand why there may be concerns about this process due to a lack of comparability. Our response below is framed as a pragmatic way of achieving local focus but also acceptability of results.

We are particularly keen to gain pre-agreement on what we can expect customers to have a meaningful view on, and where there is an expectation that decisions should be based on non-engagement activities. There is a common view that companies asked inappropriate questions to customers at PR19 due to complexity and other concerns. It may even be appropriate to ask customers where customers' opinions should be used and where they shouldn't.

2. Answers to questions/ response

Question 1 - Do you agree with the goals we have proposed for customer engagement at future price reviews? If not, why not?

In the round we agree with the goals that you propose to set for customer engagement in future price reviews

Enable Companies

This approach aligns with our AMP7 Engagement Strategy, which we are shortly to launch, for customer and community understanding. This strategy sets out our embedded process for delivering a deeper and broader understanding of needs of our communities and customers across the core areas of our business.

Recognise Preferences

Our AMP7 engagement strategy recognises the different roles and needs that may exist across our region between different groups, this is amplified within our region by two distinctive and differing regions (East and West Regional areas) with a varying range of community stakeholders and views.

Foster Collaboration

Over the last few years we have had a focus on collaboration in a number of key areas including vulnerability, environment and water efficiency. Additionally, as part of the Water Resources South East group, we have explored the opportunity to collaborate on water resources research with customers and community stakeholders. Whilst this can be seen as an opportunity for cost efficiency the need to understand local and regional needs requires robust data evidence. From our experience, this approach means that only limited cost saving with suppliers in the areas of design and development are potentially achievable, but easily lost in the negotiation of design.

Promote Transparency

We agree with greater transparency in two areas:

- a) Increased transparency into the way that companies have used obtained data and insight through engagement to determine their business decisions and planning, this is at the core of our AMP7 Engagement Strategy and we are currently developing an enhanced triangulation framework.
- b) Increased transparency from Ofwat - We would wish to encourage Ofwat to be more transparent in advance, on its intentions and on how **it will** use insight and data. This would enable companies and stakeholders to understand how insight can be improved to better meet Ofwat's needs. It was particularly opaque to us how Ofwat gained customer insights at PR19. Preferences expressed by customers and identified in our research appeared to be overridden, without it

being clear how such decisions had been arrived at.

Increase Proportionality

It is recognised that the CCW commissioned report (Blue Marble) determined that across the industry there were themes and topics that customers either struggled to understand the aspects of or did not wish to be engaged on. The Blue Marble review focused on many different company approaches and we think that this is a valid point. However, we feel that for most topics and themes, so long as customers and stakeholders are given the right material and informed in the right way, then understanding through qualitative approaches can be highly effective.

During PR19 a high reliance was placed on quantitative research and we accept that it is much harder to enable localised customer understanding, when differing methods are used and questions asked. For this reason we would support a greater emphasis on more qualitative methodologies being applied in these technical areas to enable customers to have their say.

We do support the concept of expert groups being formed for complex topics but would emphasise the need for retention of more localised regional groups to support the local and regional needs thinking that Ofwat are promoting in its 'recognising preferences' goal.

Broaden Value

We agree with the need for a better understanding of the view of customers and communities and particularly how local needs and priorities may differ across companies. A clear view on triangulating these differing views can sometimes be difficult and a consistent approach should be determined within companies' triangulation frameworks and through centralised core research whilst retaining company robustness of evidence and data.

Question 2: Are there any other goals which you think we should have for customer engagement at future price reviews?

South East Water would like to see Ofwat consider two additional goal elements:

- (1) Improved methodological clarity. Ofwat expect companies to provide ongoing engagement findings and insight. In turn, we would like Ofwat to provide a clear method on how that evidence will be utilised and triangulated, as part of business planning and service delivery improvements. We recognise however this could be drawn under the 'Promote Transparency' goal.
- (2) In relation to how Ofwat communicates with customers and communities around engagement activities. This would need to be carefully considered. It remains important for all companies to be seen to own the customer relationship (an enduring principle which we think should be maintained)

Question 3. 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?

We agree with the above principle. We recognise that results can vary based on the following key factors:

- The materials utilised to support customer decision making during the research
- The time spent working with customers in pre-task activities to inform thinking and mind-set

Despite our agreement we have some practical concerns with regard to the following areas at this stage including:

- Many companies have developed specific segmentation techniques to support engagement with customers. South East Water was the first company to develop its attitudinal segmentation approach which we continue to build on. We think this is an innovative and valuable approach to genuine understanding of customers. We would hope that Ofwat's approach will allow, or even adopt this approach.
- We agree that localised views are critical, and therefore the sample would need to remain robust at a company level, or alternatively each company would need to undertake mirrored research (we would not recommend this approach due to inefficiencies) to ensure local issues and challenges were reflected.
- In the past, cost has been a barrier to this. Given that engagement processes are now cheaper to undertake (on-line etc.) and that a central approach will be cheaper than separate approaches, cost should not be a barrier to achieving the appropriate reach across all companies.

Question 4. 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?

We agree that areas of common Performance Commitments alongside penalties and incentives should be included within the scope of national research.

We also recognise that willingness to pay, derived using consistent methods would allow a picture to be formed through a national lens.

It is our view that companies (and Ofwat) should collaborate at either national or regional level – our experience in regard to the Water Resources Management Plan collaboration is that this works well at a regional level, although as a Water Only Company there are elements that are required for Water and Sewerage Companies that are outside of our area of operations.

It is important for samples to be robust at all levels and should separate the water and waste service to allow comparisons across services and not just by total company. This is a particularly important consideration for WoCs and the research will not be useful otherwise.

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

This will depend predominantly on whether national or regional research is pursued but there are a number of participants that should play a part. Participation is the key to ensuring the acceptability of result to all stakeholders.

- WaterUK and UKWIR have an opportunity to play a pivotal role in steering this research and leading on research project management – this will also ensure that research leads remain independent for ensuring all companies are fairly represented and treated in joint research
- CCW should be involved.
- Academics – bringing new thinking and evolution to approaches

- **When should this research be undertaken?**

We recommend that this work is conducted in waves leading up to PR24. We need to be mindful of the effect that Covid-19 may have on attitudes, in either a permanent, or temporary way. We welcome the potential for:

PR24 changes:

- a) Introduce centralised national engagement whilst retaining company robustness
- b) Provide guidance on how data and evidence on additional research would be used and assessed

PR 29 changes would then focus on a larger overhaul and opportunity ensuring risks to business plan process is removed

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

Due to the unique differences in Dwr Cymru we would recommend this should be primarily for Companies in England with specific research being undertaken in Wales. We do not believe that evidence and data from Wales can or is comparable to England due to business structure.

Question 5: 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?

Research

It is our view that one of the challenges of PR19 has been the ability to compare some of the key business plan findings to better understanding comparative funding requirements. The methods, objectives and framing of research activities can lead to widely diverse understanding of participants and/or results obtained.

The scope for comparison on key themes is important, especially in the areas of customer preferences and priorities; willingness to pay, and common performance commitments and incentives.

We would welcome nationwide engagement of core themes using a common methodology and materials whilst maintaining the integrity of the localised, regionalised gathering of data and evidence to reflect differing customer views. This approach would therefore ensure that results were consistent. The remaining differences would be truly

reflective and comparable, whilst also providing company results for business planning purposes.

Obtaining these centralised results would then enable companies to focus on undertaking any enhanced research using innovative approaches around the remaining elements of their plan design.

If Ofwat is at the heart of that process, co-creating core research alongside companies, would remove the need for protracted guidance on customer engagement for these core areas. We assume that this will be the case for core ODIs. We also expect there still to be room for specific, company led engagement.

If, as we assume, Ofwat intends to assess the engagement of companies as part of the business plan process, it is important that the criteria for such assessment are established in advance. Because this is an area in which subjective opinion is important, if Ofwat does not publish its assessment criteria in advance of its assessment, the process has a random and arbitrary element to it.

Customer Challenge Group

In the paper the role of the Customer Challenge Group ('CCG') is discussed with a particular emphasis on how energy utilised company and national groups to fulfil different roles within RIIO-2.

The South East Water CCG membership is based on a skills requirement matrix that ensured we had the correct experts in the group to support the business plan process having transitioned from a 'customer' membership. We believe that this created a successful group. Participation was in line with Ofwat scope, and provided the challenge to us that was intended. This being said, we do accept that there remained areas of challenge as group members looked at scope of RIIO-2 groups and process.

During AMP7 we have chosen to remain committed to our CCG model having refreshed 50% of our independent membership and the current scope of this group is:

To provide independent scrutiny, advice and challenge to SEW regarding:

- a) The quality of its stakeholder engagement and insight
- b) The extent to which the results of this insight is driving decision making
- c) How and the extent to which SEW is delivering against its promises to customers in the business plan

CCGs predominantly act as assurance on activities, and we recognise that utilising a centralised set of core research activities with Ofwat being part of the Steering Group would remove that localised assurance need.

We do not feel there would be any need for assurance of centralised research as high quality and robust engagement would be achieved through the inclusion of appropriate participation on the Steering Group from independent academics, research and insight expertise informing the design alongside industry and regulator representation.

As mentioned in other sections of this response, additional enhanced engagement (in non-centralised areas) would require assurance. This could be achieved through either a CCG, or a Peer Review process (commonly used in other sectors) to validate the quality and robustness of the engagement alongside triangulation of data. This Peer

Review Process would utilise academics or other suppliers to review, assess methods and provide a view on assurance of the work conducted by companies and companies could then best choose their own model for the design and development of their enhanced research, which could include;

- Reliance on the chosen research supplier to provide a quality designed research method
- Third party review in the design stage from supporting external experts (which could also be a CCG style group)
- Rely on internal skill sets in the design of the method

Overall, we observe that the CCG was a value-adding element of PR19, delivering independent and robust challenge. We note that the resource required by both the company and CCG to make the process effective was substantial. It is important for all stakeholders to understand how CCG evidence is used in the price review process – for example it was not clear to us how CCG reports and findings influenced the determinations made by Ofwat. If CCG input has limited impact in the price review process we would question whether the CCG should be a part of the formal regulatory process or whether they would be more effectively used by the company in a more advisory/challenge capacity.

Question 6: To the extent that you consider further guidance is necessary, what areas should this cover?

We feel that centralised co-ordinated research is essential for ensuring comparable results that reflect accurate regional comparisons i.e. customer response across England using the same questions, materials and methods that deliver robust results. This approach is reflected across our response to this paper.

We feel guidance, if issued, would relate to enhanced engagement activities for individual companies and should focus particularly on;

- minimum standard expectations - this could provide an initial view of where qualitative approaches would be deemed acceptable and where quantitative methods would be seen as a minimum
- data expectations – Ofwat’s view of what data it expects to receive as a minimum for assessment
- assurance expectations – what minimum standard for research is required by theme as we recognise that some research is less critical to the planning process than others
- weighting – the extent to which customer research will be considered in Ofwat’s decision making in the round for particular topic areas

Through issuing this guidance then companies can determine the proportionality of focus for each topic area in research.

Question 7: 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?

Our response in question five has recommended that where assurance is considered necessary (we suggest that centralised core topic research is undertaken nationally assurance would not be required), then companies may choose their preferred assurance model, which could range from;

- peer review approach
- single expert working alongside company in design, development and triangulation stage
- panel of experts (CCG style) working alongside company in design, development and triangulation stage
- a combination of the above – different approaches for differing topic areas to enable proportionality

This flexible approach enables companies to choose a model that is most efficient and effective to achieve the organisations business planning process outcomes. This approach is also achievable without centralised research as companies would simply provide assurance against each engagement aspect.

Question 8: 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?

Our fundamental approach to this response is that centralised research enables true comparison. Whilst similar research is currently undertaken by all companies the differing questions, methods, even timing, can create a set of influences that provoke customers to provide different results. We recognise that it is difficult for true comparison to be achieved with companies undertaking their core research for the reasons outlined. It is therefore difficult to unpack true differences in customer preferences and priorities, from the impact of the question formation or timing which could be influenced by external events.

We have paid close attention to the CCW commissioned study undertaken by Blue Marble, examining companies' approaches to customer engagement at PR19: 'Engaging water customers for better consumer and business outcomes'. During PR19 we worked hard to help our customers understand complex issues and ensure they provided answers to complex questions. Customers have said there are certain areas which they find difficult, such as resilience, and areas where they are trading off small risks.

Our current research on both our collaborative work with Water Resources South East (developing the regional Water Resources Management Plan), and our most recent work relating to our Drought Plan, has enabled us to see that using a more prolonged and staged approach in the qualitative stage, has enabled customers to understand complex issues such as drought to a more significant level than ever.

We support the view that quantitative surveys are not suitable for all types of research and should not be always be relied upon at the expense of qualitative research.

Question 9: 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?

The approach taken in Scotland appears to have been successful in setting charges through a negotiated settlement approach. The process is worth exploring, but as with all such techniques in Scotland needs to be considered in the context of a one to one relationship between Scottish Water and the regulator and the customer forum.

In our opinion, the transition to this type of new approach is not a simple decision as the potential consequences and working arrangements need to be considered. As we are already collecting and curating our AMP7 PR24 evidence and data we would suggest that Ofwat consider any alternative substantial approaches in the context of price reviews beyond PR24.

Question 10: Are there any areas of the price review where the scope to solicit informed opinions from customers is intrinsically limited?

It is particularly difficult to obtain meaningful opinions from customers in three particular areas:

1. Small risks. Economic theory suggests that customers find it hard to assess small risk accurately (which is what makes things like the National Lottery possible). As a result it is very hard for anyone to understand the likelihood of something such as a supply interruption, especially when they have never experience such a thing.
2. Long term decisions. It is not easy for customers (or indeed anyone) to assess risks that are far in the future. Water industry assets often have lives in many decades, but most customers simply do not practically think in these time scales. Any such engagement, therefore, has a bit of an artificial feel to it.
3. ODI Stretch. It was not easy to achieve meaningful results from customers in this area and both us as a company and our CCG agreed on this as a difficult area without significant deliberative research being undertaken.

In addition a key factor to consider is the large difference between the price of water and the value of water. Customers pay a small fraction of the value of the service in their bills. This is a wonderful feature of our industry, which means we are constantly delivering significant public value, or consumer rent. However, it can make it difficult to engage customers in meaningful decision making.

We feel that these are valid observations, but don't detract from the need for, and importance of, customer engagement. We are a natural monopoly in many of our functions. We therefore need mechanisms which allow us to understand our customers' opinions, and make them central to our choices. When processing those opinions, we need to be mindful of the limitations of such research, but also recognise that it is the best way we have, to understand what we need to do. The quest to improve ways of understanding our customers is, and will continue to be, a central challenge for our industry.

Question 11: 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?

We are supportive of innovation and evolution in this area, and have contributed to the innovation in the industry, particularly through our approach to segmentation. We feel that there are many more opportunities and emerging innovations in this area, particularly in our highly digitalised era.

For this reason we would like to see a more long term review group of industry and regulators working with customers, communities, academics and other participants to look at longer term sustainable models that can also adapt to the changing environment.

Contact Us

South East Water
Rocfort Road
Snodland
Kent
ME6 5AH

southeastwater.co.uk

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