



David Black
Chief Regulation Officer
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA



Nicola Cocks



[Redacted]



[Redacted]

29 January 2021

Response to PR24 discussion paper on reflecting customer preferences

David,

Thank you for the opportunity to share our views on the customer engagement goals and approaches as Ofwat proposed in the PR24 discussion paper on reflecting customer preferences.

We agree and strongly support the proposed six goals. Achieving these goals in collaboration will strengthen the confidence of business plan decisions for both companies and regulator. It will also improve the effectiveness and value for money of customer research and deliver more for customers through greater public value.

We also recognise that customer engagement sits at the core of companies' wider stakeholder engagement. It would be beneficial to have another goal on integrating stakeholders' priorities so that any engagement will make clear the consequences and cumulative impact of customer or other stakeholder preferences. It would also mean enable companies to balance stakeholders' priorities in their business plans based on transparent and proportionate evidence.

We have carefully considered the three proposed ideas in delivering these goals and provide detailed responses to the individual questions in the annex. We summarise our overall thinking below:

- Centralised research would promote consistency but needs to recognise the dispersion of customers' views so that the evidence fairly represents customer preferences from different regions and demographic backgrounds. Companies may also have specific timing and granularity requirements in order to inform their business plan decisions.
- Further guidance on how nationwide research and company-led research fit together and how customer preferences are integrated with wider stakeholder priorities at future price reviews will encourage collaboration and transparency.
- The robustness of valuation research can be strengthened through triangulation of multiple customer evidence in a consistent and transparent manner. Companies increasingly draw insight from daily interactions with customers.

We appreciated Ofwat's workshop on 22nd January, which provided an interesting industry-wide discussion on customer engagement in future price reviews. It will be beneficial to have further workshops in the coming months so that companies can contribute ideas and share thoughts on the design of nationwide research, triangulation approach, assurance models and innovative techniques in capturing and reflecting customer preferences.

We hope that our response provides useful ideas and suggestions for consideration. We are keen to work with Ofwat and other water companies in progressing the ideas set out in Ofwat's consultation document, and which we have built on in our response.

We look forward to working with you and other companies as well as industry groups in developing these areas for PR24.

Yours sincerely,



Nicola Cocks
Regulation Director

Annex

In this Annex we provide our detailed comments on each of the questions raised in the discussion paper on reflecting customer preferences in future price reviews.

Goals for customer engagement in future price reviews

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

We strongly support the goal to **enable companies** to take responsibility for their relationship with their customers. Customer engagement goes well beyond researching customer opinions and acting on them. Many positive outcomes stem from actively engaging with customers. Whether that be customers who are more satisfied because service interactions are better tailored to their needs and expectations, better performance on core service issues like supply interruptions or sewer flooding, a more beneficial impact on the environment through less pollution and reduced river abstraction because of customer behaviour change, lower bills or less disruption to communities. This will also result in an enhanced level of trust in companies and the wider industry, which in turn can help fuel a virtuous circle where improved advocacy leads to enhanced engagement.

On the **recognising preferences** goal, we believe it is important to consider how geographic, economic, social, political and demographic differences can affect customer preferences and perceptions. This enables companies to better connect, understand and respond to customers' diverse needs at local community and regional level. It also promotes transparency among companies when the differences in customer preferences are well recognised in a consistent manner.

We agree that **greater collaboration** has the potential to provide more consistent and robust findings and reduce costs for more generalised issues. Collaboration helps to standardise research data that may not have been the case in previous price controls. We also consider the opportunities of working with other 'stakeholders' on customer preferences to be beneficial.

To further foster collaboration Ofwat may like to consider how it incentivises and recognises companies for sharing best practice.

We have long been a proponent of sharing best practice across the industry. Early in PR19 we convened an industry conference, with CCW and Ofwat, for research consultancies and water companies to share their techniques and recommendations and to consider new approaches to customer engagement.

We support Ofwat's goal to **promote transparency** in reflecting customer preferences. We particularly welcome Ofwat's view that transparency has two aspects: it is important to gain transparency on how companies research customers' views, triangulate different findings, and use the outputs in business plan decision making. It is equally important that there is clarity around how Ofwat reflect evidence of customer views in its price review decisions. We consider this would be a key area of focus for PR24.

On **proportionality**, we think it is necessary to recognise the areas where we can have meaningful conversations with customers, and apply a more adaptive and focused approach with high quality engagement in areas where customer preferences can have the greatest impact. This will improve both efficacy and value for money.

Our experiences at PR19 lead us to agree that companies are able to have meaningful engagement with typical customers in the following areas:

- Service received: including direct and indirect experience for water, wastewater and retail services. E.g. water pressure, blockages, service recovery, account management options;
- Price paid: E.g. bill levels, tariffs, profiles, sharing across generations; and
- Wider impacts on community, environment and society that customers care about.
 - a. Community impact: roadworks & site, traffic, odour, noise, nuisance, amenity.
 - b. Environmental impact: biodiversity, river health, climate change.
 - c. Society impact: jobs & training.

We have experienced challenges to engage customers on some of the more technical topics such as incentive design (caps/collars/deadband, standard & enhanced rate etc.) and aspects of company financing (e.g. gearing, RORE). These are areas that would benefit from industry best practice sharing and potentially regulatory guidance.

Also, we increasingly gain insights from daily interactions with our customers, rather than rely on dedicated research, to inform our continuous service improvements.

We welcome Ofwat's goal on **Broaden Value**, and we believe environmental, societal and wider public values are integral to our service delivery. When undertaking research, we frequently ask customers to view water and wastewater services in the context of the wider impact on community, environment and society, and, if necessary, to consider the right balance between them.

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

We consider the proposed goals are comprehensive. We also recognise that customer engagement sits at the core of companies' wider stakeholder engagement. Companies' business plans are responses to customer preferences as well as other stakeholders' expectations and requirements. From this perspective, it would be beneficial to have another goal on **integrating stakeholders' priorities** so that any engagement will make clear the consequences and cumulative impact of customer or other stakeholder preferences and companies are enabled to balance stakeholders' priorities in their business plans based on transparent and proportionate evidence.

Stakeholders / pressure groups may have strong interests in particular aspects of the investment proposals and business planning process, some are complex and technical topics, e.g. storm discharges and chalk streams. WRSE have already demonstrated a reduced level of interest in chalk streams in their initial customer research, which contrasts strongly with the direction we are receiving from Government, environmental regulators and stakeholders to do substantially more for their restoration. Our broad customer base is primarily more interested in the environment in terms of litter, which may not be the most pressing environmental issue.

We think there is a place for **special interest group research**, which would include communities in hotspot areas and local stakeholders with particular interests. We expect such stakeholder research will have a proportionate influence on customer preference research.

We recognise that consultation and research is a discipline in itself, it has to be led by those with expertise and experience in that discipline. We will work with Ofwat and the rest of the industry to explore how to design the methods both at a company level and nationally.

Idea 1: collaborative nationwide research to inform common areas of business plans

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?

Yes, we agree in principle that a consistent approach to generate evidence of customers' preferences will enhance confidence in the results, in areas of common concern to all customers across the industry, especially in cases where consumer preferences are likely to be stable. Collaborative nationwide research could help to achieve such consistency, and in a way that reduces costs.

Whilst customers would share common concern in certain areas, it is important to capture the **dispersion of customers' views** so that the evidence fairly represents customer preferences from different regions and demographic backgrounds. We also need to recognise that companies may have specific timing and granularity requirements for the evidence of customer preferences in order to inform their business plan decisions.

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?

We can certainly see opportunity for centralising **acceptability testing** and making it consistent across the industry. The evidence we are likely to get could be directional in nature such as customers' support for "higher" or "lower" final bills in the acceptability test of companies' proposed business plans. Similarly, a nationwide **affordability** research would provide comparable insights on the extent that customers support further investments for enhancement using their disposable incomes, providing the research has considered the demographic spread of customers from different regions.

Long term resilience, environmental aspects and **public value** are also likely in the areas of common concern for all customers, and collaborative nationwide research will help the industry develop a richer understanding of people's views as citizens as well as customers. That said, it should be recognised that there are likely to be regional/local differences. For example, not all environmental pressures are evenly split around the country and customer preference has previously been shown to be linked to the quantity of high-quality environment already available in their area. We have also previously found that there is higher willingness to pay for improvements near to where people live. This then gives rise to higher environmental value to improvements in more populated areas, or in areas with currently the lowest amount of high/good quality environment available to them (like Thames Water supply areas).

Another potential aspect for collaborative nationwide research would be **valuation research** for common measures and other comparable measures. It is important to consider:

- How geographic, economic, social, political and demographic differences can affect customer preferences and perceptions; and
- Companies may have specific timing and granularity requirements for the evidence of customer preferences in order to inform their business plan decisions.

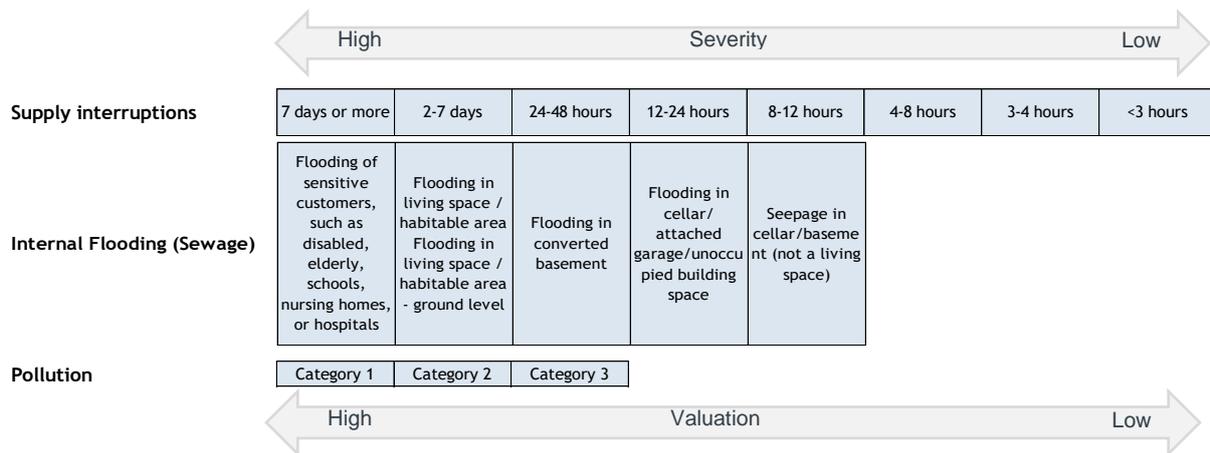
It may also be possible to centralise research that involves **'testing'** of approaches and options, e.g. proposed changes in market, social tariff cross subsidies. Centralised research

on social tariffs may derive an academic view initially, and needs to consider how demographic background would affect customer preferences in supporting cross-subsidies. DEFRA's current code of practice includes a process of customers support on cross subsidies that companies shall follow. CCW's affordability review sponsored by DEFRA is examining the best way to establish a social tariff cross subsidy, which would be a vehicle to develop potential methodology change for the sector. We recognise the importance of social tariffs in protecting vulnerable customers, and we have designed our social tariff for AMP7 period with strong customer support. We look forward to working with Ofwat and other stakeholders to take this forward.

We also consider there could be opportunity to use nationwide research on some complex but critical topics like **intergenerational aspects** including future customers and **fair return**. The consistency in collaborative nationwide research would enhance the credibility of the findings.

There are some **practical considerations** connected to cross-industry collaboration and commissioning research jointly:

- The Outcomes framework of a business plan is a package of both common and bespoke measures. Our research studies in the past have included a mix of both and at PR24 we will expect to approach research on **common and bespoke measures** in a consistent way. It may also be difficult for us to research the bespoke aspects of our plan in isolation. Customers may prefer the opportunity to talk about common areas when we are seeking their views on more bespoke topics. Many performance measures are interlinked (blockages can affect internal flooding), discussing common and bespoke measures together will provide customers with the necessary context for a more meaningful conversation, and help reveal customer preferences in the round.
- Individual companies will have specific requirements around **timings**. Research findings will need to be delivered in time for them to influence decision making. For example, during PR19 we conducted multiple rounds of valuation research and acceptability testing to inform different stages of our plan formation. We intend to develop initial bottom-up business plans for future AMPs in Year 2 of the current AMP, which will then be refined in Years 3 & 4 in a cyclical process.
- **Segmentation and sample size** in nationwide research can proportionately represent the geographic and demographic differences that companies serve. Findings may differ within company boundaries as well as between companies. The number of interviews need to be broadly proportional to the number of customers served rather than use the same fixed number of interviews for each company.
- The **granularity** of nationwide research results needs to be sufficient to inform individual companies investment decisions. This is particularly important for valuation research, as valuation can vary based on the duration, frequency, severity or location of specific metrics. The diagram below illustrates the structure of valuation we have developed for supply interruptions, internal flooding and pollution incidents. Valuation varies based on the duration of supply interruption, location of internal flooding, and category of pollution. Our decision support tools apply valuation data in this structure for risk assessment and cost benefit analysis of investment options.



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

Water companies are ultimately responsible for managing their relationships with their customers and responding to their needs. Therefore, we consider water companies should directly steer the nationwide research. Regulators (Ofwat, EA) and other industry groups including CCW should be consulted and informed so that the collaborative research focuses on the price review agenda and reflects customers’ common concerns. Bodies such as Water UK could also support this process.

If the research is steered by non-water companies, there is a risk that the research design will not reflect relevant information required for the business plan development and may dilute its effectiveness.

When should this research be undertaken?

As mentioned above, individual companies will have specific requirements around timings. Research findings will need to be delivered early for them to influence decision making. For Thames Water, we intend to develop initial bottom-up business plan for future AMPs in Year 2 of the current AMP, which are then refined in Years 3 & 4 in a cyclical process.

In practice, we think there is merit to having **multiple rounds** of collaborative research to identify common concerns and priorities, to develop detailed research on specific topics and then update and refine the evidence taking into account multiple sources of information. This will also help tackle the issue of unstable preferences.

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

We recognise that the UK and Welsh governments are currently reviewing their strategic priorities statements (‘SPSs) for Ofwat in England and Wales respectively. This may in turn influence future investment priorities and / or customer preferences. The sector will need to consider the implications of the revised SPSs once these are published.

Idea 2: consider the need for prescriptive guidance from Ofwat on customer engagement

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?

We recognise there is a limit on suitable areas for nationwide research, and some research must remain at a company-level. Furthermore, customer engagement is an essential part of wider stakeholder engagement. The sector will need clarity around regulatory expectations on how the different strands fit together. Therefore, further guidance on how nationwide research and company-led research fit together and how customer preferences are integrated with wider stakeholder priorities at future price reviews will promote collaboration and transparency.

We are particularly interested in the extent to which companies will be bound by national surveys in their future business plans.

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

Areas that would benefit from further guidance include customers' valuation and triangulation, acceptability testing, as well as how engagement should be used to inform regulatory devices such as PCs and, if necessary, ODIs.

We also think it is a great opportunity for companies to share best practice and define an industry approach together, through the initiative of collaborative nationwide research. We are keen to share our practices and thinking, and collaborate with the rest of the industry to support Ofwat in developing regulatory guidance for future customer engagement, considering the following areas in particular

- How will nationwide research be used in companies' business plan decisions (e.g. acceptability testing, cost benefit analysis, PC & ODI design)?
- How to promote a consistent approach between nationwide and company-led local research, among common PCs and bespoke PCs, whilst not discouraging innovation.
- How to triangulate customer evidence from different research and engagements including insights from daily interactions with customers. These will build on industry research (e.g. CCW triangulation research¹), lessons learnt and best practices.
- How to prioritise and balance the different sources of evidence if material differences arise between findings from various research and insights; how to prioritise and balance different preferences from customers and other wider stakeholders.

¹ [CCW – ICF Defining and Applying Triangulation in the Water Sector](#)

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 consider that CCGs have made significant contribution in providing independent challenge to companies and independent assurance to Ofwat on the quality of a company's customer engagement; and the degree to which this is reflected in its business plan.

We believe company level CCG can continue playing an active role in both the price review and in-AMP delivery to help the company to focus on delivering for customers.

Our CCG, made up of diverse and experienced members, acted as an objective sounding board during PR19, challenging us to focus on delivering for customers and also the environment. In the core period of developing PR19 business plan, we had monthly sessions with our CCG to review customer engagement and how we have applied it in our outcomes and business plan. Throughout AMP6 delivery, we met with our CCG quarterly, sharing information on our performance against our performance commitments. When relevant, various members of the Executive Committee provided additional performance information and members of our Board attended on many occasions. This ongoing involvement provided an independent view of our performance and helped us to focus on areas of particular concern to customers.

We welcome the support from Ofwat on how the CCG input will be used going forward, recognising the valuable contribution the CCG can make toward informing our PR24 outcomes. We are keen to actively work with Ofwat to improve the design of the CCG for providing assurance at future price reviews.

Idea 3: better capturing and reflecting customers' preferences

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?

We consider the conventional valuation research technique like Willingness-to-Pay (WTP) provide a relevant and plausible quantitative information to inform business plan development (e.g. cost benefit analysis), and our WTP research has followed best practice, as assessed in the PR19 IAP.

The robustness of valuation research is strengthened through triangulation of multiple customer evidence in a consistent and transparent manner. In addition to using stated preference and revealed preference to establish Willingness-to-Pay, companies can also draw evidence from deliberative and behaviour research, market value and insights from ongoing interactions with customers. Triangulation is the use of multiple data sources and/or research methods to produce a common perspective or understanding of customer preferences. It is:

- A means for cross-checking, validating, and providing confidence in research findings;
- An ongoing iterative process that integrates new sources of evidence as they become available; and
- A proportionate process - the larger the investment or customer benefits, the more sources and validation that is required.

There might also be areas that customers are not intuitively able to express their view or preference because of the lack of direct or indirect experience, such as asset health in water networks and resilience in water resources. A risk and benefit mapping between asset health and service outcomes to customers and environment would enable companies to translate valuation on service measures to asset health measures. Such mapping also provides useful context for customer engagement to stimulate a more meaningful conversation. A similar approach could be explored for long term resilience topics. We are keen to work with the industry to further improve the robustness and effectiveness of customer research in these challenging areas.

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?

We consider there is merit in incorporating a Citizens' Assembly approach, which would build on and deepen the deliberative research approaches currently used in the water sector.

A group of customers, chosen to reflect the wider customer base or community within it, would be brought together to discuss aspects of the business plan and reach a conclusion about what they think should happen. This approach would give members of the public the time to learn about a topic and discuss it with their peers, before reaching conclusions. Participants would also be asked to make trade-offs and arrive at workable recommendations.

The water sector can also explore a wide range of other research techniques to complement the conventional approach and broaden our understanding on public value:

- Experimental research using behavioural economics;
- Immersion techniques to explain complex scenarios;
- Deliberative research sessions such as extended workshop, present a range of information and encourage differing points of view and perspectives to be presented;
- Gamification in engagement tools to visualise complex trade-offs and encourage more participation;
- Expert panel method to discuss more technical or specialised topics; and
- Use of proxy data from other sectors price controls or general market research, market intelligence for hypothesis making from our community activities.

We also note that companies are increasingly drawing insights from daily interactions and other big data like social media. All of these need to be brought together to inform both business plan development and continuous service improvements.

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

We have experienced challenges to engage customers on some of the more technical topics such as incentive design (caps/collars/deadband, standard & enhanced rate etc.) and aspects of company financing (e.g. gearing, ROE). These are areas that would benefit from industry best practice sharing and potentially regulatory guidance.

Evidence from the behavioural economics literature identifies a series of biases that have an impact on consumer responses². Customers may exhibit confirmation, loss aversion, and anchoring biases that influence their responses to questions. These biases may interact in

² Dan Ariely, Predictably Irrational Harper Collins 2008, Edward Cartwright, Behavioural Economics Routledge 2011

cases where the research design asks consumers to rank their preferences or make more complex trade-offs. Great care must be taken for researchers to consider how to limit the degree of complexity introduced to respondents during the course of the survey.

General

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?

The pandemic has challenged companies' approaches to customer engagement and support in delivering outcomes, with many activities shifted to an online format. The acceptance by customers and the effectiveness of virtual engagement through online platforms has increased significantly in 2020.

We think there is a case to build on these positive practices, and further develop an online research community with industry open data that reflects the demographic features and service risks in local areas that individual companies serve. We consider the online research community will have high potential to enable ongoing engagement on a wide range of selected topics in a more efficient manner, in alignment with the proposed goals of recognising preferences, increasing proportionality, and broadening value.