United Utilities Water

Response to Ofwat's discussion paper on public value in the water sector

United Utilities welcomes Ofwat's discussion paper on public value in the water sector and the opportunity to comment. We are pleased to see featured in the paper many of themes we covered with you in our public value discussion last Autumn.

We support Ofwat's position that "companies will need to be run with a clear purpose, adding wider public value for customers and communities as well as for shareholders" as this has been our view for many years. We agree that where companies have fallen short in demonstrating this in the past, it has damaged the reputation of the sector and been to the detriment of public value perceptions. Through better demonstrating the purpose-led nature of a company and communicating this more effectively, companies can improve legitimacy and reputation amongst the customers they serve and the public more widely. This can only help in tackling the challenges ahead.

In summary, we believe it is right for Ofwat to expect water companies to demonstrate how they create and provide value to all stakeholders, including through delivery of purpose objectives.

In this response, we offer some observations under the three headings set out in the discussion paper:

Scope and Ambition

a) ***External factors and constraints***

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?

Delivering public value should start first with effective delivery of core services. Once this is established, companies can then look to go further and optimise public value outcomes. These may be influenced by many factors including a company's location, situation and behaviour.

From the perspective of location, environmental factors (e.g. levels of rainfall, topography, length of coastline), social factors (levels of deprivation, age profiles, local and devolved governance) and economic factors (urban versus rural economy, industrial base, population growth and seasonal migration) all influence how value is generated and how actions taken by the company are perceived by its stakeholders.

From a situation perspective, the way in which companies have managed assets inherited at privatisation (land, age of infrastructure), prioritised investment since then (environmental, quality, customer), responded to opportunities and incentives in financial markets, pension arrangements, and ownership models, all contribute to different foundations upon which they can seek to build public value. Public value can also be delivered through non-core services such as access and recreation, education and training and through the activities of organisations within company supply chains.

Past behaviour has varied across companies, some of which has rightly been highlighted as falling short of expectations for responsible businesses. These feed the external context in which companies are seen and is not supportive when companies, by necessity, go on to explain the difficult decisions and trade-offs that they have to make in delivering against competing priorities from different stakeholder groups. However, with renewed focus and stimulus, companies should be able to improve this position, particularly by evidencing the actions they take to work in partnership with other organisations and communities to maximise the prospects of delivering better public value. This can create a virtuous circle of improvement in both outcomes and reputation.

b) Risks

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

A key risk is that despite the best intentions of a company, its stakeholders do not see value in the actions taken, rejecting the trade-offs or decisions made. Proving value-led decision-making is challenging but to prove that a company's purpose is being fulfilled needs to move beyond words and on to the measurement of outcomes.

The sector must guard against the risk of 'purpose washing' where headline proclamations herald purpose-led initiatives but where proof that value has been delivered is lacking. Any incentives set for companies should reward the delivery of outcomes and value, not process and plans.

To offset these risks, companies should demonstrate they understand the issues that are material for each of the stakeholders they serve – including but not exclusively customers – and evidence the way in which companies are adding value (and also acknowledging where this has not been achieved whether as a result of company action or otherwise.)

Focusing on those material issues would help address a further risk, which is the difficulty in establishing any universal framework for public value. A universal framework raises questions about definition, scope and measurement as well as consistent application and assessment of outcomes. In this regard we believe parallels could be drawn with other regional planning frameworks such as the water resource management planning which is a material issue for many stakeholders. Each company will produce a plan that will often contain similar items and which is established within a single objective framework. However, the specific factors which impact its local region drive the plan, the approach to stakeholder engagement, and the credibility and acceptability of that plan to those who are served by it.

c) Culture

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 are clear that a company cannot be purpose-led if this isn't evident in the culture of the company and/or where the actions of the company do not reinforce such a culture. We recognise that it can be challenging to provide proof points on culture and to reconcile with other issues equally as important, such as a health and safety culture, or 'customer first' culture. Explaining that each of these is part of a purpose culture makes sense but the communication is challenging.

Culture is one aspect of delivering better public value outcomes and permeates through the governance, structures, systems, measures, targets and behaviours – both corporate and individual – that a company has in place. The maturity (strengths and weaknesses) of companies across these aspects will vary and some will require more targeted approaches in certain areas than others. If a company wants to prove it is embedding its purpose, it needs to build stakeholder confidence and understanding in each of these areas.

Incentives and barriers

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

a) Regulatory framework

There have been positive developments in the regulatory framework from a value perspective. The focus on outcomes is welcome and a significant step forward, although the challenge to measure this is not be underestimated. Indeed, there are few companies in or outside of the water sector that have robustly embraced outcome measurement. This is not because of any lack of commitment – this thinking is relatively immature, extremely challenging, lacking standards and principles and companies do not wish to increase reporting overhead.

Although the ODI framework has helped, measures still focus largely on delivering outputs. Value is generally realised for companies (and investors) through financial rewards and to customers through improved service performance.

UU's natural capital performance commitment and outcome delivery incentive points to a broader approach, based on providing additional public value through changing our approach to solutions – this type of measure and incentive is innovative and an important step to incentivising greater public value under this framework. Much more work is needed to understand how broader environmental and societal value would feature under such a framework e.g. how greater access and recreation on water company land contributes to society's health outcomes and how this could be funded.

In our view, the regulatory enablement of purpose would be enhanced where companies were given more leeway and discretion about how to deliver for customers through – for example – greater latitude for companies to make decisions on how and where to invest to deliver for customers and communities on the most holistic basis. This would, of course, require greater regulatory forbearance and trust and we recognise that this is a challenging ask given both the monopolistic nature of the sector and the damage to trust that has occurred due to some past behaviours by some companies. Nevertheless, we believe it is important that the sector, its regulators and other stakeholders take steps to re-emerge and re-engage to build the trust to facilitate flexibility and enable superior outcomes which go well beyond following a series of rules or regulations.

b) Encouraging public value

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

We consider that there are two key ways in which the price review can serve to encourage and incentivise company delivery of public value.

The first is to recognise and reward companies that are stretching their performance and demonstrably delivering public value which goes far beyond the baseline standards that stakeholders expect the sector to achieve. This would recognise and reward the additional effort and stretch by management in striving to deliver public value with the twin benefit of delivering more in the region and also of providing examples which could be followed by the sector more generally in pursuing a purpose agenda.

The second is to facilitate a framework for outcomes and incentives which provides more room for trusted companies to innovate and act with some freedom and discretion in order to maximise the opportunities to deliver public value in addition to the core service offering. We consider that approaches such as our Natural Capital Performance Commitment make a good start on this, but that if there was some added flexibility of scope and application of the ODI the opportunity to deliver natural capital benefits would be substantially greater. This does involve a greater degree of trust from the regulator that the company will behave responsibly in using any discretion it is afforded; however, we believe that for companies with a strong track record of commitment to purpose – and its actual delivery - that such an approach is both justifiable and implementable.

More generally, we welcome the recognition that delivering public value goes much further than delivering core services at an efficient price with affordable bills. There is scope to investigate, as UU has, the value arising from performance improvements. For example, there is a wider value to society reducing the number of water supply interruptions than just what customers value – supply interruptions can have economic consequences too (closed schools/businesses) and we are looking to investigate and demonstrate how this value can be estimated and considered. Likewise, there are wider societal benefits from fewer customers being in water poverty and, if this matters to society, there should be scope for us to do more in this area. We expect that a framework – including the price review framework – which embraces a broader approach to estimating value could significantly alter the composition of approved company investment plans.

We would advocate that the price review process should seek to encourage companies to consider broader valuation techniques and, where robust evidence is presented, that such representations are considered as providing justification for programmes of work. Looking at business planning through a value lens will result in new solutions – already this is evident with natural capital solutions but value manifests in other forms too, such as human and social capital. In this vein, we believe that the price review "Cost Assessment" framework should be redeveloped as a "Cost and Value Assessment" to take into account additional value that can be delivered through company investment which may not be captured in historic cost or output models.

Understanding impact

What are the markers of progress on public value, both in the context of enabling culture and outcomes?

To build trust and demonstrate value, transparency is key. Companies must disclose what they do, and why, and explain what value it is generating in a manner that is relevant to the stakeholder group at which it is targeted. Increasingly 'one size fits all' communications will not reach stakeholders who form as a community with a specific interest binding them together. Information that companies disclose should focus on subjects that are relevant to as many sector audiences as possible, not the things the sector cares most about.

Markers of public value will be influenced by the topics material to the companies' stakeholders. If changes to culture, governance, structures, systems, checks, measures, targets and behaviours are required because the activity/area of focus is relatively new, then disclosing progress in implementing such enablers may be necessary but should be limited. That's because what we believe matters most is what has been done and delivered, and that companies should be able to satisfy their stakeholders they are delivering value with the right performance and management measures in place. This will evolve over time as value and outcome measurement matures.

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?

Ofwat should expect companies to demonstrate the value they are delivering as part of their core services and beyond. This should go beyond annual reports (although it should be recognised that the evolution of integrated reporting and the communication channels used has significantly broadened the audience for such documents) and be evident throughout communication and engagement with stakeholders – including through bespoke reporting or publications directed at specific stakeholder groups.

Given the external factors referred to in the first question, it will be difficult to create for Ofwat – or any organisation – a set of standardised metrics and we would not advocate a standardised approach which leads to a compliance or "box ticking" mindset. A broader framework that defines value in a water sector context but allows companies the freedom to define value for the issues material to its stakeholders and to innovate to deliver them would be more appropriate. For example, we believe there is considerable value to society through what UU can do with our catchment land but not every company has the same level of opportunity. It would be right for Ofwat to expect us to demonstrate how we are realising that value but not to prescribe how that should be done.