

Public value in the water sector

Severn Trent Response

9 February 2021

WONDERFUL ON TAP



Summary of Response

We welcome the opportunity to respond to the consultation on public value in the water sector.

We are proud of our history as being a company driven by a sense of public service and want to lock in this approach for the long-term. We also believe that water companies are in an ideal position to help set the agenda: we are generally deeply embedded in our communities, the very nature of what we do requires a long-term approach and we have a strong interest in helping to address long-term environmental and social challenges.

As a socially purposeful company, we make a positive impact for the good of our stakeholders and wider society. For example:

- How we respond to crises – e.g. the support we are giving to our customers, local businesses and frontline charities during the Covid-19 pandemic;
- How we run the business – e.g. recruitment that supports greater social mobility), incentivising our employees based on our sustainability strategy and introducing the Living Wage for all our employees;
- How we deliver our services – e.g., nature-based solutions and ensuring the least impact on our communities whilst undertaking our work; and
- How we help our communities – e.g., through our charitable giving (our Community Fund), supporting the government's Kick Starter scheme by recruiting 500 apprentices and our employee volunteering programme.

For the most part, these changes can be made without additional costs or changes to regulation or public policy. Instead they can be delivered if companies think and act differently by considering the impact of what they do, and how they do it, in a beneficial way for society. However, there will be situations where delivery of wider public value, such as net-zero carbon emissions or some nature-based solutions will require additional investment compared to using the lowest-cost technologies for delivering water and wastewater services.

Defining public value

To promote greater public value there is a question about whether public value should be defined.

There are clearly many pros and cons – definition gives clarity and helps drive the outcome. However, there is no universal, east-fit, approach to defining what public value is. If Ofwat defined a version of what “public value” in the water sector is, for example, then that becomes the target, and this can run the risk of companies having a “tick box” approach to delivering public value. This has parallels in corporate governance, where companies are often considered as producing information to satisfy regulators rather than to provide insight to their stakeholders. There are also other benefits that may be missed through a standard definition of public value; if it's not included in the definition and not seen as valuable, then it may stifle other great opportunities and innovation in the sector.

One potential idea is that instead of defining a rigid set of outcomes for what public value is, a more flexible approach could be taken; one in which companies demonstrate what they have delivered in terms of public value across environmental and social factors. It could be these environmental and social factors that are defined in a framework, under which water companies could self-report to Ofwat. For example, what companies have achieved in terms of their communities, employees, biodiversity, climate change adaptation and mitigation. Such an approach allows for innovation, whilst also setting clear parameters within which companies should be delivering public value. It also allows for adaptability of the framework under which self-reporting should occur, rather than rigid targets which would have to be constantly under review as this area matures over time.

Incentivising public value

As we mentioned in our response to your consultation on reviewing PR14, we would like to see the role of water companies in delivering public value considered in the price review process in some way and we look forward to future discussions on this. We suggest you could place more weight on the track record of companies, including their behaviours, through their self-reporting on the public value they have delivered, to inform your initial assessment of plans (IAP) at PR24 and your decision on fast track status at future price reviews.

To complement this, the use of incentives could be a useful tool in helping deliver wider public value. At PR19, Ofwat showed great foresight by approving bespoke ODIs relating to public value, such as our ODIs on biodiversity and green communities. Similarly, other companies have incentives that promote nature based solutions in relation to flooding. The scope for these could be significantly increased at PR24.

Potential barriers to greater public value

In many instances delivering public value will not generate additional costs, however there will be some projects where there is a trade-off between:

- lowest cost versus most cost beneficial approaches – e.g., some nature-based solutions and low-carbon solutions will be more expensive than traditional approaches; and
- lower-risk versus higher-risk approaches, where innovation and new technology could deliver better outcomes for customers;

The current regulatory approach generally works well to make sure water companies' allowances for repeatable activities are efficient. However, the challenge is for aspects of regulation, such as the econometric models, to take account of public value where future activities will be different to the past - such as achieving net-zero carbon emissions; eliminating harm from storm overflows; and removing lead from pipes. To deliver public value in these examples Ofwat might need to allow additional efficient expenditure.

Conclusion

We think it is right to be thinking about public value now and to be having conversations on these issues. Our view is that the water sector needs to come together to work through these issues. We also believe that any framework or definition of public value should be considered once an understanding of what customers want is undertaken. We would like to see the role of water companies in delivering public value considered in the price review process in some way, perhaps through the IAP process and encouragement for bespoke ODIs on public value at PR24.

We would welcome further discussion with Ofwat to help consider ways to deliver and demonstrate public value in the water sector. We are also happy to share ideas in terms of how we have demonstrated public value in the past and help input into how a framework could work for the water sector in the future.

We provide our responses to the specific consultation questions below. Should you require any further information please do not hesitate to contact me.

Kind regards

Shane Anderson
Director of Regulation and Strategy

Response to detailed questions

Scope and Ambition

a) What factors – outside regulation – impact on water companies' ability to deliver 'optimal' public value outcomes when delivering their core services? What are the constraints to meeting ambitions in this area?

Clearly, economic and quality regulation matters and shapes the water industry accordingly. It can encourage positive behaviour or lead to risk averse behaviour that detracts from the goal of maximising public value.

However, arguably the biggest factor on optimising public value is a company's commitment to 'long-termism'. Companies with a long-term mindset (and supporting governance) will seek to maximise public value. As stewards of an essential public service, we recognise that our commitment to social purpose cannot be short term. For example, the impact of climate change is becoming ever more urgent and companies must consider this as part of their provision of our core services.

We have a unique position in society as a company delivering a public service. To deliver public value, companies should also try to understand what public value means to our customers and wider stakeholders. Working in isolation of what our customers or stakeholders want (and in some cases, are willing to fund) may lead to discontent with the water sector. Last year we consulted with our stakeholders to understand their expectations of a socially purposeful company. We know from our customers that they want us to be a company that can be trusted and is socially purposeful.

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

There is a risk that a focus on public value could lead to a lack of focus on core services. This can be solved easily by including the quality of core services in any assessment of public value.

There is also a risk that companies attempts to demonstrate public value are more about "talking the talk" through boilerplate disclosures to demonstrate compliance with frameworks rather than "walking the talk", leading to public cynicism and societal views that companies are trying to "greenwash" their commitments. This can have the opposite effect to the idea of demonstrating public value.

c) In pursuit of better public value outcomes, to what extent should companies focus on an enabling culture that drives public value holistically; versus a more discrete, targeted approach?

Culture should be the priority. In order to deliver long term sustainability goals, help deliver value to communities and demonstrate the positive role and impact water companies can have in their regions, the employees of the companies need to be invested in delivering these goals. This is because, at all levels where decisions are being made, in order to really consider the public value and the impact on different stakeholders, this has to be a part of the active decision making processes of companies. By this we mean making decisions that consider environmental and societal benefits in conjunction with financial benefits.

The barrier to this is not having a clear culture that sets out these parameters as part of an organisations decision-making process. For example, instead of going for the cheapest option to build new assets, companies need to innovate to use green alternatives; companies should think about how they can reduce their carbon impact and reduce their waste; companies should think about the circular economy and how they can help with cleaning up rivers and reducing flood risks even when it is not part of their regulatory statutory duties. If these issues are considered on an individual targeted basis, it will be inefficient and not drive long term embedded change to deliver public value. Instead having a focus on public value across the organisation, i.e., through its culture, will deliver real change quicker. It will also have the added bonus of positive engagement from employees. Our experience is our employees are positively impacted the more we can clearly articulate our approach to being a socially purposeful company across the organisation.

Incentives and barriers

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

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

Understanding impact

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

g) What role, if any, should Ofwat have in monitoring progress? How else can we, customers and other stakeholders be assured that genuine and meaningful progress continues to be made?

We have answered these questions collectively below.

There are various global and national frameworks that enable stakeholders to assess companies' progress in delivering public value, for example, the UN's Sustainable Development Goals. As a FTSE100 company investors also assess our sustainability credentials through independent indices, for example, the Tortoise Index. Whilst these are helpful frameworks, the metrics within indices are becoming increasingly prescriptive and, as such, there is a risk that emphasis is placed on crafting boilerplate disclosures to demonstrate compliance to investors rather than providing meaningful insight to all stakeholders. Additionally, a 'one size fits all approach' does not in fact fit all companies and can lead to outliers, for example, oil and gas companies ranking higher on many indices than water companies.

We believe it should be for companies themselves to demonstrate their public value in a way that resonates with all stakeholder priorities – and this should be articulated through existing integrated business reporting. For example, we published our Sustainability Report last year which set out our Sustainability Framework under three main pillars covering the following strands:

1) Taking care of the environment

- a. Ensuring a sustainable water cycle
- b. Enhancing our natural environment
- c. Making the most of our resources
- d. Mitigating climate change

2) Helping People to Thrive

- a. Delivering an affordable service for everyone
- b. Providing a fair, inclusive and safe place to work
- c. Investing in skills and knowledge
- d. Making a positive difference in the community

3) Being a company you can trust

- a. Living our Values
- b. Balancing the interests of all our stakeholders
- c. Running our company for the long term
- d. Being open about what we do and sharing what we know

Our reporting was considered as part of the Purpose Union and the Impact Institute, Ofwat commissioned Report; "The company is clear about how its activity supports the SDGs, how it factors in social and environmental issues into its risk planning and has targets for its CSR activity, approaches which we believe the

sector can develop more (using Severn Trent as good practice). One of the most impressive aspects of Severn Trent's commitment to societal value is their extensive transparency in reporting on their goals, and whether they have been met."

By Ofwat defining and then applying a set of markers to demonstrate value across the water sector, we believe this in fact could stifle innovation in this area. For example, regional differences may mean water companies invest and innovate to deliver public value in different areas. If there is a marker for one but not the other, this disincentivises companies from pursuing such activity, unless they are set out in a rigid set of parameters of what public value is.

That said, we do believe that how companies behave and how they demonstrate public value to Ofwat, and its stakeholders is vitally important. Therefore, a framework under which companies should self-report on delivery of public value could be introduced by Ofwat. The framework should not be prescriptive in nature. Instead it could set out "buckets" under which the companies could report against to show that it is delivery public value. These buckets could be under environmental and social factors, such as, nature-based schemes, supporting our communities and improving diversity in the sector.

Progress could be reviewed as part of the price control process. The price review could encourage positive behaviour if an assessment of a company's track record in maximising public value is included in the assessment. We believe this can be achieved through the price control process in two ways:

- 1) In adapting conventional schemes to help deliver better outcomes for society in the long term, companies need to demonstrate the value for money in providing a scheme that is beneficial to the public (i.e., the use of SUDS for drainage schemes). Any associated implications in terms of an increase in the costs of the scheme, would be duly considered as part of the price determination process; and
- 2) As part of the business planning process, Ofwat should ask companies to demonstrate how they delivered public value over the current AMP and how it will deliver further public value as part of the next AMP as part of the schemes they have submitted in their price determinations. It is for the companies to present their evidence as to how they are delivering on public value. Ofwat should use this as part of its final price determination, rewarding those companies that demonstrate a track record in achieving benefits for society.

Incentives should also be used to help deliver public value in the sector. This could be through the ODI mechanism and would be specific to each water company. This would mean that each company could consider how they can deliver public value in their business plans through a mechanism that is already in place. It will also mean an avoidance of all water companies having to deliver the same public value, instead recognising the regional differences and different issues that water companies may face.

Other

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

In the consultation Ofwat rightly highlights that the *delivery of public value risks being undermined if customers can only see the benefit of greater public value through greater cost*. This underscores the importance of companies doing everything within their gift to drive public value as we highlighted above. However, there will inevitably be instances where driving additional public value comes at a cost – how this issue is navigated will require careful consideration. We think customers and Government should inform this debate to ensure the best outcomes are delivered.