

PR19 - WILL IT DELIVER A BETTER FUTURE FOR WATER CUSTOMERS?



Tim Williams reflects on the recent PR19 submissions and opportunities for the Water Industry to deliver performance improvements



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Setting the focus for water company business plans

In September, water companies in England and Wales submitted their business plans to Ofwat. Ofwat will publish their initial assessment on

31 January 2019 and their final determinations in December 2019.

The September submissions marked an important milestone in the price review process. Initial press reaction and commentary quietly focused on headline figures given in Water UK's 'A Manifesto for Water' – i.e. over £50 billion projected spend across the next five years, domestic bills to fall on average by more than 4% in real terms, a 16% reduction in leakage, and a 36% decrease in the time supplies are interrupted. Now, the water sector's key stakeholders, dedicated press and supply chain, are scrutinising these business plans to determine what the future may hold and the key challenges.

Ofwat's PR19 Methodology set the focus for business plans to:

- Strengthen customers role in water companies' decision-making;
- Promote new markets in bioresources and water resources;
- Push companies to open-up high value

infrastructure schemes to third party competition through proposals for direct procurement;

- Improve levels of services customers receive through upper quartile incentives;
- Improve resilience-in-the-round, i.e. resilient supplies, resilient systems that recover quickly from problems like bursts and floods, resilient companies with sound governance, and securing resilience for our environment;
- Ensure affordable bills, which demonstrate value for money, are clear, fair and as low as possible, while ensuring the right amount of investment for the future
- Increase innovation, addressing concerns that not enough has been done in the past to improve and innovate.

Embracing opportunities in AMP7 - how have water companies responded?

Customer involvement in shaping PR19 plans has been greater than ever. Approaches have varied, but greater information on what customers want,

mean companies now have real opportunities to involve customers and stakeholders in making decisions on service outcomes and expenditure. It will be interesting to understand how customer research has truly shaped plans and decisions that companies have made. Understanding what customers do or don't want is very different to willingness-to-pay tools applied in previous business plan submissions. Companies can now also involve customers in their decision-making on a regular, ongoing basis, rather than a snapshot every five-years.

Most companies have proposed falling bills in real terms. There is an increase in expenditure in the sector in the period 2020-25 compared to 2015-20, which should be a welcome investment in the infrastructure of UK plc. Falling bills appear to have been achieved along with improvements in service and significant investment to improve the environment. Yorkshire Water is considering opening its Bioresources business to the market. South West Water are offering customers a real financial stake, a WaterShare, in their business, sharing up to £20m accrued from AMP6.

Improvements in service and standards proposed by companies, coupled with decreasing customer bills make innovation to drive and realise efficiencies essential. Several companies are making their data publicly available, to generate new insights and drive improvements. This will require combining data sources, better use of technology and increased use of analytics for the growing amount of information. This, when analysed effectively, can enable real step changes in value for money to customers. In delivering these ideas, it is critical companies embed new technology and practices to sustain service commitments to customers and returns to shareholders.

There are a few less obvious areas. For example, the level of efficiency improvements required to achieve or beat financial targets isn't clear. Ofwat stated this was the price review where Direct Procurement for Customers (DPC) was to play a part in delivering greater value for money for larger projects. So it may take the view that there has been disappointing response in the level of DPC proposed, with few projects suggested and several companies with potentially suitable projects delaying the decision on DPC until later in AMP7. However, as many companies now operate integrated supply and distribution networks providing resilient supplies, the scope for discreet DPC projects may be less than originally envisaged.

What makes a good plan?

Ofwat has been clear on its expectations and how it will undertake its initial assessment of business plans. The likely attributes of a submission being received positively are:-

- Clear demonstration customers have

been engaged in the co-creation of the business plan, that this has influenced its development and will be integral to its delivery;

- Ambitious performance commitments, leading to upper quartile performance, supported by customers, with appropriate risk and reward mechanisms to incentivize companies and drive the right behaviors;
- Falling bills despite increased expenditure, rather than rising bills hidden behind poor efficiency challenges and rising expenditure;
- A plan that embraces innovation and manages risk, not one relying on the same old techniques and processes, hoping some innovation will deliver what's needed
- Demonstration that a true evaluation of what markets can do for the customer has been carried out, covering water resources, bioresources and DPC opportunities, rather than a short term 'tactical' plan that leaves difficult decisions for another day and management team.

From our initial view of the submissions it seems a few companies may fall into the 'significant scrutiny' or 'slow track' categories, but only one that might be rewarded with an enhanced status determination. A normal distribution wouldn't be a surprise given the Ofwat criteria listed above.

Has Ofwat achieved its intended PR19 outcomes?

DPC feels like 'the dog that didn't bark', with many a company ducking the opportunity offered. Either ignoring it on grounds of complexity or just leaving it for later in the period.

Bills falling is a good thing, especially with big improvements in performance. But, could they fall further? Has bill reduction mainly been achieved by reduction in the cost of capital? If companies had challenged themselves further could customers have benefited more? The industry faces challenges and has set itself ambitious targets, on leakage, pollution and flooding from sewers for example. Likewise, some companies have large environmental improvement programmes.

Delivering these efficiently will require fresh thinking and innovative approaches if performance commitments are to be met and deliver best value for customers. The supply chain undoubtedly has a role in helping companies deliver on challenging use of digital technologies. Greater resilience and system thinking will be essential in enabling improved performance. Similarly, wider catchment management and potentially offsetting or combining consent performance will need embracing by the sector to drive the lowest long-term cost to the customer.

However, tight regulatory deadlines may detract from this approach and prevent companies developing innovative means of achieving environmental outcomes compared with the certainty of Capex, carbon and costly end of pipe solutions. There is room for wider water cycle thinking to finally come to the fore and deliver for customers, land users and the environment.

Customers have increasingly engaged in the development of business plans and now can be involved in more frequent and dynamic decision making. Companies also have the chance to think more widely about resilience and promote long term resilience to the many industry stakeholders. Innovation has also been promoted as a key requirement in the delivery of these plans.

The Challenges Ahead

The industry has achieved much in recent years and through submissions for 2020-25, proven there is much more to go for. Environmental improvements are vigorously being pursued, but additional innovative thinking will be required.

Efficiency, Totex and resilience are the broad areas discussed in the press, and most coverage is aligned with Ofwat's four key themes of resilience, customer service, affordability, vulnerability and innovation. Some commentary has noted this being a 'successful' price review, especially considering the increasing 'politicisation' and re-nationalisation messages from the opposition benches.

The question remains, how to achieve even more? And what would be enough to prove the industry is moving forward fast enough in a challenging political environment?

Overall, the industry has reacted well, the challenges ahead are clear, with recognition that innovation must play a key role in delivery. The reaction may be that there is more to play for, and for the first time, customers and others can play a role in decision making, more often than every few years. Companies have proposed significant improvements in performance which in themselves are likely to be challenging, alongside improving resilience and overall bill reductions.

The supply chain must also step up and provide answers to more efficient, innovative delivery in what will undoubtedly be a dynamic environment. It is essential they lead the sector in areas such as digital, leakage, resilience and environmental improvements. The supply chain can also be the key to unlocking areas that benefit from collaboration and other sector involvement including catchment management and market reform in areas like water resources, bioresources and strategic water transfers.