



# Encouraging innovation in regulated utilities

A HM Government consultation

## 1 Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory body representing the interests of domestic and business water and sewerage customers across England and Wales. We have four local committees in England and a committee for Wales.
- 1.2 We welcome the opportunity to comment on the Government's consultation on encouraging innovation in regulated utilities.

## 2 CCWater's perspective

- 2.1 Innovation, and the need for the water sector to increase this, has been a topic of much discussion for over a decade.
- 2.2 The Martin Cave review 2011<sup>1</sup> concluded that 'there is general agreement on the potential benefits of greater levels of innovation for customers and the environment and a recognition that such innovation should be supported through market mechanisms and regulation as appropriate'.
- 2.3 We believe that innovation should not be viewed as an end by itself, but we agree that it can help overcome some of the significant challenges faced by the water sector including: climate change; aging assets; a growing population; and changing customer expectations.
- 2.4 CCWater's main focus in the area of innovation is where change makes a material positive impact on customers; for example, in areas such as service, affordability and vulnerability.
- 2.5 We have detailed our response from the perspective of our expertise and experience in the water sector.

## 3 Consultation questions

### 3.1 What barriers, if any, are there to the development and implementation of innovative technologies and methods in the utilities sectors?

- 3.1.1 We do not see any fundamental barriers to innovation in the water sector.
- 3.1.2 We believe that comparative measures used in the water sector can lead to innovation driving up performance. However, we recognise that the increasingly competitive nature of committing to upper quartile performance at regulatory price reviews can result in companies being less willing to share innovation / good practice.
- 3.1.3 There are a number of barriers to innovation perceived by companies. These include fear of failure (missing regulatory targets) and the lack of a bespoke pot

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<sup>1</sup> <https://www.gov.uk/government/publications/competition-and-innovation-in-the-water-markets-cave-review>

of customers' money to fund innovation. However, it is our view that neither of these should act as a fundamental blocker to innovation.

### **3.2 What are the best way(s) for utility regulators to further promote innovation in their sectors, while ensuring the interests of consumers (present and future) are protected?**

3.2.1 We believe that the consumer should be the primary focus for companies when promoting and trialling innovation. If all companies strive to meet their customers' needs and expectations, and price limits are calculated correctly by the regulator, then innovation should naturally follow.

3.2.2 Sharing innovation and good practice could be made an explicit expectation, by the regulator, for companies at price reviews. This could be included as a test within the business plan assessment (akin to the series of tests Ofwat are applying to plans at PR19). This would help break down any barriers to sharing innovation.

3.2.3 We also believe that an increased regulatory incentive based on consumers' views could help further drive innovation. Ofwat's proposal to introduce C-MeX (Customer Experience Performance Commitment) should be a positive step forward. This is a mechanism which incentivises water companies to provide an excellent customer experience for residential customers. It is our view that strengthening this incentive further would increase the focus on delivering for consumers, without picking winners, which could help to drive innovation in the most important areas. By aiming to mimic what competition does in other highly competitive sectors, this incentive could force companies to reflect on the different needs and expectations of residential customers and to better segment their customer base.

### **3.3 What barriers, if any, are there to innovative sector specific and cross-sector business models?**

3.3.1 We don't think there are any barriers but there could be a risk that a business model could stifle innovation if it is too rigid. We would like to see incentives as described above (C-MeX) that press companies to meet the needs and expectations of their customers on an ongoing basis. We prefer this to the approach we see in other utilities where an amount of money is awarded to individual innovative projects.

### **3.4 How have utility regulators most successfully encouraged innovation in their sectors?**

3.4.1 Innovation featured prominently in the narrative for the methodologies for the 2009, 2014 and 2019 price reviews.

3.4.2 Innovation is one of the three characteristics that Ofwat has said it is looking for in PR19 business plans. The expectation has been set that water companies should innovate to address challenges around affordability and resilience. Companies have also been actively encouraged to collaborate with others and through partnerships bring in new skills and ideas.

3.4.3 It is too early to say whether the increased focus on innovation at PR19 has been successful or not. However, we have seen in past price reviews that when the regulator allows and encourages innovation it is taken forward by water companies. An example of this is the area of catchment management since PR09, which is now 'business as usual' for a lot of water companies.

**3.5 What additional tools and expertise, if any, do utility regulators need to respond to technological change and promote innovation in their industries?**

3.5.1 The regulator needs to use existing tools to encourage innovation. As detailed above, strengthening initiatives such as C-MeX in the water industry would focus companies and drive innovation in the areas most important to consumers.

**3.6 To what extent would a statutory duty to promote innovation help regulators focus further on encouraging greater development and adoption of innovation in their sectors?**

3.6.1 We believe that the regulatory framework should provide enough incentive to innovate without the need for a statutory duty. The regulator needs to set the price limits at the correct level and incentivise companies to get service levels and priorities right for their customers. Companies will then need to innovate to deliver the promises they make to their customers.

**3.7 What other measures might support an innovation duty in helping regulators to focus on encouraging innovation in their sectors?**

3.7.1 We believe the ultimate measure should be the satisfaction of consumers, who should always be at the heart of companies' plans and day-to-day management of the business. As detailed above C-MeX is a good start but more can be done to incentivise the right behaviours across the industry.

## **Enquiries**

Enquiries about this consultation response and requests for further information should be addressed to:

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