

CEO VIEW

Three years ago we asked customers how they felt about proposals by the regulator Ofwat to introduce a new system of financial rewards and penalties for water companies - called Outcome Delivery Incentives (ODIs). We agreed - and still do - with Ofwat that incentivising companies in a way that better aligns the interests of investors with customers is necessary. But most customers responded very negatively to the idea of paying more for the proposed service related ODIs. They told us they did not like the idea of paying more money for their company to provide the day-to-day services that they felt they were already paying for through their bills. It was a point we made forcibly to the regulator but ODIs were still introduced for all companies at the 2014 Price Review.

Fast forward to today and some of the concerns voiced to us by customers are starting to ring true. Two of the three companies that opted to collect their rewards or penalties on a yearly basis - Severn Trent Water and Anglian Water - are accruing substantial financial rewards. The largest of these is the £38 million Severn Trent is set to receive for its outperformance on sewer flooding, as well as other commitments. To the company's credit, it has opted to defer £27 million of its reward to dilute what would have been a substantial rise in bills for its customers next April. At some point, however, customers will probably pick up the tab, including customers of the majority of companies whose rewards or penalties are set to be applied cumulatively at the end of the decade.

Ofwat has set out in its methodology for the next Price Review in 2019 proposals to remove the cap on the rewards companies can achieve if they meet their ODI performance targets. Although Ofwat stressed that this will only be for exceptional performance, the major concern over customers' lack of acceptance of these rewards remains. It is possible that much more stretching ODIs might reduce the causes of dissatisfaction for some customers. However, it is not at all clear that Ofwat knows that it will actually drive improved satisfaction and offset the negative impact of price increases for companies doing what many customers view as the 'day job'. And that is before you factor in the impact of inflation being added to bills.

We think there is a better solution that could address this problem and really align customers' and investors' interests. Ofwat could soften the incentive on service metric ODIs and transfer most, or even all, of these rewards to a measure of customer satisfaction with value for money or another similar metric. This would be regulation mimicking competition by directly and strongly incentivising water companies to focus on doing the things that really satisfy their customers and segmenting them, as they would in a competitive market. We know from our research that customer satisfaction with value for money also has a big influence on the amount of trust customers have in their water company. Ofwat has rightly placed a strong emphasis on trying to boost customers' trust in the sector and we believe our proposals could help to achieve this.

With the water industry under intense public and political scrutiny, there is an urgent need to improve the perception of the sector among consumers. That should be a big enough reason to make this bold move as the 2019 Price Review gathers momentum.

Tony Smith

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Consumer Council for Water