

MARKET REFORM IN THE WATER INDUSTRY

As market reforms take hold, driving innovation and embracing change is going to be ever more important to attract and sustain investment in *the water industry for the benefit of customers*. Ken Gedman, Business Consultancy Director at MWH, now part of Stantec gives his views on what the future might hold.



Ken Gedman
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What are the Outcomes we are looking for...?

As far back as 2015, Ofwat stated some clear outcomes for reforms in the industry:

- Value creation and allocation;
- Improved incentives for the long term;
- Looking beyond immediate boundaries;
- Support the development of the market;
- Incentives to act in the customers' interest;
- and
- Active investors joining the sector.

To achieve these outcomes, as an industry, we need to be more disruptive in our thinking, challenge the norms and create attractive propositions for both customers and investors.

It is easy to think out of the box, but very difficult to see how radical transformation can be implemented in an industry which sees the pace of change as challenging.

New and innovative Service Providers being formed...

In the run-up to competition in the non-household retail market we have seen some surprising non-household retail models forming, largely falling into three broad categories:

1. Some companies have decided to exit the non-household retail market altogether, gaining from divesting these activities to new entrants in the English retail markets.
2. We have seen others create joint ventures with their traditional competitors to retain and extend their reach of services to non-household customers in England (and potentially Scotland).
3. Some organisations have chosen to retain a traditional approach, establishing separate retail businesses to preserve or extend their market share.

Whichever organisational and retail arrangement has been established, each is attempting to create differentiated value propositions for their current and prospective customers. Some state benefits arising from their investment in customer-facing systems, including mobile 'Apps' to help customers manage their accounts. Some are differentiating through their focus on particular customers or sectors, e.g. farmers, small businesses, voluntary organisations. Others are offering a range of value-added services to provide advice, helping to save water and save their customers money.

Although these changes can be described as innovative, are customers getting the market

(and benefits) they want and what else can stimulate change in the industry? Maybe we need to think a little differently and beyond the paradigms we operate in today.

What might the future hold...?

There is some scepticism that opening up retail will be a burden to water companies and not deliver the benefits (through efficiencies and innovation) to customers that are expected.

There is an argument that the margins aren't there to stimulate customer switching or that customers may be reluctant to switch because it's too much effort for too little gain. This argument appears to get stronger when applied to the future potential for opening of competition in the household retail market.

This suggests that customers aren't being innovative enough or, at worst, are unaware of the opportunity market reforms present. What if large, national, non-household customers decided to seek a retail licence, cut-out the middle-man and buy their water and wastewater services at wholesale prices?

With it being announced that a major pub retailer and brewer (Greene King) has become the first non-household water customer to apply to provide its own retail services when the market opens in April, this innovative approach is therefore not wild speculation. It's also not hard to imagine that others will follow their example, disrupting some of the added-value other established retail operators are looking to provide.

The process for applying for retail licences is not easy and there will need to be more streamlining of the process to realise the outcomes Ofwat is looking for from market reform.

Ofwat too will need to facilitate game-changing innovation in the industry, through swift response and support.

Checks and balances to protect customers' interests need to be in place, but support for innovative models and rewards are also needed to secure investment and drive the pace of change.

Looking ahead to the potential of household competition opening, this presents its own challenges and opportunities for wholesalers and retailers. The industry is expecting retailers in other sectors to enter the water retail sector, using their experience in the gas and electricity markets to drive efficiencies through scale.

This has the potential to lead to consolidation of current incumbent retailers with new entrants, providing savings to customers by bundling utility bills and offering discounts – e.g. one bill for gas, electricity, telephone, broadband, mobile telephone and water.

Integrating information platforms and metering technology will be needed to support better data to aid consolidated and accurate billing and customer confidence in switching between providers. This may also need a consolidated view of how these retailers would be regulated.

Changes in retail competition, in addition to upstream wholesale separation market reforms, may also stimulate game-changing approaches to water and energy production.

Water companies have been utilising and investing in their assets to drive sustained savings in their own energy needs and reduce carbon emissions.

Utilising advanced wastewater treatment (digestion) processes to generate energy, coupled with utilising land to establish solar and wind electricity generation has delivered real savings and environmental benefits.

Taking this a step further, could further investment in these facilities and technologies be used to reduce the national infrastructure need for new large scale energy generation facilities?

To replace them with more smaller scale, dispersed and sustainable energy generation by companies operating not only as water wholesale companies, but instead water and energy wholesale companies? Again, should this happen, this will need a consolidated view from regulation or even the consolidation of regulators.

What does this mean...?

Whatever happens in the future, it is certain that market reforms will drive change for the water industry.

Retail competition will be stimulated by innovation coming not only from the current incumbents, but the disruptive change from new entrants and customers alike, particularly as customers' awareness and confidence changes.

Water companies (and their investors) have some strategic choices to make. It seems reasonable to suggest these decisions may be needed sooner rather than later to ensure they are positioned at the forefront of disruptive change, not just reacting to it.

Regulation will also have to change both to support and stimulate disruptive, new entrants into markets and particularly if consolidation between water and energy sectors is used to drive attractive benefits in retail.

The poster features a large, dynamic splash of water forming a circular frame. Inside this frame, the word "TOGETHER" is written in a large, blue, textured font, with the phrase "WE ACHIEVE MORE" in a smaller, blue, sans-serif font directly below it. To the right of the water splash, the text "INSTITUTE OF WATER" is in a small, black, sans-serif font, followed by "ANNUAL CONFERENCE" in a large, bold, black, sans-serif font, and "15 | 16 JUNE 2017" in a medium-sized, black, sans-serif font. Below this, "CHETHAMS SCHOOL OF MUSIC, MANCHESTER" is written in a small, black, sans-serif font, followed by "CHAired BY THOMAS FAULKNER, EXECUTIVE VICE PRESIDENT, SKANSKA" in a small, black, sans-serif font. Further down, "BOOK NOW AT" is in a blue, sans-serif font, with the website "www.instituteofwater.org.uk" in a small, black, sans-serif font. In the bottom right corner, the "Institute of Water" logo is displayed in a large, bold, black, sans-serif font.

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