

## **Putting customers at the centre of the price review process Water Industry Commission for Scotland consultation**

<http://www.watercommission.co.uk/UserFiles/Documents/CustomerEngagement%20-%20final.pdf>

This work is likely to involve simplifying the regulatory system and encouraging greater customer participation in decision-making. It is important to emphasise here that we envisage evolutionary development of existing processes rather than fundamental change.

### **Initial proposals**

The cornerstone of our approach is that customers should be at the centre of future decision making. In particular, we think that customers should have more of a say about discretionary aspects of the investment programme and their timings.

Consumers can be at the centre of decisions without themselves participating in them. This has been the traditional role of economic regulators, to protect (essentially passive) consumers from abuse of market dominance. WIC is suggesting that consumers should be more actively involved, as they need to be to make markets work well. It would be helpful to understand whether the increased consumer involvement is to improve the quality of the decisions made by WIC, or their legitimacy, or both and/or for other reasons. The objectives of the change are not clear from the discussion paper, which provides evidence that the regulatory system has delivered good results for consumers in the past. However which measures to involve consumers are appropriate depends on which of these, or other objectives, are motivating the evolution to which the paper refers.

### **Overcoming barriers to participation**

We acknowledge that at present there are a number of barriers that may deter customer participation in future price reviews.

Participation may be costly for consumers in terms of time and attention, and perhaps monetarily if it involves travelling to meetings. It is important to acknowledge the cost to consumers, as well as the potential benefit, of involvement to assess potential changes.

A related issue is which consumers would be involved. Would this be a representative group? If so, on what dimensions would representativeness be assured, i.e. geographical, socio economic, usage? How would the process deal with issues where one group of consumers benefit and others do not, which might arise in questions of tariff setting, or in location of particular improvements where there is a choice of where they would be situated? How would WIC deal with the fact that different groups may trade off costs and benefits in different ways, for example environmental improvements may be more valued (relative to the higher cost which they might impose) by some consumers (perhaps those with higher income?) than others?

These include the following:

### **Complexity**

The current price setting process is complicated and technical. Simplifying the process and reducing the amount of technical information involved could be expected to encourage greater participation.

There are a lot of complex issues involved in determining water supply and prices, and it would not be appropriate to introduce greater simplicity if it means that the outcome is less able to reflect the complications of cost and trade off which are intrinsic to the decision. Over simplification merely invites unrealistically simplistic solutions. Of course complexity for its

own sake is unhelpful, and the process itself should be made as simple as is consistent with taking all the important aspects into account, but not at the expense of the 'quality' of the decision itself.

### **Too late to influence**

We are sharing our thoughts at this early stage in order to incorporate comments and suggestions when we come to define the next price review process. Involving customers earlier in the process should allow their views to be incorporated more effectively in the decision-making process. It would also allow more time to enable a fuller discussion and engagement with customers, and for this engagement to influence policy.

Ideally information on consumer preferences and trade-offs should be an input into a price determination process, so should be collected as early as possible to inform the process as well as the decision. Any change in preferences as the result of the process (or extrinsic factors) need to be taken into account, while at the same time not raising unrealistic expectations from consumers about how far their own preferences (for higher quality water and environment and lower prices) can be realised. If the latter is not avoided, the greater involvement of consumers could end up undermining rather than increasing the perceived legitimacy of the process.

### **Relevance to the customer experience**

It is important that customers understand and value the improvements they are paying for and the costs and benefits of alternative approaches and options. This in part involves providing them with information such as the impact on their bills of improvements; this is likely to be a more relevant measure for customers than the total cost of a given project.

Providing appropriate information without overburdening or confusing consumers, or excluding some consumers from effective participation, is a major challenge, particularly since these trade offs involve individuals and households as both consumers and citizens. In other areas of complex substitutions and balancing (eg local government provision of services) citizens traditionally elect representatives to deal with the detail. The boundary between appropriate consultation on specific issues (equivalent to referenda), and the need for a responsible body to identify the best compromise will be a delicate one. Moreover internal inconsistencies in consumer preferences are well known from work on valuation of environmental benefits, and the increasing focus on 'behavioural' consumers shows that they are not always good at making decisions which are 'correct' when simple market choices are involved (see for example work from the Centre for Competition Policy on consumer switching and consumer choice), let alone where the choices appear hypothetical and not necessarily of immediate relevance.

### **Planning for the long term**

In our current process investment plans appear to be constrained by the length of the regulatory control period. While this may provide certainty during the period, it is unlikely to match the investment profile of the industry. Looking beyond the five-year period would allow for a more comprehensive long-term strategy where investments are phased and planned at the time they are needed. Planning to improve Glasgow's drainage, for example, is a long-term commitment that cannot easily be made consistent with five-year plans. Similarly does such planning allow us to understand the potential for innovation or rationalisation of Scottish Water's assets?

The long term nature of investment highlights the problem of consulting 'future' consumers, who by definition are not available to give their views yet. This emphasises that for some consumers at least, WIC is likely to have to make a decision which anticipates their preferences, rather than involving them directly. In practice it may be difficult to avoid a good deal of this 'in loco consumer' role for many groups of current as well as future consumers,

for example in balancing the conflicting interests of different consumers, as well as assessing competing needs of consumers and provider.

### **Working with others to encourage wider participation**

There are a number of actions that we believe will help us to develop customer participation:

- We will continue to work closely with the Scottish Government, Scottish Water, Waterwatch Scotland, Consumer Focus Scotland and a range of other household and business stakeholders to explore new ways to involve customers.

It is important to recognise when this is appropriately direct involvement, when it can be 'disinterested consumer representation' and when other interests held by the bodies being consulted are likely to distort the 'pure' transmission of consumer preferences

- We will seek to expand the list of stakeholders who might help us to evolve our price setting process.

Listening to more voices will give WIC a wider range of views and can improve decision making, but responsibility for the decision making will still remain with WIC and require distillation and balancing of the views'. This needs to reflect legitimate underlying principles of relative evaluation, and not just reflect the voices of those who shout loudest.

- We plan to undertake a review of the ways in which customers have been successfully involved in other industries.

This seems an appropriate first step, though the criterion for 'successful' involvement will require definition.

- We have set up a dedicated team to foster customer engagement and are working closely with other stakeholders to explore new ways of engagement across different industries.

This could have a valuable effect of capturing economies of scope by enabling consumers to make informed decisions across industries and markets. Evidence from CCP and elsewhere shows that the single greatest effect on whether consumers are active in one market (eg changing energy supplier) is whether they are active in others. Similarly a group of informed consumers who can deliver useful information across a range of industries may be helpful, particularly where, for example, social support is provided across several utilities, so long as it does not degenerate to a group of 'professional representatives' who reflect only their own views.

This greater proposed involvement of consumers in WIC's decision making contrasts with the reduction of consumer representation in other utilities following the abolition of Consumer Focus, Consumer Direct and the Office of Fair Trading's consumer protection role, and the reallocation of tasks to voluntary and local bodies whose resources will themselves be cut. Such changes will reduce help for individuals to be active, a necessity to 'make markets work well'; and eliminate the consumer advocacy role which these bodies have undertaken in the past. Increasing analysis of consumer preferences and moves to increase consumer representation in the Scottish Water Industry may provide a valuable focus to capture consumer influences and apply them in a regulatory setting at a time when existing knowledge and expertise may be lost through institutional changes.

### **Next steps**

This document outlines our initial thoughts on how customer involvement in the price review process might best be encouraged.

Alternatively we would welcome comments and suggestions on our proposed approach.