



A Report for

South West Water

Customer Research:
Market Reform and Industry Structure

April 2015

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1 Executive Summary

1.1 Objectives

ICS Consulting (ICS) has a history of supporting South West Water (SWW) with customer engagement and research.

A new area of interest for South West Water is customers' views on market reform and industry structure. This includes South West Water customers but also the customers of other companies to see if there are marked differences in views.

Of particular interest are the views of the customers of Sembcorp Bournemouth Water and South West Water around their appetite for mergers and consolidation.

We have worked with two market research companies - Facts International and YouGov - to develop and implement a customer survey. Facts International has been the lead market researcher, with YouGov used to bolster the sampling in the Sembcorp Bournemouth Water region.

The survey has explored a number of issues around industry structure and market reform such as:

- Customers understanding of, and views on, the current structure of the market and ability to choose their own retail supplier.
- Views on what factors encourage and discourage switching of retail supplier.
- Mergers and acquisitions, including when mergers are appropriate and the return of any merger savings.

1.2 Survey Design and Implementation

The survey design and implementation process involved 4 steps:



STEP 1: Questionnaire Design

- A survey was designed based on the project objectives. No pilot study was undertaken or recommended as the survey is relatively straightforward in nature, and built on previous studies examining similar issues explored by ICS and Facts International.

STEP 2: Set Sample Sizes and Quotas

- Three samples were collected in total: National, South West Water, and Sombcorp Bournemouth Water. All three had target sample sizes and quotas set.

STEP 3: Online Fieldwork

- The survey of household customers used online panels. To support the household online survey in the Sombcorp Bournemouth Water region, YouGov was engaged as a second market researcher.
- The survey of businesses used online panels. In the case of Sombcorp Bournemouth Water, Facts International boosted the results with telephone recruitment to the online survey.

STEP 4: Analysis

- The collected fieldwork data has been disaggregated for analysis by region and customer type (household, business).
- Some further analysis by breakdown of customer type, e.g. SEG, has been undertaken in some instances, where relevant.

1.3 Sample Summary

The sample size set for Sombcorp Bournemouth Water was smaller than the National and South West Water samples, due to difficulties in recruiting large samples in this area. It is, however, large enough to collect views of the customers in this region.

Table 1.1: Sample sizes

		Target	Actual
Household	<i>Overall</i>	<i>1250</i>	<i>1279</i>
	National	500	501
	SWW	500	511
	SBW	250	267
Business	<i>Overall</i>	<i>350</i>	<i>362</i>
	National	150	168
	SWW	100	105
	SBW	100	89

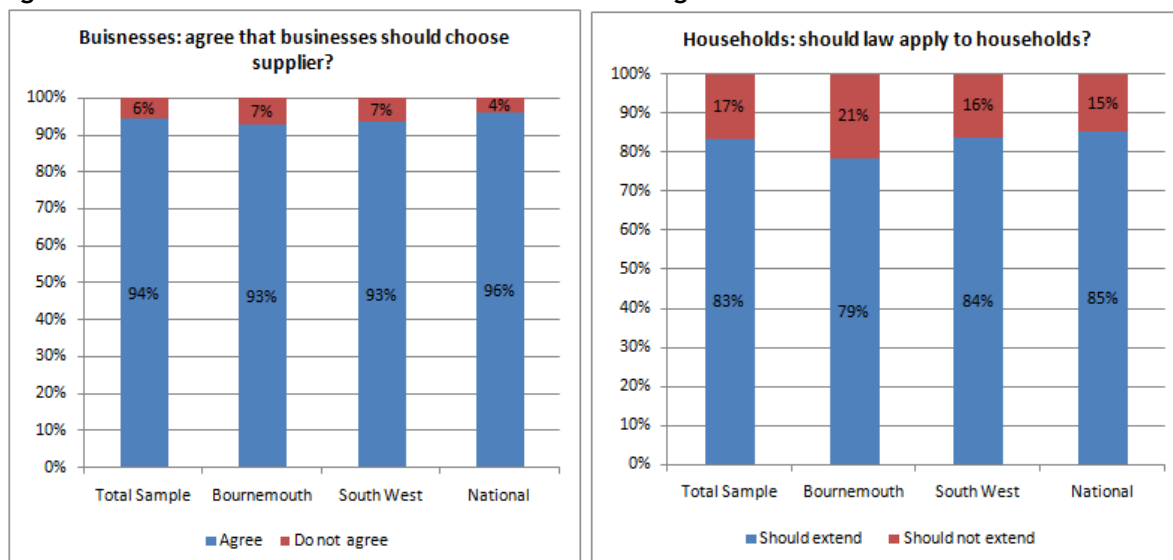
The sample sizes for the household samples are sufficient to apply statistical analysis for households in total and for each of three regions; for businesses the samples are sufficient to apply statistical analysis for businesses in total, and caution should be applied when reviewing the business customer findings at the regional level.

A total of 1641 respondents were surveyed in total, against an initial target of 1600. The three samples are all representative of the customer base.

1.4 Customer Views on Market Reform

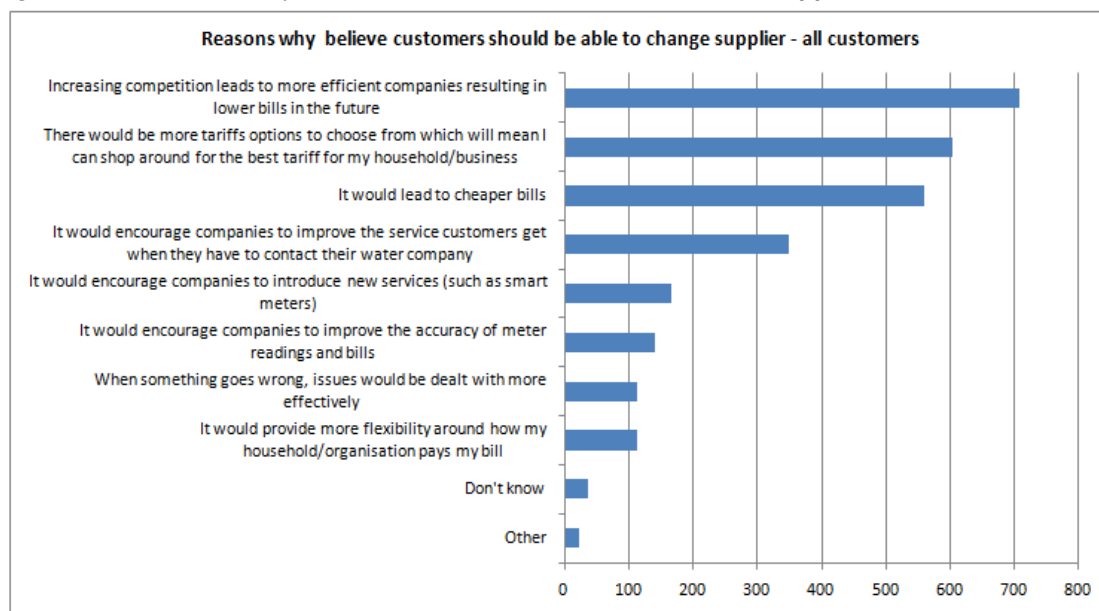
The survey results show that customers were not aware of the changes to the law around businesses choosing their own supplier. Businesses supported the moves to allow them to change supplier in England from 2017, and households expressed the view that this should be extended to household customers.

Figure 1.1: Household and business views on the changes



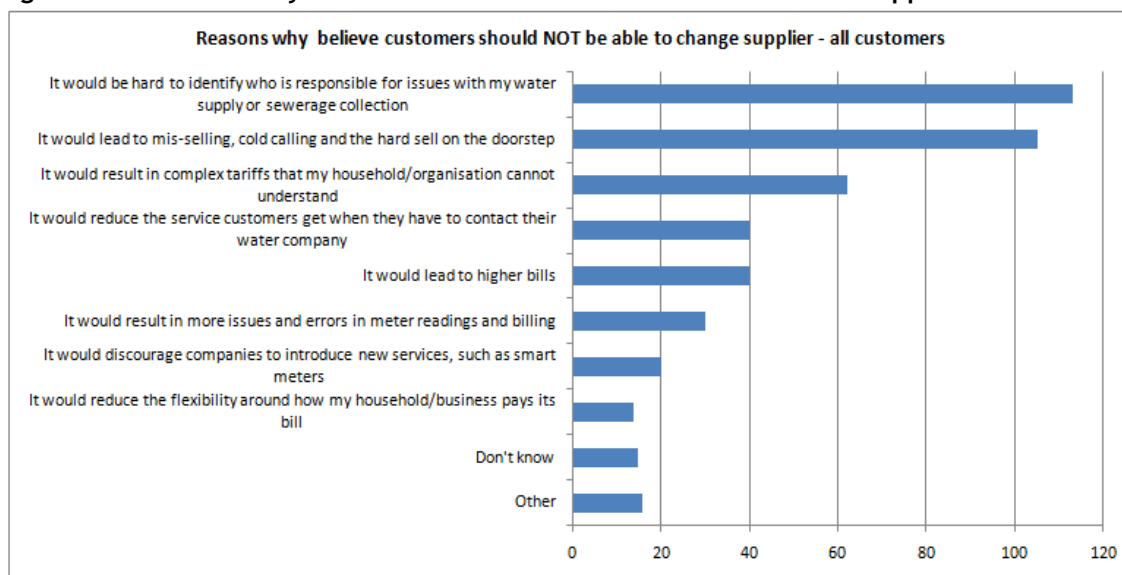
The key reasons that customers consider they should be able to choose their own supplier are around reducing overall bills through efficiency or shopping around for a better deal.

Figure 1.2: Reasons why customers want to be able to choose supplier



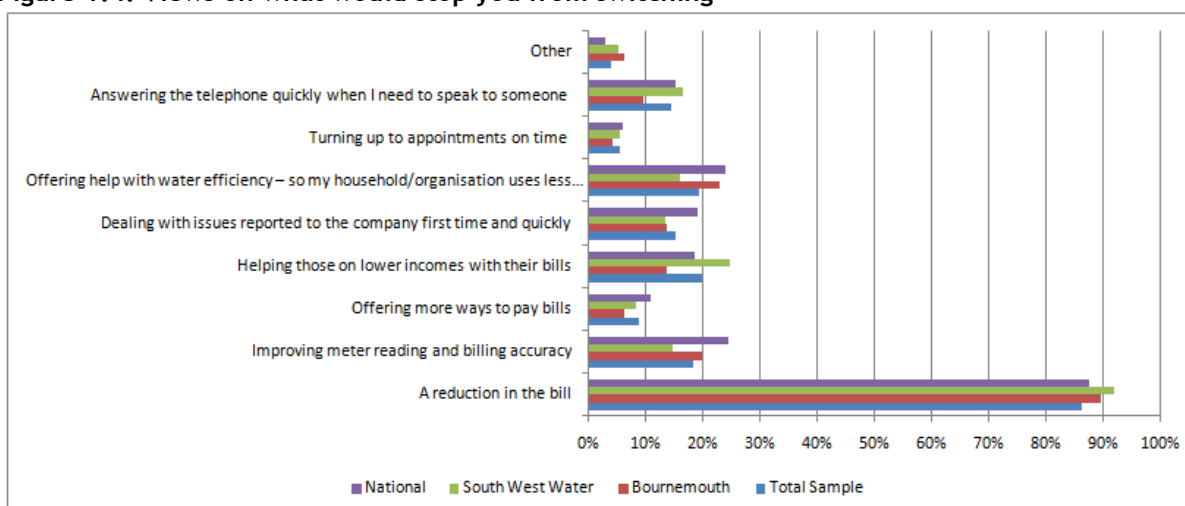
For those customers that were against allowing customers to choose their own supplier the reason was concern about who would be ultimately responsible for issues in water supply/sewerage collection; concerns around cold-calling and the hard sell; and worries about the complexity of tariffs.

Figure 1.3: Reasons why customers do not want to be able to choose supplier



Across all three regions considered in the survey the main reason to stop switching would be a reduction in the bill. All other issues were secondary to this overriding driver.

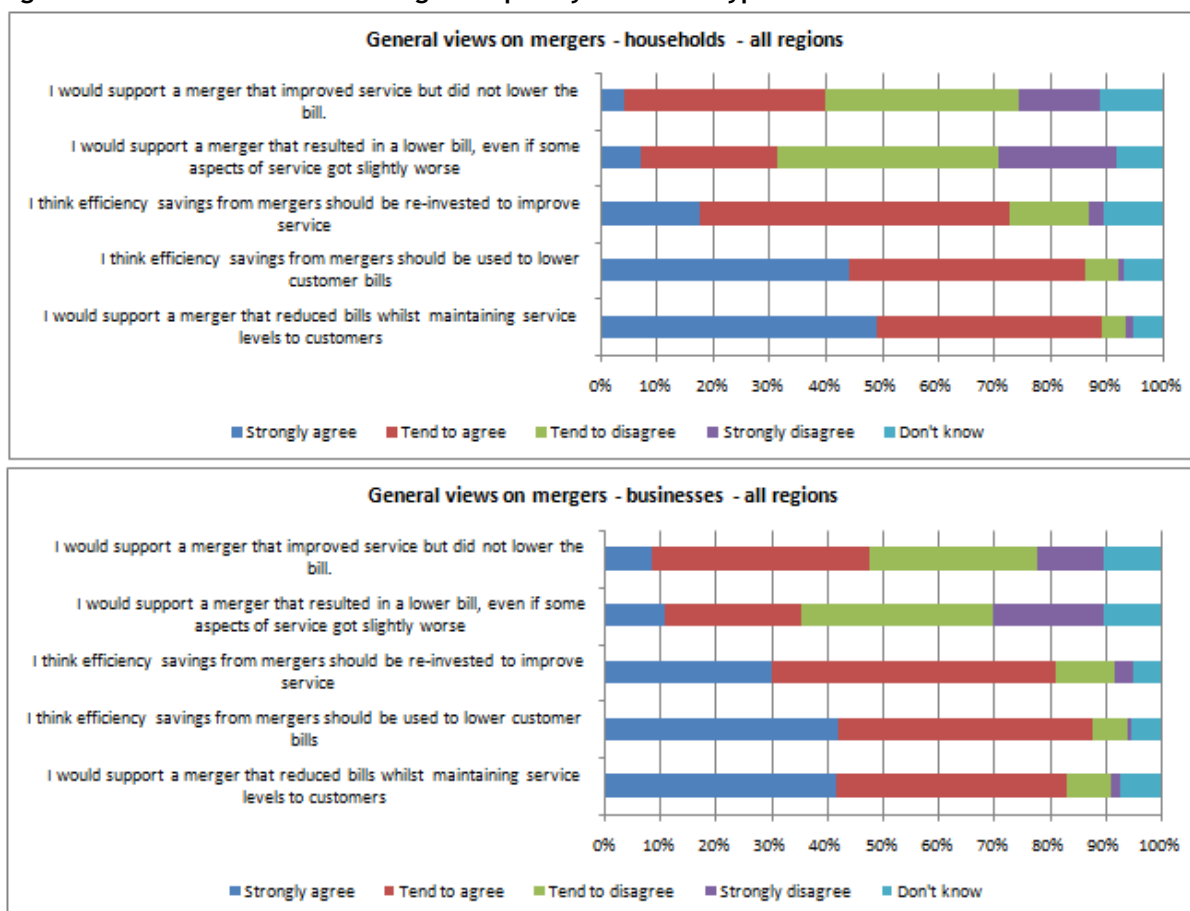
Figure 1.4: Views on what would stop you from switching



1.5 Views on Industry Structure and Mergers

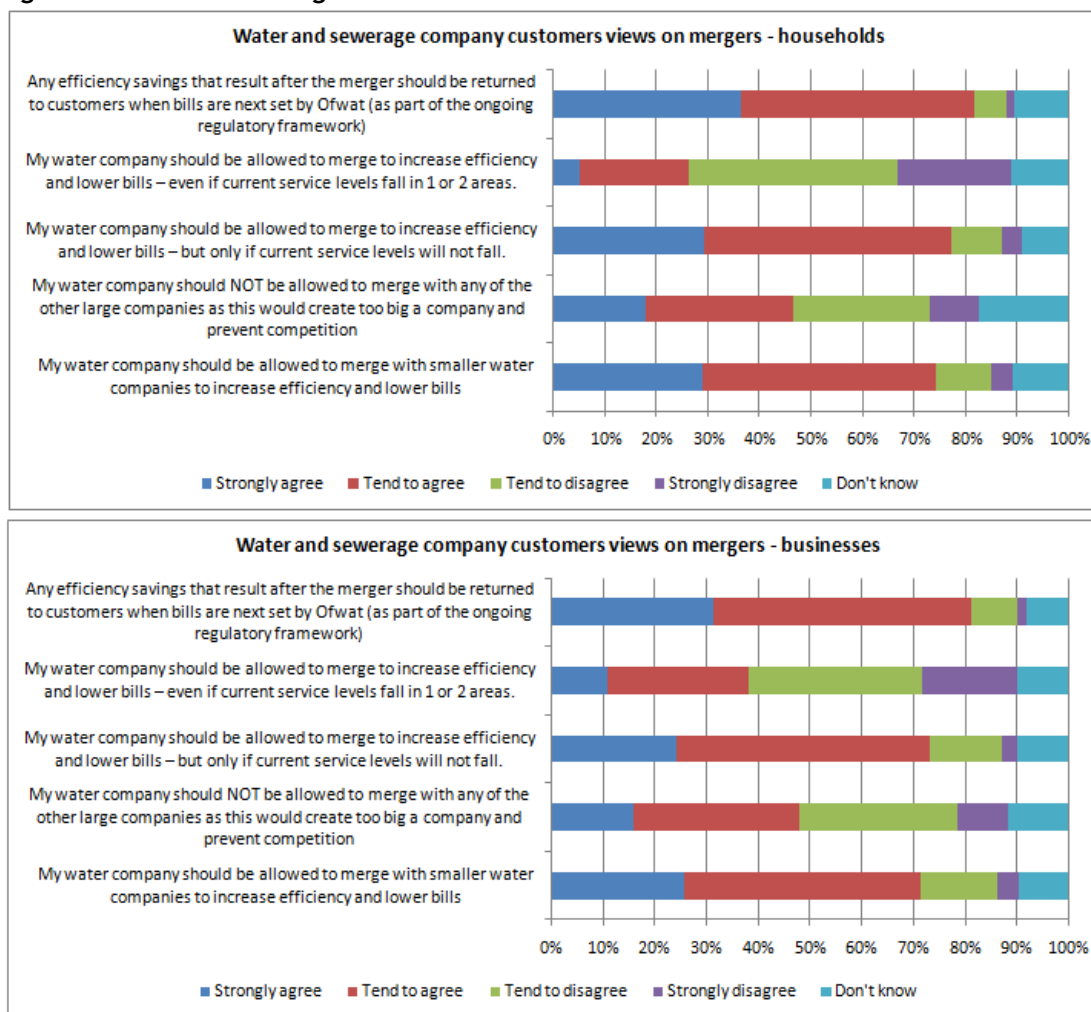
The survey shows that there is strong support for mergers that lower bills across all three regions sampled. This also shows there is some appetite for mergers resulting in an improvement in service but maintaining service is very important, and customers do not generally support mergers that cause overall service to drop.

Figure 1.5: General views on mergers - split by customer type



Views of customers from WASCs

The respondents that are customers of WASCs were shown five statements around mergers affecting their water company. This showed that customers of the larger WASCs generally support mergers with the smaller companies if this can increase efficiency. There is less support for larger companies merging on the grounds that this may create companies that are too big. Customers are keen for service in general to be maintained post merger.

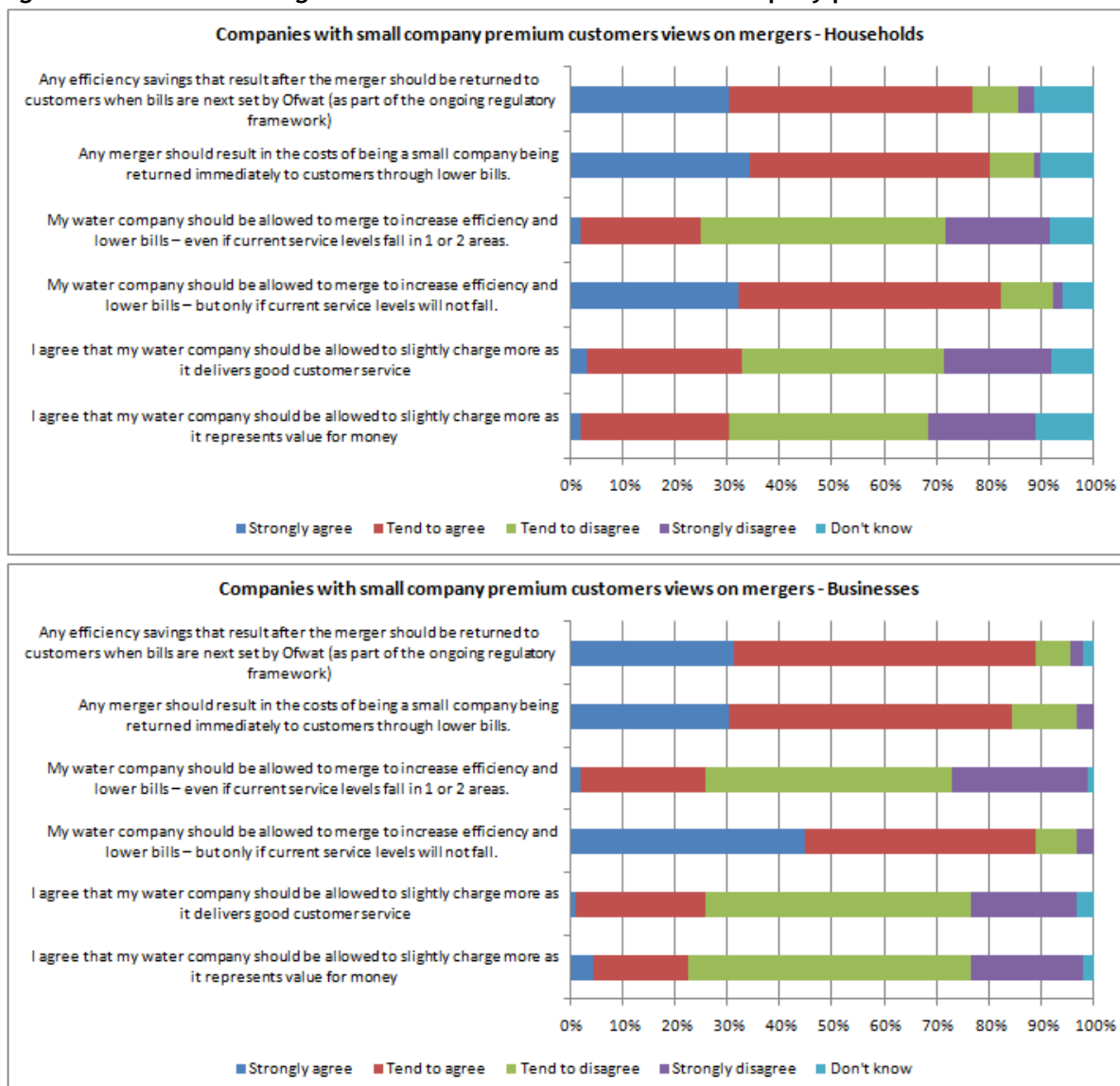
Figure 1.6: Views on mergers - WASC customers - household and business

Views of customers from WOCs with small company premium

The respondents that are customers of Sembcorp Bournemouth Water or Portsmouth Water were informed about the small company premium. They were shown statements around mergers.

This showed that customers of companies with the small company premium generally support mergers that lower bills, and return savings to customers through the regulatory process. They also did not see the small company premium as value for money or being in return for good customer service.

Customers are very clear that it is important for service in general to be maintained post merger.

Figure 1.7: Views on mergers - customers of WOC with small company premium

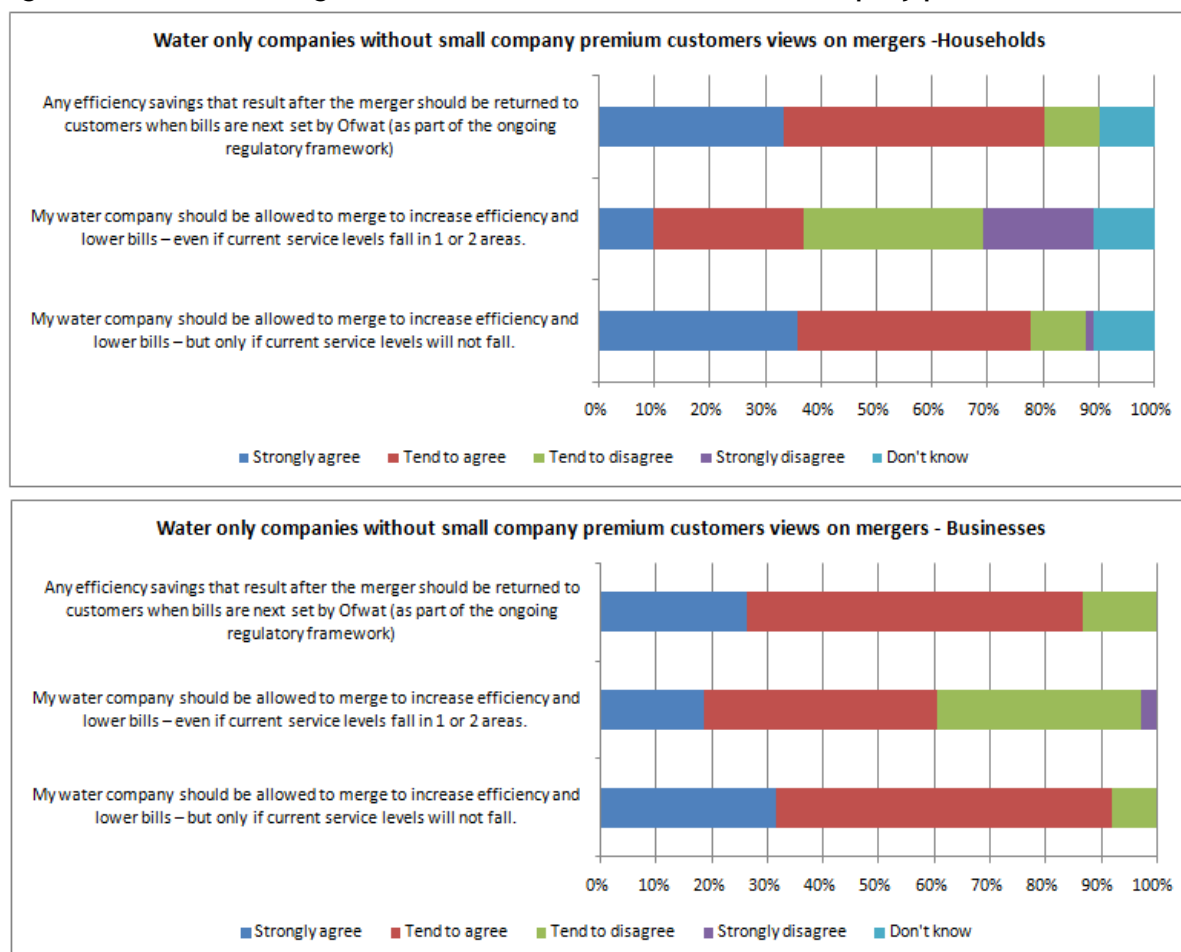
Views of customers from WOCs without the small company premium

The customers of water only companies other than Sembcorp Bournemouth Water or Portsmouth Water were informed about the small company premium, but it was explained their water company would not have this over the period 2015-2020 as they were not efficient or not small enough to qualify.

They were shown statements around mergers and were asked to indicate to what extent they agreed or disagreed with the statements.

This showed that customers of these companies also support mergers that lower bills, and return savings to customers through the regulatory process.

There was a clear steer, especially from households, that it is important for service in general to be maintained post merger.

Figure 1.8: Views on mergers - customers of WOC without small company premium

1.6 Conclusions

The customer research has been useful in understanding customers' views on market reform and industry structure in England and Wales. This shows that views across the country on these issues are very similar, with household and business customers from small and large water companies having consistent views.

Market Reform

The study shows that overall there are low levels of understanding of the changes underway in the industry to increase competition, with only a small proportion of customers aware of changes to retail from 2017.

Despite the low levels of understanding of market change, respondents indicated they were keen to see competition increased in the water industry, along the lines of the energy industry. Customers believe this will result in innovation, lower bills, and improvements in service. However some customers did highlight concerns that this could cause confusion about who would be responsible when there are issues with water or wastewater services, and increases in cold-calling and the hard sell.

Across customer types, there is some appetite to look for an alternative supplier. The overriding consideration would be whether this could lower the bill. All other issues were secondary to this.

Mergers and Consolidation

The study showed that customers are very positive about mergers, as this may be a way to lower bills. The study also highlighted that the mergers should not result in lower service to customers.

The survey considered the customers' views of (1) the larger water and sewerage companies; (2) the two water only companies that qualify for the small company premium over 2015-2020; and (3) the other water only companies. This showed that there is support for mergers between the smaller companies, or between the larger and smaller companies; but there is less support for the consolidation of the larger companies.

The study showed there are very strong views that any costs of being a small company (i.e., the small company premium) and any ongoing savings following the merger are returned to customers in the form of lower bills.

Views of Sembcorp Bournemouth Water Customers

The study shows there are high levels of support for Sembcorp Bournemouth Water, with a below average proportion of customers that would consider switching supplier if they had the choice.

Despite this, most customers said they did not see the small company premium as value for money or being in return for good customer service. Consequently, customers would support a merger that would see this returned to customers. Any further savings that are realised should also be returned to customers through the regulatory framework.

Finally, the customers of Sembcorp Bournemouth Water were cautious about bill reductions being at the expense of service. A focus for further customer research could consider what aspects of service are considered critical.

2 Introduction

2.1 Project Objectives

ICS Consulting (ICS) has a history of supporting South West Water (SWW) with customer engagement and research.

A new area of interest for South West Water is customers' views on market reform and industry structure. This includes South West Water customers but also the customers of other companies to see if there are marked differences in views.

Of particular interest are the views of the customers of Sembcorp Bournemouth Water and South West Water around their appetite for mergers and consolidation.

We have worked two market research companies - Facts International and YouGov - to develop and implement a customer survey. Facts International has been the lead market researcher, with YouGov used to bolster the sampling in the Sembcorp Bournemouth Water region.

The survey has explored a number of issues around industry structure and market reform such as:

- Customers understanding of, and views on, the current structure of the market and ability to choose their own retail supplier.
- Views on what factors encourage and discourage switching of retail supplier.
- Mergers and acquisitions, including when mergers are appropriate and the return of any merger savings.

This document sets out the findings of the study, in particular around customer views in relation to any merger between South West Water and Sembcorp Bournemouth Water.

2.2 Report structure

This report presents the approach and results of the study. The report is structured as follows:

- Survey design and implementation (Section 3)
- Fieldwork results (Section 4)
- Conclusions (Section 5)
- Appendix, containing copies of the household and business survey (Section 6)

3 Survey Design and Implementation

The survey design and implementation process involved 4 steps:



3.1 STEP 1: Questionnaire Design

We consulted with South West Water to confirm the objectives, scope and key requirements for the research. Based on this, an initial survey was designed.

Facts International reviewed the survey and provided recommendations based on their extensive experience of fieldwork. The survey was then reviewed by South West Water and the survey finalised.

No pilot study was undertaken or recommended as the survey is relatively straightforward in nature, and built on previous studies examining similar issues explored by ICS and Facts International.

Copies of the household and business surveys are in the Appendix to this report. The questionnaire structure is outlined in the table below.

Table 3.1: Questionnaire structure

Section	Descriptions
Section A: Recruitment and screening	<p>This section confirms the respondents' eligibility to complete the survey.</p> <p>These questions are asked to determine the representativeness of the sample (such respondent's water company, age and gender for household customers, and company size and industrial classification for business customers).</p>

Section B: Market Reform and Industry Structure	<p>Section B of the survey explains that from April 2017 all business customers in England will be able to choose their water and sewerage supplier, and asks respondents their views on the changes - to understand their views on whether they support this change and if so why. This section also asks household customers if they would consider changing supplier and captures the reasons for their answers.</p> <p>This section also questions household and business customers about mergers in the sector, including under what situations they would favour mergers, what should happen to the small company premium and any other merger savings, and what do they expect in terms of service changes.</p>
Section C Socio-economic questions (<i>household survey only</i>)	<p>These questions are asked to gather information to ensure that the survey provides wide coverage of customers' characteristics. Examples include the composition of the respondents' household. The data in this section can be used to understand how customers' views differ as their characteristics change.</p>

3.2 STEP 2: Set Sample Sizes and Quotas

Three samples were collected in total:

- National
- South West Water
- Sembcorp Bournemouth Water

All three had target sample sizes and household quotas set based on 2011 Census data, using NOMIS¹.

3.3 STEP 3: Online Fieldwork

The survey of household customers used online panels. While this approach avoids the potential for interviewer bias there is greater potential for the exact meaning to not be interpreted correctly. However given the lack of complexity in the survey this was not considered to be an issue.

¹ NOMIS is a service provided by the Office for National Statistics, ONS, which gives access to UK labour market statistics from official sources.

To support the household online survey in the Sembcorp Bournemouth Water region, YouGov was engaged as a second market researcher. Both Facts and YouGov warned about the difficulty in achieving a representative sample in this region; however the overall sample does reflect the nature of the population in this area reasonably well.

The survey of businesses used online panels. In the case of Sembcorp Bournemouth Water, Facts International boosted the results with a CATI-to-Online approach, whereby businesses in the region were contacted by telephone and directed to an online link to complete the survey.

3.4 STEP 4: Analysis

The collected fieldwork data has been disaggregated for analysis by:

- Region: split into South West Water, Sembcorp Bournemouth Water, and National (excluding the former two areas)
- Customer type: split household and business
- Some further analysis by breakdown of customer type, e.g. SEG, has been undertaken in some instances.

The data collected has been analysed and the results presented in Section 4.

4 Survey Fieldwork Results

4.1 Sample Size

There are three samples in total. The sample size set for Sembcorp Bournemouth Water was smaller than the National and South West Water sample, due to difficulties in recruiting large samples in this area. It is, however, large enough to collect views of the customers in this region.

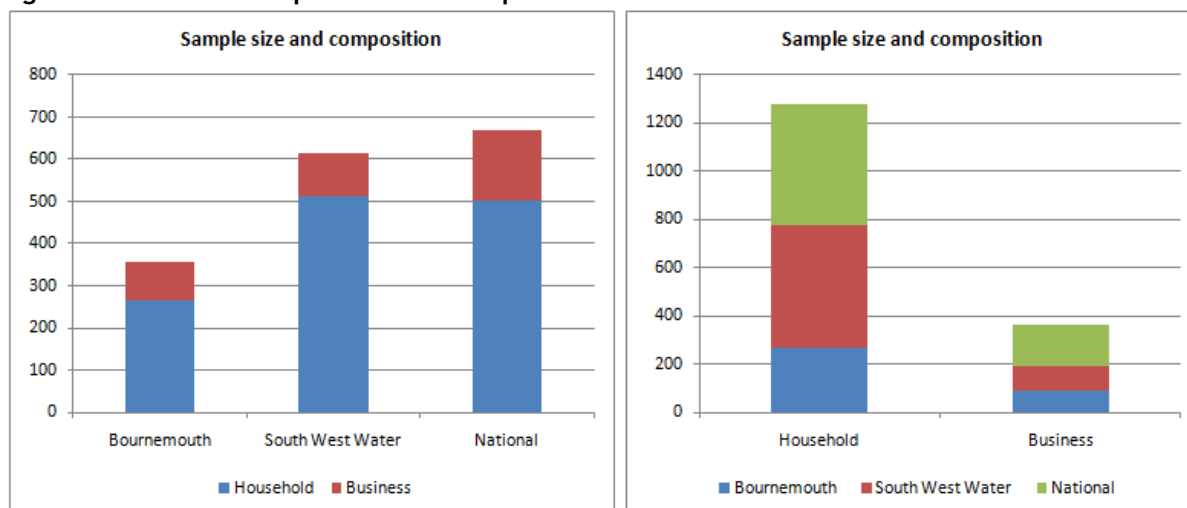
Table 4.1: Sample sizes

		Target	Actual
Household	<i>Overall</i>	<i>1250</i>	<i>1279</i>
	National	500	501
	SWW	500	511
	SBW	250	267
Business	<i>Overall</i>	<i>350</i>	<i>362</i>
	National	150	168
	SWW	100	105
	SBW	100	89

The sample sizes for the household samples are sufficient to apply statistical analysis for households in total and for each of three regions; for businesses the samples are sufficient to apply statistical analysis for businesses in total, and caution should be applied when reviewing the business customer findings at the regional level.

A total of 1641 respondents were surveyed in total, against an initial target of 1600.

Figure 4.1: Overall Sample size and composition



4.2 Household Sample

The household dataset had quotas set, despite some concerns about being able to meet quotas in the Sembcorp Bournemouth Water region:

Table 4.2: Household Quotas

		National	Sembcorp Bournemouth Water	South West Water
Gender	Female	51%	51%	52%
	Male	49%	49%	48%
Age	18-29	21%	18%	11%
	30-44	26%	23%	31%
	45-64	32%	32%	34%
	65+	21%	28%	24%
SEG	AB	23%	23%	24%
	C1C2	52%	55%	46%
	DE	26%	22%	31%

Note: the National quotas were based on data across the UK, and the Sembcorp Bournemouth Water quotas were based on Bournemouth postcodes.

The sample quotas are similar for all three samples, although the Sembcorp Bournemouth Water region has less socio-economic group 'DE' and more in the higher age band than the National and South West Water sample.

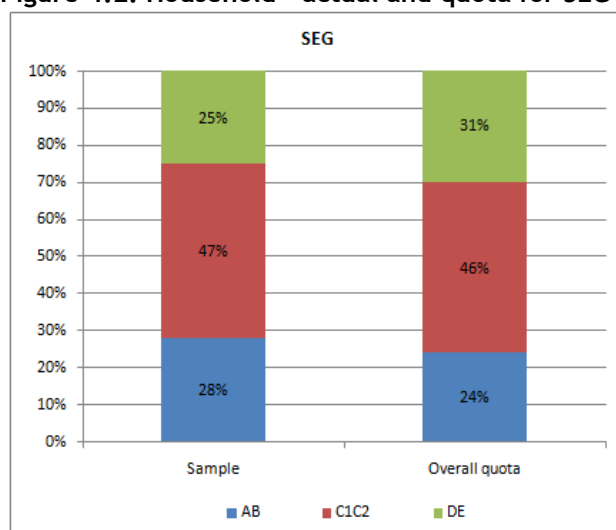
YouGov has a pre-set age profile categories, which were used for the booster sample. The quotas for this sample were:

Table 4.3: YouGov Age Quotas - Bournemouth Region

	Quota
18-24	12%
25-34	17%
35-44	17%
45-54	16%
55+	37%

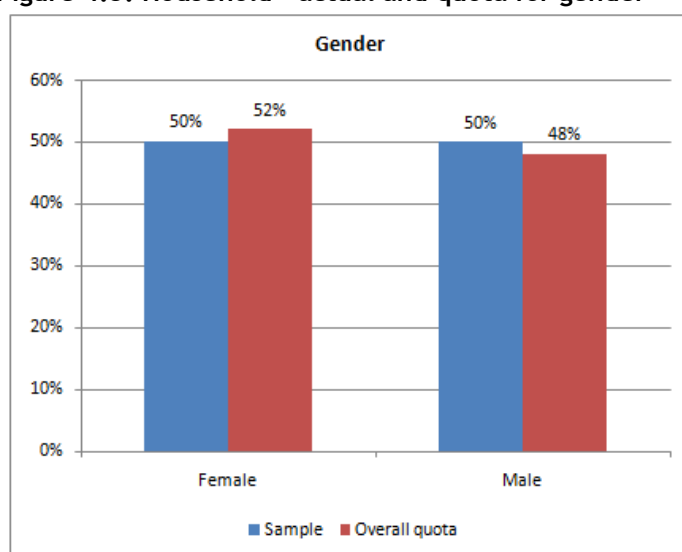
The figure below shows that overall the sample SEG is close to the quota.

Figure 4.2: Household - actual and quota for SEG

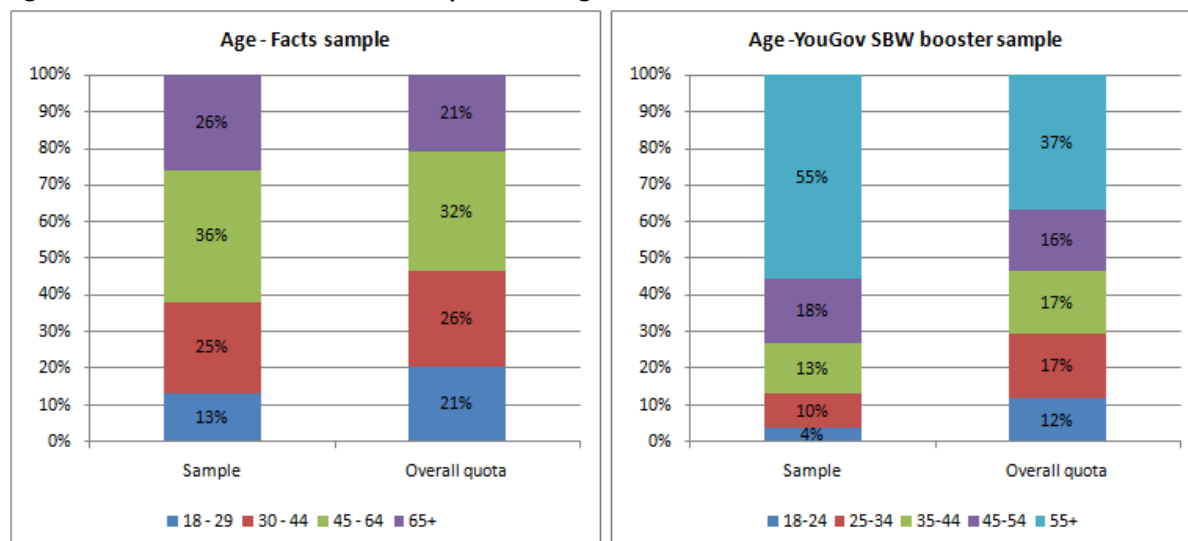


All samples show very close alignment to the quotas for gender.

Figure 4.3: Household - actual and quota for gender

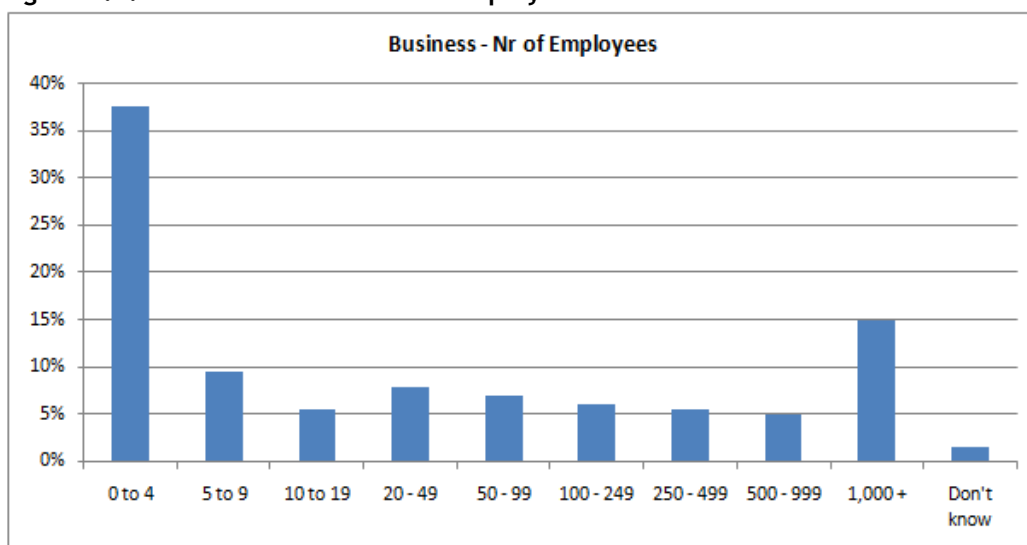


All samples show reasonable alignment to the age quotas. YouGov has a pre-set age profile categories, which were used for the booster sample. The YouGov sample is more biased towards older people, but overall there is a reasonable spread of all ages.

Figure 4.4: Household - actual and quota for age

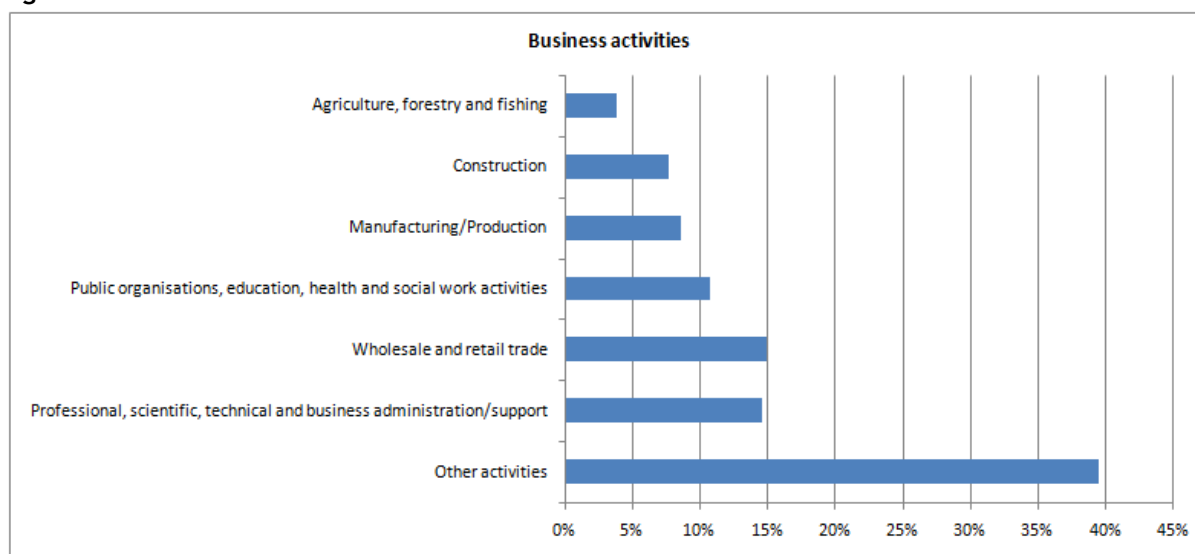
4.3 Business Sample

The business sample reflects a mix of business sizes:

Figure 4.5: Business - actual size in employee numbers

The business sample reflects a good mix of business types:

Figure 4.6: Business - industrial classification



4.4 Customers Views on Market Reform

Awareness of legislative changes

The introduction to Section B of the survey explained to customers the services provided by water and sewerage company can be divided into two services:

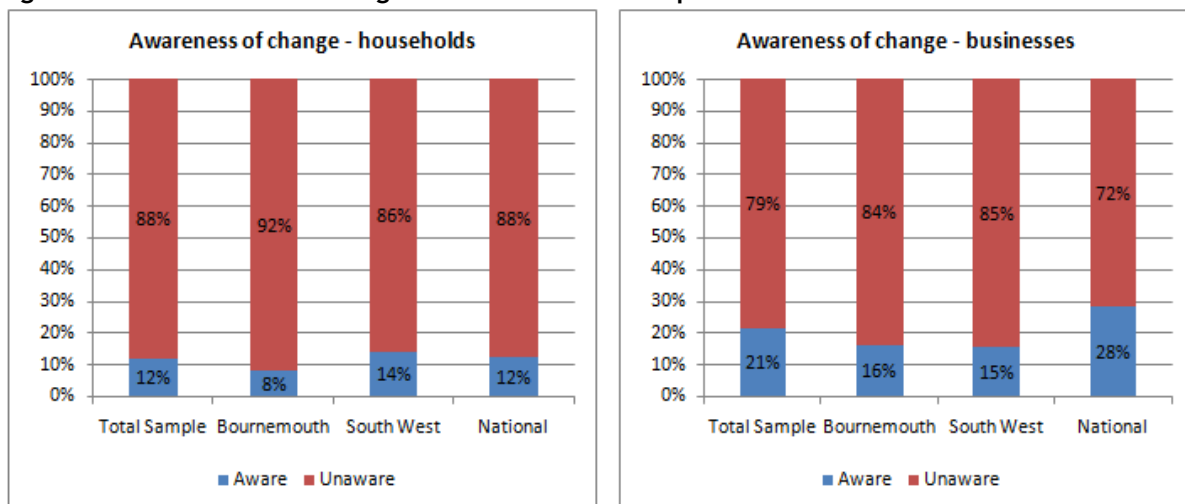
- providing water and sewerage services through the pipes to and from households/organisations
- retail services, which includes handling customer queries and complaints, billing and meter reading.

It subsequently explained that the government has recently passed legislation to increase competition in the water industry, meaning that from April 2017 all businesses will be able to switch their supplier of water and sewerage retail services.

Businesses were also informed that businesses with water usage over a certain threshold could already change retail supplier. Households were told they were not allowed to switch retail supplier yet.

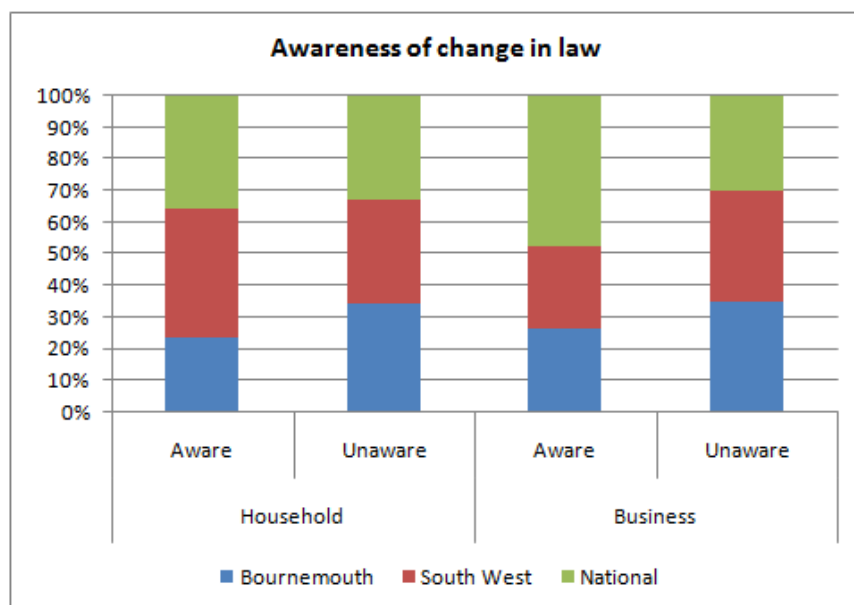
The survey then asked both household and businesses how aware they were of the changes to legislation allowing all businesses to choose their own supplier from 2017. There were low levels of awareness across the whole sample, with businesses slightly more informed.

Figure 4.7: Awareness of changes to law from 2017 - split households and businesses



This can also be shown as:

Figure 4.8: Awareness of changes to law from 2017 - all customers

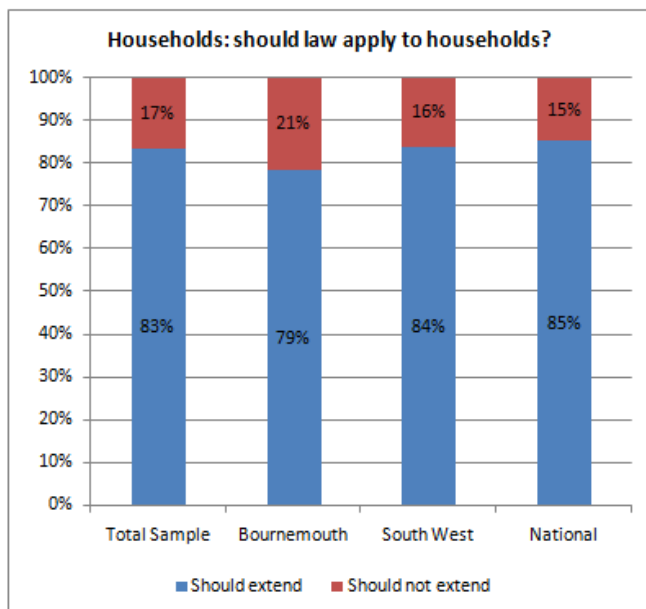


This shows that there are low levels of awareness of changes across all customers, with Sembcorp Bournemouth Water households the least well informed households; and South West Water businesses the least well informed businesses.

Views on the changes

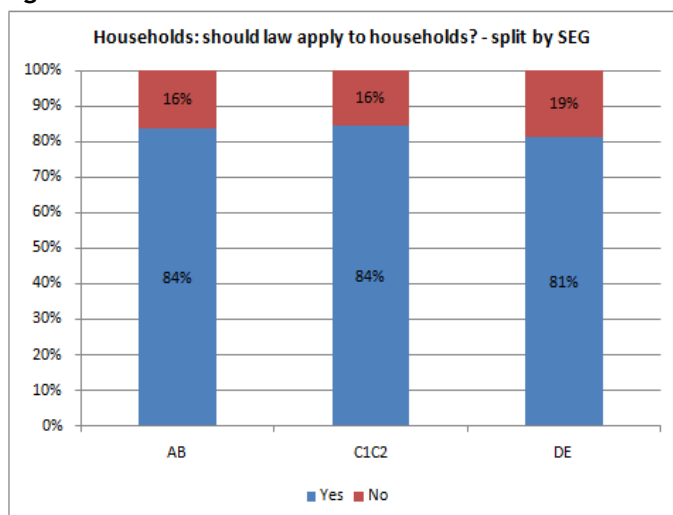
Households were asked if the changes should be extended to household customers. Households were in favour of extending the provisions to households.

Figure 4.9: Households - should households have the choice of supplier



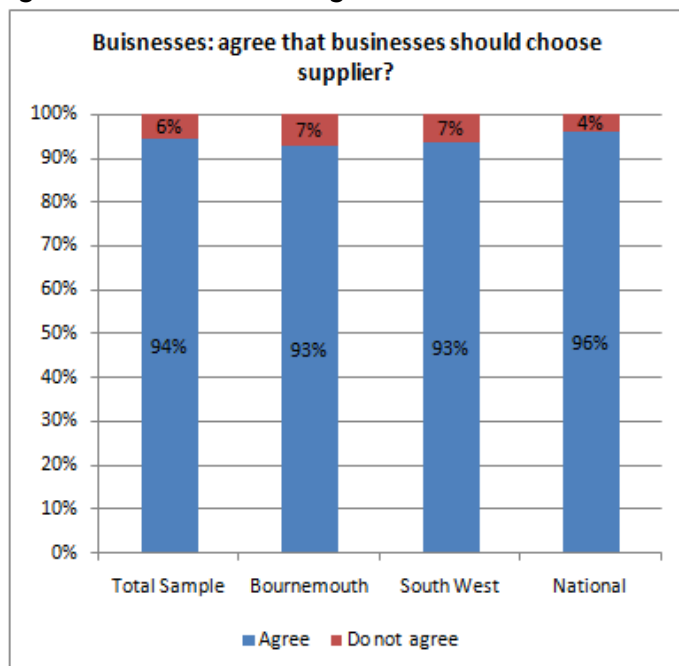
This result was consistent across all of the socio-economic groups (SEG), with those in the lower band slightly more in favour of household choice.

Figure 4.10: Households - should households have the choice of supplier - split by SEG



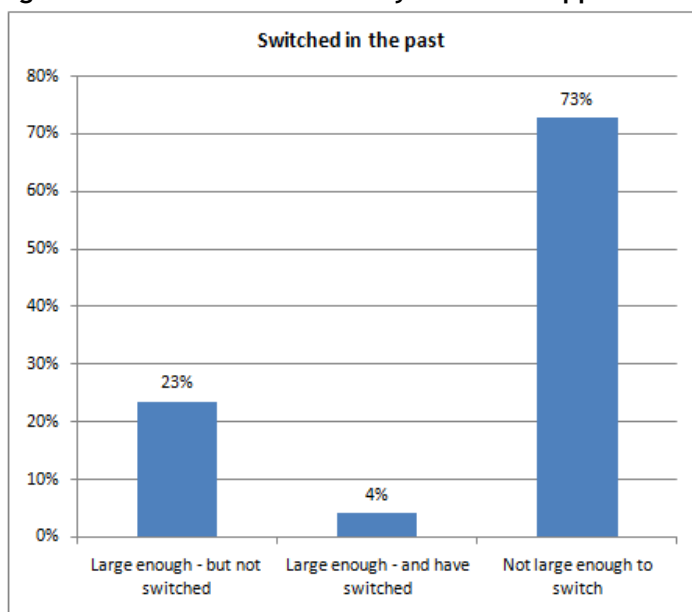
In contrast to this question, businesses were asked if they agreed that businesses should be able to choose their own supplier. Few businesses disagreed with the provisions.

Figure 4.11: Businesses - agree businesses should have the choice of supplier



A small percentage of businesses in the sample indicated they were large enough to currently switch supplier, with some indicating they had switched supplier.

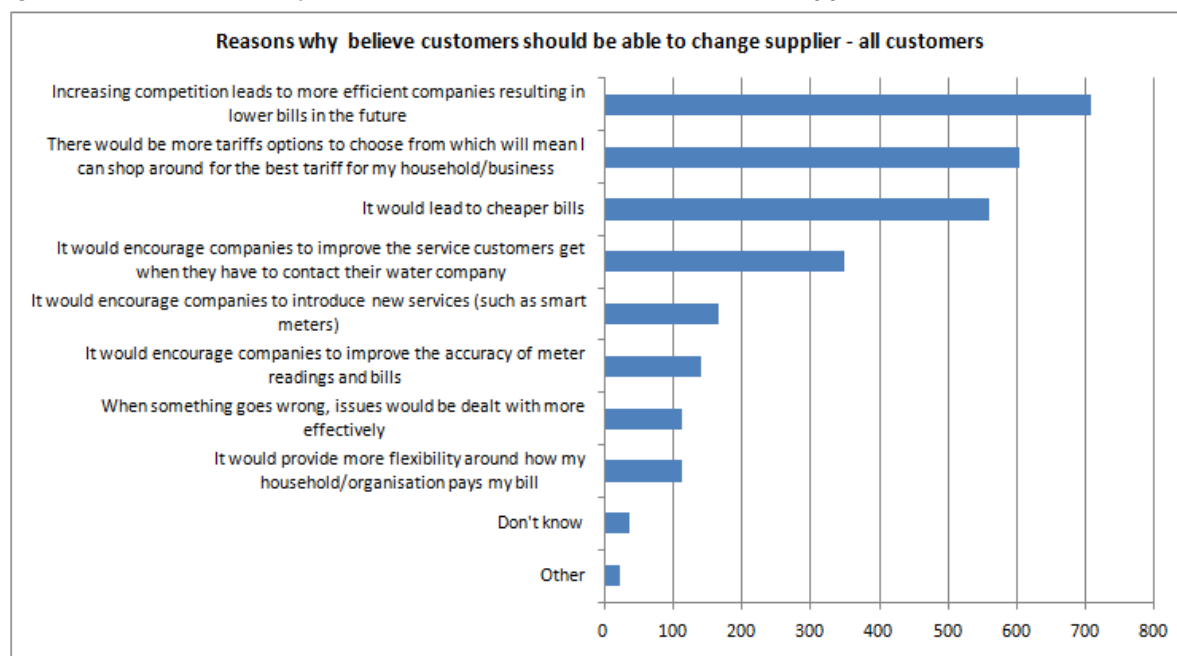
Figure 4.12: Businesses - already switched supplier



Reasons to switch

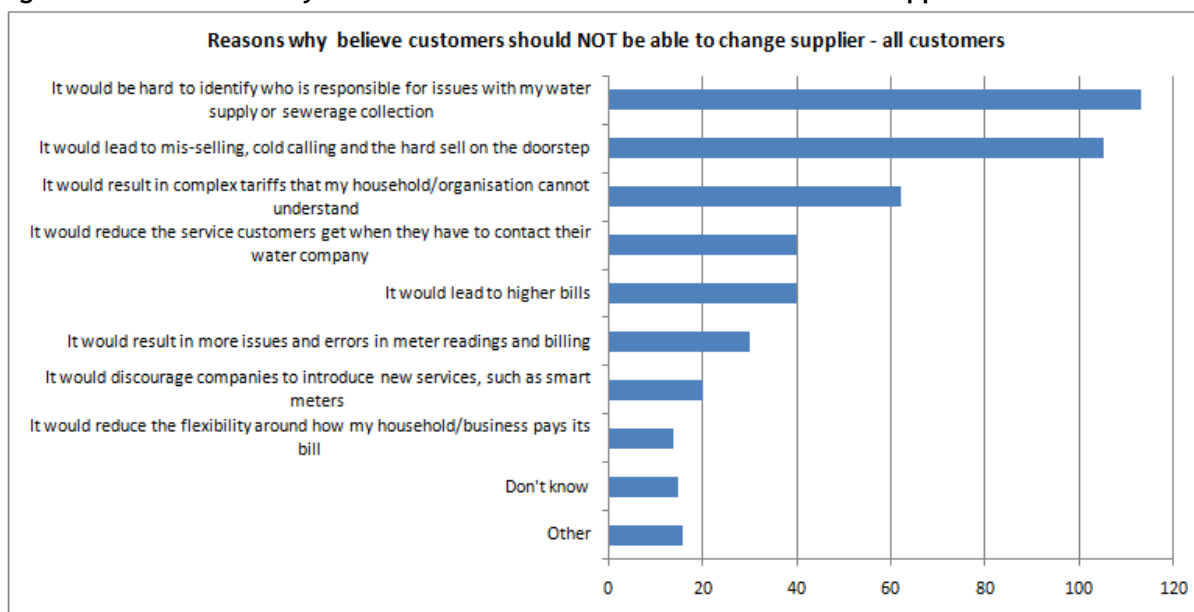
The key reasons that customers consider they should be able to choose their own supplier are around reducing overall bills through efficiency or shopping around for a better deal.

Figure 4.13: Reasons why customers want to be able to choose supplier



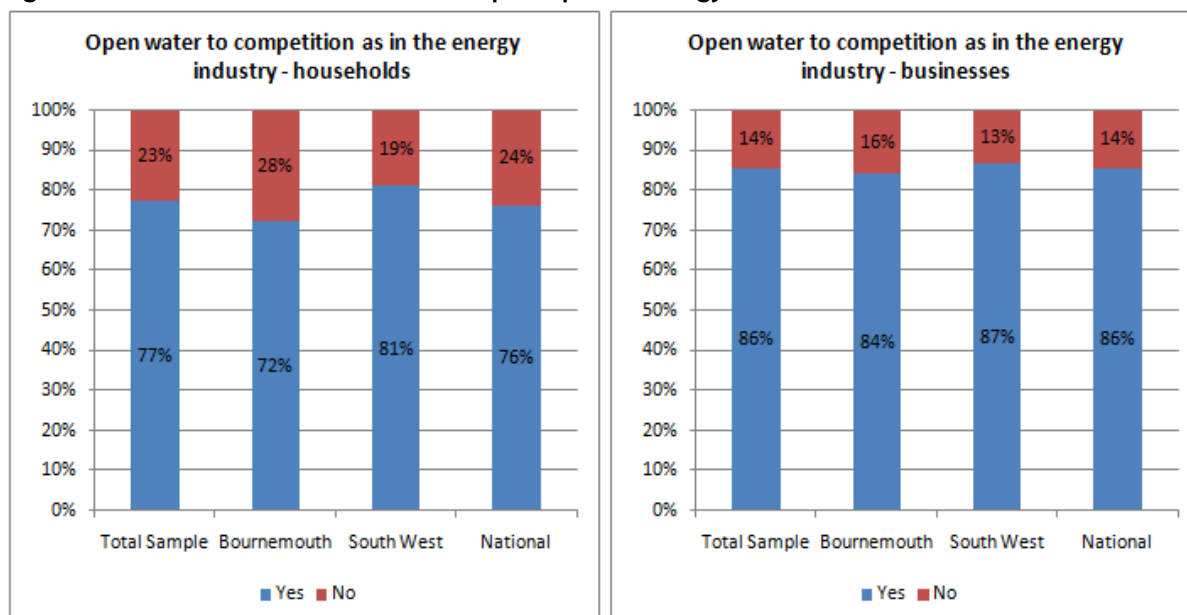
For those customers that were against allowing customers to choose their own supplier the most cited reasons was concern about who would be ultimately responsible for issues in water supply/sewerage collection; concerns around cold-calling and the hard sell; and worries about the complexity of tariffs.

Figure 4.14: Reasons why customers do not want to be able to choose supplier



Customers were asked if they would wish the water industry to open up the same way as the energy market has. Despite the recent media attention around the energy industry, customers generally would welcome similar moves in the water industry. The views for this were strongest amongst the business customers.

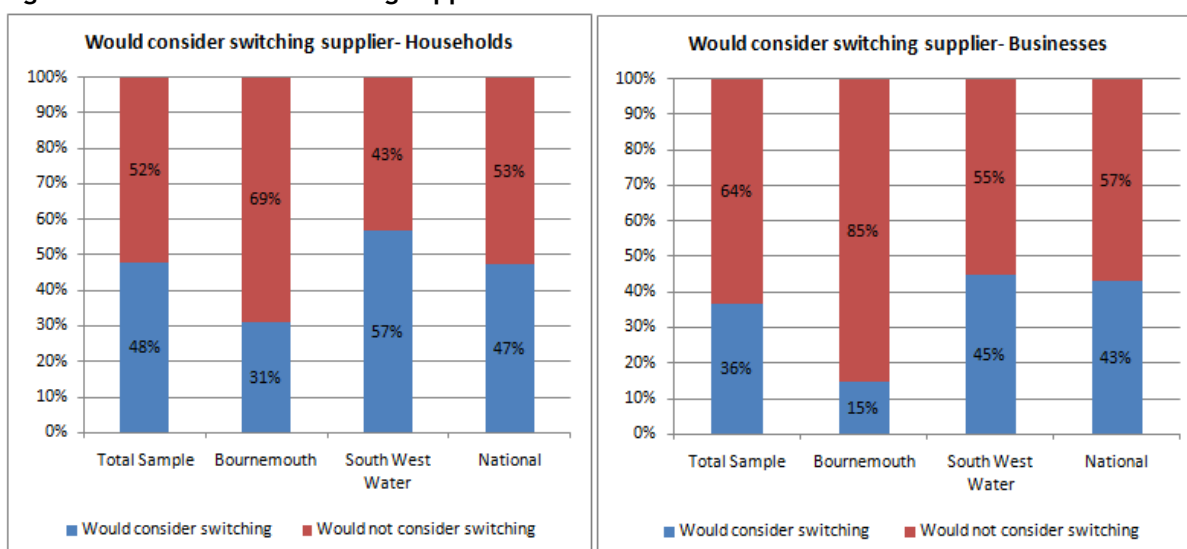
Figure 4.15: Views on if water should open up like energy has: Household and Business



Views on current supplier

All customers were asked if they would consider switching supplier themselves.

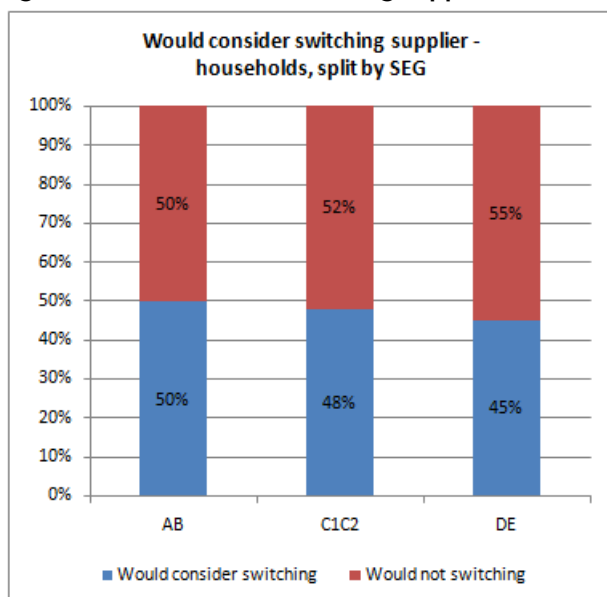
Figure 4.16: Views on switching supplier - households and businesses



Despite earlier support for the move to open up the market, there were not very high levels of support for switching supplier. Sembcorp Bournemouth Water has the lowest support for considering switching supplier of all the samples considered. Note: the business results are based on relatively small sample sizes and caution should be applied to the regional results.

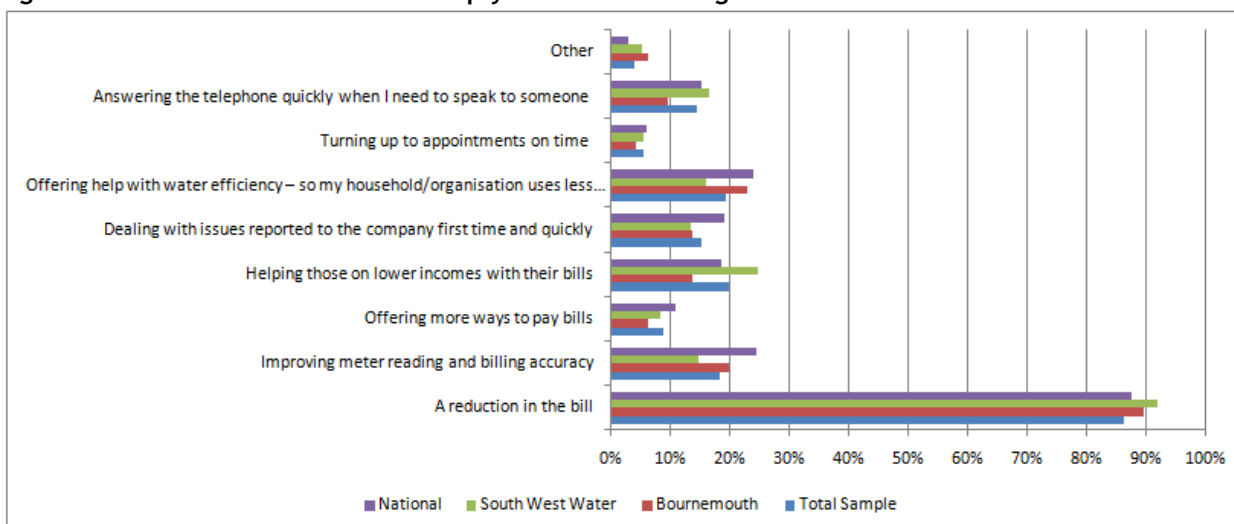
The figure below shows that household views on switching supplier were not affected by SEG:

Figure 4.17: Views on switching supplier: households, split by SEG



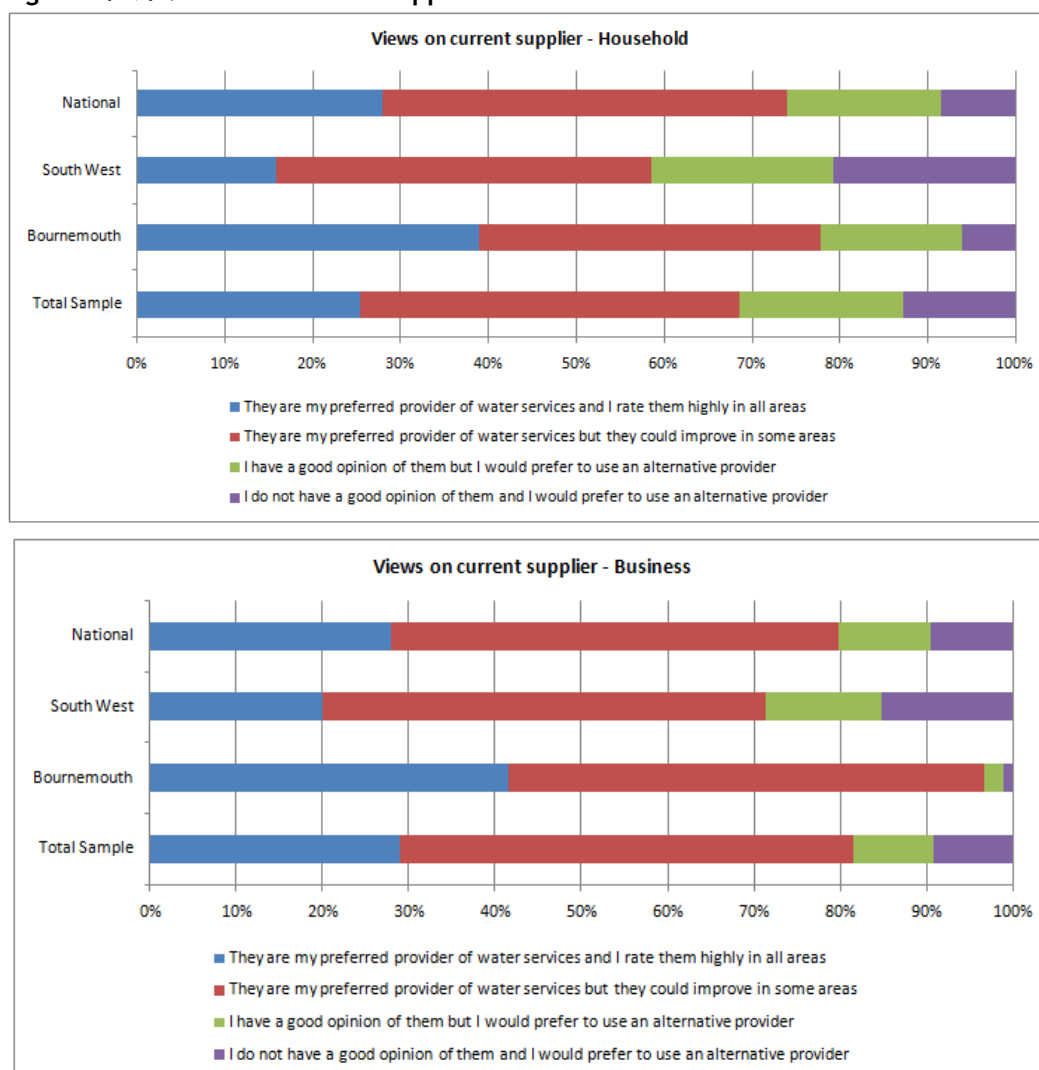
Across all samples the main reason to stop switching would be a reduction in the bill. All other issues were secondary to this overriding driver.

Figure 4.18: Views on what would stop you from switching



When asked their views on their current supplier, Sembcorp Bournemouth Water customers were the most positive about their water company. Household and business views were the same on this issue.

Figure 4.19: Views on current supplier



4.5 Views on Industry Structure and Mergers

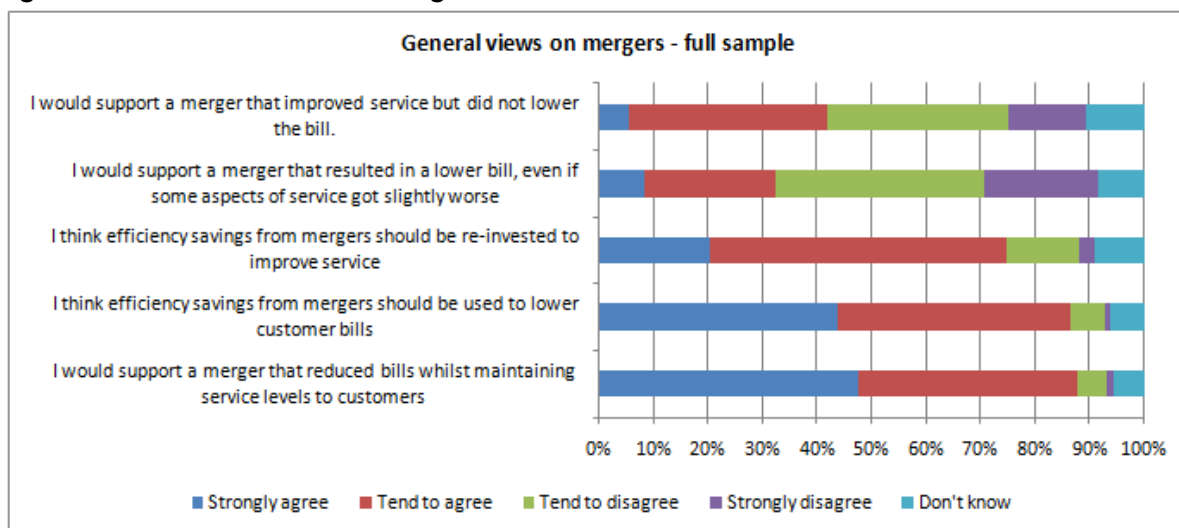
Customers were informed of the structure of the industry, and how this has changed since privatisation through the mergers of smaller companies, or smaller companies merging with the larger companies.

In addition the role of the small company premium was explained, adding that this is only applicable over the period 2015-2020 to the smaller companies that can demonstrate they are efficient for their size (i.e., Sembcorp Bournemouth Water and Portsmouth Water).

Customers were then all asked a general set of questions on mergers. A series of statements were shown to the respondents and they were asked to indicate to what extent they agreed or disagreed with the statements.

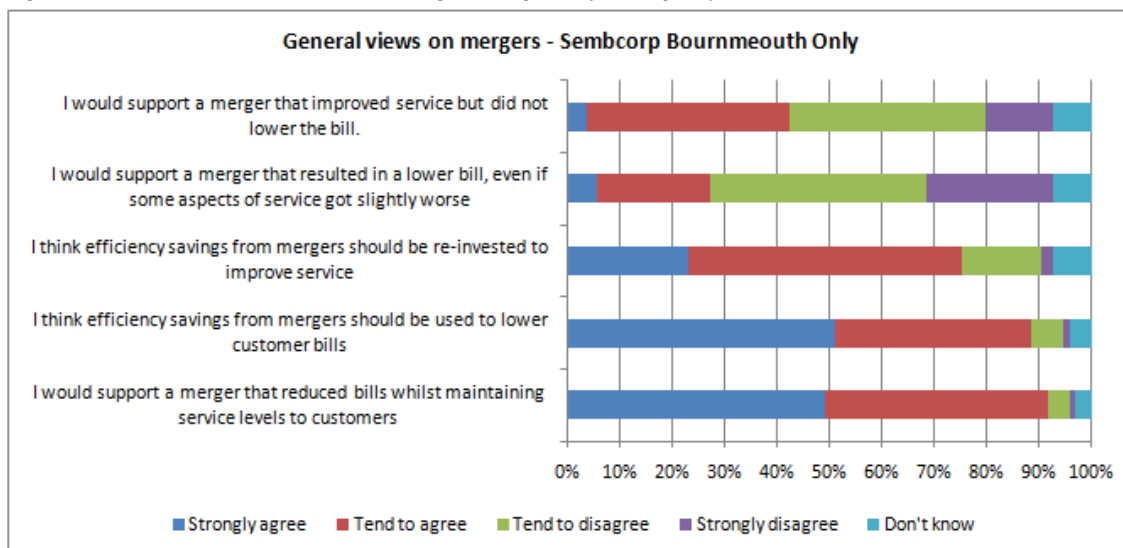
This shows there is strong support for mergers that lower bills across all three samples. This also shows there some appetite for mergers resulting in an improvement in service as well as a lowering of the bill. However maintaining service is important, and customers do not generally support mergers that cause overall service to drop.

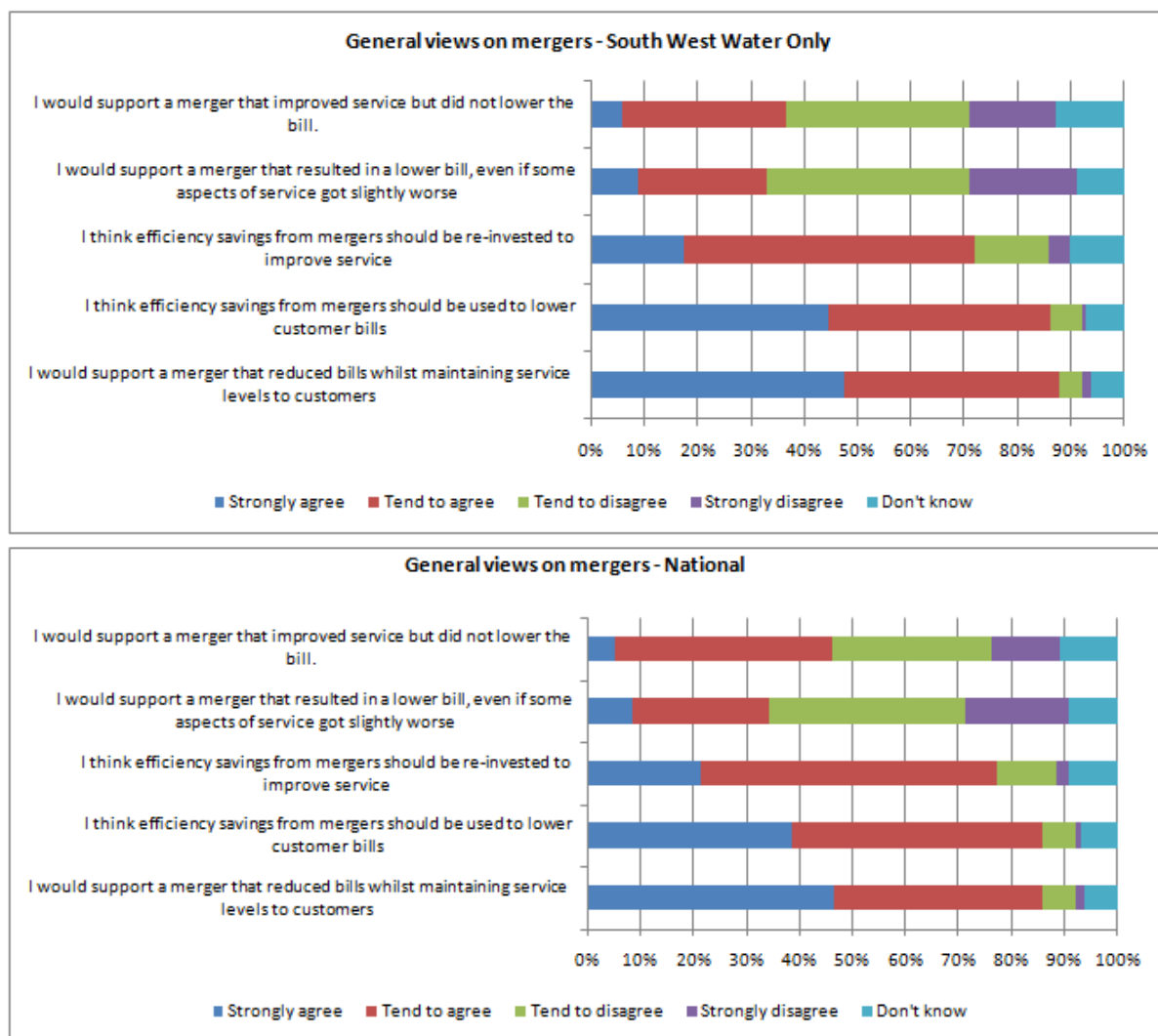
Figure 4.20: General views on mergers - all customers



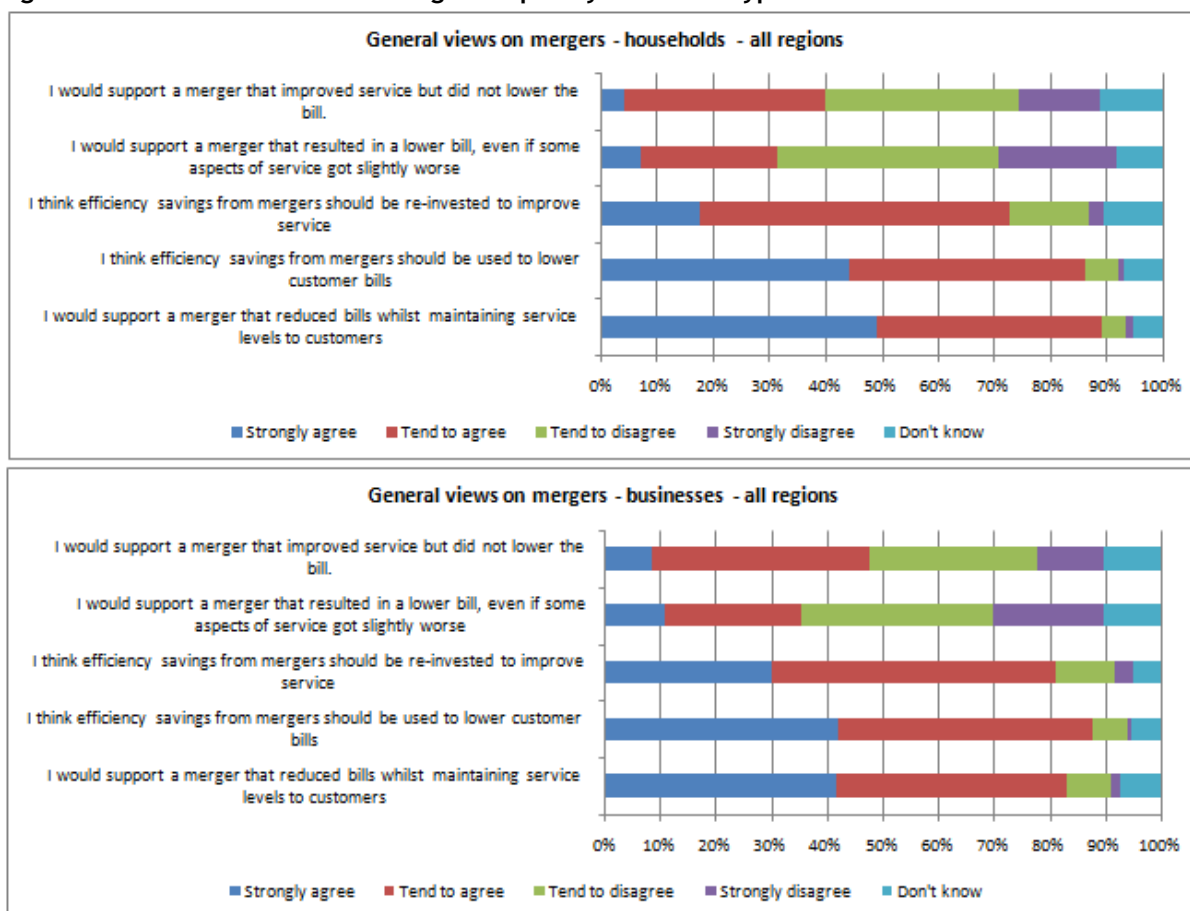
The results are represented across all three regions.

Figure 4.21: General views on mergers - split by company





This is also consistent across households and businesses:

Figure 4.22: General views on mergers - split by customer type

The next set of merger questions was split according to the nature of the water company supplying the customer:

- customers of water and sewerage companies
- customers of the two companies eligible for the small company premium over the period 2015-2020
- customers of the remaining water only companies

Views of customers from WASCs

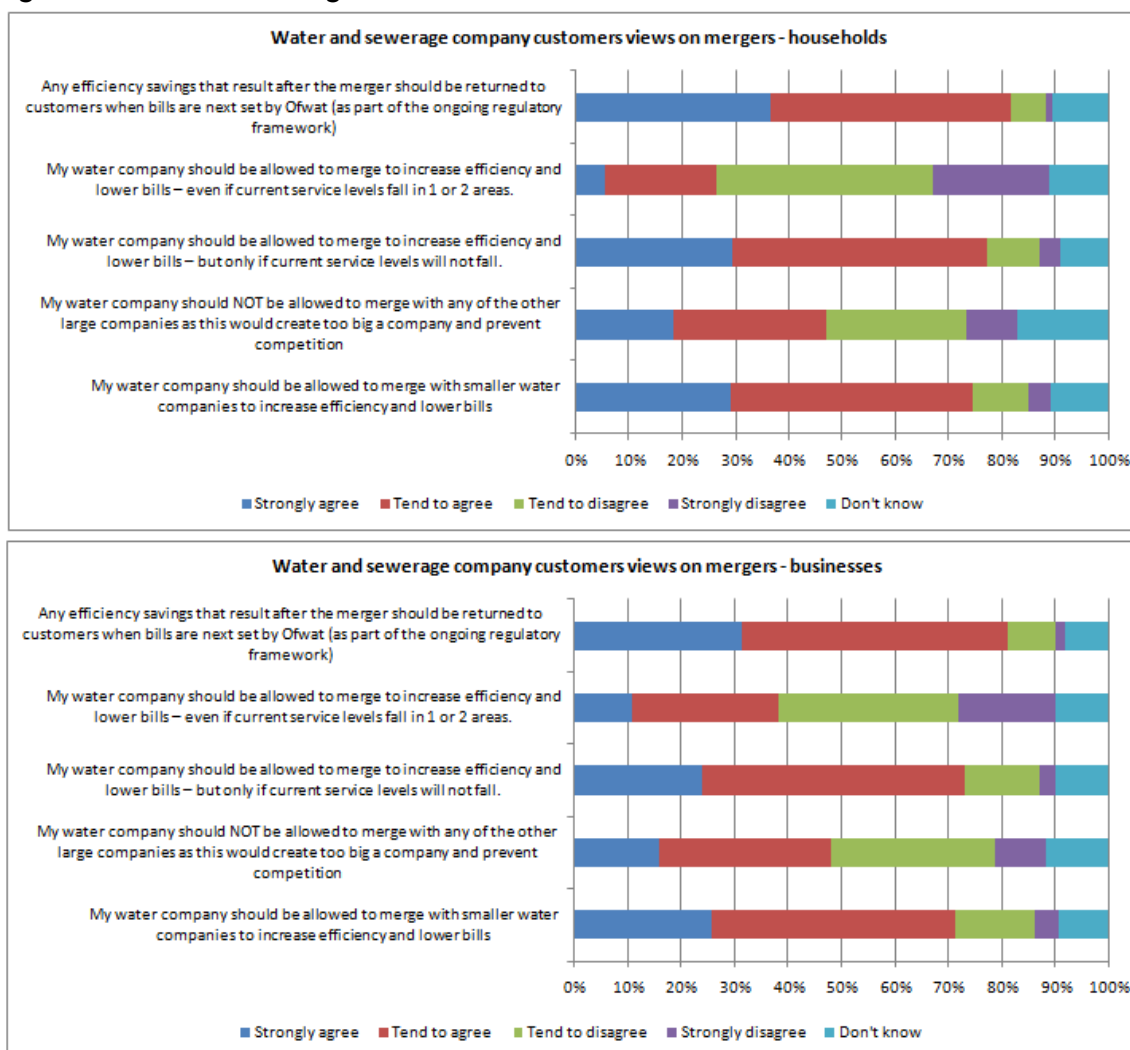
The respondents that are customers of WASCs were shown five statements around mergers affecting their water company. They were asked to indicate to what extent they agreed or disagreed with the statements.

This showed that customers of the larger WASCs generally support mergers with the smaller companies if this can increase efficiency. There is less support for larger companies merging on the grounds that this may create companies that are too big. Around half of customers supported and half did not support mergers between large companies.

Customers keen for service in general to be maintained post merger.

Both household and business customers have similar views.

Figure 4.23: Views on mergers - WASC customers - household and business



Views of customers from WOCs with small company premium

The respondents that are customers of Sembcorp Bournemouth Water or Portsmouth Water (in total there are 5 Portsmouth Water customers in the sample, which were all households) were informed about the small company premium. They were shown statements around mergers - and the impact this could have on the small company premium - and were asked to indicate to what extent they agreed or disagreed with the statements.

This showed that customers of companies with the small company premium generally support mergers that lower bills, and return savings to customers through the regulatory process. They also did not see the small company premium as value for money or being in return for good customer service.

Customers are very clear that it is important for service in general to be maintained post merger.

Figure 4.24: Views on mergers - customers of WOCs with small company premium

Views of customers from WOCs without the small company premium

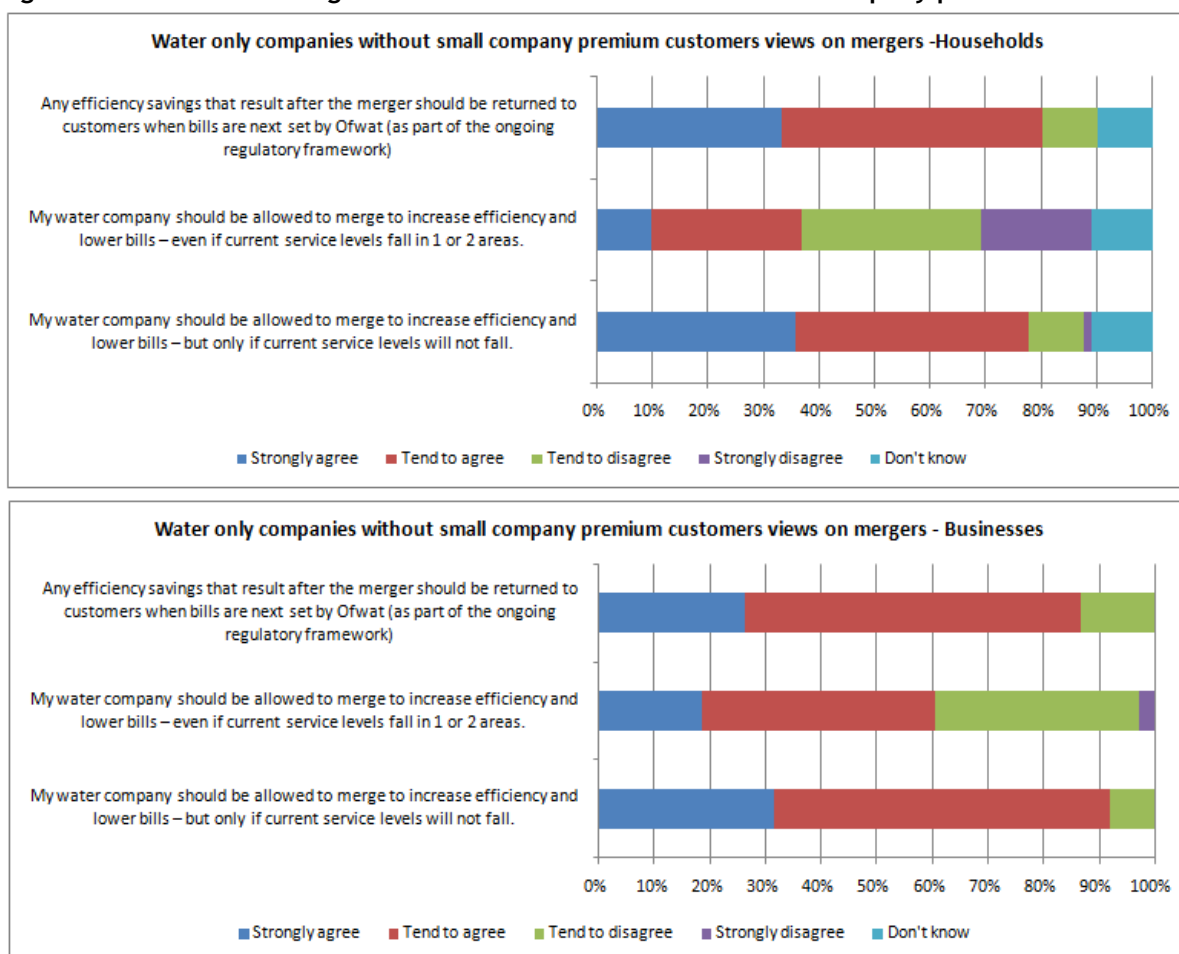
The customers of water only companies other than Sembcorp Bournemouth Water or Portsmouth Water were informed about the small company premium, but it was explained their water company would not have this over the period 2015-2020 as they were not efficient or not small enough to qualify.

They were shown statements around mergers and were asked to indicate to what extent they agreed or disagreed with the statements.

This showed that customers of these companies also support mergers that lower bills, and return savings to customers through the regulatory process.

There was a clear steer, especially from households, that it is important for service in general to be maintained post merger.

Figure 4.25: Views on mergers - customers of WOC without small company premium



5 Conclusions

The customer research has been useful in understanding customers' views on market reform and industry structure in England and Wales. This shows that views across the country on these issues are very similar, with household and business customers from small and large water companies having consistent views.

This study has focused in particular on the views of the customers of Sembcorp Bournemouth Water and South West Water, and their appetite for mergers and consolidation.

5.1 Market Reform

The study shows that overall there are low levels of understanding of the changes underway in the industry to increase competition, with only a small proportion of customers aware of changes to retail from 2017.

Despite the low levels of understanding of market change, respondents indicated they were keen to see competition increased in the water industry, along the lines of the energy industry. Customers believe this will result in innovation, lower bills, and improvements in service. However some customers did highlight concerns that this could cause confusion about who would be responsible when there are issues with water or wastewater services, and increases in cold-calling and the hard sell.

Across customer types, there is some appetite to look for an alternative supplier. The overriding consideration would be whether this could lower the bill. All other issues were secondary to this.

5.2 Mergers and Consolidation

The study showed that customers are very positive about mergers, as this may be a way to lower bills.

The study also highlighted that the mergers should not result in lower service to customers.

The survey considered the customers' views of (1) the larger water and sewerage companies; (2) the two water only companies that qualify for the small company premium over 2015-2020; and (3) the other water only companies. This showed that there is support for mergers between the smaller companies, or between the larger and smaller companies; but there is less support for the consolidation of the larger companies.

The study showed there are very strong views that any costs of being a small company (i.e., the small company premium) and any ongoing savings following the merger are returned to customers in the form of lower bills.

5.3 Views of Sembcorp Bournemouth Water Customers

The study shows there are high levels of support for Sembcorp Bournemouth Water, with a below average proportion of customers that would consider switching supplier if they had the choice.

Despite this, most customers said they did not see the small company premium as value for money or being in return for good customer service. Consequently, customers would support a merger that would see this returned to customers. Any further savings that are realised should continue to be returned to customers through the regulatory framework.

Finally, the customers of Sembcorp Bournemouth Water were cautious about bill reductions being at the expense of service. A focus for further customer research could consider what aspects of service are considered critical.

6 Appendix: Survey Questionnaire

6.1 Household Survey

SECTION A: INTRODUCTION

We are carrying out a customer survey to understand your views on the water industry and how it may change over time.

The research is being carried out by one of the national water companies and covers households and businesses in England and Wales.

The survey will take around 15 minutes to complete. Any answer you give will be treated in confidence in accordance with the Code of Conduct of the Market Research Society.

Recruitment and Screening

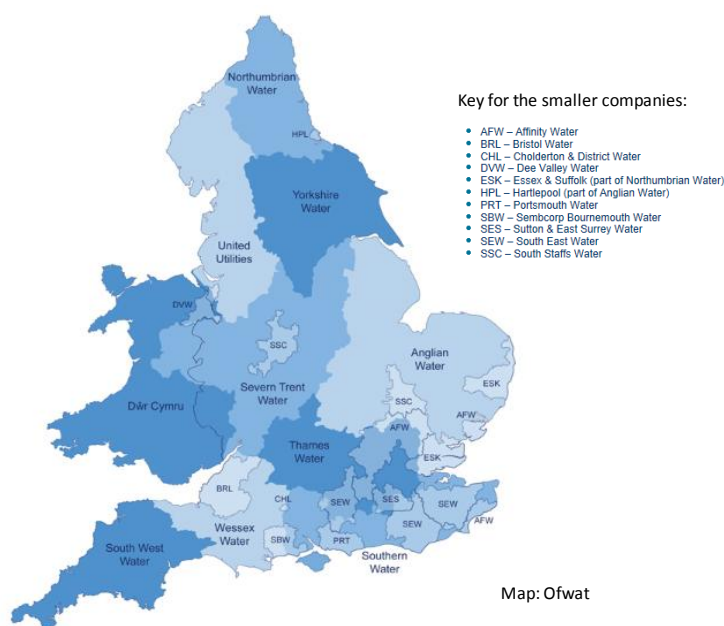
Q1 Do you or any of your close family work or have worked in the past in any of the following professions: marketing, advertising, public relations, journalism, market research or the Water Industry? **SINGLE CODE**

Yes	1	CLOSE
No	2	ASK Q2

Q2 Are you the person most responsible for paying the utilities bills (such as water, electricity, and gas) in your household, or are you jointly responsible with someone else? **SINGLE CODE**

Person most responsible	1	ASK Q3
Jointly responsible	2	ASK Q3
Not responsible	3	CLOSE
Don't know	4	CLOSE

Q3 The water industry in England and Wales has 18 water companies.
SHOW MAP:



Which company provides your household water supply services? **SINGLE CODE**

		Code as:
Affinity Water	1	Smaller water only company
Anglian Water	2	Water and sewerage company
Bristol Water	3	Smaller water only company
Dee Valley Water	4	Smaller water only company
Dŵr Cymru Welsh Water	5	Water and sewerage company
Essex and Suffolk Water (part of Northumbrian Water)	6	Water and sewerage company
Hartlepool (part of Anglian Water)	7	Water and sewerage company
Northumbrian Water	8	Water and sewerage company
Portsmouth Water	9	Smaller water only company
Sembcorp Bournemouth Water	10	Smaller water only company
Severn Trent	11	Water and sewerage company
South West Water	12	Water and sewerage company
South Staffs / Cambridge Water	13	Smaller water only company
South East Water	14	Smaller water only company
Southern Water	15	Water and sewerage company
Sutton & East Surrey Water	16	Smaller water only company
Thames Water	17	Water and sewerage company
Wessex Water	18	Water and sewerage company
United Utilities	19	Water and sewerage company
Yorkshire Water	20	Water and sewerage company
Not connected to mains water (a possibility in rural areas)	21	CLOSE
Don't know	22	CLOSE

<IF SCREENED OUT>

Thank you very much for your time. That's all the questions that we have for you today.

< CLOSE SURVEY>

Background and Quota Questions

Q4 Please can you indicate your gender: **SINGLE CODE**

Male	1
Female	2

Q5 Which of these age groups do you fall within: **SINGLE CODE**

18-29	1
30-44	2
45-64	3
65+	4
Refused	5

Q6 Could you please tell us your postcode?

The postcode is used simply to help us classify different areas. We don't need your house number or any other identifying information. You will not receive any marketing materials, calls or junk mail as a result of supplying this information.

Postcode

Q7 Are you the main income earner in the household? **SINGLE CODE**

No	0	
Yes	1	
No income earners	2	SKIP NEXT QUESTION AND GOTO Q9

Q8 What is the main income earner's occupation? **SINGLE CODE**

If the main income earner has now retired, which of the following categories best describes their employment status before they retired

Higher managerial, administrative or professional	1	A
Intermediate managerial, administrative or professional	2	B
Supervisory or clerical and junior managerial, administrative or professional	3	C1
Skilled manual worker	4	C2
Semi or unskilled manual worker	5	D
Casual worker, pensioner or dependant on state welfare	6	E

Q9 What is the total amount your household pays for both water and sewerage services?

A. Exact amount per year (£)

OR

Q4B:

Less than £13 per month	Less than £150 per year	1
£13 - £16 per month	£151 - £200 per year	2
£17 - £20 per month	£201 - £250 per year	3
£21 - £24 per month	£251 - £300 per year	4
£25 - £28 per month	£301 - £350 per year	5
£29 - £32 per month	£351 - £400 per year	6
£33 - £37 per month	£401 - £450 per year	7
£38 - £41 per month	£451 - £500 per year	8
£42 - £45 per month	£501 - £550 per year	9
£46 - £50 per month	£551 - £600 per year	10
Over £50 per month	Over £600 per year	11
Don't know	Don't know	12

Section B: Market Structure and Reform

The next few questions are around the structure of the water industry in England and Wales.

- Q10 The service your water and sewerage company provides can be divided into two services:
- providing water and sewerage services through the pipes to and from your household
 - retail services, which includes handling customer queries and complaints, billing and meter reading.

The water industry was privatised in 1989. All services provided by water companies are regulated by Ofwat. Every 5 years Ofwat sets the level of the bill that water companies can charge and sets service targets to make sure that customers are protected.

The government has recently passed the legislation to increase competition in the water industry. This means from April 2017 all businesses will be able to switch their supplier of water and sewerage retail services. Households will not be allowed to switch retail supplier yet.

Switching supplier would mean that a different company would handle your calls, and provide you with bill and meter readings. There is no change to the company that provides water and sewerage services through the pipes to and from your household.

Were you aware of the changes to the law allowing all businesses to choose their own supplier?

SINGLE CODE

Yes	1
No	2

- Q11 Do you think the law should be extended so that households as well as businesses can choose their own retail supplier?

SINGLE CODE

Yes	1	GO TO Q12
No	2	GO TO Q13

Q12	What are the two main reasons why you think households should be able to choose their own supplier?	
	Two responses:	
	Rotate	
	(a) Main reason	(b) 2nd reason
	It would lead to cheaper bills	1
	It would encourage companies to improve the service customers get when they have to contact their water company	2
	It would encourage companies to improve the accuracy of meter readings and bills	2
	It would encourage companies to introduce new services (such as smart meters)	3
	When something goes wrong, issues would be dealt with more effectively	4
	There would be more tariffs options to choose from which will mean I can shop around for the best tariff for my household	5
	It would provide more flexibility around how I pay my bill	6
	Increasing competition leads to more efficient companies resulting in lower bills in the future	7
	Don't know	8
	Other [RECORD VERBATIM]	9
	Other [RECORD VERBATIM]	10

Q13	What are the two main reasons why you think households should not be able to choose their own supplier? Two responses:		
	Rotate	(a) Main reason	(b) 2nd reason
	It would lead to higher bills	1	1
	It would lead to mis-selling, cold calling and the hard sell on the doorstep	2	2
	It would result in more issues and errors in meter readings and billing	3	3
	It would discourage companies to introduce new services, such as smart meters	4	4
	It would be hard to identify who is responsible for issues with my water supply or sewerage collection	5	5
	It would reduce the service customers get when they have to contact their water company	6	6
	It would result in complex tariffs that I cannot understand	7	7
	It would reduce the flexibility around how I pay my bill	8	8
	Don't know	9	9
	Other [RECORD VERBATIM]	10	
	Other [RECORD VERBATIM]		11

Q14	You have stated your water company is <<Answer to Q3>>.		
	If you were allowed to choose your own supplier, do you think you would like to switch from <<Answer to Q3>> to another supplier?		
	SINGLE CODE		
	Yes	1	GO TO Q15
	No	2	GO TO Q13

Q15	Would any of the following encourage you to stay with <<Answer to Q3>> and not switch away? Tick all that apply.			
	Rotate		Yes	No
	A reduction in the bill	A	1	0
	Improving meter reading and billing accuracy	B	1	0
	Offering more ways to pay bills	C	1	0
	Helping those on lower incomes with their bills	D	1	0
	Dealing with issues reported to the company first time and quickly	E	1	0
	Offering help with water efficiency - so my household uses less water	F	1	0
	Turning up to appointments on time	G	1	0
	Answering the telephone quickly when I need to speak to someone	H	1	0
	Other [RECORD VERBATIM]	I	1	0

Q16 Which of the following statements best reflects your view of <<Answer to Q3>>.

SINGLE CODE

They are my preferred provider of water services and I rate them highly in all areas	1
--	---

They are my preferred provider of water services but they could improve in some areas	2
---	---

I have a good opinion of them but I would prefer to use an alternative provider	3
---	---

I do not have a good opinion of them and I would prefer to use an alternative provider	4
--	---

Q17 Overall do you think that competition in the water industry should be increased - as it has been for the energy sector - as this is in the best interests of customers?

SINGLE CODE

Yes	1
-----	---

No	2
----	---

Please add a few comments to explain your answer	
--	--

>.....

Q18 Since the water industry was privatised in 1989 some of the smaller water companies have merged to form larger companies. This has led to a reduction in the number of small water companies in the industry.

This process of smaller companies combining to form a larger company is known as a 'merger'. Mergers in the water industry have to be approved by Ofwat and the competition regulator to ensure they are in the best interests of customers - they need to lower bills and maintain good levels of service.

Ofwat sets bills and service level targets for the water companies. Ofwat allows some of the smaller companies to charge a slightly higher price to customers. These extra costs recognise that there are higher costs associated with being a smaller company, even if the smaller company is efficient for its size.

Mergers allow companies to reduce costs through an increase in size - through cheaper access to resources and finance, pooling of resources and reducing duplication of activities. These are known as efficiency savings.

When there is a merger any efficiency savings are passed on to customers and bills are lowered. The regulators make sure bills are lowered whilst maintaining good levels of service.

Please could you state to what extent you agree or disagree with the following statements about mergers.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know
	I would support a merger that reduced bills whilst maintaining service levels to customers	1	2	3	4	5
	I think efficiency savings from mergers should be used to lower customer bills	1	2	3	4	5
	I think efficiency savings from mergers should be re-invested to improve service	1	2	3	4	5

	I would support a merger that resulted in a lower bill, even if some aspects of service got slightly worse	1	2	3	4	5	
	I would support a merger that improved service but did not lower the bill.	1	2	3	4	5	

Q19 If Customer is from any of the Water and Sewerage Companies - (i.e., Anglian, Thames, Southern, South West, United Utilities, Northumbrian Water, Wessex, Severn, Dwr Cymru Welsh Water, Yorkshire)

You have indicated your water company is <<Answer to Q3>>. This is one of the larger companies in the industry, providing both water and sewerage services.

Please could you state to what extent you agree or disagree with the following statements about your water company.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know	
	My water company should be allowed to merge with smaller water companies to increase efficiency and lower bills	1	2	3	4	5	
	My water company should NOT be allowed to merge with any of the other large companies as this would create too big a company and prevent competition	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - but only if current service levels will not fall.	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - even if current service levels fall in 1 or 2 areas.	1	2	3	4	5	
	Any efficiency savings that result after the merger should be returned to customers when bills are next set by Ofwat (as part of the ongoing regulatory framework)	1	2	3	4	5	

Q20 If Customer is from Bournemouth Water or Portsmouth Water.

You have indicated your water company is <<Answer to Q3>>. This is one of the smaller companies in the industry, providing water services only (and not sewerage services).

Ofwat allows your water company to charge customers a slightly higher bill as it is considered to be efficient for its size but has higher costs associated with its small size. *These costs are generally associated with the higher costs of borrowing money from investors to pay for investment pipes and water treatment works.*

Please could you state to what extent you agree or disagree with the following statements about your water company.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know	
--	-----------------------	----------------	---------------	------------------	-------------------	------------	--

	I agree that my water company should be allowed to slightly charge more as it represents value for money	1	2	3	4	5	
	I agree that my water company should be allowed to slightly charge more as it delivers good customer service	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - but only if current service levels will not fall.	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - even if current service levels fall in 1 or 2 areas.	1	2	3	4	5	
	Any merger should result in the costs of being a small company being returned immediately to customers through lower bills.	1	2	3	4	5	
	Any efficiency savings that result after the merger should be returned to customers when bills are next set by Ofwat (as part of the ongoing regulatory framework)	1	2	3	4	5	

Q21 If Customer is from any of the 'smaller water only company' (i.e., Affinity Water, Bristol, Dee Valley, South Staffs/Cambridge, South East, Sutton & East)

You have indicated your water company is <<Answer to Q3>>. This is one of the smaller companies in the industry, providing water services only (and not sewerage services).

Ofwat allows some small water companies to charge customers a slightly higher bill if it is considered to be efficient, as smaller companies have higher costs associated with its small size.

These costs are generally associated with the higher costs of borrowing money from investors to pay for investment pipes and water treatment works.

Despite the small size of your water company, Ofwat does not allow your water company to charge this as it is either not a leading efficient company is not small enough to qualify for the extra costs.

Please could you state to what extent you agree or disagree with the following statements about your water company.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know	
	My water company should be allowed to merge to increase efficiency and lower bills - but only if current service levels will not fall.	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - even if current service levels fall in 1 or 2 areas.	1	2	3	4	5	
	Any efficiency savings that result after the merger should be returned to customers when bills are next set by Ofwat (as part of the ongoing regulatory framework)	1	2	3	4	5	

SECTION E - SOCIO-ECONOMIC QUESTIONS

To finish the survey, please could you provide a little more information about yourself and your household.

Q22 Thinking about all the people in your household, including yourself, please indicate how many people there are in each of the following age groups						
Age	Number of people (circle number)					
Up to 5 years (less than 5 years)	0	1	2	3	4	5+
5 to 15 years	0	1	2	3	4	5+
16 to 64 years	0	1	2	3	4	5+
65+	0	1	2	3	4	5+

Q23 Which of these statements best describes <u>your</u> current employment status? SINGLE CODE	
Self-employed	1
Employed full-time (30+ hrs)	2
Employed part-time (up to 30 hrs)	3
Student	4
Unemployed - seeking work	5
Unemployed - other	6
Looking after the home/children full-time	7
Retired	8
Unable to work due to sickness or disability	9
Other (please specify)	10
.....	
Prefer not to say	11

Q24 At what level did you complete your education? If you are still studying, which level best describes the highest level of education you have obtained until now. SINGLE CODE	
O levels / CSEs / GCSEs (any grades)	1
A levels / AS level / higher school certificate	2
NVQ (Level 1 and 2). Foundation / Intermediate / Advanced GNVQ / HNC / HND	3
Other qualifications (e.g. City and Guilds, RSA/OCR, BTEC/Edexcel))	4
First degree (e.g. BA, BSc)	5
Higher degree (e.g. MA, PhD, PGCE, post graduate certificates and diplomas)	6
Professional qualifications (teacher, doctor, dentist, architect, engineer, lawyer, etc.)	7
No qualifications	8
Prefer not to say	9

Q25	Which band best describes your <u>total</u> household income <u>before tax</u> and other deductions?		
	Please note this information will be used to check that we have surveyed a range of customers. It will be not be possible to identify any particular individual or address in the results.		
	SINGLE CODE		
	PER MONTH	PER YEAR	
A	Up to £539	Up to £6,499	1
B	£540 - £789	£6,500 - £9,499	2
C	£790 - £1289	£9,500 - £15,499	3
D	£1290 - £2079	£15,500 - £24,999	4
E	£2080 - £3329	£25,000 - £39,999	5
F	£3330 - £4999	£40,000 - £59,999	6
G	£5000 - £7499	£60,000 - £89,999	7
H	£7500 and over	£90,000 and over	8
	Don't know		9
	Prefer not to say		10

That's the end of the survey. Thank you for your time and help, it is very much appreciated.

6.2 Business Survey

SECTION A: INTRODUCTION

We are carrying out a survey to understand your organisation's views on the water industry and how it may change over time.

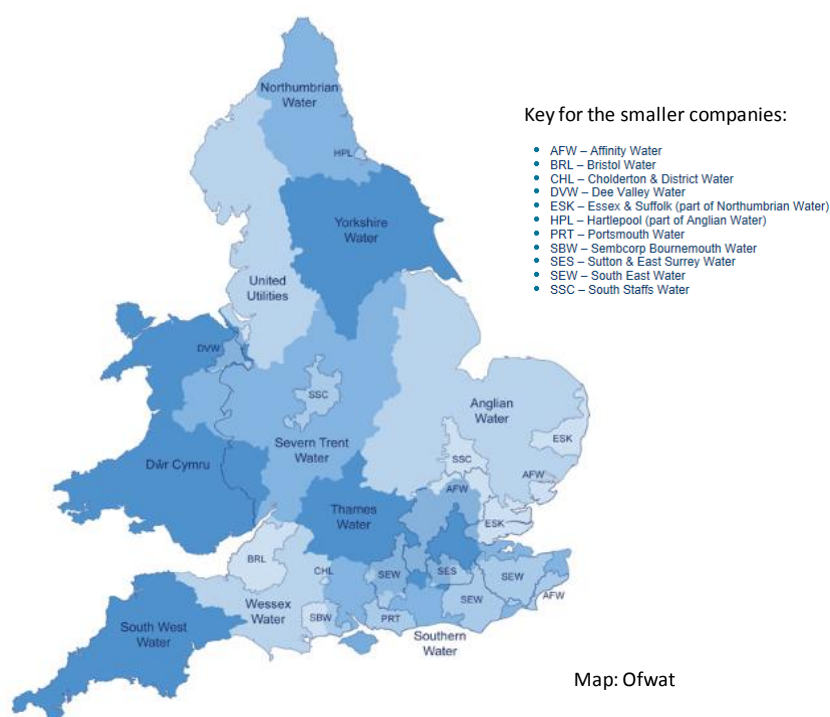
The research is being carried out by one of the national water companies and covers households and businesses in England and Wales.

The survey will take around 15 minutes to complete. Any answer you give will be treated in confidence in accordance with the Code of Conduct of the Market Research Society.

Recruitment and Screening

Q1 The water industry in England and Wales has 18 water companies.

SHOW MAP: - SEE ATTACHED POWERPOINT SLIDE



Which company provides your organisation with water supply services? **SINGLE CODE**

	Code as:	
Affinity Water	1	Smaller water only company
Anglian Water	2	Water and sewerage company
Bristol Water	3	Smaller water only company
Dee Valley Water	4	Smaller water only company
Dŵr Cymru Welsh Water	5	Water and sewerage company
Essex and Suffolk Water (part of Northumbrian Water)	6	Water and sewerage company
Hartlepool (part of Anglian Water)	7	Water and sewerage company
Northumbrian Water	8	Water and sewerage company
Portsmouth Water	9	Smaller water only company
Sembcorp Bournemouth Water	10	Smaller water only company
Severn Trent	11	Water and sewerage company

South West Water	12	Water and sewerage company
South Staffs / Cambridge Water	13	Smaller water only company
South East Water	14	Smaller water only company
Southern Water	15	Water and sewerage company
Sutton & East Surrey Water	16	Smaller water only company
Thames Water	17	Water and sewerage company
Wessex Water	18	Water and sewerage company
United Utilities	19	Water and sewerage company
Yorkshire Water	20	Water and sewerage company
Not connected to mains water (a possibility in rural areas)	21	CLOSE
Don't know	22	CLOSE

<IF SCREENED OUT>

Thank you very much for your time. That's all the questions that we have for you today.

< CLOSE SURVEY>

Q2 What is the main activity of your organisation?

A	Agriculture, Forestry and Fishing	1
B	Mining and Quarrying	2
C	Manufacturing	3
D	Electricity, gas, steam and air	4
E	Water supply, sewerage, waste management and remediation activities	5
F	Construction	6
G	Wholesale and retail trade; repair of motor vehicles and motorcycles	7
H	Transport and storage	8
I	Accommodation and food service activities	9
J	Information and Communication	10
K	Finance and insurance activities	11
L	Real estate activities	12
M	Professional, scientific and technical activities	13
N	Administrative and support service activities	14
O	Public administration and defence; compulsory social security	15
P	Education	16
Q	Human health and social work activities	17
R	Arts, entertainment and recreation	18
S	Other service activities	19
T	Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use	20
U	Activities of extraterritorial organizations and bodies	21
X	Other	22

Q3 How many people does your organisation employ?

0 - 4	1
5 - 9	2
10 - 19	3
20 - 49	4
50 - 99	5
100 - 249	6
250 - 499	7
500 - 999	8
1,000 +	9
Don't know/not stated	10

Q4 Could you please tell us your postcode?

The postcode is used simply to help us classify different areas. We don't need your house number or any other identifying information. You will not receive any marketing materials, calls or junk mail as a result of supplying this information.

Postcode

.....

<<option to refuse>>

Q5 What is the total amount your organisation pays for both water and sewerage services?

A. Exact amount per year (£)

.....

OR

B:

Less than £500 per year	Less than £200 per year	1
£500 to £999 per year	£201 - £250 per year	2
£1,000 to £4,999 per year	£251 - £300 per year	3
£5,000 to £9,999 per year	£301 - £350 per year	4
£10,000 to £24,999 per year	£351 - £400 per year	5
£25,000 to £49,999 per year	£401 - £450 per year	6
£50,000 to £99,999 per year	£451 - £500 per year	7
£100,000 to £249,999 per year	£501 - £550 per year	8
£250,000 to £499,000 per year	£551 - £600 per year	9
More than £500,000 per year	£601 - £650 per year	10

Section B: Market Structure and Reform

The next few questions are around the structure of the water industry in England and Wales.

- Q6 The service your water and sewerage company provides can be divided into two services:
- providing water and sewerage services through the pipes to and from your household
 - retail services, which includes handling customer queries and complaints, billing and meter reading.

The water industry was privatised in 1989. All services provided by water companies are regulated by Ofwat. Every 5 years Ofwat sets the level of the bill that water companies can charge and sets service targets to make sure that customers are protected.

Currently only companies using large volumes of water are allowed to choose their own retail supplier. This is over 5 million litres (5,000 cubic metres) in England and in Wales this is more than 50 million litres (50,000 cubic metres) of water a year.

The government has recently passed the legislation to increase competition in the water industry. This means from April 2017 all businesses in England will be able to switch their supplier of water and sewerage retail services. Households will still not be allowed to switch retail supplier.

Switching supplier would mean that a different company would handle your calls, and provide you with bill and meter readings. There is no change to the company that provides water and sewerage services through the pipes to and from your organisation.

In total 26,000 businesses are currently allowed to switch supplier. From April 2017 over 1.6m businesses will be able to switch supplier.

Were you aware that some businesses could choose their own supplier, but from April 2017 all businesses will be able to choose their own supplier? **SINGLE CODE**

Yes	1
No	2

- Q7 Do you agree that all businesses should be allowed choose their own retail supplier?
SINGLE CODE

Yes	1	GO TO Q12
No	2	GO TO Q13

- Q8 What are the two main reasons why you think businesses should be able to choose their own supplier?
Two responses:

After this question - skip Q13 and go to Q

	(a) Main reason	(b) 2nd reason
It would lead to cheaper bills	1	1
It would encourage companies to improve the service customers get when they have to contact their water company	2	2
It would encourage companies to improve the accuracy of meter readings and bills	2	2
It would encourage companies to introduce new services (such as smart meters)	3	3
When something goes wrong, issues would be dealt with more effectively	4	4
There would be more tariffs options to choose from which will mean I can shop around for the best tariff for my business	5	5
It would provide more flexibility around how my business pays its bill	6	6
Increasing competition leads to more efficient companies resulting in lower bills in the future	7	7

Don't know	8	8
Other [RECORD VERBATIM]	9	
Other [RECORD VERBATIM]		10

Q9 What are the two main reasons why you think businesses should not be able to choose their own supplier? Two responses:		
	(a) Main reason	(b) 2nd reason
It would lead to higher bills	1	1
It would lead to mis-selling, cold calling and the hard sell	2	2
It would result in more issues and errors in meter readings and billing	3	3
It would discourage water companies to introduce new services, such as smart meters	4	4
It would be hard to identify who is responsible for issues with my organisation's water supply or sewerage collection	5	5
It would reduce the service customers get when they have to contact their water company	6	6
It would result in complex tariffs that my organisation cannot understand	7	7
It would reduce the flexibility around how my organisation pays its bill	8	8
Don't know	9	9
Other [RECORD VERBATIM]	10	
Other [RECORD VERBATIM]		11

Q10 Is your organisation a large user of water, and currently eligible to change supplier? SINGLE CODE		
_____	Yes	1 GO TO Q
_____	No	2 GO TO Q

Q11 If answered Q as Yes. Have you ever switched water supplier? SINGLE CODE		
_____	Yes	1 GO TO Q
_____	No	2 GO TO Q

Q12 What encouraged you to switch supplier? Tick all that apply. After this question - go to Q				
			Yes	No
	To reduce my organisation's bill	A	1	0
	To improve meter reading and billing accuracy	B	1	0
	My organisation was offered more flexible ways to pay the bill	C	1	0
	To ensure issues reported to the company were dealt with first time and quickly	E	1	0
	My organisation was offered to help with water efficiency - so my organisation uses less water	F	1	0
	To ensure appointments would be on time	G	1	0
	To improve the speed at which telephone calls were	H	1	0

	answered when my organisation needs to speak to someone			
	Other [RECORD VERBATIM]	I	1	0

Q13 If answered 'No' to Q:
When the law changes in 2017, do you think you are likely to switch from <<Answer to Q3>> to another supplier?

If answered 'Yes' to Q:

Do you think you are likely to switch from <<Answer to Q3>> to another supplier?

SINGLE CODE

Yes	1	GO TO Q15
No	2	GO TO Q

Q14 Would any of the following encourage you to stay with <<Answer to Q3>> and not switch away? Tick all that apply.

			Yes	No
	A reduction in the bill	A	1	0
	Improving meter reading and billing accuracy	B	1	0
	Offering more ways to pay bills	C	1	0
	Dealing with issues reported to the company first time and quickly	E	1	0
	Offering help with water efficiency - so my organisation uses less water	F	1	0
	Turning up to appointments on time	G	1	0
	Answering the telephone quickly when my organisation needs to speak to someone	H	1	0
	Other [RECORD VERBATIM]	I	1	0

Q15 Which of the following statements best reflects your view of <<Answer to Q3>>.

SINGLE CODE

They are my preferred provider of water services and I rate them highly in all areas	1
They are my preferred provider of water services but they could improve in some areas	2
I have a good opinion of them but I would prefer to use an alternative provider	3
I do not have a good opinion of them and I would prefer to use an alternative provider	4

Q16 Overall do you think that competition in the water industry should be increased - as it has been for the energy sector - as this is in the best interests of customers?

SINGLE CODE

Yes	1
No	2
Please add a few comments to explain your answer >.....	

Q17 Since the water industry was privatised in 1989 some of the smaller water companies have merged to form larger companies. This has led to a reduction in the number of small water companies in the industry.

This process of smaller companies combining to form a larger company is known as a 'merger'. Mergers in the water industry have to be approved by Ofwat and the competition regulator to ensure they are in the best interests of customers - they need to lower bills and maintain good levels of service.

Ofwat sets bills and service level targets for the water companies. Ofwat allows some of the smaller companies to charge a slightly higher price to customers. These extra costs recognise that there are higher costs associated with being a smaller company, even if the smaller company is efficient for its size.

Mergers allow companies to reduce costs through an increase in size - through cheaper access to resources and finance, pooling of resources and reducing duplication of activities. These are known as efficiency savings.

When there is a merger any efficiency savings are passed on to customers and bills are lowered. The regulators make sure bills are lowered whilst maintaining good levels of service.

Please could you state to what extent you agree or disagree with the following statements about mergers.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know
	My organisation would support a merger that reduce bills whilst maintaining service levels to customers	1	2	3	4	5
	Efficiency savings from mergers should be used to lower customer bills	1	2	3	4	5
	Efficiency savings from mergers should be re-invested to improve service	1	2	3	4	5
	My organisation would support a merger that resulted in a lower bill, even if some aspects of service got slightly worse	1	2	3	4	5
	My organisation would support a merger that improved service but did not lower the bill.	1	2	3	4	5

Q18 If Customer is from any of the Water and Sewerage Companies as coded in Q3 (i.e., Anglian, Thames, Southern, South West, United Utilities, Northumbrian Water, Wessex, Severn, Dwr Cymru Welsh Water, Yorkshire)

You have indicated your water company is <<Answer to Q3>>. This is one of the larger companies in the industry, providing both water and sewerage services.

Please could you state to what extent you agree or disagree with the following statements about your water company.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know
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	My water company should be allowed to merge with smaller water companies to increase efficiency and lower bills	1	2	3	4	5	
	My water company should NOT be allowed to merge with any of the other large companies as this would create too big a company and prevent competition	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - but only if current service levels will not fall.	1	2	3	4	5	
	My water company should be allowed to merge to increase efficiency and lower bills - even if current service levels fall in 1 or 2 areas.	1	2	3	4	5	
	Any efficiency savings that result after the merger should be returned to customers when bills are next set by Ofwat (as part of the ongoing regulatory framework)	1	2	3	4	5	

Q19 If Customer is from Bournemouth Water or Portsmouth Water in Q3.

You have indicated your water company is <<Answer to Q3>>. This is one of the smaller companies in the industry, providing water services only (and not sewerage services).

Ofwat allows your water company to charge customers a slightly higher bill as it is considered to be efficient for its size but has higher costs associated with its small size. *These costs are generally associated with the higher costs of borrowing money from investors to pay for investment pipes and water treatment works.*

Please could you state to what extent you agree or disagree with the following statements about your water company.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know	
	My water company should be allowed to slightly charge more as it represents value for money	1	2	3	4	5	
	My water company should be allowed to slightly charge more as it delivers good customer service	1	2	3	4	5	
	My water company should be allowed to merge to reduce costs and lower bills - but only if current service levels will not fall.	1	2	3	4	5	
	My water company should be allowed to merge to reduce costs and lower bills - even if current service levels fall in 1 or 2 areas.	1	2	3	4	5	
	Any merger should result in the costs of being a small company being returned immediately to customers through lower bills.	1	2	3	4	5	
	Any efficiency savings that result after the merger should be returned to customers when bills are next set by Ofwat (as part of the ongoing regulatory framework)	1	2	3	4	5	

Q20 If Customer is from any other WOC as coded in Q3 (i.e., Affinity Water, Bristol, Dee Valley, South Staffs/Cambridge, South East, Sutton & East)

You have indicated your water company is <<Answer to Q3>>. This is one of the smaller companies in the industry, providing water services only (and not sewerage services).

Ofwat allows some small water companies to charge customers a slightly higher bill if they are considered to be efficient for their size, as smaller companies have higher costs associated with their small size.
These costs are generally associated with the higher costs of borrowing money from investors to pay for investment pipes and water treatment works.

Despite the small size of your water company, Ofwat does not allow your water company to charge this as it is either not a leading efficient company is not small enough to qualify for the extra costs.

Please could you state to what extent you agree or disagree with the following statements about your water company.

SINGLE CODE FOR EACH LINE

	Rotate question order	Strongly agree	Tend to agree	Tend to disagree	Strongly disagree	Don't know	
	My water company should be allowed to merge to reduce costs and lower bills - but only if current service levels will not fall.	1	2	3	4	5	
	My water company should be allowed to merge to reduce costs and lower bills - even if current service levels fall in 1 or 2 areas.	1	2	3	4	5	
	Any efficiency savings that result after the merger should be returned to customers when bills are next set by Ofwat (as part of the ongoing regulatory framework)	1	2	3	4	5	

That's the end of the survey. Thank you for your time and help, it is very much appreciated.

APPENDIX H – OTHER SERVICE METRICS

This section sets out the counterfactual to the merger, Pennon has considered whether there is any potential detriment as result of the merger in respect of the loss of a comparator for other service metrics (beyond ODIs). Below we provide a table of the qualitative indicators of an impact on Ofwat's company performance, using the criteria in the Europe Economics report. In doing this we provide a summary of how our plans relate specifically as evidence against these criteria.

Area of comparison	Indicator	SWW position – PR14 Risk based review	Bournemouth position – PR14 Risk based review	Benefits of the merger
Customer engagement	Was either merging party identified as having best practice with regard to customer engagement?	A	C – gap in WTP information gathering and mapping	SWW approach exceptional. Post merger SWW approach can be applied for BW (such as the research included in this case). Future customer surveys can maintain results and Willingness to Pay (WTP) for BW and SW areas separately. Merger raises no issues.
	Did Ofwat request that companies should undertake further engagement on their business plan following the risk based review?	No	Yes – to support small company premium	Customer research on removing small company premium supports this case.
	Was either merging party identified as having best practice with regard to its affordability measures?	B – SWW social tariff & long term approach	B – marginal. Lack of evidence on longer term affordability / PAYG	BW have a very low bill but Wessex and Southern both have social tariffs for sewerage element and BW do not. SWW approach to social tariff would reflect combined need for BW and provide tariff choice. No issue from merger for comparability.

Specific cost adjustments	Do either of the merging parties share similar operating characteristics with other companies (or a sub-set of companies)? For example in relation to density, rural coverage, length of coastline, topography, water quality?			The entities are different to each other. SWW is unique in soft water and largely rural but with urban coastal characteristics. BW has different water sources and is a largely urban/coastal cost base. So the merged entity is likely to be more similar to other water comparators (Wessex and Southern) than BW is to other WoCs in terms of scale and water resources currently. Merger results in better comparator.
	Has either merging party used comparisons with other companies to make the case for a special factor cost adjustment?	Not at PR14 – other than bad debt which is an econometric approach.	Comparisons used for small company premium. Fawley, mains renewal, metering variable and SDB accepted as deep dives. NEP and leakage not accepted.	Fawley cost allowance is unlikely to apply – averaging across a wider area from the merger could be a benefit. The same would apply to the mains renewal/ meter amounts. BW may not be reliable for comparative purposes.
	Was either merging party identified as having low outlying costs for areas in which specific cost adjustments were considered in respect of bad debt, energy costs or any other special cost claims at PR14?	High – bad debt special factor.	No – high on energy due to scale economics.	Not applicable – efficient costs but not low outlying costs. Not sure why energy cost factors are included as there was no consideration of this at PR14 by Ofwat. No adverse impact on comparability.

Company behaviour	Were issues identified in Ofwat's risk based review with respect to the degree of Board assurance for either merging party?	B – high quality plan reflected in enhanced status	B	SWW Board / Pennon relationship and assurance means plan is exceptional and would be reflected in governance over BW acquisition.
	Have any issues been identified with Board assurance on information which either of the merging parties has provided to Ofwat (outside of PR14)?	No	Some concerns on cost allocation	The separate non-household retail business unit would be a benefit with no subsequent concerns over BW cost allocation.
	Were issues identified in Ofwat's risk based review with respect to the process undertaken by either merging party in preparing business plans?	No – enhanced	No	PR19 business plan approach sharing best practice.
	Was either merging party identified as having best practice with regard to business planning?	Yes - enhanced	No	PR19 business plan approach sharing best practice.
	Have any issues been identified with either merging party meeting Ofwat's board leadership, transparency and governance principles?	No	No	SWW self assurance status at the start of AMP6 compares BW targeted assurance status. The assurance benefits of a merged organisation may be relevant but are modest.
	Has action been taken against either of the merging parties following investigation of non-compliance with market rules?	No	No	Sharing best practice enhances position even further.
	Has action been taken against either of the merging parties following investigation of non-compliance with their duties under WIA91 or their licence conditions?	No	No	Sharing best practice enhances position even further.

Accounting and reporting of data	Has either party previously been challenged to improve the degree of assurance of regulatory reporting, or any other information that has been reported to Ofwat?	No	No	BW had to commit to the codification of their equivalent of WaterShare in the FD.
	Has the company previously been challenged with respect to transparency and/or reporting of data?	No	No	Sharing best practice enhances position even further.
	Has the company been challenged by Ofwat with regard to its tax assumptions in its business plans?	No	No	Sharing best practice enhances position even further.
	Has the company previously challenged for not following cost allocation guidelines for its regulatory reporting?	No – Acceptable at PR14	Yes – retail cost allocation even after plan resubmission challenged	Retail non-household plan will improve cost allocation through a merged entity – similar for other areas. This will be maintained during AMP6 as a minimum.
	Has either merging party been identified as having best practice with regard to regulatory reporting?	Yes – as above	No	Sharing best practice enhances position even further.
	Is either of the merging parties an outlier in any policies?	Leader on IFRS adoption	Yes – PAYG	BW high (small company) PAYG rate could be considered an outlier.

Financeability risk and reward	Is the financing structure and governance arrangements of the Appointee and its parent companies transparent and easily accessible to stakeholders?	Yes	Mostly	Artesian debt is not necessarily as transparent as listed company financing as the whole company is securitised.
	Is the financing structure that has been put in place by the merging companies prudent and/or have concerns been raised around the financing or governance structures of the merging companies?	Best practice – thick equity	Mostly transparent – Artesian securitised	Transparency will be improved by the merger. Equity financing of transaction as a benefit.
	Did Ofwat intervene in either company's choice of PAYG rate, RCV run off rate or asset lives at PR14 and were the merging companies choices of PAYG rate, RCV run off rate and asset lives consistent with customer views?	Exceptional	Some concerns	SWW equity model allows long term investor decisions (low gearing relatively) to benefit customers (e.g. smoothing out bill changes – e.g. price freeze in 2014/15). BW also have relatively low gearing able to achieve this but the combined equity model with Pennon will enhance this.
	Did each company provide appropriate Board (or external) assurance that their plan was financeable on an actual and notional basis?	Yes – exceptional	Yes – high PAYG rate and small company premium necessary	BW – small company premium will be returned to customers as a result of the merger.
Performance commitments and outcome delivery incentives	Has either merging party developed an innovative set of performance commitments that have not been used by other companies?	Yes – exceptional and enhanced	No	Upstream and downstream thinking and improved outcome incentives provide likely benefits to BW.
	Has either merging party adopted an innovative approach to setting outcome delivery incentives that has not been used by other companies?	Yes	For some specific projects	WaterShare can consider whether BW customers would benefit from further outcome innovation.
	Does the company's proposal for reporting and sharing out- and under- performance represent a leading approach?	Yes	Some	WaterShare – PR14 leading approach and also for sharing some benefits - we will work with a BW panel to agree an appropriate arrangement.

On the basis of the evidence set out above it is clear that the merged entity is well positioned to maintain and improve other service metrics Ofwat use for comparison purposes.

In particular the exemplar standards of board leadership, transparency and governance will be shared across companies.

APPENDIX I – OFWAT REGULATORY REFORMS AND SWW RESPONSE

This section sets out the counterfactual to the merger, in terms of what could be expected to happen to the regulatory and market framework and Bournemouth water

The Regulatory & Market Framework

The value of the water industry rests in providing essential public services as efficiently and effectively as possible.

Ofwat's primary duties, to protect consumer interests and ensure that efficient functions can be financed clearly require consideration of effectiveness (including transparency and legitimacy of what is delivered) as well as cost efficiency. Economic concepts of efficiency recognise this in distinguishing between:

Productive efficiency – “doing the things right” – largely cost efficiency

Allocative efficiency – “doing the right things” – chiefly effectiveness of delivery across policy areas specific to the water industry

Dynamic efficiency – “doing different things” – innovating to deliver better / wider economic, social and environmental outcome.

The key generic complex challenges facing the water industry in assessing the value of its potential activities are:

- the local and geographic nature of economic, social and environmental factors, in the context of a national policy framework and wider supply chain
- exposure to long term and uncertain global sustainability factors, including climate change, water scarcity, resilience, biodiversity impacts of change in land use etc
- increasing consumer and stakeholder expectations and reduced tolerance of failure, particularly where responsibilities are not clear and easily understood.

These factors are not specific to the water industry and similar (if not harder) challenges are faced by other public services – the water industry having benefitted from the willingness of investors to finance improvements, supported by a stable and well regarded economic regulation regime and a track record of the industry in delivering outcomes in recent years.

This provides background to the reforms to the regulatory regime that Ofwat undertook at PR14. These reforms for price controls reflected the direction of travel towards a greater use of markets (both retail and upstream) and a likely restructuring of the industry, including through mergers.

Ofwat set separate price controls for different areas of the value chain (retail household, retail non-household, wholesale water, wholesale wastewater:

- retail household – a revenue control based on a cost to serve per customer, based on an Average Cost to Serve and no price indexation, with the clear expectation that companies may need to merge their retail activities to an efficient scale in order to meet this challenge
- retail non-household – default tariffs based on a cost per customer plus net margin, again recognising that customer choice and level playing field

requirements for the retail market from 1 April 2017 would require companies to change their business models, including mergers and sales (exit) of retail non-household businesses

- wholesale revenue controls based on totex cost allowances and incentive menus that included a defined sharing rate for actual costs with customers.

Cost incentive mechanisms were combined with Outcome Delivery Incentives that were linked to delivery costs and customers Willingness to Pay for service improvements. These were designed so that companies could innovate how services were delivered – with a significant reduction in the cost of capital so that the balance of risk and opportunity to cost and service delivery incentives as well as financing incentives was redrawn. The previous “change protocol” for output requirement changes and “notified items” for specific risk factors that were outside of general inflation and management control were substantially withdrawn.

Further reforms before 2020 were also signalled by Ofwat – in both upstream and retail regulatory controls and markets, including:

- further transfer of wholesale responsibilities to retail or other market controls (e.g. meter services, developer services)
- Disaggregation of wholesale into “Network Plus” and “upstream markets”. Upstream markets initially water abstraction, water resources and sludge treatment and disposal. This could then migrate for upstream to include water and wastewater treatment.
- Development of sludge markets that could be wider than current company activities
- Development of System Operator and interconnections to boost water resource sharing and trading, including separate entities operating and financing increasing capacity
- Abstraction Incentive Mechanisms and potential for compulsory trading of abstraction licences
- further reforms to household retail controls (upper quartile rather than average cost to serve, moves from industry service incentive mechanism comparisons to comparisons with wider utility and other retail businesses)
- more dynamic Outcome Delivery Incentives (ODIs) where they can be standardised (e.g. annually increasing the level of performance needed to avoid penalties/earn rewards as the industry upper quartile increases).

Many of these changes to markets and regulation will result in different information sources and cost models than have been used in the industry previously, in particular to support access pricing for the disaggregated wholesale activities. Reforms to the structure of Water company Licences and a move to a modular format that can cope with restructured and merged activities are necessary to support the reforms signalled in the list above.

State of Play – a South West Water perspective

We believe it is helpful to reflect on the PR14 Ofwat regulatory framework and the implications for the further developments in the market out to 2020 and beyond. The PR14 framework was presented as a stage of development of the market and regulatory framework for the industry. The approach to setting revenue controls for the industry at PR14 should be seen in the context of a policy framework of:

- the 2009 Cave review into competition and innovation in water markets
- the 2011 review of water economic regulation by David Gray
- the Government's 2011 "Water for Life" White Paper
- the 2014 Water Act.

This context has a number of features which Ofwat has had to reflect at PR14:

- the significant investment on compulsory quality improvements since privatisation had resulted in a range of bill levels across the country
- for future investment requirements (in particular the Water Framework Directive) it was less clear than in the past that improvements would be best delivered by "end of pipe" capital investment solutions by water companies, because of the long term cross-section and uncertain factors driving requirements such as the impact of climate change
- even where demand and supply risks such as water availability emerge within specific areas of the country, in particular the South East, the best solution may not be arrived at through solutions that focussed on individual water companies
- the concern (particularly from the Gray review) that with maturity of the industry framework there was evidence that company decisions and approaches may be influenced more by the regulatory regime than focussing on customer and stakeholder views
- the Water Act opening of a non-household retail market in 2017 and upstream reforms including abstraction trading from 2019
- the Government stated intention that the approaches taken by the Water industry should take into account the wider benefits and outcomes in the way they are delivered (for instance on the environment).

SWW recognised these concerns and challenges. At PR09 we proposed our "Upstream Thinking" catchment management approach which would rewet peat moorlands in partnership with landowners, farmers, regulators and environmental groups. Even though there was consensus for piloting this novel approach amongst stakeholders, it took significant effort to force it into a regulatory framework designed for monitoring detailed delivery of capital investment outputs.

Comparative efficiency cost modelling based on separate opex and capital models that focussed on historic costs at a point in time also did not lend itself to the future challenges for the industry. For wholesale services, local economic and environmental factors require a focus on customer and stakeholder outcomes, with the optimal solution unlikely to involve the same activities across the country, particularly within a five year control period. Our perspective on the PR14 approach of Ofwat risk based review using wholesale totex modelling thresholds and menu incentives is that it is necessary given the context set out above, in order to balance the duty to protect consumers with the duty to secure essential and efficient investment.

The risk based review process at PR14 did not only rely on the wholesale totex modelling thresholds, but used a large number of other criteria that could test consistency of the plan presented with past delivery, board assurance statements and other supporting evidence such as from customer research. It was a key part of the process that the models Ofwat used to set the risk based review thresholds weren't specifically known to companies before

plans were submitted, in a similar way that other criteria of the risk based review weren't specified in detail. Companies had to focus on assuring themselves that their own delivery plans were efficient and effective, given the likelihood that increases in bills (certainly by more than inflation) were unlikely to be acceptable to customers given low levels of wage growth. Logic suggests that Ofwat should consider how cost comparisons between companies may change for the next price review to maintain the benefits of this process (rather than rolling forward PR14's models now the variables and coefficients are known).

The benefits to SWW of this approach was that we could shape the regulatory mechanisms and our plans in a way that best met the requirements of our customers, stakeholders and investors. For our plan, this included:

- innovation and investment in new technology, such as a relocated water treatment works for North Plymouth
- continued partnership working in upstream catchments, with the approach expanded to joint funding of flood defence schemes and a "downstream thinking" approach to urban catchment management
- accelerating investment on bathing waters so that it was delivered before PR14, ensuring the outcome of meeting new European standards was met in 2015.
- smoothing out customer bill changes by introducing a price freeze in 2014, which otherwise would have seen a bill increase followed by an even larger bill reduction the following year. This is an example of how flexibility in the regulatory framework can work in customer and investor interests, rather than application of fixed rules that satisfy no-one and limit the ability of companies to be fully responsible for the approaches that they take.
- using outcome incentive rewards and penalties and the totex menu cost incentive framework to protect customers where we were proposing innovative investment if the desired outcome was not delivered, whilst also allowing for additional investment where uncertainties or cheaper methods of delivering emerged during the next five years.
- recognising the importance of transparency of performance and a need for ongoing dialogue with customer representatives and stakeholders about the impact of outcome and cost incentives on future bills and services by establishing the WaterShare framework.

Ofwat's assessment of the SWW plan as enhanced does not necessarily mean that our investment plans are superior to those of other companies, or that current service levels and delivery is optimal. It merely reflects the view of the regulator that the plan coherently balanced customer and stakeholder requirements, was financeable for investors and included necessary protection of consumer interests. By its nature, it is unlikely to be the lowest risk plan in the industry (noting the comments of the Cave and Gray reviews on the concerns that the regulatory framework resulted in excessive risk aversion from companies), but the risks are understood and allocated to those with responsibility to manage them. Transparency of the plan and its delivery in this context is as much a benefit to investors as customers.

It is important to note the success of the PR14 framework across the industry as a whole. In completing the risk based review in March 2014 Ofwat noted in the pre-qualification decision document that:

“All water and wastewater companies have worked hard to take ownership of their plans. We have seen a real change in approach, which will benefit customers. It is clear that companies have engaged actively with customers, and have sought to reflect that engagement in formulating customer-focused plans. The customer challenge groups (CCGs) have made a significant and important contribution to this step change.”

Linked to this, Ofwat did not feel that the original “resubmission” category status for company plans was required. Resubmission would have seen extensive Ofwat intervention, with the cost menu and outcome incentive framework for PR14 withdrawn and most likely being replaced with fixed efficiency targets and output regulation similar to PR09— effectively an indicator that the company was not ready for the new regulatory framework. Instead, all company plans were of a good quality enough that customers and investors would benefit from the move to the new framework. Companies had the opportunity (for instance through gap analysis) after the risk based review to set out how their plans could change in response to Ofwat’s challenge. Ultimately companies as a whole appear to have achieved the balance in the framework that Ofwat were trying to achieve, indicated by:

- Ofwat including in wholesale price controls totex expenditure at levels in line with the original industry plans (compared to the reductions imposed at all previous reviews)
- a monitoring framework for 2015-20 based on company Board defined self-assurance or targeted assurance required by Ofwat, building on the PR14 assurance framework. Only one company has more prescribed assurance initially set in place by Ofwat.

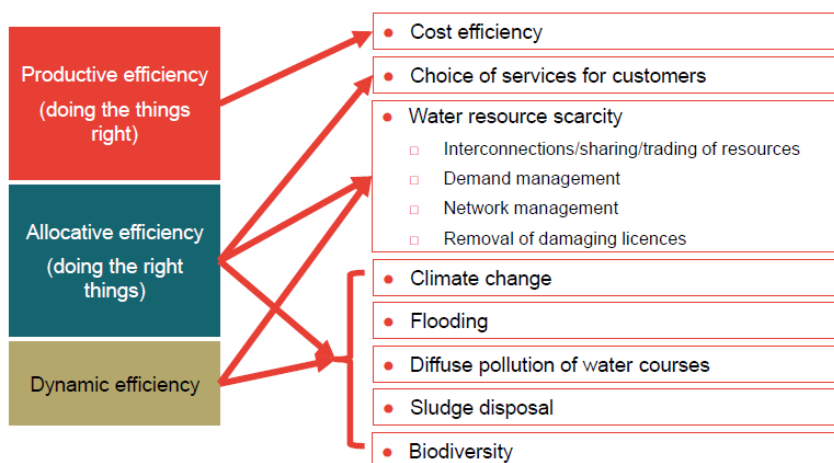
Comparative efficiency

We think it is important to emphasise that the wholesale cost models are generally just concerned with measuring productive efficiencies. Ofwat emphasised during PR14 that in a mature water industry the value of allocative and dynamic efficiencies are likely to be greater.

We simplify these different sources of incentives as descriptions of:

- Productive efficiencies – “doing the things right”
- Allocative efficiencies – “doing the right things”
- Dynamic efficiencies – “doing different things”

For PR14 this meant that companies should consider the efficiency of their totex costs with the effectiveness of delivery in order to design their cost menu and outcome incentive proposals as a coherent package. This was evident from Ofwat’s development of the Return on Regulatory Equity (RORE) concept for PR14. The objective was in part to move companies away from focussing delivery on financing incentives for outperformance to considering service and cost incentives as of equal importance. From our perspective this was essential given the context of the Water for Life White Paper and the Water Act. For instance, in our own assessment we considered the main challenges that the wholesale activities of companies face and the degree to which they different types of economic efficiency considerations were relevant to their achievement:



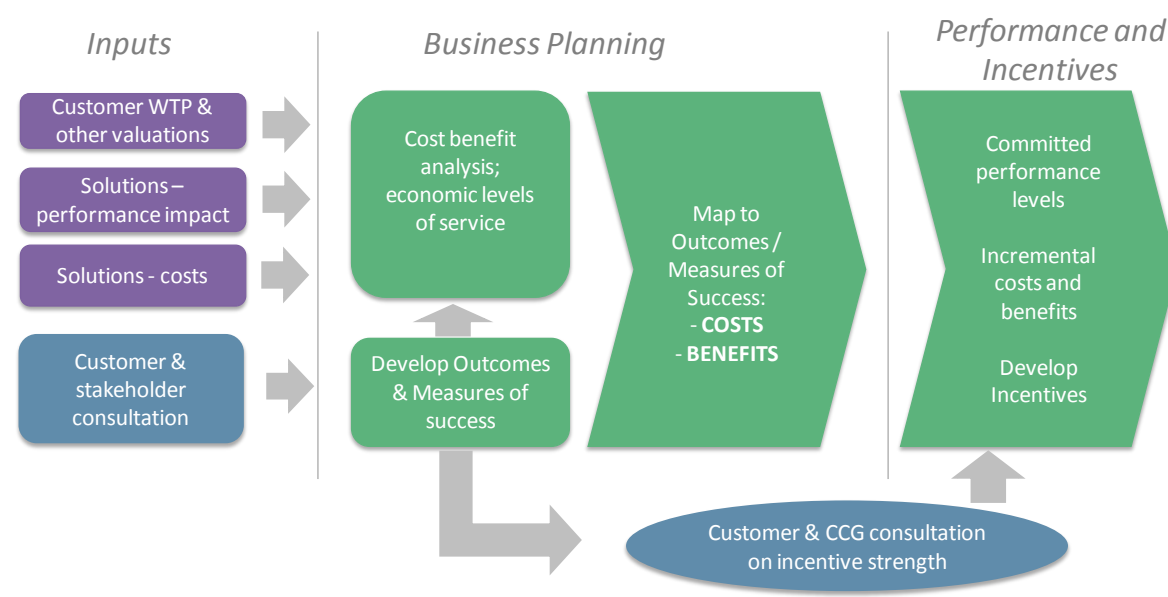
Source: Frontier analysis for SWW

The role of productive efficiency in the plan is that it provides one aspect of the challenge being faced by a company. Cutting costs for current activities may not produce the optimal outcome for delivering the wider expectations on companies. Knowing areas of costs that are currently higher (or lower) than for other companies does help to identify where environmental and service requirements require a different allocation of resources, and where there are dynamic and innovative solutions to this challenge. We saw greater long term risks for SWW in just trying to achieve productive efficiency gains on current ways of working and therefore appreciate a regulatory framework that allows the balance of different sources of efficiency improvements to be sought.

SWW approach to PR14 and beyond

The SWW approach was built on the follow decision making principles:

- the ability to link customer research through to investments through to outcomes and regulatory incentives
- making the link of delivery back through to customer and stakeholder engagement and support for investments and ways of delivery:
 - in the case of tariffs, linking business cost through to end customer tariffs and creating an optimisation model that considers both external legal and regulatory requirements as well as internal objectives and customer and stakeholder priorities as part of the governance and assurance framework
 - for investments, a consistent consequence framework of social, environmental and private costs, built on extensive peer-reviewed customer research into Willingness to Pay.
 - assessment of the financial consequences for business risk consistent with the above, ensuring alignment with Board decision making and assurance processes.
- detailed delivery plans considered using measures consistent with strategic decisions. This enables all delivery options to be considered on a consistent basis, including those that involve working with customers and stakeholders to help manage future risks (e.g. water efficiency, working on misconnections to our network, upstream catchment management) as well as our assets and internal processes.



The Water industry remains heavily regulated, with c5 yearly price reviews likely to remain necessary. There are extensive investment requirements to meet Government /customer /regulator driven quality of service and environmental improvements. Despite industry asset values of £500bn and capital investment of c. £5bn p.a, at the recent price review the industry delivered a 5% bill reduction before inflation 2015-20. For South West Water, where investment requirements have historically been the highest per customer, with the Government providing funding to reduce household bills by £50 each year to reflect historic unfairness of the scale of environmental improvements, bill reductions of 13% over 2014-2020 before inflation have been delivered. Bills following PR14 in 2015-16 are at their lowest level since 2007.

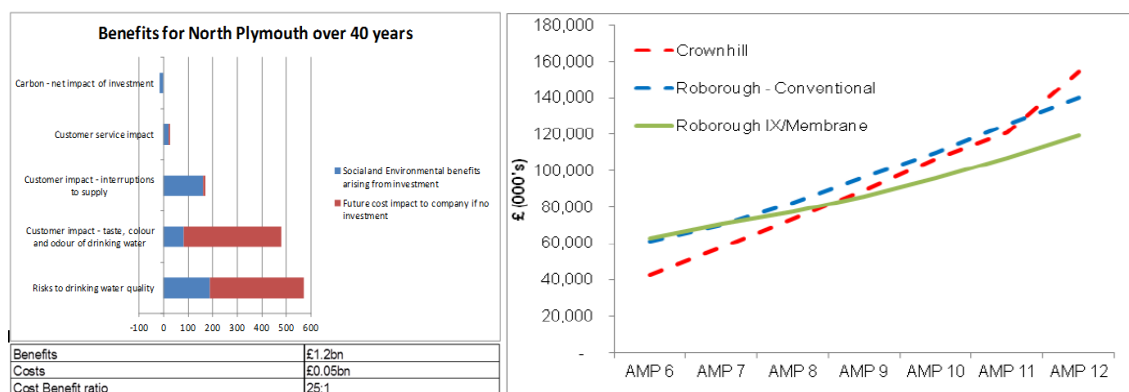
Given the significant choice about future bill and service levels (in terms of risk, timing and price), asset planning informed by cost benefit analysis plays a key role in decision making in producing a business plan. The focus is on the risk and uncertainty for services over the timing of investment needs rather than just the asset performance risk. This provides context for customer research and engagement that allowed a long term set of 8 overarching outcomes to be developed.

There is an extensive amount of customer and stakeholder research and willingness to pay evaluation carried out. This starts with a long term (25 year) vision of the context and outcomes that are desired. The acceptability of the overall programme is tested through producing scenarios, as well as considering current level of satisfaction with services and value for money. Engagement with customers involves both long term tracking surveys of customer views, specific research surveys and engagement such as the “Build your own WaterFuture” on line tool that allowed customers to explore the issues faced.

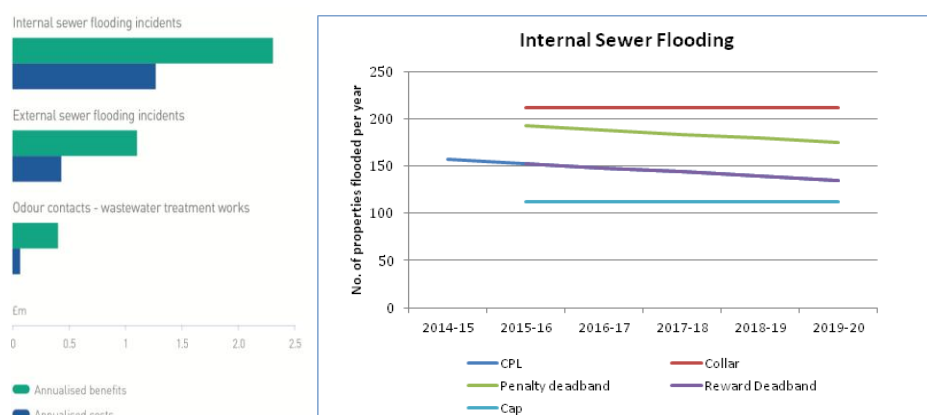
Cost benefit analysis is used to determine both the economic level of service that should be provided and the most beneficial mix of projects over time that will deliver this. Uncertainty analysis over both the costs and benefits is used in order to assess whether the project is

robust from both delivery and stakeholder risks (e.g. from the supply chain and sustainability factors).

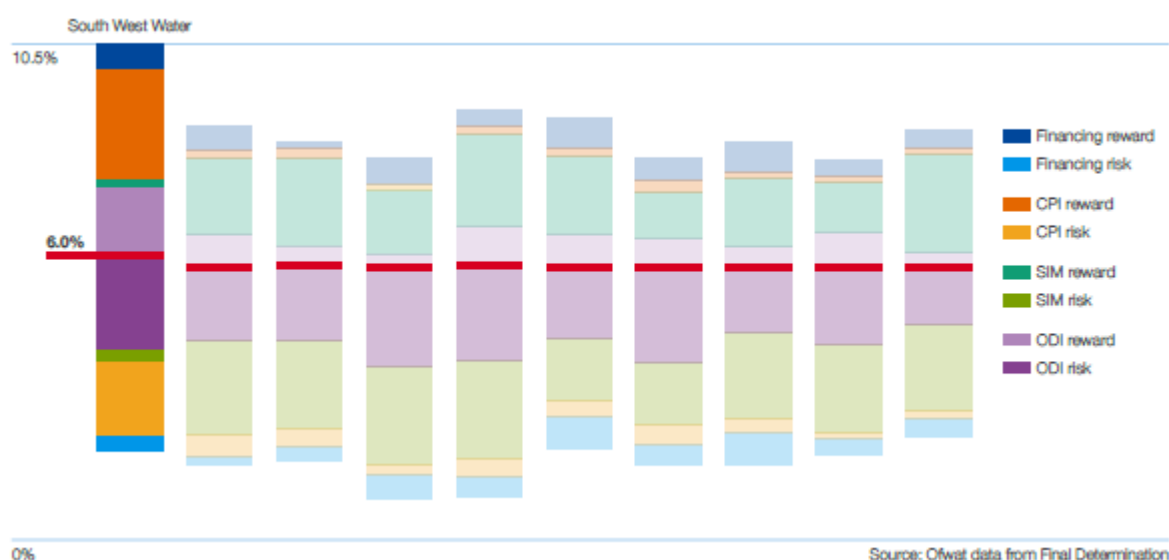
An example is shown below for North Plymouth WTW. There had been a long term desire to improve resilience and reduce service risk by moving the water treatment works away from urban Plymouth to a new site. Before PR14, this project could not easily be included in the business plan as separate capex and opex assessment did not reflect that the benefits required additional overall expenditure in the first 10 years. The move to an outcomes and totex menu framework allowed more innovative solutions to be proposed. Because of the stakeholder and customer support and the strength of the business case put forward, Ofwat made a “deep dive” allowance for this project in addition to the amount allowed in the wholesale totex cost model baseline. The details of the specific cost models were unknown to SWW when the case for an adjustment to cost models for North Plymouth were included in the business plan, but this did not prevent a justification for the project using cost benefit analysis being sufficient to allow Ofwat to judge the proposals at risk based review stage.



The economic level of service from the most efficient and effective set of investments is translated into a set of performance commitments and financial incentives that provides incentives for the company to deliver more improvements as opportunities arise, with the financial reward offsetting the additional cost. Equally customers are protected by financial penalties for non-delivery, to avoid the risk that incentives for cost efficiency result in short-termism in cost reduction. Uncertainty about the ability of the water company to influence delivery (e.g. for sewer flooding because of weather impacts that will be increasing because of climate change) are taken into account through “deadbands” around performance levels before rewards and penalties apply. This reduces risk from the framework for both customers and company, as long as there is good quality information on the factors that affect performance and the uncertainty surrounding this.



Ultimately, SWW performance is monitored cost and the performance incentive targets. This is considered through the return on equity, as external impacts of performance (e.g. pollution incidents) have been taken into account in the incentive framework, with the value of the incentive reflecting the social and environmental factors considered by customers in their willingness to pay surveys, and other social and environmental valuation data sources.



The impact of this approach stretches beyond the price review to delivery. Monitoring this return on equity at Board level, along with the outcomes that drives it allows for a balance with traditional Board reporting on cost performance and financing performance, as well as customer satisfaction and complaints measures that also traditionally are used in balanced reporting. There are two key differences to the past now embedded in the SWW approach:

- social and environmental factors, with targets that take into account the sustainability trends within them have enhanced status, alongside financial consequences within Board reporting
- the return on equity measure is consistent with a short term (one month or current year), medium term (2 to 3 years) or long term perspective (the five years of the price control period or 25 years of the strategic plan for the company for its stakeholders).

SWW has recognised the importance of engaging with customers and stakeholders on performance and how wider factors affecting company performance should be shared between prices, service levels (including to the environment) and investors. Through the WaterShare framework, the company has committed to transparent reporting on performance against commitments with scrutiny from an independent representative panel, and where there are gains, discussing how these should be fairly shared.

The WaterShare framework is a key part of SWW's proposals for 2015-20. We are implementing a framework that allows for sharing the benefits of excellent performance and other beneficial factors in a timely manner with customers. The proposal was inherent to the plan and works alongside the wider industry regulatory framework, with the overarching message being that **this mechanism protects customers and is one from which customers can only gain.**

Specifically the WaterShare framework:

- monitors cost and outcome incentive performance from regulatory mechanisms
- considers other performance areas of risk and opportunity ("other factors") that are not subject to regulatory mechanisms
- where there is net gain in these other areas of performance, sets out what has accrued to date, how this has been shared between shareholders and customers, and what remains to be shared
- where there is net pain to customers in regulatory mechanisms that could affect their bills "in-period", WaterShare acts as an additional check. Other gains within WaterShare are considered before regulatory mechanisms that could offset customer bills are applied
- where customers are due net gain through lower bills from regulatory mechanisms "in-period", WaterShare does not apply and customer bills will benefit.

Future context

It is important to recognise that the issues of how companies can make better longer term decisions that balance wider sustainability considerations with customer and investor needs is not limited to the water industry. For instance the Prince of Wales Accounting for Sustainability CFO Leadership Network has recently published a series of guides on improving decision making for future risks which consider that many of the same issues facing the water industry are shared by other sectors. Case studies in these guides from SWW and a number of other water companies suggests that the changes associated with the PR14 regulatory framework were necessary for the long term sustainability of the industry, as foreseen in the policy framework developed after PR09.

We would be concerned by a move away from the risk based framework that Ofwat developed for PR14, back to a framework that required the regulator to scrutinise individual companies plans in detail in a way that wasn't targeted by a sense of economic value and risk. The onus must remain with companies to make the case by understanding the delivery risks from customer and regulator perspectives, rather than the price review process being by default responsible for achieving this. Companies' considering more than short term productive efficiency in how they consider the success of their activities against their comparators is a growing expectation in many industries – it is part of risk and opportunity management in developing the business model for any organisation. The data and

processes used by companies can be expected to vary with their local circumstances; comparisons between sectors are likely to be more revealing of risks than those within the industry. For the water industry returning to a performance and comparative measure framework determined *ex ante* by Ofwat is unlikely to be fit for purpose in this wider context and companies will need to continue to adapt to this.

Ofwat's future strategy focuses on influencing the behaviour of those that are regulated. We agree that this can be a very powerful approach, and in many cases can be more effective than reliance on formal regulatory tools such as enforcement action. We agree with the vision that this approach can be supported by a focus on outcomes, and with companies building strong relationships with stakeholders that look at issues through the customer lens.

Outcomes, and the incentives attached to them, are important for a number of reasons, not least of which is because of how they can reflect the customer perspective. Well constructed rewards allow for changing customer needs to be funded outside of a regulatory cycle, which combined with penalties allow for a more immediate link between company performance and customer's bills than has been possible before. A key to the success of this framework will be demonstrating how this approach can help a company to maintain strong relationships with both stakeholders and those customers who do not have market choice. Our WaterShare approach is our recognition of the importance of this transparency, not only for customers, but also to build the link to investors. This encompasses Ofwat's primary duties, and in the context of PR14 all companies need to consider how they want to demonstrate transparency of performance, both during price reviews and for ongoing delivery.

The work towards upstream reform post the 2019 price review means that a wider range of potential cost models and efficiency and performance rankings between companies can be expected. A very dynamic situation can be expected – depending in part on the business models that companies undertake in response to the PR14 incentives as well as their preparation for the upstream reforms. It is not clear currently what comparative information will be and Ofwat would need to change their wholesale cost models for the next price review even if the framework was identical to PR14, as the lack of knowledge about these is crucial to the risk based review process.

The distinction between regulatory and market tools will inevitably blur (e.g. with enhanced role for access pricing and cost models behind these, with retailers comparing wholesale company cost and tariff structures), with existing company comparators having less obvious and certain values. There is a greater value in allowing new market and company delivery models and structures to emerge (including through mergers of companies and activities), as:

- the choice that is available to the industry on the combination of price regulation and markets used in the future for the upstream value chain
- choice is not necessarily the same as whether policy is planned or market mechanisms are used to determine the outcome (all markets operate within a legal / licensing framework)
- defining the industry value chain should not be limited to the current perception of the water industries responsibilities. The role of wider environmental, eco-systems services and developer services markets should also be considered. The impact of retail markets in terms of what services wholesalers and other organisations may

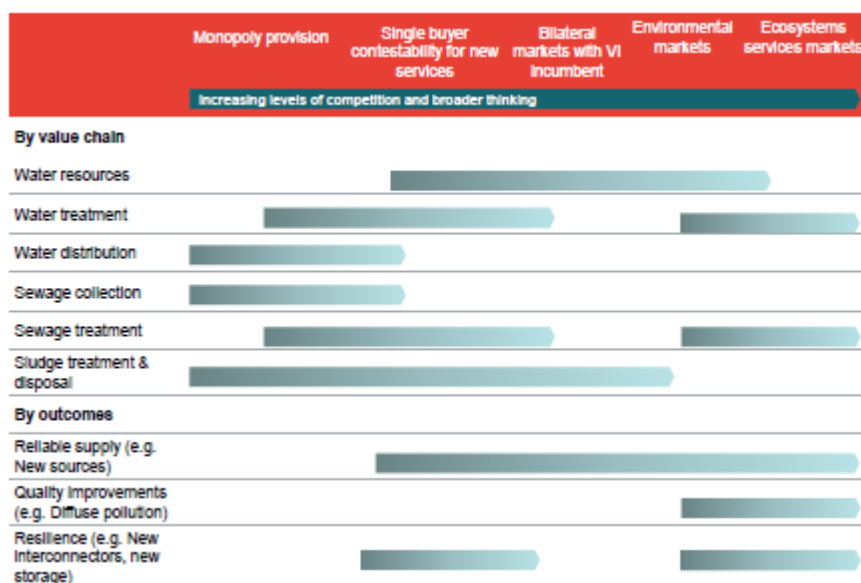
offer (“business to business”) is also important. The industry cannot appear insular and isolated from other markets and social/environmental trends.

- Where trade-offs between objectives are likely to arise, without assuming a particular pricing and efficiency approach

Across the value chain, markets are likely to be distinguished between combinations of:

- Regulated prices and regulated access
- Bilateral business to business markets
- Single buyer market brokers
- Regional and national markets
- Wider use of market mechanisms
 - Environmental markets (water, carbon pricing, waste recycling/disposal)
 - Paid ecosystem services (including auctions for delivery of water capacity / quality requirements)
 - Within regulatory frameworks (beyond outcomes and productive efficiency)

As shown in the model below, monopoly comparisons could form a relatively limited part of the overall value chain as a range of potential market and regulatory approaches are possible:



ANNEX J – GLOSSARY

ACTS	Average Cost to Serve
AMP[x]	Asset Management Plan[year]
Botex	Basic Maintenance Expenditure
Bronze	Project Bronze, internal code name given to this acquisition
BW	Bournemouth Water Investments Limited
BWL	Bournemouth Water Limited, a subsidiary of BW
CAPEX	Capital Expenditure
Cave Review	Professor Martin Cave, <i>Independent Review of Competition and Innovation in Water Markets: Final Report</i> , April 2009
CC	Competition Commission
CCWater	Consumer Council for Water
CIS	Capital Expenditure Incentive Scheme
CMA	Competition and Markets Authority
CTS	Cost to Serve
Customer View Group	BW's equivalent scheme to Pennon's WaterShare
Defra	Department for Environment, Food and Rural Affairs
DWI	Drinking Water Inspectorate
EA	Environment Agency
FD[x]	Final Determination [year], Ofwat's company specific decision on pricing
FPL Consultation	Ofwat, <i>Future price limits – a consultation on the framework</i> , 23 November 2011
ICS Consulting	Professional advisers to Pennon
Linklaters	Linklaters Solicitors LLP, advisers to Pennon

Mid Kent	<i>South-East Water and Mid Kent Water: a report on the completed merger (2007)</i>
NPV	Net Present Value
ODI	Outcome Delivery Incentives
Ofwat	The Water Services Regulation Authority
Open Water	Statutory body to develop retail market rules
OPA	Overall Performance Assessment
Oxera	Oxera Consulting LLP, advisers to Pennon
Opex	Operational Expenditure
Pennon	Pennon Group Plc
PC	Price Control
PR[14]	Price Review for period starting [2014]
PUROS	Phase Utilisation of Remote Operating Services
RCM	Revenue Correction Mechanism
RCV	Regulatory Capital Values
SDB	Supply Demand Balance model
SCP	Small Company Premium
SIM	Service Incentive Mechanism
SWW	South West Water Limited
Totex	Total Expenditure (i.e. Opex plus Capex)
Uplift Paper	Ofwat's Final Price Control Determination Notice, Annex 3 "benefits assessment of an uplift on the cost of capital" (2014)
VOC	Value of Comparator
WaSC	Water and Sewerage Company
WaterShare	A Pennon framework to share benefits with customers

WIA	Water Industry Act 1991
WoC	Water Only Company

