



# Developing a National Approach to Customer Research

Proposal for an approach

# A National Approach to Customer Research

## Proposal for an approach

Ofwat has proposed to undertake a collaborative, nationwide approach to customer research at future price reviews. Whilst we believe that other options for change could also effectively address some of the lessons learnt from the PR19 process, we agree that some degree of national customer research could play a role in future prices reviews, if appropriately specified and delivered.

It is essential that companies are directly involved in the development of such research in order to get the benefits of collaboration and ensure that they support the results. Without this companies would not have ownership of their business plans, and would not have confidence that plans reflected customer priorities.

We have set out in this paper a number of key elements which we believe will lead to effective national customer research results that all stakeholders have a greater chance of being able to endorse.

In its consultation on customer engagement in price reviews, Ofwat identified a number of limitations with companies' customer research efforts at PR19. In particular it was noted that companies' estimates of customers' willingness to pay for comparable service levels varied markedly. Ofwat observed that it was unclear to what degree these differences reflected genuine differences in preferences and, if not, which values, if any, best reflected customers' views.

Ofwat has proposed to address this issue in future by using a collaborative, nationwide approach to research. We recognise some of the concerns that underpin this proposal, and whilst we consider other options for change could also effectively address some of the lessons learnt from the PR19 process, we agree that some degree of national customer research could usefully play a role in future prices reviews. To be successful, this will require active engagement between all companies and the regulators and UUK is keen to contribute to the effective implementation of a national research approach, should it be decided it is necessary.

In our initial response to Ofwat's consultation we committed to providing further thoughts on the effective delivery of a national research programme for PR24. To that end, this paper sets out our views on how a national approach can be developed and applied effectively. In doing so we have had regard for the key objectives when considering customer preferences as part of price review, as set out by Ofwat.

## Key elements of a national approach

- There needs to be up front clarity on the role of customer research within the price review.
- Apply a national approach for research only in those areas that are likely to benefit from it. Ensure companies retain responsibility for delivering regionally focused research where they are best placed to deliver it.
- Recognise the limitations of Willingness to Pay choice experiments in determining customer valuations of service, and consider evidence from other research approaches to improve valuations.
- Ensure national research can establish real differences in valuations between regions and social groups. Where regional differences exist, and are supported by local research, allow for variance in performance targets on common measures to reflect these preferences.
- Put in place robust research design, with independent oversight. Clear governance is needed to develop and oversee the national research framework – we are proposing an Ofwat-led working group, with all companies able to participate.

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## Focus on key objectives

A well-designed national approach to customer research can contribute to achieving key objectives. In particular it could support:

- **Increasing proportionality** – the national approach should reduce the need for multiple local studies and ensure that research is focused on areas where it will influence the price review.
- **Promoting transparency** – with a centralised research project it can be easier to see how customer valuations have been derived.
- **Fostering collaboration** – a centralised research effort, drawing in contributions from companies can drive collaborative working and contribute to ensuring that best practice is implemented.

In order to achieve these objectives, it is essential that companies are directly involved in the development of the research in order to get the benefits of collaboration and ensure that they understand and support the credibility of the results. Without this, companies would struggle to demonstrate appropriate ownership of their business plans, and may not have confidence that utilising the research results in plans which reflect local customer priorities.

We have set out in this paper a number of key elements which we believe will lead to effective national customer research results that all stakeholders have a greater chance of being able to endorse. Key elements of a national research exercise should include:

- **The role of customer research in the price review:** The need to expressly link the research approach to the role of customer research within the price review.
- **Aspects of the price review to be included in centralised research:** Applying a national approach to research only for aspects of service that are likely to benefit from such an approach. Ensuring companies retain responsibility for delivering regionally focused research where they are best placed to deliver it.
- **Appropriate use of Willingness to Pay choice experiment approach:** Recognising the limitations of Willingness to Pay choice experiments in determining customer valuations of service, and considering potential supplementary research approaches to improve valuations.
- **Regional and social variations in customer preferences:** The need for research to establish any real differences in valuations between regions and social groups, which can then be taken into account in setting performance targets. Where regional differences exist, and are supported by local research, we consider that there should be scope for varying incentive rates and performance targets on common measures to reflect these preferences.
- **Developing a national approach:** Robust research design, supported by oversight mechanisms for stakeholder engagement is crucial. Clear governance is needed to develop and oversee the national research framework – we are proposing an Ofwat-led working group, with all companies able to participate.

We address each of these points below.

It is important to recognise that a national, centralised research exercise, with common outcomes to be applied across all companies naturally carries with it increased delivery risk compared to regionally focused research conducted directly by companies. Under a centralised approach many companies may not conduct their own comprehensive research, meaning any erroneous results from national research could be amplified across many companies' price controls. As such it is vital that substantial efforts are made by all stakeholders to ensure such research is of the highest standard, and subject to independent review and challenge.

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## The role of customer research in the price review

Before commencing a national programme of research, it will be important to set out what it will influence. This framework should be specified before deciding what research to carry out and it should drive both coverage (e.g.: which aspects of service) and methods (i.e.: the type of research which is needed.) Research only to determine valuations for incentive rates, or research to determine relative priorities, would probably be different from that required to assess absolute valuations for setting service performance targets.

Carefully considering the scope of national centralised research will be crucial for its successful delivery. Conducting national research which is able to recognise actual and legitimate regional differences in existing service experiences and the wider social context is complex. As such establishing sound principles for determining when a national approach is absolutely needed, to address issues such as unexplained regional variations in service valuations, should be established.

A clear framework can also support aspects of customer research where a national approach is not needed. Defining what will, and will not, be covered by national research will enable companies an early opportunity to put in place customer research covering areas not covered as part of a national approach but which are significant factors influencing their business plan.

Much of the customer research at PR19 related to customer preferences on service levels which were ultimately determined by national comparisons. Determining the role of research will ensure that research is focused on determining customer preferences accurately in aspects of the price review where it makes a difference.

## Aspects of the price review to be included in centralised research

Ofwat has suggested that the national research would focus on aspects of business plans which are common across companies. It indicated that this would cover common performance commitments and their outcome delivery incentive rates. It could also include aspects of plans which are tested at a 'package' level such as bill profile testing and acceptability testing.

Measures which were treated as comparable at PR19, such as water aesthetics and external sewer flooding, could form an appropriately structured national approach. Alongside this, more work is needed on ensuring that companies are applying common definitions and methodology for these measures. However it is important that companies retain responsibility for delivering regionally focused research where they are best placed to deliver it. As set out in section 4 below, there are limitations with willingness to pay choice experiments, and other forms of research are not well suited to being conducted at a national level.

For example, whilst common national research could deliver a willingness to pay choice experiment for some common service measures, it is likely to be more difficult to consistently apply a national approach for other forms of customer research, such as a revealed preference work based on companies' operational data. Similarly much of the immersive preference work that companies have conducted in recent years requires substantial information on local context and costs to support it, limiting the ability for such research to be conducted at a national level.

In addition there are a number of common measures that do not lend themselves well to a national research approach. For example, serviceability measures would be difficult to usefully include in such research. Customer views on serviceability measures are not directly meaningful, as the customer experience is based on service outcomes, not upstream asset issues. The use of customer research derived values in areas such as this risks creating double-counting with values for the measures which serviceability failures ultimately affect. Customer research tends to show that customers feel this is an area for companies and regulators to make judgements on. National research should, therefore, be focused on common measures directly related to service delivery.

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Research relating to bespoke performance commitments, company-specific investment needs or more general customer preferences should continue to be wholly carried out by individual companies. Bespoke commitments have proven to be a valuable aspect of recent price reviews, enabling companies put in place protections for customers when local circumstances dictate atypical investment, or where innovative service aspirations need bespoke incentives to be applied. Attempting to conduct national research on such metrics would be burdensome. A centralised research approach would either require national surveys on issues that only relate to smaller regions, or a centralised body attempting to design multiple region specific research projects.

Similarly, whilst bill profile testing and acceptability testing could theoretically be conducted at a national level, companies' past regional research has been effective, with few concerns raised by key stakeholders in this area. As such it would seem that continuing with a company led approach in this area would best serve the stated objectives of enabling companies to take responsibility for their relationship with customers, without adversely affecting other goals.

## Appropriate use of Willingness to Pay choice experiment approach

The standard approach to assessing service valuations has been through willingness to pay choice experiment (WTP-CE) research, with customers making a choice from alternative packages of services and bills. This method of assessing willingness to pay can be effective, but also creates recognised anomalies in terms of the valuation of aspects of service. Examples from PR19 include:

- As noted in Ofwat's consultation, large differences in valuations between companies is possible. There are examples from PR19 of the highest company valuation for a given service failure being several hundred times the smallest value.
- Valuations which appear excessive, such as a valuation at PR19 from one company of over a thousand pounds for a 6-hour interruption in service.
- Anomalous differences, such as long interruptions receiving a WTP valuation that is less than short-term interruptions.

A consistent approach through national research may address the first of these issues – the large differences between companies. However, there may still be anomalies, and a single research exercise risks removing the opportunity to identify anomalies through comparisons between companies.

Given the generally robust approach adopted to research at PR19 we believe that these anomalies did not arise because research approaches were flawed, but because of the inherent difficulty in establishing willingness to pay. The WTP-CE approach may well produce reliable results in determining what a service failure, such as an interruption, is worth to a customer experiencing it. However, in a price review process WTP-CE surveys are frequently conducted with customers in such a way that asks for choices to be made about:

- Aspects of service of which customers have no experience.
- Changes in service performance at a company level, rather than directly affecting the individual customer.

This approach is attempting to establish altruistic values, i.e. willingness to pay for improvements from which the customer themselves may not directly benefit. In such surveys, customers tend to focus on the aspect of service e.g. sewer flooding, rather than the scale of improvement, because there is often too much information to be able to absorb it all. This means that a small increment of improvement tends to lead to a larger unit value – the “denominator effect”. This denominator effect partly explains the differences in values between companies, and why there are anomalies between different aspects of service.

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This denominator effect was shown in an analysis of PR14 WTP studies but is also evident in PR19 results. There are numerous cases, of which some examples are:

- **Interruptions:** It is well-established from detailed customer research on interruptions that the inconvenience of an interruption to customers increases at least proportionately to its length. However, one company had virtually identical willingness to pay for 3-6 hour and 6-12 hour interruptions (suggesting research participants were more focused on the interruptions issue than the different durations). In addition, a larger service increment was used for the longer duration interruptions, meaning that WTP per customer affected was lower for a long interruption.
- **Water taste and smell compared with discolouration:** At PR19 our own customer research shows that customers regard discolouration as a more significant issue than taste and smell. Total WTP was greater for discolouration than for taste and smell. However, in the research we used a larger service increment for discolouration than for taste and smell. This resulted in the untriangulated WTP per customer for taste and smell being greater than for discolouration, requiring us to intervene to rectify the issue.
- **Comparisons between companies:** taste and smell: Work we completed comparing across water companies observed that the choice of service increment for improvement in taste and smell problems significantly affected customers implied valuations for service level change. Where smaller service increments were used in survey work higher customers valuations emerged.

## Addressing the limitations

The limitations of WTP-CE were recognised at PR19, and Ofwat encouraged companies to apply other methods of research. Companies triangulated these different approaches to produce an overall value. The wide range of research approaches and methods of triangulation meant that companies' had the tools and evidence needed to challenge raw WTP-CE valuations that were inconsistent with wider results and evidence. This led to more consistent valuations across each companies' own business plans than would have been the case had WTP-CE research been the only source of data on customers' views. Of course as companies had no insight into other companies' triangulation efforts the large variances in valuations across the industry remained.

Ofwat's customer preferences consultation noted that: "There is clearly value in evaluating findings from disparate pieces of analysis which attempt to address the same question. Triangulating across the different sources of evidence can increase confidence in any inferences made (where results point in the same direction), or alternatively help to highlight uncertainties (where results diverge significantly)".

Using more than one approach in national research will contribute to enabling anomalies to be eliminated in the overall valuations. Other research methods which produce quantitative results and can be representative of the customer base should be considered. Potential options to apply as additions to the WTP-CE approach, all of which were applied by some companies at PR19, include:

- Research to determine relative rather than absolute values, e.g. how much one interruption is worth relative to one sewer flooding incident. This approach has been used by some companies, and it can give customers more meaningful choices than making choices between increments to overall company-wide levels of service.
- "Sliders" research, which gives customers the opportunity to build their own plan by varying the level of service for different performance measures and seeing the impact on bills.
- Research to determine customers' overall affordability limits for service improvements in general, which could be used to calibrate the general level of ODI incentives.

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- Research on customers' general priorities, rather than specific values. Ofwat suggested in its consultation that it "could seek to set outcome delivery incentive rates for performance commitments based on customers' broad preferences, as opposed to their willingness to pay for a specific service improvement". Valuation research is still needed, e.g. customers may give a high priority to reducing sewer flooding but that does not determine how high the incentive rate per incident should be. Such research could, however, be used to check the valuations derived from WTP research.
- Immersive research - in-depth research which aims to help customers imagine what it would be like to experience a service problem. Ofwat raised the possibility of citizens' assemblies, which might similarly lead to greater customer understanding of complex topics.

A mix of research techniques helps promote confidence in outcomes, where results are consistent, or identify areas of higher uncertainty. Combined with a transparent research programme a multi-pronged national research programme will more robustly reflect customers' views and help to increase companies' confidence in research conclusions

## Regional and social variations in customer preferences

Ofwat noted that geographical as well as social and economic differences would need to be taken into account in future research, and said that "it will be important to ensure that key differences between customers and communities can be identified and reflected throughout the process". We agree that results are needed which can provide information on differences between company areas and social groups, which requires that:

- Sample sizes must be large enough that the results are statistically significant, not just at a national level, but for different regions and customer groups.
- Service increments tested with customers need to be carefully designed to avoid differences between regions arising from denominator effects, rather than reflecting real regional differences. We have shown in Section 4 above how differing service increments in WTP-CE research significantly distort comparisons between companies. Without appropriate research design, this could make it impossible to draw conclusions about genuine differences between the preferences of companies' customers.

In particular we believe that special consideration should be given to a number of key customer segments that are likely to have requirements and expectations that have historically shown variances from the 'average' or 'typical' customer.

Developing the right approach to research will increase confidence that variations in valuations between regions or customer segments reflects true differences in customer preferences.

We consider that a future framework for utilising customer research in a price review process should allow individual company research to influence performance commitment levels and incentives, where there is strong research evidence that demonstrates regional variations from the conclusions of national evidence. Ofwat has noted the potential for local research to be taken into account and the need to decide how to prioritise and weight different sources of evidence. The approach to customer research needs to be improved so that there is confidence that differences between company valuations reflect real differences in customer choices.

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## Key customer groups

**Vulnerable groups:** For a wide range of reasons people living in vulnerable circumstances have different service needs to the average. They can be hard to reach using standard online or telephone research channels. This group may highly value improved accessibility options on company websites, increased security measures for property visits, or provision of bottled water during interruptions. Robustly capturing and reflecting these increased needs is crucial to an effective research programme.

**Low income groups:** Many customers face immediate challenges in meeting day to day living costs. Our own research has shown even small changes in water charges can disproportionately contribute to levels of water poverty and overall challenges in managing household budgets. A national research programme needs to capture the views on low income customer groups, and understand how WTP and overall affordability differ from the average for these groups.

**Future bill payers:** It is important that the views and concerns of future bill payers are understood, and that we as an industry enable their views to form part of our future planning. Research in this area has repeatedly shown that future bill payers have different priorities to the ‘average’ customer, and a national research programme should provide the insight needed to enable companies to develop plans to address these priorities.

**Non-household customers:** Wholesale price reviews impact the service and bill levels of non-household customers as much as they do householders. It is crucial that national research accurately reflect the views of these customers. Non-households represent a very diverse group, from small corner shops, to large industrial manufactures. Each of these groups have different needs and priorities. National research will need to effectively capture this range of views, recognise the limitations of Willingness to Pay choice experiments in determining customer valuations of service, and consider evidence from other research approaches to improve valuations.

**Retailers & Developers:** Retailers, developers, SLPs and NAVs are crucial customers and stakeholders of wholesalers, and their views need to be reflected in business planning and price reviews. The ‘many to many’ structure of these relationships does not easily lend itself to a national centralised WTP-CE research exercise. However, many retailers and NAVs have expressed a preference to avoid needing to engage independently with 17 different wholesaler on each issue as it emerges, preferring in some instances a nationally coordinated approach. Consideration should be given to the best way to engage these groups in the price review process.

## Developing a national approach

There are a number of issues to be resolved in designing a national research programme. In many cases there are choices that need to be made in establishing research, including:

### *Survey design*

**The way in which services are described to customers** – information provided needs to be easily understandable and presented in a neutral way. There are balances to be struck in terms of providing enough information for an issue to be understood, without overloading the customer with information or leading the customer towards a particular conclusion.

**The aspects of service to be included in the research** – as noted above, we consider that this should include common and comparable measures but exclude serviceability indicators, or company specific programme elements.

**Presentation of service risks** – as noted by Ofwat “most market research which uses probabilities tends to run into difficulties” but this does not mean that customer research on risk-related issues should be ruled out. We consider that immersive research, as we applied to potential long-term interruptions at PR19, helps to reveal customer preferences.

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**The customer research methods to be used** - As discussed above, we feel that more than one approach is needed to establish reliable valuations. However choices will need to be made around which alternative research approaches should be applied, in which areas, and how much confidence should be applied to results from different research techniques. It also needs to be aligned with the decisions about the aspects of the price review which customer research will influence.

**How the research is to be carried out** – Multiple methods for surveying customers are routinely used, including online, face to face, or by telephone. Each approach has pros and cons, and the relative proportion of each method can have important implications for survey results. For example younger and more affluent customer groups are more likely to be reached with online survey techniques, whereas face to face surveys can reach customers that may not be reached via other methods.

**How to decide the levels of service and incremental changes to be put to customers** – this can significantly affect both comparisons between companies and between different aspects of service provision.

## *Using research in the price review*

**Consistency across national and local research** - it is clear that national customer research is not an appropriate mechanism for deriving valuations for asset health and bespoke service measures. However it would be desirable to have a degree of consistency and comparability with those aspects of common service that do form part of a national research effort. An early collective effort to develop guidance on how best to achieve this is therefore desirable.

**The timing of the research** – a national research exercise would most likely need to be complete by early calendar 2022 if it is to be used in developing business plans, but the required timing depends partly on decisions about what aspects of the price review will be influenced by customer research. There needs to be sufficient time for the results to be triangulated and for companies to review the research, consider whether any additional local research is needed, and incorporate the results into business plans.

**Consistent company input** – Substantial contributions from companies will be needed in designing national research, including data on current performance, potential impacts of external factors such as climate change and population growth, impacts of new legislative drivers, etc. Developing these inputs is likely to take time and resources, so early clarity on when and how such contributions will be required, and how consistency of company submissions into the process will be ensured will need to be a primary focus should national research go ahead.

**Ensuring that the research process and results are valid** – this requires academic review of the method, and also a review of the credibility of the results. In the past research projects have been shown to follow good practice and have had academic support but have still generated widely divergent valuations. An oversight role at a national level comparable to that which CCGs performed at PR19 at company level is needed. Given the centrality of the customer research to company business plans, it is important that this approach has the support and confidence of the companies themselves. We consider there should be direct industry participation as part of the oversight role.

Given the wide range of choices that need to be made in developing a national research programme, and the importance of independent review and oversight in securing stakeholder support for such research, we consider that a working group led by Ofwat, with all companies on the group who wish to be involved, and CCW also participating, would be the most effective way to decide these issues. As a starting point, companies could share their previous WTP-CE research, which would help to establish why companies' valuations were so different.

The working group approach worked well for debating and resolving issues relating to the new Water Resources and Bioresources price controls at PR19, and in developing of new C-MeX and D-MeX surveys. If companies are to have confidence that the research represents customers' views and provides a sound basis for business planning, then they need to have the opportunity to be directly involved in the development of the research approach. We would be very willing to devote time in the working group to ensuring that the research is successful.

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Coordination through WaterUK or a subset of companies would not be sufficient. We support the position taken by Ofwat in its customer preferences consultation that companies are “ultimately responsible for managing their relationships with their customers and responding to their needs”. This would not be achieved without companies taking joint responsibility for development of a national research framework.

Joint funding arrangements will be needed for advice on developing the approach and for carrying out the research. However, in terms of developing the approach, we feel that there is sufficient expertise in companies for the working group to carry out much of the development work. As with other Ofwat working groups, individual companies or sub-groups can work on specific issues to work on developing proposals for the main group.

## In conclusion

Whilst we believe that other options for change could effectively address some of the lessons learnt from the PR19 process, we agree that some degree of national customer research could play a role in future prices reviews, if appropriately specified and delivered.

A national, centralised research exercise, with common outcomes to be applied across all companies naturally carries with it increased delivery risk compared to regionally focused research conducted directly by companies. As such it is vital that substantial efforts are made by all stakeholders to ensure such research is of the highest standard, and subject to independent review and challenge.

We believe that careful consideration should be given to:

- The role of all customer research within the price review.
- The scale and scope of national research projects.
- The limitations of Willingness to Pay choice and the alternative research approaches that are available.
- Ensuring national research can establish real differences in valuations between regions and social groups.
- Putting in place robust research design, with independent oversight.

We believe addressing these issues up front will help lead to robust customer research results that all stakeholders have a greater chance of being able to endorse.

## Key references

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