

POLICY BRIEFING:

2019 Price Review for the Water Industry in England & Wales

Resilience and Workforce Resilience



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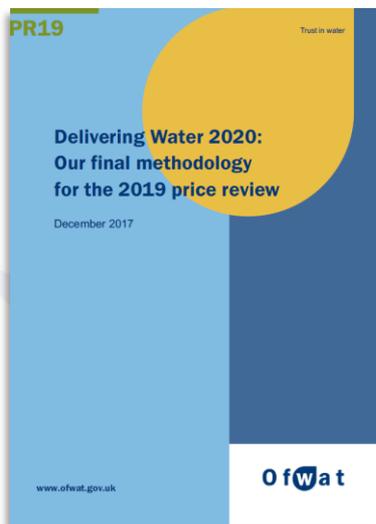
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Policy Briefing: 2019 Price Review, Resilience and Workforce Resilience

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Introduction

Ofwat has duties to promote economy and efficiency, contribute to the achievement of sustainable development and secure long-term resilience. The economic regulator's strategy of 'Trust in Water' describes a shared vision for the water sector in England and Wales whereby customers and society have confidence and trust in the water and wastewater services provided in the UK. The next price review, known as PR19, deploys the Ofwat duties and seeks to address those priorities.



PR19 aims to empower and incentivise companies to address the future challenges facing the sector, including:

- Resilient companies and services
- Environmental challenges
- Customer expectations
- Affordability for all customers

It will set price controls for the period between 2020 and 2025, and has been developed following a full consultation, which took place in July 2017. The final methodology is underpinned by four key focusses: customer service, affordability, innovation and resilience.

Resilience in the round is about considering all aspects of resilience, including – operational, corporate and financial resilience. Resilience is not just about outcomes and expenditure. It means making sure the right people, leadership, infrastructure, systems and processes, are all in place and working effectively.

Ofwat PR19

This Policy Briefing focusses primarily on resilience, and specifically the new price control focus on ensuring the sector's workforce resilience within the approach to corporate and operational sustainability.

Resilience is a key focus of PR19. Ofwat has stated regularly and publicly over recent years that regulated water companies in England and Wales will be assessed on how well they have considered and planned for resilience, how well they have foreseen and mitigated risks and how they consider the holistic picture of resilience throughout their business.

Companies are expected to undertake longer-term thinking, providing long-term projections for at least ten years beyond the five-year price setting period. They are required to collaborate with stakeholders and other companies, employing innovation and taking a

wholesale view of their business in relation to the benefits of innovation and effective risk management to society and the economy.

The subject of workforce resilience is a new feature of the price control approach, featuring heavily in PR19. The economic regulator's views on the vital nature of human capital to company and sector's performance were set out well in advance, through their 'Resilience in the Round' document and the draft PR19 methodology. Quality regulators such as the Drinking Water Inspectorate have also been explicit in setting out their expectations for companies to have the workforce competence and behaviours necessary to protect public health and deliver a continuous supply of safe, wholesome drinking water.

The general need for a resilient, skilled and sustainable workforce has increasingly been recognised by central and devolved governments, as a key challenge for all the main UK business sectors in a post European-exit economy. The UK government Industrial Strategy explicitly recognised 'people' as one of its five key pillars for action, but also the vital nature of 'infrastructure' as another pillar that is key to the future of the UK economy and society.

Market studies and data from the Office of National Statistics show clearly that labour availability in the UK is tightening, and the costs of general employment are steadily rising.

More detailed sector studies by the Energy & Utilities Skills Partnership and Energy & Utility Skills have made clear the impact of such risk on the utilities sector and also set out the vital role that delivery partners and the supply chain play in the overall sustainability of the main asset operators.

Labour Market Analysis Towards Brexit

EU Nationals Seeking Work in the UK



EU nationals migrating to the UK down by

47,000*

EU nationals emigrating from the UK up by

28,000*

Unemployment Levels



Unemployment levels are the lowest since 1975 at

4.2%

Less than **1%** people claiming Job Seeker's Allowance were seeking work in the energy-related occupations on the UK's Shortage Occupation List (545 of 475,000)

*Year on year figure.

For full list of sources [click here](#).

Employment Levels and Labour Costs



Highest level of employment since records began (1971) at

75.4%

Gross weekly full-time earnings have increased by

2.2%*

Graduate Market



University applications fell by

2%*
in the UK

Only **1%** of higher education leavers choose to work in the energy and utilities sector

The Details of the 2019 Price Control Process: Resilience

Resilience: What is it?

The 'Task and Finish Group' defined resilience as: the ability to cope with, and recover from, disruption, and anticipate trends and variability in order to maintain services for people and protect the natural environment, now and in the future.

Ofwat expects companies to prove that they have the necessary systems, processes and capability to deliver the services customers expect not only today, but in the long term.

Resilience is different from simply managing risk exposure. It requires a much broader range of options, often systems-based ones, which not only reduce risk, but enhance the ability to cope with, and recover from, pressures and shocks. This extends not only to service delivery but also to financial and workforce resilience, ensuring the right people and leadership is in place as well as the right systems, processes and infrastructure.

Companies must look at innovative ways to consider resilience in the long term. If the way services are delivered today affect or increase the risk to the service delivery in the future, the company is not securing long-term resilience.

Resilience in the Round

Ofwat has defined 'resilience in the round' as achieving strong operational, corporate and financial resilience and robust infrastructure. Each element of it reinforces overall resilience.

Within the definitions of achieving successful corporate and operational resilience, Ofwat sets out the need for a resilient and sustainable workforce.



In planning for effective resilience, water companies must consider their business as a whole, taking into account not only external factors, but also how different aspects relate to one another internally. This should now also explicitly consider their relationships with the vital suppliers in the context of resilience in the round. The component parts are:

Operational Resilience: focussing on the day-to-day operation of the business, water resource management, asset health and a total expenditure approach.

Corporate Resilience: focussing on the leadership teams and the processes and infrastructure in place in the company as well as transparency and company monitoring framework.

Financial Resilience: ensuring financial sustainability through innovation, monitoring and long-term financial viability statements.

The approach is underpinned by water companies ensuring that they have the right skills, the right people, the right leadership and the right systems. Workforce resilience is now a stated element of a sustainable and balanced business plan.

Workforce Resilience

Resilience is not just about expenditure and outcomes. It is also about making sure that companies have the right people, leadership, infrastructure, systems and processes in place and that all of these are working efficiently and effectively.

Ofwat is clear that human assets are in the spotlight for its approach to business plan assessments, and states that in order for a company to be corporately resilient, *“companies must ensure that they have the capability within their workforce to provide the services their customers expect not only today but over the long-term, in the face of potentially significant changes in how they do this and the wider employment landscape.”*



In order to be corporately resilient, companies must ensure that they have the capability within their workforce to provide the services their customers expect not only today but over the long term, in the face of potentially significant changes in how they do this and in the wider employment landscape. A focus on long-term resilience should therefore also include companies identifying and addressing possible skills gaps in the future. The Energy and Utilities Skills Partnership ‘workforce renewal and skills strategy’ (2017), which includes the water and wastewater sector, estimates that a third of vacancies are “hard to fill”. It also suggests that over 220,000 new recruits will be required by 2027. Companies therefore need to ensure that they have plans in place to secure access to the workforce they need, including transferring knowledge and increasing diversity.

Ofwat PR19

The Energy & Utilities Skills Partnership *Workforce Renewal and Skills Strategy* estimated that over 220,000 new recruits will be required in the whole utility sector by 2027.

Many of those labour needs are now common between water, gas, power and recycling utilities, creating useful synergies but also direct competition between the sectors for skilled workforce. In addition, and increasingly, the asset owners' chosen delivery partners and supply chain companies build and operate assets for multiple utility clients concurrently and work across infrastructure and wider disciplines. To achieve this, their workforce must be retained, dispersed and balanced across those industries and to meet the project timings required by their clients. Demand for the available skilled talent is therefore high and the cost of attracting and retaining human assets is identified by the Office of National Statistics as steadily rising.

Increasing competition for skilled talent is also now coming from other parts of the economy and specifically from non-water infrastructure businesses, such as energy generation, renewable energy, digital and a fast-growing rail sector that is expanding at record levels. Major projects such as HS2, Hinkley Point, Crossrail 2, expansions to southern airports, highways investment and the development of commercial infrastructure in Northern England, are all impacting the future resilience of the water industry workforce and challenging the ability of the water companies and their core delivery partners to retain the talent they need for meeting future service delivery. It is estimated that a third of skilled vacancies in the utility industry are now difficult to fill.

It is therefore important that water companies are thinking of 'resilience in the round' across their entire operational business, including their supply chain, and do not only consider the workforce they directly employ.

Under the final methodology, companies are required to focus on long-term resilience and demonstrate how they will ensure they have **the right quantity and quality of workforce**, with the right skills to meet their business and customer needs **for the price review period, plus long-term projections for at least ten years beyond.**

Ofwat is looking for regulated companies to show they have plans in place for securing access to the workforce they need in an increasingly competitive labour market, and can evidence how they will transfer knowledge and increase diversity within their workforce.

Business plans that deliver long-term resilience in the round should show how companies will make the best long-term decisions, on the basis of effectiveness and efficiency. Where collaboration with other water companies, stakeholders or partners can bring about a more efficient and effective outcome, this should be exploited.

Resilience and the Bigger Picture

In producing business plans that address long-term resilience risks, Ofwat expects companies to look outside their own geographical borders and have regard to the wider cost and benefit of their resilience to the industry, the economy and society as a whole.

Effective planning for resilience in the round will look for consideration of systems as a whole, taking into account the relationships between different segments of their business, as well as relevant external factors. This includes considering the resilience of the supply chain.

Companies (where able) should benchmark their performance against not only other water companies, but also against performance standards in other companies and industries.

How it will be assessed

Ofwat's outcomes framework, with its performance commitments and financial and reputational incentives encourages companies' management teams to identify and mitigate risks to operational resilience.

Ofwat will be assessing companies with the following two initial questions in mind:

1. How well has the company used the best available evidence, including engagement with its customers, to objectively assess and prioritise the diverse range of risks and consequences to its systems and services? Ofwat has clarified that 'risks' encompasses **all risks**.
2. How well has the company objectively assessed a comprehensive range of options to mitigate these risks? How well has the company selected the solutions that have support from its customers and also represent the best value for money for them?

Where investment is needed because of historical failures in a company's approach to resilience, Ofwat will consider whether these issues were as a result of evolving best practice or as a result of the company failing to do what they should have done. They also expect to see evidence that similar situations would be avoided in the future, whether these relate to processes, structure or governance.

Expectations for Business Plans

Ofwat expects business plans to be **based on cost efficiencies** that deliver value for money for its customers and secure trust and confidence, in accordance with Principle 5: Delivering best value solutions for customers.

operational resilience - the ability of an organisation's infrastructure, and the skills to run that infrastructure, to avoid, cope with and recover from disruption in its performance;

In order to be corporately resilient, companies must ensure that they have the capability within their workforce to provide the services their customers expect not only today but over the long term, in the face of potentially significant changes in how they do this and in the wider employment landscape.

Ofwat PR19

Companies are expected to challenge their business plans and ensure that customers are not paying for inefficient or ineffective performance, delivery or risk mitigation.

The business plans must deliver resilience in the round in the long term, and not just for the price review period. Resilience measures must be informed by a comprehensive assessment of the company's resilience: **not only the resilience of its systems, procedures and people but also of its customers' views about the management of resilience in harmony with their long-term interests.**

Ofwat expects to see ambitious business plans. An ambitious business plan is one that raises the standard across the industry and therefore benefits all customers. This could be by significantly reducing customer costs, or by managing risks in an exceptional way.

Companies' boards are expected to be accountable for business plan robustness: they must provide the assurance that the expenditure forecasts included in the business plans are both robust and efficient, and **companies are expected to benchmark their performance** both within the sector and against other sectors.

Ofwat will set cost baselines for companies with a forward-looking view of efficiency in mind. In setting these baselines, Ofwat will incorporate forecast productivity gains in the wider economic picture.

Ofwat expects to see a strong link between the mitigation and management of operational risks and a company's outcome performance commitments. The performance commitments should also reflect future risks, as well as customer preferences.

Applying Resilience in the Round

In line with Ofwat's assessment framework, resilience contributes heavily (along with security, high quality customer service, ambition and innovation) in their decision of how to categorise a company's plans.

- Companies are expected to consider risks in relation to operational, financial and corporate resilience
- Companies should consider whether (and how) resilience risks can be best managed across company boundaries as well as at a regional and possibly a national level
- Companies' appraisals should include a robust, comprehensive and qualitative assessment of the risks to the resilience and delivery of services to their customers both over the five-year period (2020-2025) and provide long-term projections for at least ten years beyond
- Companies must ensure they have the right infrastructure in place and the right skills in order to effectively run that infrastructure to avoid, cope with and recover from service and performance disruptions
- Companies must consider possible failure points across both the organisation **and the supply chain**, including:
 - The risks of failure occurring in each of the three areas (operational, financial and corporate)
 - The impact on customers if those risks occur
 - The extent to which those risks have already been mitigated
- **The appraisals should cover risks associated with infrastructure and assets as well as systems, processes and people** and require the company to look at the future challenges as a whole
- Companies should look past their own internal boundaries in addressing the challenges they face and should exploit opportunities to work alongside partners and other water companies.

Timeline of Action Needed

Companies must submit business plans to Ofwat	3 September 2018
Ofwat's initial assessment and categorisation of business plans	Late January 2019
Early draft determinations	March/April 2019
Other draft determinations	July 2019
Final determinations	December 2019

Ofwat will run a queries process for specific questions around the methodology. Companies and stakeholders should email PR19@ofwat.gsi.gov.uk with queries for clarification, corrections or further explanation. Ofwat will publish widely relevant queries on their website for other stakeholders to access.

Working with Energy & Utility Skills

All of the UK water companies and many of the major delivery partners are members of the Energy & Utility Skills Group. We work across the UK with policy makers, economic, quality, environmental and health and safety regulators, regulated companies, delivery partners and the main sector unions.

Companies can be supported on workforce resilience through:

- A CEO level strategic skills forum to set direction on ensuring future workforce renewal and resilience – The Energy & Utilities Skills Partnership
- A Director level cross-sector Delivery Board, deploying initiatives to address the key workforce issues of quantity, quality and transferability
- A UK-wide and cross sector Apprenticeship Levy and Technical Education Advisory Group, bringing together utility sector employers to assist workforce sustainability through quality apprenticeships and to optimise recovery of their Apprenticeship Levy

- The sector's apprenticeship end-point assessment service – the Energy & Utilities Independent Assessment Service
- Strategic workforce planning services to help companies understand their labour market needs and develop plans for sustainability
- Mass talent and sector attraction initiatives, such as Talent Source Network
- Investment in training and productivity through procurement contract commitments – The Procurement Skills Accord
- Competence and capability schemes – health and safety awareness; public health; water hygiene; UK-wide water industry competency frameworks
- Development of National Occupational Standards and input to the latest UK-wide apprenticeship and technical education fora
- Networks sharing best practice on diversity and inclusion across UK utilities