DEFINING THE SOCIAL CONTRACT

Essential public services, private business and better outcomes for society

A summit from INDEPEN THE WATER REPORT

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‘Defining the Social Contract’ – summit report

The health of the relationship between business and society is under pressure. This is particularly true of companies that provide essential public services like water, energy, transport and telecoms.

These companies have been urged to address perceived failings and to show more ambition in their delivery for customers and the environment. How they respond to this challenge, and how that response is perceived, will define the future of these sectors.

On 6 November, The Water Report and Indepen held an inaugural summit to discuss a constructive and effective way forward. We brought industry leaders together with regulators, politicians, investors and those representing social and environmental interests to address the fundamental question: how can private companies providing essential public services deliver better outcomes for society?

We also specifically explored and attempted to define the contribution a “social contract” between essential service companies and their investors on one hand, and customers through government and regulators on the other, could make to rebuilding trust in the industries that underpin our lives. The day was ably chaired by business broadcaster Steph McGovern.

CORPORATES: ALL ABOUT PROFIT?

Co-director of the Centre for Law and Enterprise at the University of Bristol Nina Boeger kicked off the day with some context about how these debates are playing out in the corporate world in general. The standard corporate today is fundamentally there to make profit within the rules of the game, she said, adding that years have been spent trying to perfect that model. Today, questions are being asked about the model itself rather than just how to perfect it. This follows, Boeger explained, three major developments: “corporate irresponsibility scaling new heights”; the overhaul this year of corporate governance codes with a move away from the primacy of the shareholder; and plummeting levels of trust in business, particularly among millennials (with implications for talent recruitment as well as customer sentiment).

The fundamental question is: should corporates be all about making profit within the rules of the game? This has given rise to a series of emerging conversations and developments, including:

Academics and policymakers discussing reform of company law, particularly the provisions on directors’ duties. Boeger explained the intention of the law is for directors to act in an “enlightened” way and to take account of the interests of stakeholders beyond shareholders, but business culture and other factors mean “in practice profits get heavily prioritised”. So a rethink of these directors’ duties is on the table.

Targeted interventions to force more responsibility into business – for example, the Modern Slavery Act and the Social Value Act, which calls for all public sector commissioning to take account of social and environmental wellbeing as well as economic value.

The review of corporate governance codes mentioned above, with views on the nature of companies’ purpose altering.

The emergence of “mission-led” or “purposeful” companies, whose constitutions define a purpose beyond profit generation. B-Corp now offers accreditation of this nature.

The growth of social enterprises, committed to a social purpose – such as cooperatives.

Boeger concluded that the emergence of alternative business models on the one hand and corporate reform on the other combine to present a real push for change.

Another good read on these topics is *Reforming business for the 21st century – a framework for the future of the corporation*, a report on work led by Professor Colin Mayer for the British Academy. It contends that corporations were originally established with clear public purposes and that it is only over the last half century or so that corporate purpose has come to be equated solely with profit. This has damaged the trust in and reputation of business and had a negative impact on the environment, inequality and social cohesion – all exacerbated by globalisation and technological advance that regulations have struggled to keep up with.

The work argues there is a need to reconceptualise the corporation around “purpose” and attempts to do that via a framework based on the principles of purpose, trustworthiness and culture. It identifies five “levers” of action: associating both ownership and corporate governance with defining and implementing corporate purpose; overhauling regulation including for companies which perform significant

Steph McGovern

social functions to incorporate public purposes in their corporate purposes; linking tax levels with public purpose; and in terms of investment "where corporations perform important public and social functions, that private and public purposes need to be aligned through the adoption of public purposes in corporate charters and articles of association."

ESSENTIAL SERVICES – A SPECIAL CASE?

How these enormous debates play out for essential services companies specifically was one theme at the summit. For some, like Conservative MP John Penrose, it is desirable for utilities to be treated as mainstream as possible – "like cornflakes or coffee or cars". Penrose has recently penned a wide ranging paper on topics relevant to summit themes – *A shining city upon a hill: rebooting capitalism for the many not the few*. For others, the essential nature of utility services, together with their natural monopoly characteristics, combine to make them something of a special case. And as Atkins' international client director Matthew Toy pointed out, these industries also occupy a space where, through sheer need, the background noise is all about circular economy, social inclusiveness, demand side cooperation and interconnectivity.

One of the most compelling accounts on this issue came from Peter Peacock, chair of the Customer Forum which is charged with negotiating a price and service settlement for Scottish Water customers for 2021-27. Scotland, he pointed out, is in the "happy position" of not having privatised its water company, and is therefore not dogged by accusations of corporate greed and the like. But far from allowing Scottish Water to sit back and relax through these debates, Peacock said "as the people's water company, it shouldn't just be a good citizen, but the best citizen". It should go, as Scotland's environmental regulator SEPA suggests, "beyond compliance". Consequently, Peacock reported, the whole social contract theme is "highly relevant" even in the publicly owned context as his Customer Forum seeks to hammer out a "deal" with Scottish Water in the years to come. "Today's discussion really broadens the agenda out about what companies need to think about beyond their core activities. The only way to establish that, is to engage," Peacock said.

Jonathan Ford, the Financial Times' City editor and now renowned challenger of the private water model, suggested the water sector in particular had some social ground to make up. He cited a recent FT article which argued English water companies could have financed all investment since privatisation out of cash-flow but instead have built up £51bn in debt which costs customers £1.2bn a year to service, as well as indulging in tax havens and opaque structures, and alienating the public through bulging executive pay packets even when performance had been poor (he cited specifically Thames on pollution).


Rachel Fletcher

Meanwhile, Ofwat's chief executive Rachel Fletcher said a case could be made for introducing social contracts in water on multiple grounds – for companies to thrive as businesses, to meet looming environmental challenges (firms need customers on side) and to answer legitimacy questions. She said: "It is quite obviously the case that it is no longer enough for a water company just to provide a reliable supply of safe drinking water and wastewater services at a reasonable price… Customers are taking an ever greater interest in where their money is going. They care about the dividend payments and tax affairs of their company and the more widely topical question of executive pay. They also want the company to contribute to society and protect the environment. And in the context of low real wage growth, the squeeze on public expenditure and high profile corporate failures which have harmed the public, not the owners, I don't think these expectations are going to go away."

IS IT ALL ABOUT OWNERSHIP?

For some, yes. This view was represented at the summit by both Ellen Lees, campaigns officer at public ownership lobby group We Own It, and David Hall, visiting professor at the Public Services International Research Unit at the University of Greenwich. For them, nothing short of public ownership can properly 'fix' the problems of private capital.

Lees delivered what some privately remarked was a compelling argument for returning water to public hands in a modern, democratic way – what Lees called Public Ownership 2.0. She said the financing arrangements in water look like "an organised scam", detailing what are now becoming familiar arguments about investment being financeable by revenue (£10bn annual revenue, £5bn annual investment); near matching dividends (£56bn) and debt figures (£51bn); unnecessarily high bills; and English firms comparing poorly with Scottish Water's record. She claimed public support for transparent, accountable and innovative public ownership and wrapped up with a plea to the high ranking people in the room to facilitate a smooth transfer when the time came to renationalise, which could be within five years.

Professor Hall followed up with a presentation entitled *The global normality of public water*. As the name suggests, this concentrated on the anomaly of England and Wales' private ownership of assets – just 0.5 of a country (excluding Scotland and Northern Ireland from the UK), he pointed out, adding one might conclude "194.5 countries are on to something". He said even factoring in private operation of publicly owned assets, only about 11% of cities and 5% of other areas have private water.

Hall detailed the ownership and

governance arrangements in some exemplar areas including Paris, Stockholm and the whole Netherlands where the private operation of water services is illegal. He quoted low leakage rates for these places as 5%, 8% and 3·7% respectively. Hall wrapped up with the added 'bonus' that with democracy, these cities did without a regulator. He pointed out Ofwat's current budget is £31m, 50% higher than two years ago, and there were 210 staff at last count – "an awful lot of people to determine prices".

There was stunningly little challenge to Lees and Hall in the Q&A session following their slot. Over the course of the day, though, challenges to the public ownership proposition seeped out. These included from Penrose that the idea of a public water service run at arm's length from politicians was pie in the sky – "People like me will always meddle, it's a question of when and how badly." Should push come to shove in the public finances, for instance, "the chancellor of the the day will raid utilities".

The point was reinforced by Wessex Water chief executive Colin Skellett who has been at the company through its various ownership guises since before 1974. He said the national ownership model is "a great idea if capital keeps coming". But in his experience, that wasn't the case as capital was stripped out in the early 1980s, leaving the UK the laggard in Europe.

The chair made the point that rather like with Brexit, a lot of people if asked wouldn't really understand what they were choosing between in terms of water ownership models. Even critics of the private model didn't necessarily jump to the conclusion that public ownership is the best way forward. The FT's Ford, for instance, questioned the need for private capital in water and challenged the assumption that the private sector is inherently more efficient. But was cautious about the "rupture" the transition to public ownership would cause and about the replacement of economic regulation with political price setting. He offered the not for profit model as an alternative, but noted "the snag of getting there" seeing as shareholders would have little appetite to sell assets at a discount to RAB. In light of all these factors, he declared himself engaged by Dieter Helm's system operator ideas.

DESIRABLE OUTCOMES

There was considerable agreement among speakers and contributors at the summit about the areas to concentrate on to build trust and legitimacy. These chime with the social purpose themes being discussed across business more broadly. Among the key issues arising were:

Peter Peacock, Roger Darlington, Sharon Darcy, Tony Juniper

Better provision for long term outcomes

Jacobs' utilities vice president Bryan Harvey made the case for repositioning water at the heart of our society as Singapore has. He reviewed the evidence from the National Infrastructure Commission and others on long term resilience needs, and contrasted that with the low value we place on water today ($1 a barrel, compared with $70 a barrel for oil, $130 for bottled supermarket water, and $190 for petrol) and the price cuts slated by 70% of water companies for PR19. "The value of water is dropping further" he said, while time to address resilience needs is running out. Harvey called for water to be recognised as a national resource that needs investment, and saw the social contract as an opportunity to align around a common vision of water resilience.

WWF director Tony Juniper said environmental protection perfectly fitted the bill for a social contract, given that implies "a common endeavour and collective response". Like Harvey, he pointed to evidence of the need for action, including the IPCC's recent study of the implications of 2° global warming v 1.5° (the former including the total loss of coral reefs), and WWF's own *Living Planet* report on biodiversity loss. Juniper said the environment had been "buried" in recent political exchanges about profits and prices, which contributed to the popular narrative about "green crap" getting in the way of lower bills. He continued that customers, though, do care about the environment and said "companies, policy makers and consumers need to be on the same page, going in the same direction – not taking us visibly backwards". Juniper suggested social contract considerations in water might include variable tariffs; better balancing profit with green investment; better alignment between public and private finance post Brexit (CAP reform); and business backing of binding green targets. In fact he considered there to be an an "enormous opportunity" for business to win consumer trust by showing leadership in the environmental space.

Fairness and service

Roger Darlington, chair of the Essential Services Access Network, gave his view on what customers want from utility providers. This included the bedrock of good service (trusted products at a fair price; choice; responsiveness to problems; vulnerable customer inclusion) and no mess ups (service, physical, technological, human). But it also included good governance – trustworthy owners, acceptable structures, boards with independent, consumer and worker representation, adequate and sustainable investment and fair return for risk. And Darlington said customers care about the future and want to see proper regard for sustainability and climate change challenges. Darlington saw each of these pillars as a possible component of a future social contract.

There was some discussion of the difficulty – and huge effort – water companies had gone to to establish what their customers want, and the limitations of this while public understanding of the sector and its services are stunted.

Transparency and trust

One of the stated advantages of democratic public ownership is greater transparency and accountability. The summit heard that is an idea worth exploring regardless of the ownership issue. Responding to a question about the prospect of customer or citizen 'observatories' as proposed under Labour's model, Ofwat's Fletcher welcomed the idea of a wider range of stakeholders playing a scrutiny role. Ofwat was not looking to offload responsibility, she said, but customer challenge groups had produced some "robust exchanges" and developments of the theme, such as observatories or open board meetings, merit exploring.

Peter Allen, corporate affairs director at Highways England, dedicated his presentation to exploring how to better engage with customers and win trust. "Trust comes from character" he asserted, suggesting that companies need to reset how they engage in the digital age. Annual reports and press releases pale in comparison to the influence of YouTube vloggers and direct, meaningful online contact with individuals as parents or sports fans or however they might define themselves. Employee advocacy is also powerful, so time should be spent on staff engagement too.

Communities

The summit heard a few ideas on how essential service providers might deliver more for the various communities they operate in, be these geographical, communities of interest or of people. Atkins' Toy said Scottish Water's work in the Highlands and Islands is a good example of localised circular economy thinking in action – not only has care been taken to identify the right solutions for each place, but many personnel and services have been locally sourced.

Meanwhile chief inspector of railways and railway safety director at the Office of Rail and Road Ian Prosser offered a very different example of giving back to the community: the rail industry is volunteering one million hours to work with the Samaritans on suicide prevention. Prosser, who sponsors the project, said: "This will not only help the Samaritans as they seek to cope with increased demand for their vital services but will also be beneficial for the mental health of all of us in the sector who volunteer our time, not least by encouraging us to talk with each other, and the wider community, about the issues involved."

Murphy's chief operating officer Peter Anderson contributed some thoughts on how utilities might get better value from the supply chain community. These included collaborating early ("it's just good business"); committing to longer term contractual relationships (ten to 15 years rather than five); and paying promptly. Regulators, he added, could benefit from engaging more with the supply chain too. It is "very infrequently" that he has direct contact with them.

SOCIAL CONTRACT – A USEFUL CONCEPT?

While we didn't measure appetite for the social contract concept scientifically in any way, the mood of most at the summit seemed very supportive. For sure, it would not suffice for those like Lees and Hall committed to full structural change, but many indicated they saw value in some kind of overt commitment to a greater social contribution.

We did not agree a hard and fast definition for what is, at this stage, something of a nebulous concept. But among those who did attempt to define it, there was considerable commonality. Most agreed, for instance, that it would involve casting the net wide among stakeholders in a common endeavour and towards a collective response. These stakeholders included but were not limited to government, regulators, utilities, investors, household/agriculture/business users, infrastructure providers, emergency responders, environmental interests and supply chain companies.

Rachel Fletcher set out her thinking on what a social contract might mean in practice for water firms. This was not a matter of new rules, she explained, but of shifting the fundamental culture of companies: "We are not talking here primarily about new rules and regulations...I think the social contract has to be much deeper than a set of externally imposed rules. It involves engaging the passion for serving customers and the environment that I know sits with many who work in and lead the water sector. It involves bringing these wider elements into play, so that the company is not just focused on profit maximising within a set of regulatory constraints. This ownership for addressing a wider set of challenges, for making a positive contribution to society needs to infuse the culture and leadership of the company and drive everything the company does."

She went on to set out her view on what the key elements of the social contract might be:

"The foundation stone would involve the company doing the basics right, based on a deep understanding of, continual feedback from, and a relationship with the customers it serves.

The company would examine its own corporate behaviours and ensure that these withstand scrutiny in all respects. The company would uphold the highest levels of corporate governance.

The company would have links into and an understanding of the community it serves – whether this is geographically defined or defined in other ways. And it would be looking to benefit or support the community across the full suite of business decisions it makes – procurement, employment, expenditure, investment.

In a similar way, the company would not limit itself to simple compliance with environmental regulations. It would understand the impact it is having on the environment and would be constantly looking for new ways to improve the ecosystem it is built on."

As helpful were contributions on where a social contract would not have value. David Gray, until five weeks before the summit chair of Ofgem, argued the idea is relevant to regulated energy networks, but not to the energy retail market which is active and offers plenty of choice. He cautioned that a 'contract' assumes parties are stable, which is not necessarily the case in the energy retail space, and that the idea would be of questionable value if it was confined to the old incumbent suppliers alone.

HOW TO... SOCIALLY CONTRACT

The most detailed thinking on the 'how' of social contracting was offered by Sharon Darcy. Her think tank, Sustainability First, has just published Fair for the future – which seeks to frame what it terms a 'sustainable licence to operate' for water and energy

Frazer Bennett, Peter Allen, Colin Skellett

companies. This identified four "pillars": a public purpose, philosophy and public service values; making the best use of all different types of "capital" (natural, manufactured, social and so on); roles and responsibilities; and a strategy and accompanying narrative. Darcy stressed its report sets out a straw man which is open to challenge and refinement as the work continues.

John Reynolds, best known in this sector as chief executive of Castle Water but speaking at the summit as an experienced ethical investor for the Church of England, cautioned that "you can't easily put numbers on ethical concepts" and advised that an ethical framework would be beneficial for companies exploring this space. This framework should among other things define duties in relation to each stakeholder group and set out "cast iron rules that you will not break".

John Penrose argued that "delighting" the customer should be a guiding principle. While there is "no magic bullet" to that, his sense is that more competitive exposure outside of the network monopoly elements, with associated diminished regulation, would help. The point was echoed by Wessex's Skellett, whose own company's business model for PR19 involves exposing more of its value chain to the market and edging towards a system operator role. Skellett also commented on the growing cost and complexity of regulation and warned of unintended consequences.

WHO SHOULD LEAD?

Most agreed companies themselves should take the lead, and certainly not wait to be told what to do or that would defeat the purpose. Regulators and policy makers would of course need to offer a supportive role should firms go down the social contract route. PA Consulting's chief innovation officer Frazer Bennett pointed out regulation is "the single biggest lever" the government has to keep its side of the bargain in a social contract. Regulation, he continued, "can be a blunt tool but it doesn't need to be a blocker". He urged regulators in fact to be "a catalyst for the new" by being flexible, promoting information availability and accessibility, and being stringent where necessary – he cited in illustration of the last point that when a state in India banned plastic water bottles, whole new industries had opened up within a week.

Fletcher said Ofwat as regulator is and will continue to play a part in developing a new deal with society – including through its price review methodology; wider encouragement of innovation;

its work on board leadership and governance; and its developing post PR19 strategy and sector vision. But she left companies in no doubt that they should get on with making "the deep seated and pervasive changes needed right now" rather than wait to be told.

And she indicated that a considerable upping of game was needed in the round: "We are beginning to see companies move in this direction with some interesting ideas emerging in company business plans. But make no mistake, bringing about a new social contract will be a journey for the water sector, unlike any it has taken since privatisation. And I believe it is vital for every water company to be an enthusiastic participant on that journey."

However, Jonathan Ford argued Ofwat could be more direct in its directions – for example, setting a cap on leverage rather than a complex set of incentives to reach the same end. Such retrospective changes were little welcomed by the companies present.

David Gray said positive regulatory incentives were usually preferable, but other tools might be considered too, such as naming and shaming or league tables, which he described as "more powerful than they ought to be".

CULTURE AND COMMUNICATION

Finally, two other crucial points came up that need to be front of mind if companies are to explore social contracts further.

The first concerns culture. Vision Consulting's chief executive Billy Glennon pointed out that most utilities will need to work on their culture and organisational mood if the move to a social contract is to stand any chance of success. He characterised the culture prevalent in most large, bureaucratic organisations including water and energy utilities as "resignation" which smothers new ideas and entrenches the status quo. He advised industry leaders to find and nurture the passion that drove them and their peers into the industry in the first place.

The second concerns communication. This is covered in Sustainability First's work, but was put front and centre at the summit by Sonia Brown, Visa Europe's executive director of regulatory policy and public affairs. She shared details of the success of Visa's FIFA sponsorship and World Cup ad campaign which sought to encourage the behaviour of card use for small purchases, like buying a pint – particularly among millennials. She contrasted that work, of a global top 20 brand, with a Thames Water campaign on wet wipes, which she said was hard to discern the target audience for, and which was met with cynicism against the backdrop of well publicised leaks, profiteering accusations and plentiful roadworks. Brown held her hand up and admitted that when she ran PR14 at Ofwat, she "red-lined" money some companies had put in their business plans for marketing. But now believes: "Whatever the new licence to operate is, it needs to be combined with a lot of investment in the brand of the sector."

This caused various strands of debate, including whether companies could invest in branding successfully individually or had to act as a collective; whether marketing was a valid use of customer money for monopolies; and whether the money would be better spend on messaging – for instance on consumption reduction – rather than more commercial branding. Whatever your view, this is clearly an area that needs attention: many have commented that water wouldn't have found itself at the front of the queue for nationalisation if it had been better at communicating the value it brings to customers and society in the first place.

All round the summit provided much food for thought, with the main message perhaps being that sticking to statute alone is unlikely to serve societies, or companies, particularly well.