Welsh Water

A Model for the Purposeful Ownership of a Utility?

A Case Study of Dŵr Cymru Welsh Water

January 2021

Dŵr Cymru Welsh Water

Contributor

Chris Jones
Former CEO,
Dwr Cymru Welsh Water

Contributor

Marcel Metzner
Oxford University School of Geography, Smith School of Enterprise and the Environment

Contributor

Dr Judith C. Stroehle
Oxford University,
Saïd Business School

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This series of case studies explores how mutual approaches to business can help companies and their partners tackle some of the most pressing global challenges. The businesses featured in this series share a commitment to objectives beyond purely financial performance, as well as a serious intent to implement mutual practices through new forms of ownership, governance, leadership, measurement and management.

In particular, these cases address the measurement of multiple forms of capital, ecosystem shaping approaches, leadership development, business education, and policy formulation through laws and regulation that promote mutual conduct. The authors appreciate the collaboration of participating companies in creating these cases.

These cases were first developed for the annual Economics of Mutuality Forum, the convening event of the Mutuality in Business Project, a joint research programme between Saïd Business School, University of Oxford, and the Catalyst think tank at Mars, Incorporated. The Economics of Mutuality Forum brings together global companies, MBA candidates, scholars and activists to share their experience in confronting key challenges in their ecosystems to generate financial, social and environmental value.

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Mutuality in Business
Tel: +44(0)1865 422875
Email: **responsiblebusiness@sbs.ox.ac.uk**
Web: **Economics of Mutuality**
Web: **Oxford Saïd Mutuality in Business**

Introduction

Dŵr Cymru Welsh Water (from here on: Welsh Water) is the sixth largest of the regulated water and sewerage companies in England and Wales. Welsh Water provides more than 3 million people in most of Wales, Herefordshire, and parts of Deeside with fresh drinking water and takes away, treats, and disposes of their wastewater. With over 3000 direct employees, Welsh Water is the fourth largest company in Wales.

The purpose of the business is to:

"provide high quality and better value drinking water and environmental services, so as to enhance the well-being of our customers and the communities we serve, both now and for generations to come."[1]

Since 2001, Welsh Water has been owned, financed, and managed by Glas Cymru, a company limited by guarantee that has no shareholders and is run exclusively for the benefit of Welsh Water's customers. Glas Cymru thus reinvests its financial surpluses into the business to improve services and lower customer bills, allowing it to foster high standards of customer trust and natural capital maintenance and protection.

But is this model of ownership really inherently purposeful? This corporate governance approach was certainly unique in the UK utilities industry. The case study at hand therefore explores how Glas Cymru came into being and reviews the long-term financial and sustainability performance implications of Glas Cymru's distinct ownership structure. The case study is structured as follows: Section 2 provides a brief historical overview of the UK water sector up to the year 2000. Against this historical background, Section 3 discusses the establishment of Glas Cymru and the takeover battle for Welsh Water in 2000 – 2001. Section 4 explores how Glas Cymru's governance structure has shaped the management and strategy of Welsh Water. Section 5 reviews various dimensions of Welsh Water's performance and reflects on the impact of Glas Cymru's ownership structure on its operations, performance and management over the past two decades. Section 6 summarises key learnings and discusses some general insights into the nexus between ownership, corporate purpose and performance, whilst Section 7 seeks to draw some conclusions.

1 Welsh Water, 2018, "Our Purpose and Our Vision". Dwr Cymru Welsh Water online under https://corporate.dwrcymru.com/en/library/company-statements

Historical Context

In 1989, the Conservative UK government under Prime Minister Thatcher took the contentious decision to privatise the water sector and with it all water services. To do so, it established ten regional, integrated water and wastewater companies responsible for treating and pumping water as well as maintaining and owning the necessary infrastructure within England and Wales. Three regulatory bodies were created to oversee and regulate the water industry in England and Wales: (1) the Drinking Water Inspectorate (DWI), charged with safeguarding drinking water quality; (2) the National Rivers Authority (now part of the Environment Agency and of Natural Resources Wales), responsible for environmental regulation of rivers and freshwater bodies; and (3) the Water Services Regulation Authority (Ofwat), in charge of the economic regulation of water utilities.

Following the privatisation in 1989, water companies generated substantial profits, and as a result many attempted to diversify and grow their businesses. The economic success of UK utilities post-privatisation also didn't go unnoticed internationally, with energy businesses from the US and French water companies starting to buy into UK utilities in the early 1990s. Responding to the large profits generated in those years, the Labour UK government introduced a windfall tax in 1997 and Ofwat cut water prices by around 20% in 1999. The combination of these measures put the UK water sector under financial pressure for the first time and, faced with falling share prices, some water companies had to consider restructuring their businesses. These restructuring efforts, however, were the subject of significant regulatory scrutiny with a strong focus on ensuring customer protection, which often limited the economic possibilities of these companies. For example, when Severn Trent and Wessex Water both attempted to buy South West Water in 1996, the competition authority required that the economic benefits of a merger would be passed on to consumers. A requirement that ultimately led to a failure of both deals.[2] Other water companies considered turning themselves into mutual companies owned by their customers, but regulators blocked these plans over concerns that it would transfer too much risk to consumers. Against this background, Glas Cymru was established as a company limited by guarantee, acquiring Welsh Water in 2001.

2 The Economist, Jan 2001, Pipe dreams.

Glas Cymru and the acquisition of Welsh Water

Welsh Water originated from the privatisation of the Welsh National Water Development Authority in 1989. After taking over the local electricity company Swalec in 1996 and other international diversifications, Welsh Water renamed itself Hyder, becoming a combined water and electricity utility. In the wake of the 1997 Windfall tax and the 1999 water and electricity price reviews, Hyder started to experience significant financial difficulties. Confronted with burgeoning debt and a plummeting share price, the company sold off its retail power business and started looking for a potential buyer of Hyder's remaining businesses.[3]

In April 2000, the Japanese investment bank Nomura opened the bidding with an offer of 260p a share that valued Hyder at £402 million.[4] Shortly after, the US energy group Western Power Distribution (WPD) bid 300p, planning to join Hyder's electricity business with its South-West England power distribution network. After a protracted takeover battle, WPD ended up buying Hyder in September 2000 for 365p per share, extracting the electricity network business, and subsequently putting Hyder's remaining businesses – including the former Welsh Water – back up for sale.

During these developments, two former directors of Welsh Water, Nigel Annett and Chris Jones, founded Glas Cymru in April 2000 as an independent company, registered and based in Wales, with the sole purpose of acquiring and owning Welsh Water. Glas Cymru was established as a company limited by guarantee, that is, a company without shareholders but instead with a body of members. These members, around 50 individuals selected by an independent membership selection panel, are appropriately qualified local individuals whose duty is to promote the good running of the company in the best interests of its customers and therefore the community of Wales. They represent part of the corporate governance of Glas Cymru without, however, having a financial stake in the company nor receiving a fee for their service. The role of members is to ensure that Glas Cymru delivers on its purpose and that the Board and management team act in the best interest of the company.[5]

The choice of this particular organisational and legal design was motivated by two fundamental reasons:

1. Moral rationale: As a regional monopoly, Welsh Water would be run for the benefit of its customers and the community it was serving, predominantly in Wales. In the absence of shareholders, it would be possible to expand timeframes and reinvest profits for these goals.
2. Financial rationale: As a low-risk business with stable cash flows, Welsh Water would be able to raise capital in bond markets at low rates to fund its asset-intensive business without needing to draw on more expensive, equity capital.

In the view of its founders, the absence of shareholders would restore the legitimacy of Welsh Water, a monopoly supplier of an essential public service, in the eyes of its customers. It would help to build customer trust in the business, which would be beneficial, for example in times of service disruption or where difficult business decisions needed to be taken. An "alignment of interest" would be created between bondholders and customers, with improved financial performance leading both to reduced risk for bondholders and the scope for future benefits for customers.

After setting up its unusual corporate governance as a company limited by guarantee, Glas Cymru entered the bidding process for Hyder with a proposal centred on providing benefits for water customers in Wales. Without having to pay dividends to shareholders, Glas Cymru pledged that financial surpluses would be re-invested into maintaining services and lowering water bills for customers. Importantly, customers would receive these benefits without assuming additional risks. In contrast to a mutual company model, customers would neither own nor assume any responsibility for Glas Cymru's liabilities. As part of a low risk business model, the company planned to focus its activities solely on financing the water assets while competitively outsourcing asset operations and service delivery to contractors.[6]

On 3 November 2000, Glas Cymru announced that it had reached agreement with WPD to acquire Welsh Water for approximately £1.8 billion.[7] Glas Cymru's offer, however, required regulatory approval and was initially met with scepticism by both Ofwat and the UK government. The concerns raised revolved around three issues:[8]

1. Separation of asset ownership and operational responsibility: Both Ofwat and the Department of the Environment, Transport and the Regions (DETR) were concerned that outsourcing the operation of water assets to contractors would risk a deterioration of service quality. Moreover, it was feared that in case of serious problems, contractors and asset owners would blame each other for shortcomings, making it difficult to establish a clear line of responsibility.
2. Ability to raise capital and withstand risks: The Department of Trade and Industry (DTI) had doubts whether debt financing was an adequate funding model for a privatised monopoly such as a water company. In particular, the DTI was concerned that Glas Cymru would be unable to build up sufficient reserves to withstand unforeseen events such as droughts, raising the prospect that the UK government might need to step in as a lender of last resort – a scenario vehemently opposed by the UK Treasury.
3. Incentives: Concerns were also raised with regard to the incentive structures of Glas Cymru's model. The

3 Hyder's share price fell from 1048p in January 1998 to 179p in March 2000.
4 FT, 16.08.2000: How the battle for control of Hyder bordered on farce
5 Glas Cymru Members' Handbook
6 Most operational activities were outsourced for the first two regulatory periods, being largely brought back "in house" between 2010 and 2015, when the financial position of the business was considerably stronger.
7 Glas Cymru Press Release, 3 November 2020.
8 The Guardian, 10.01.2001: Water deal blocked

DTI, for example, questioned whether Glas Cymru's leadership would be sufficiently incentivised to increase efficiencies and take painful business decisions, without the scrutiny of shareholders holding management to account.

Glas Cymru addressed these issues in an open letter to Ofwat on 3 November 2000,[9] detailing how its proposal for taking over Welsh Water mitigated the concerns listed above. This included a procurement strategy for ensuring a consistently high service quality provided by contractors, which involved, amongst other measures, a combination of incentives and sanctions to prevent contractors from under-investing in the maintenance of water assets. While Glas Cymru acknowledged the strengths of the equity model, it emphasised the advantages of its proposed debt funding model. In particular, it was pointed out that the company's low-risk business model would allow for issuing bonds with strong investment grade ratings, thus promoting the financial stability of the company. Furthermore, the company committed to building up reserves that would serve as a financial cushion and mitigate risks emanating from unforeseen events such as droughts. As for concerns over incentives, Glas Cymru emphasised that its executive directors would be subject to strong pressures to perform from the independent directors on the Board, by the membership and by an external regulatory environment of "comparative competition". Moreover, the company indicated that it would introduce performance-based remuneration structures and adopt disclosure practices and other obligations as though it were listed on the London Stock Exchange.

After announcing the agreement with WPD to acquire Welsh Water in November 2000, Glas Cymru engaged with a variety of stakeholders to discuss its proposal. While parts of the UK government remained sceptical, Glas Cymru received strong support from the newly created National Assembly for Wales and local civil society groups, strengthening its proposal. In January 2001, Ofwat eventually decided not to block the proposal, giving Glas Cymru a green light to proceed with trying to raise the market capital needed to fund the acquisition of Welsh Water. In May 2001, Glas Cymru completed the acquisition of Welsh Water from WPD for £1.9 billion, which was financed by the largest non-government backed, Sterling corporate bond issues at the time.[10]

9 Glas Cymru, 03.11.2000: Open Letter to Director General of Water Services

10 The bonds to finance the takeover were issued through a newly created financing subsidiary, which then on-lent the proceeds to Welsh Water. In order to avoid costs that would be incurred in such circumstances due to certain technical provisions of UK company legislation at the time, it was common to set up such a financing subsidiary in the Cayman Islands, which had simpler company legislation that was less costly to comply with. While at times such arrangements have been questioned in relation to tax concerns (see, e.g., Financial Times Oct 19,2020 under https://www.ft.com/content/cb794b64-3454-4328-986e-d93a397ce96f), Welsh Water ensured that at all times, both the company itself and the whole Glas Cymru group of companies have been resident in the UK for tax purposes, so these arrangements have had no impact on its tax liabilities (Glas Cymru Annual Report 2019/20, page 215).

Corporate Governance and the Management of Welsh Water

Glas Cymru's ownership model and its strong focus on delivering benefits to customers have shaped the governance and management of Welsh Water. This section explores how Welsh Water's governance and management structures both reflected the corporate purpose and supported the company in delivering benefits to customers.

Membership

An important feature of Glas Cymru's governance model are members, who are appointed by Glas Cymru's board to ensure that the Board and senior management act in the best interest of the company. When Glas Cymru was established, there was a question whether introducing membership would be beneficial for the company. On the one hand, establishing an independent forum for holding directors accountable was considered to be important – particularly for the assurance of the delivery of its social purpose. On the other hand, members could introduce potentially difficult to resolve conflicts of interest. Consider, for example, the possible concern amongst bondholders that members might decide to prioritise lowering water bills to customers during a recession over honouring debt obligations and repaying investors. In such a scenario, Glas Cymru's ability to fund its asset intensive business would be put at risk. Glas Cymru eventually decided to go ahead with establishing membership as a form of checks-and-balances and indeed this model has proven to work well to date, despite the early concerns. Beyond holding the Board and senior management to account, members served as an important source of expertise and supported the company in fostering strong relationships with local communities.

Leadership

Another key feature of the corporate model developed for Welsh Water was that it should always have a Board with a majority of independent, non-executive directors (NEDs), who would be people with significant commercial reputations and experience. In part this would offer assurance to potential bond investors that the company would have effective management and would remain financially prudent and secure. In addition, the role of the NEDs would be a key feature in answering the challenge that Welsh Water would not be as driven as a shareholder owned business to deliver efficiency and to take unpalatable business decisions. In line with Welsh Water's purpose, the Board placed a strong emphasis on bringing down customer bills, which have always been above the average in the sector, so as to demonstrate a very clear and tangible benefit from the model for all customers.[11] Likewise, a Quality and Environment Committee of the Board (QEC) was created which met every month and which focused on the key performance metrics of drinking water quality and environmental performance. [12] As a consequence, the Welsh Water Board under Glas Cymru's ownership had a much greater focus on service delivery for customers and the environment than before, with consequently less emphasis on short-term financial performance, albeit always with a close eye to the long-term strengthening of the balance sheet.

These points were echoed in conversations with current and former NEDs of Glas Cymru, who were asked to comment on how the experience with Welsh Water differed from that of being a board director at other, generally shareholder owned businesses. In particular, respondents highlighted the following points. Firstly, deliberations of the Glas Cymru Board were dominated by issues relevant to its customer-centric purpose, at a time when most other businesses were exclusively concerned with shareholder value. Secondly, and related to the previous point, the Board was much more focused on business performance in delivering for customers (and debt holders), rather than much of the Board's time being taken up with potential M&A activity or takeover defence. Thirdly, the clear articulation and prominence of Welsh Water's purpose helped to foster a sense of shared endeavour and enabled trusted and transparent relationships between the executives and NEDs on the Board.

Strategy

The Board of Welsh Water has increasingly sought to frame its strategy and investment plans in terms of a much longer time horizon than would be usual for most businesses. For example, in 2018, "Welsh Water 2050" was published after a year-long programme of engagement with customers and other stakeholders.[13] This document set out a vision of the challenges that Welsh Water would face over the course of a generation, such as the impact of climate change, the growing digital economy and potentially dramatic changes in rural land use patterns. It also set out 18 Strategic Responses which should frame the priorities for the company's future investment plans, thereby seeking to move beyond the constraints of five-yearly regulatory investment cycles.

Equally, the investment solutions adopted by the company have evolved in the direction of being longer-term and more sustainable. A good example of this is the company's "Rainscape" approach to pioneer the use of Sustainable Urban Drainage Systems (SuDS) in the UK, which was informed by 30+ year modelling of the impact that changing rainfall patterns under likely climate change scenarios will have on the risk of flooding in towns and cities across the Welsh Water region. These SuDS solutions are designed to absorb rainwater from roofs, streets and car parking in local natural features, such as ponds or soakaways, rather than collecting it in traditional drains and sewers, which can be overwhelmed and lead to widespread flooding of properties and urban areas. SuDS solutions are often a cheaper whole-life cost solution that can be augmented over time to keep pace with climate change, as well as bringing significant well-being and biodiversity benefits to communities.

11 The levels of customer bills are controlled by Ofwat and are set at 5-yearly regulatory reviews so as to reflect the varying operating environments and investment needs of the individual water companies.

12 Glas Cymru Annual Report 2003/04, page 39. The QEC is chaired by an NED and includes two independent experts on drinking water quality and environmental sciences. Its formal, annual report to the Board is published on the company's website.

13 https://corporate.dwrcymru.com/en/about-us/our-plans/water-2050

Management Control

For any company with a strong social purpose operating in a competitive marketplace, remuneration, and executive remuneration in particular, is a difficult balancing act. One the one hand, potential providers of very long-term, low cost finance would always need to be reassured that the business would be able to pay competitive levels of remuneration sufficient to attract and retain people with the skills and experience necessary to ensure the long-term, successful management of the business. On the other hand, the level of pay in a company which provides an essential public service would clearly also be contentious. Welsh Water sought to reconcile these considerations by setting levels of remuneration which were attractive enough that the business would be able to attract new senior talent, albeit at levels below those paid by the shareholder owned water companies in England. That would then be balanced by structuring that remuneration in such a way that a significant proportion of the potential maximum remuneration would only be paid if the performance metrics delivered by the business were improving and ranked well as against the rest of the sector.

The performance metrics used for remuneration purposes have evolved over time but have consistently been of relevance to customers and other key stakeholders, both in terms of service delivery metrics and the financial performance which would enable future return of value to customers. By tying the remuneration schemes to the core elements of Welsh Water's purpose, executives are incentivised to run the company for the benefit of its customers. Moreover, the performance metrics underpinning these remuneration schemes include both short-term and longer-term elements, with a Long-Term Incentive Scheme aligning executive remuneration with Welsh Water's long-term strategic orientation. For instance, a significant proportion of any payment earned under the initial Long-Term Incentive Scheme would be forfeited in the event that the company's credit ratings were downgraded, seeking to directly align the incentives under the executive remuneration scheme with the interests of bondholders. Finally, these performance metrics have also formed the backbone of a company-wide bonus scheme in which all employees participate, providing an unambiguous signal to employees as to those measures of performance that are considered most important by the Board.

Culture

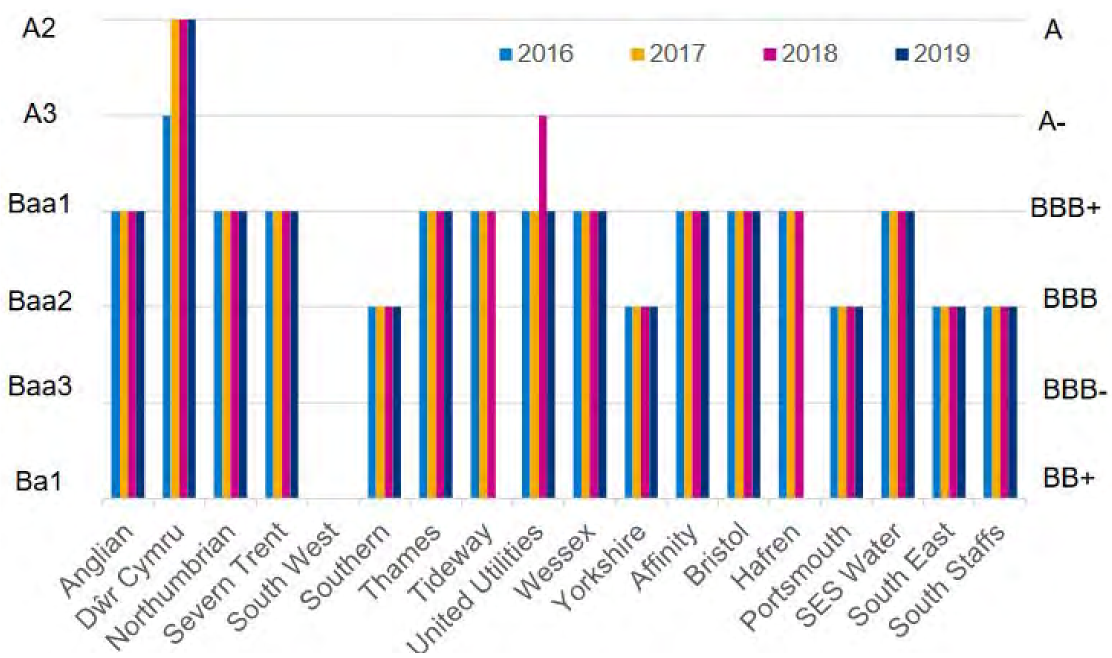
While Welsh Water's remuneration schemes have been an important element in aligning purpose and performance, current and former non-executive directors pointed out that the company's approach to remuneration more reflects the culture of the organisation, rather than being a driver of it. Shaped by Welsh Water's purpose and its non-shareholder ownership structure, this culture has been a powerful attraction for some people to join its business, especially amongst younger generations, and also acts as a strong motivator for its people to "go the extra mile" in delivering a high quality service for its customers. The unifying sense of purpose is also believed to encourage a willingness to innovate and to accept change within the business, in order to deliver a better outcome for customers. This has also been helped by co-operative, five-yearly Working Together Agreements between Welsh Water and its three recognised trade unions, which have involved a commitment to flexible working patterns in return for good terms and conditions, both of which have evolved to keep pace with changes in the marketplace.

A Rear-view: Welsh Water's Long-Term Performance

In 2020, Glas Cymru looks back on almost two decades of owning and managing Welsh Water. This 19-year history allows us to revisit the question underpinning much of the scepticism that Glas Cymru faced when announcing its proposal to acquire Welsh Water in 2000: Can a non-shareholder driven company be trusted with running a key part of the UK economy? From today's perspective, an additional question enters the realm: Has this ownership model really enabled the company to uphold the promise of its social purpose over time? This section addresses these questions in two parts, reviewing the management of financial performance at Glas Cymru first, and reviewing a variety of other performance dimensions of Welsh Water from 2001 – 2020 thereafter.

Ensuring the financial value of the business
In the years following the acquisition of Welsh Water, Glas Cymru was determined to prove the validity of its corporate governance model and demonstrate the commercial effectiveness of a company without shareholders. This was partly a reaction to the scepticism that Glas Cymru encountered before acquiring Welsh Water and the company addressed the concerns around the viability of its non-shareholder model by hiring experienced, non-executive directors, often from FTSE 100 companies, and placing a considerable focus on achieving a strong financial performance. In fact, Glas Cymru initially focused primarily on promoting its commercial legitimacy, rather than its unique corporate governance model. In the absence of shareholders providing equity funding, Glas Cymru had to fund its asset-intensive business by issuing corporate bonds and the company placed a strong focus on maintaining good relationships with bond investors. Particularly for a company with a gearing ratio initially above 90%, building trust with its bond holders had to be a number one priority and required a strong public narrative around the commercial success of the business. To this end, the company scheduled regular meetings with bond investors and issued quarterly reports to bondholders to ensure a high level of transparency. After the acquisition of Welsh Water, Glas Cymru took a prudent approach to de-gearing and decreased its debt to regulatory capital ratio from 93% in 2001 to 60% in 2020.[14] As a result, Welsh Water's credit ratings improved and the company consistently achieved the highest credit rating among UK water companies in the years 2016 – 2019 (see Figure 4). Welsh Water's reliable financial performance and its transparent approach to communicating with bond investors enabled the company to raise capital in bond markets at low rates, even as compared to other UK utility companies.

Figure 4: Credit ratings in UK water sector. [15]
Dwr Cymru is the Welsh name of Welsh Water.



But what about the promise of Welsh Water's social purpose and its performance in this regard? The following section reviews a variety of customer-related and environmental performance dimensions to examine whether the initial focus on its credit ratings and financial robustness had an adverse impact on its social performance dimensions.

14 Glas Cymru (2020) Annual Report and Accounts 2019-2020
15 Ofwat (2020) Monitoring financial resilience. Available from: https://www.ofwat.gov.uk/wp-content/uploads/2020/01/Monitoring-financial-resilience-report-2018-19.pdf

Welsh Water Performance, 2001-2020

Considering regulatory, customer, and operational data, Welsh Water performed similarly or better than other, shareholder-driven companies in the UK water sector. Delivering benefits to customers through its social purpose was a key pillar of Glas Cymru's proposal for taking over Welsh Water. Given its unique structure as a company limited by guarantee, i.e. without shareholders, Glas Cymru pledged to reinvest financial surpluses into the business to improve services and lower customer bills. Looking back over two decades, Glas Cymru was largely able to deliver on this promise, reportedly returning over £440 million of value to its customers.[16] This included customer bill reductions – both rebates for all customers and part-funding by the company of social tariffs for those most in need – and investments in infrastructure, resilience and long term improvements (see Table 1).

Table 1: Return of Value to Customers, 2001-2020[17]

Period	Type	Value
2001-2005	Customer rebates	£23 million
2006-2010	Customer rebates	£129 million
2011-2015	Social tariffs	£22 million
	Additional investments	£114 million
2015-2020	Social tariffs	£37 million
	Additional investments	£116 million
Total		£441 million

In addition to the customer rebates, the Board placed a high degree of emphasis on tight cost control, which would enable the average household bill to come down relative to the rest of the sector. By 2019/2020, the average household bill of Welsh Water's customers, including those on social tariffs, was 4% lower than in 2001 in real terms, which is the largest reduction in customer bills in the water sector in England and Wales. In comparison, the average bill in the sector in 2019/2020 was 8% higher than in 2001 (see Table 2).[18]

The performance of Welsh Water in delivering customer benefits was also informed by customer feedback. In the local "Have Your Say" engagement programme in 2016, customers were asked how a potential financial surplus of £30 million a year should be used. Somewhat unexpectedly, there was a very strong preference amongst customers to reinvest that money to ensure an efficient and reliable service in the long-term, together with targeting help to those customers who were struggling to afford their water bills. On the other hand, there was surprisingly little support for simply returning all the money to customers through across the board price reductions. This result was not replicated in similar surveys by other water companies of their customers' willingness to pay extra to support hard pressed customers. It may be that the non-shareholder ownership model means that Welsh Water is relatively more trusted by its customers to invest any financial headroom for their long-term benefit. But it may also simply be that preceding (real terms) price reductions had moved the customers' pain points away from price towards other key improvements in the infrastructure.

Table 2: Average household bill change (real terms, RPI), 2000 to 2020.

Company	Bill change
Dŵr Cymru Welsh Water	-4%
Anglian	-1%
South West	1%
Severn Trent	3%
Southern	7%
Industry Average	8%
Yorkshire	11%
UU - North West	14%
Wessex	17%
Thames	20%
Northumbrian	21%

Since 2001, Welsh Water has also delivered substantial operational improvements (see Table 3). According to Ofwat's Overall Performance Assessment (OPA) – a weighted combination of customer service and other performance measures[19] (such as flooding incidents, and water quality) – Glas Cymru performed comparatively well between 2001 and 2010, ranking among the top four water utilities in England and Wales in 7 out of 9 years (see Figure 2), with a sector leading performance in 2002/03 and 2004/05. This contrasts with Welsh Water's poor relative performance in 2000/01, prior to the acquisition by Glas Cymru.

Table 3: Welsh Water Operational Performance Indicators.

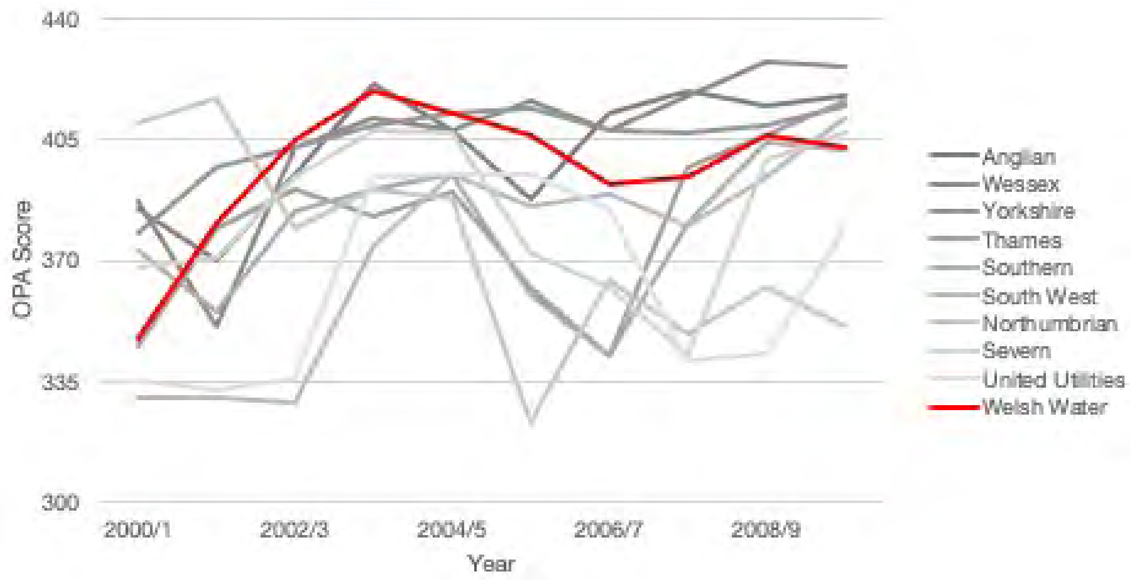
Performance Indicator	2020	2001
Reportable safety incidents	8	42
Serious pollutions	2	9
Leakage	168 ml/d	260 ml/d
Distribution input	874 ml/d	899 ml/d
Written complaints	2,693	13,000

Source: Glas Cymru (2020) Annual Report and Accounts 2019-20. ml/d is megalitres per day of water.

16 Glas Cymru (2020) Annual Report and Accounts 2019-2020
17 The Water Report, April 2020. Available from: https://www.thewaterreport.co.uk/
18 Analysis of Ofwat data
19 See Ofwat (2004) "OPA conclusions and methodology for 2004/05 onwards" under https://www.ofwat.gov.uk/wp-content/uploads/2015/11/pap_rsh_opa2004-05.pdf

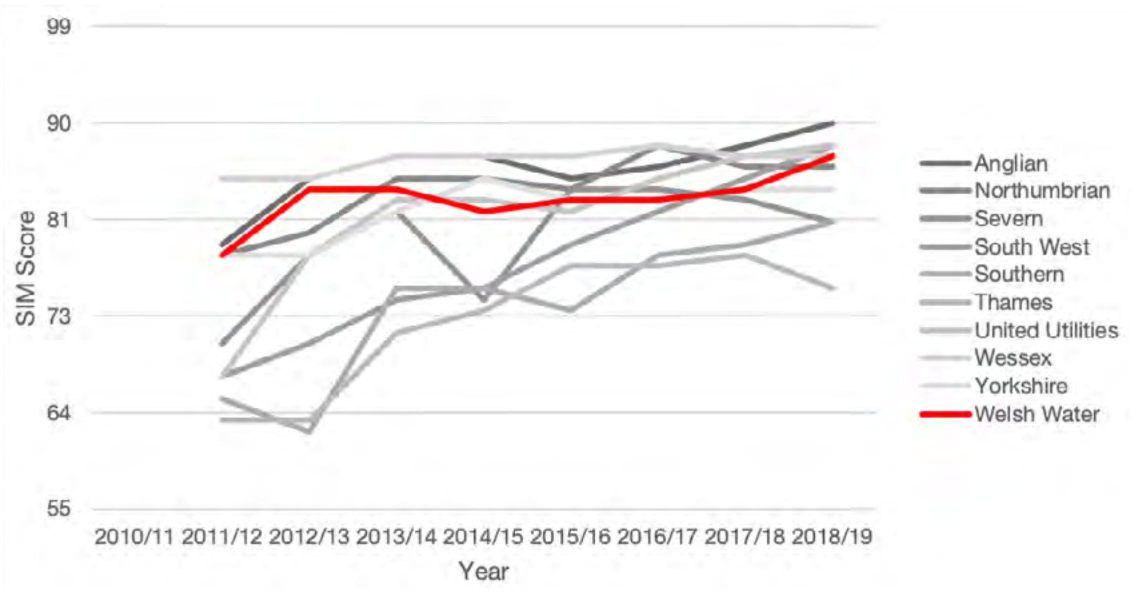
This is not to say that Welsh Water is a top performer on all individual measures. For example, it has consistently experienced more water supply interruptions than most other water companies – although it is a matter for debate to what extent that reflects differing topography in the various company regions. On environmental performance measures, Welsh Water has generally been rated a "three star" performer by the environmental regulators – good but not one of the top "four star" companies.

Figure 2: Ofwat Overall Performance Assessment (OPA) data, 2000-2010



In 2010, Ofwat stopped monitoring OPA data and introduced the Service Incentive Mechanism (SIM), a new performance measure comprising an independent customer satisfaction survey and a company reported data section. Figure 3 provides an overview of the combined SIM scores in the English and Welsh water sector and shows that Glas Cymru continued to perform reasonably well on this metric between 2010 and 2019. In the final year, it ranked fourth amongst the ten Ofwat regulated entities on this scale. In 2019-20, Ofwat introduced an improved measure of overall customer satisfaction (C-MeX), which placed greater weighting on independent customer survey data. In the first pilot year for C-MeX, Welsh Water was the top performing company.[20]

Figure 3: Ofwat Service Incentive Mechanism (SIM) data, 2010-2019



20 https://www.ofwat.gov.uk/regulated-companies/company-obligations/customer-experience/c-mex-and-d-mex-2019-20-results/

According to the Consumer Council for Water (CCW),[21] Welsh Water is consistently one of the leading water companies in England and Wales when it comes to consumer satisfaction (see Table 4). When asked by CCW about the satisfaction with overall customer service[22], customer rated the satisfaction level with Welsh Water at 87% (3-year average, 2016-2018), whereas the average industry satisfaction level was 82% over the same time period.[23] Moreover, Welsh Water achieved the highest Net Promoter Score (Welsh Water: 44; sector average: 18) in the sector in 2018, indicating that Welsh Water had the highest share of customers that would recommend the company to family and friends. The good customer satisfaction performance of Welsh Water is also reflected in the latest UK Customer Satisfaction Index, in which the company was the only water utility that has ever been ranked as one of the top 50 organisations in the UK.[24]

Table 4: Customer Satisfaction, average scores for 2011-2018.

Customer Satisfaction Indicators	Welsh Water	England & Wales water sector
Customer trust: Customers were asked to what extent they trust their water company on a scale of 1 –10 with 1 being 'do not trust them at all' and 10 being 'trust them completely'.	7.86	7.54
Value for money (water service): Customers were asked how far they agreed that the water services they receive are value for money.	77.9%	72.1%
Value for money (wastewater service): Customers were asked how far they agreed that the sewerage services they receive are value for money.	79.8%	74.7%

Source: Consumer Council for Water (2019) Water Matters 2018.

Overall, Welsh Water has performed relatively well against regulatory, customer, and operational performance benchmarks over the past two decades, thus demonstrating that a commercial, non-shareholder-company limited by guarantee can effectively and efficiently provide water and waste-water services.

21 The Consumer Council for Water (CCW) is a non-departmental public body that is sponsored by the Department for Environment, Food & Rural Affairs. As such, the CCW is independent of both water companies and Ofwat. CCW has been tracking customers' views of water companies since 2011 and publicly discloses the outcomes of its annual surveys.

22 This considers meter readings, bill provision and frequency, payment options and any other aspect of customer service.

23 Consumer Council for Water (2019) Water Matters 2018.

24 UK Customer Satisfaction Index (UKCSI) is an independent, national benchmark of customer satisfaction published each January and July by the Institute of Customer Service. The July 2020 version of the UKCSI can be accessed here: https://www.instituteofcustomerservice.com/product/uk-customer-satisfaction-index-july-2020/

Discussion

The case of Glas Cymru is an interesting one to examine when focussing on purpose in business and the question of whether and how ownership and governance can play a role in implementing it. While, certainly, Welsh Water has taken a very unusual route in deciding on its non-shareholder and membership-based model, it has also been a very successful one in terms of both economic and social outcomes: in addition to achieving consistently high credit ratings and building a strong balance sheet, the company was able to reduce customer bills in real terms over time, and outperform most its competitors in the delivery of customer performance metrics. Regarding this objective success of the "Welsh Water project", why has this approach not been adopted more widely in the UK water sector and beyond?

The answer to this question is multi-dimensional and is not least to be connected with the importance of water supply to local communities, with water and wastewater services in many countries being a long standing, municipal responsibility. While some national and regional governments[25] signalled interest in Welsh Water's system, the creation of a non-shareholder entity is still a form of privatisation, albeit without the imperative of profit maximization. From a political perspective, therefore, it would mean giving up control over a local public utility and to place it into the hands of a new group of independent stewards. From a private ownership perspective, on the other hand, it would mean giving up the creation of profits and pay-out of dividends. In both scenarios, an active transformation away from either a public or private business towards a mutual form such as Glas Cymru was therefore unlikely without a historical point of disruption in the industry and a motivated and capable leadership willing to take on this transformation – as both was the case for Welsh Water.

Furthermore, the creation of Glas Cymru has in many ways been an experiment, combining components of mutual ownership with those of more conventional private corporate forms. While the company can ultimately look back on a successful twenty years, it has not always outperformed its peers in all categories of interest and has for long had to prove its commercial viability and worth to sceptics in both the regulatory and economic environment (including bondholders). Indeed, the social purpose enshrined in Welsh Water's governance led to an increased scrutiny of its economic performance, particularly in its early years of existence, and therefore to somewhat counterintuitive initial focus on demonstrating the economic and financial strengths of the business. This dynamic shows that the deliverance on both economic stability and social returns was not necessarily guaranteed by the ownership structure, and instead had to be actively managed by the company. In other words, as long as external evaluation of performance (in this case from bondholders) continued to be purely financial, even an ownership structure bound to social purpose did not remove the need for management to weigh the prioritization of economic and socio-economic prerogatives. A larger system-shift around performance evaluation in capital markets would be needed to alleviate such tensions completely. While Welsh Water's ownership and governance structure may have led to increased financial scrutiny, it also enabled its management to find appropriate responses to these pressures. Benefitting from the reduced pressure for short-term financial deliverables as they exist in the stock-markets, Welsh Water management had the freedom to respond with long-term focussed investments and perspective which was key to maintaining a balance of social, environmental and economic goals.

Due to this history, Welsh Water is also an interesting case when looking at the public nature and narrative around the concept of corporate purpose. While few companies have a social purpose as clearly enshrined in their governance structure as Welsh Water, the company was discouraged in early years to market this unique feature, since it would risk attracting scepticism and increased scrutiny in a market still largely governed by a profit-first mentality. Indeed, Welsh Water only started to promote itself widely as a "non-profit company" in 2013, thereby initiating a shift in branding which reflected a more confident stance towards its governance structure and social purpose. This was partly inspired by the public declaration of social purpose at other organisations, such as Transport for London, but also marks a shift in the public narrative and zeitgeist which started to challenge the shareholder primacy paradigm and not only allowed but encouraged companies to promote their social purposes. As such, Welsh Water is an example of a company that has been implementing a social purpose for 20 years but only started to talk about it recently, and stands in stark contrast to companies that have developed a strong rhetoric around corporate purpose without necessarily embedding this purpose in corporate practices.

The case of Glas Cymru Welsh Water illustrates how ownership and governance can be instrumental for the implementation of corporate purpose. The importance of local connections (through members) and stakeholder inclusion, for example, sharpened the grounding of the company's purpose and ensured stakeholder scrutiny over its implementation. It furthermore allowed management to take a longer-term view than it would have been able to take under the pressure of quarterly earnings reports, enabling a different kind of operational planning for environmental assets and social performance goals. The benefit of an ownership structure such as Glas Cymru's has also become apparent in the light of the current COVID-19 pandemic, to which the company was able to react swiftly while demonstrating remarkable resilience. In the face of this crisis, Welsh Water was quickly able to prioritise the delivery of essential services and customer support, while still being able to maintain its long-term investment programme.

Overall, the model of Glas Cymru Welsh Water is one that is likely to be particularly useful for companies in other asset intensive sectors where there is a strong Regulatory Asset Base against which to secure commercial borrowings. Additionally, being a provider of essential goods and services in a specific geographic area lends itself to implementing

25 Discussion of the Glas Cymru model took place, for example, in Scotland, Northern Ireland and Lombardia (Italy).

a social purpose. Welsh Water's business model is firmly rooted in Wales and the company's operations both impact and depend on the prosperity of local communities and environment. This embeddedness in local (social and natural) ecosystems has been conducive to fostering strong ties with stakeholders. While Welsh Water could quite naturally connect with its local stakeholders, members and customers on questions around the social purpose of its business and establish its corporate governance around it, this might be less intuitive and easy for companies with a more commercial business model and a less narrow geographical scope (and thus sense of belonging) who operate in more competitive, liquid and global markets. Still, Glas Cymru's ownership of Welsh Water remains an interesting example of how companies can act and, in fact, exist differently when seeking to implement a social purpose.

Conclusion

The purpose of business has long been construed as the generation, if not the maximisation, of financial profits. According to this shareholder-centric view of the firm, companies should be run first and foremost for the benefit of their shareholders. In recent years, however, cracks have appeared in the consensus around the shareholder-centric model. For example, the Business Roundtable – a business group representing US companies with more than $7 trillion in annual revenues – recently moved away from its long-held position that corporations principally exist to serve shareholders. Instead, the Business Roundtable issued an updated Statement on the Purpose of the Corporation that called on CEOs to lead their companies for the benefit of all stakeholders, including customers, employees, suppliers, communities and shareholders.[26] While public statements supporting a much broader stakeholder-orientation of firms are increasingly abundant, it is not obvious if and how companies should go about putting a social purpose into practice.

In this context, the case of Welsh Water is instructive in at least three aspects. Firstly, Welsh Water is a real-life example of a company that has embedded a stakeholder-oriented purpose into its corporate governance and management structures – and it has a successful 20-year track-record demonstrating the long-term viability of this approach. Secondly, the case study highlights that alternative legal and corporate governance structures – such as a company limited by guarantee – can be powerful levers for delivering a social purpose. Thirdly, in the case of Welsh Water, determining the social purpose came first and registering Glas Cymru as a company limited by guarantee followed the initial definition of the corporate purpose. In other words, Glas Cymru selected a structure that was fit for purpose. And while many existing companies might not be able to start with a blank sheet of paper in the same way, the case of Welsh Water highlights the potential benefits of aligning corporate purpose with its legal and governance form.

26 https://opportunity.businessroundtable.org/ourcommitment/