How effective is your board in meeting 'future customer' & wider stakeholder needs?
Key conclusions for energy and water company boards

Sustainability First would like to share some of the key conclusions of a two year in-depth analysis of 'future customer' needs in the energy and water sectors – New-Pin.[i] Ofgem and Ofwat have been actively engaged throughout this work.

This bears directly on compliance with Section 172 of the Companies Act and how directors should best promote the success of the company overall.

Our findings show how future success for a water or energy company depends on the board's firm grasp of consumer and wider stakeholder requirements today - and a clear future view of how those needs are changing given more flexible, responsive and decentralised models of service delivery.

Working with executives, board members, regulators, consumer and civil society groups, we have produced a significant body of work in this area. This includes a short check-list designed *specifically* for energy and water company boards to assess how effective they are in meeting 'future customer' needs.

Energy & water companies deliver essential services and are stewards of critical infrastructure. A focus at board level on meeting future customer and wider stakeholder needs, including those of the environment, is therefore vital. Current approaches to board effectiveness are being disrupted by wider societal change. Diminishing trust in business in general, and the particular complexities this poses for regulated sectors, adds to this challenge.

Board approaches to governance need to evolve further to ensure consumer interests are put at the heart of how the company is run; enabling long-term customer outcomes to be delivered and to embrace the future. Boards will clearly behave in their own fiduciary interests. However, those that fail to adapt will not be able to maximise the opportunities of the new world and even risk failure. A more proactive stance by boards that seeks to shape and influence technological and structural change in the sectors is therefore essential.

Companies are already doing much good work in this area and there is good practice out there. However, societal and political demands are increasing. There is a distance to go before some can provide sufficient evidence that they are 'doing the right thing' in terms of long-term public interest outcomes. Regulation is also evolving; with PR19 in water, the introduction of Principles Based Regulation in energy retail and early thinking on RIIO2 for energy networks.

Sustainability *First* is a registered charity. Chair: Ted Cantle CBE, DL. Other trustees: Peter Atherton, Richard Adams OBE, Phil Barton, Sarah Deasley, Sarah Harrison MBE, Don Leiper, Derek Lickorish MBE, Professor Gordon Mackerron, Derek Osborn CB, Trevor Pugh and David Sigsworth OBE
Registered company no : 3987720. Registered charity number : 1078994
Address: c/o IEEP, 11 Belgrave Road, 3rd Floor, London, SW1V 1RB
www.sustainabilityFirst.org.uk @SustainFirst

Our analysis shows that energy and water company boards face three major challenges in meeting future needs.

Challenge 1 - How to demonstrate that total returns are 'acceptable'
The monopoly characteristics of the sectors and short-comings with retail competition make this the key challenge for board effectiveness in energy and water. Boards need to be able to demonstrate to regulators and the wider public that they have heard the views of their stakeholders and responded appropriately, that they understand the fast changing societal and ecological context in which they operate and that 'future customer' requirements sit at the heart of their decision-making. Acceptable returns ensure a fair balance of interests across different stakeholders; in business plan submissions to regulators for monopolies and when considering pricing strategies for a particular geography / country for retailers.

Challenge 2 - What boards can do to build better regulator/company relationships
The complex, and sometimes disputed, web of responsibilities in the sectors along with opaque group structures can lead to an undue compliance mind-set and company inertia. Relationships between companies and regulators need to mature. Companies that can demonstrate they are ready for more autonomy should be given more space to lead. Energy and water regulators should work with the Financial Reporting Council and investor groups as they implement the BEIS corporate governance reform programme [ii] and re-set the framework for company / regulator dialogue to focus on strategy and the 'big' picture.

Challenge 3 - The important role of the Non Executive Director
Around the energy and water board table, NEDs have a key role in providing assurance on the delivery of long-term customer outcomes, fulfilling fiduciary duties and dealing with political and regulatory risks. These risks are already high as companies face a step change as they adapt to climate / technological transition. This needs more board level focus. Chairs and NEDs need to be able to show that they have responded in a fair, transparent and accountable way to future customer requirements to ensure their approach to governance is fit for the future.

Sustainability First energy and water ten point check-list: How effective is your board in meeting 'future customer' & wider stakeholder needs?

Sustainability First has developed the following ten point check-list for the boards of energy and water companies to use to assess how far they address the above challenges and meet future customer and wider stakeholder requirements.

1. Within your corporate structure, is it clear where responsibility sits for current and future UK customer needs across each part of the ownership chain?

2. How does your TopCo (or equivalent board) demonstrate due consideration to ethical / fair behaviour and conduct and how to deal with different interests – current / future consumers, the natural environment, different communities in which you operate etc?

3. How are you strategically engaging with your customers and wider stakeholders to ensure your board risk appetite is appropriately aligned with the public interest and your risk framework captures any resulting issues?

4. Does your board have an agreed set of criteria as to what it means to be a 'respected corporate citizen' in the water or energy sector (eg in terms of gearing, tax etc) and does it assess how it measures up against these?

5. What is your board doing to 'reclaim strategy' and move from an undue focus on compliance, in the process demonstrating that you are embracing the spirit of Section 172 of the Companies Act (even if not listed) and acting as long-term stewards for the company and the sector?

6. Where appropriate, are you developing 'safe spaces' for board/regulator and board/sector dialogue, to discuss difficult issues such as the level of regulatory intervention/company autonomy, strategic/systemic issues & wider sector responsibility?

7. What is your board doing to create effective feedback loops to link the different parts of the complex system in which you operate?

8. Does your board have the appropriate skill-mix to understand current and future customer and wider stakeholder needs and does director induction sufficiently cover these issues?

9. How does your board set 'the tone from the top' to ensure that public interest values percolate down throughout your business, that staff are engaged on these issues and that reward and recognition practices take these into account?

10. The public is increasingly open to radical and new ideas for the energy and water sectors. How does your board address not just opportunity, but also 'difficult' risk (eg public ownership, difficult relationships etc)?

This summary is taken from a much longer slide set. If you would like a copy, or to discuss what this means for you and your team, please contact Sustainability First's Director, Sharon Darcy, at sharon.darcy@sustainabilityfirst.org.uk

October 2017

[i] This research is a key part of Sustainability First's New Energy and Water Public Interest Network ('New-Pin') programme. See www.sustainabilityfirst.org.uk

[ii] BEIS (August 2017) Government Response: Corporate Governance Reform

Sustainability *First* is a registered charity. Chair: Ted Cantle CBE, DL. Other trustees: Peter Atherton, Richard Adams OBE, Phil Barton, Sarah Deasley, Sarah Harrison MBE, Don Leiper, Derek Lickorish MBE, Professor Gordon Mackerron, Derek Osborn CB, Trevor Pugh and David Sigsworth OBE
Registered company no : 3987720. Registered charity number : 1078994
Address: c/o IEEP, 11 Belgrave Road, 3rd Floor, London, SW1V 1RB
www.sustainabilityFirst.org.uk @SustainFirst