Thought Leadership Series: Utility customer engagement and the uninformed response bias

What is customer engagement really telling us?

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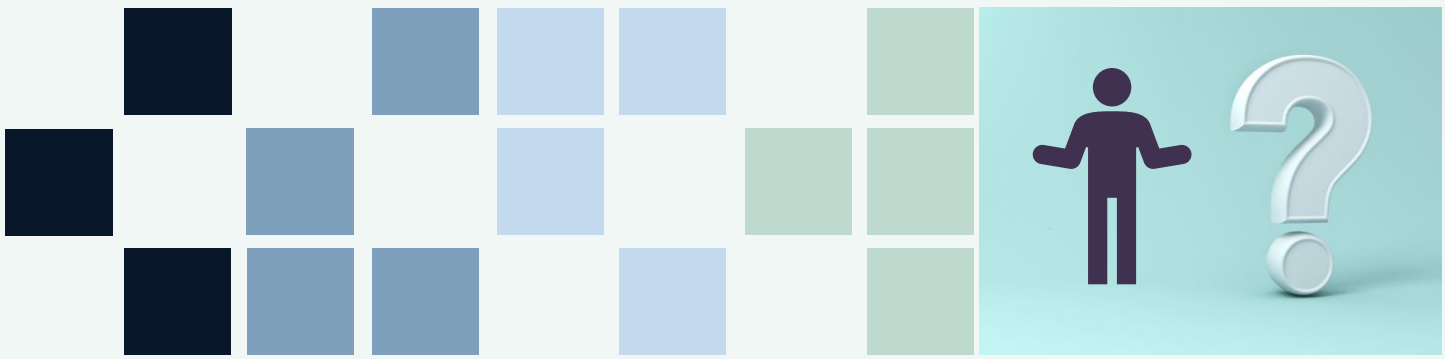

Should your water utility prioritise more spending on preventing leaks?

If you worked for the utility, you would likely consider the question posed above based on whether the benefits outweighed the additional costs. In your assessment, you might consider the extent to which additional expenditure prevents leaks, the value of the water conserved and the avoided poor publicity and disruption to customers. You would realise the question cannot be answered easily. In your investigations, you would discover that there is a sizeable literature on how to determine the optimal level of leak prevention.[1]

Given the complexity it is hard to imagine that customers could make an informed response to the question. However, the question is typical of what utilities ask their customers in surveys and workshops. More broadly, utilities may ask customers about the utility's role and priorities, whether to increase spending on an issue and whether they are getting value for money. Despite not having the time, resources, and skills to do the necessary research and answer such questions, customers dutifully respond, and utilities pay attention to the responses.

There is (literally) decades of empirical research that shows people respond to questions despite being uninformed – an issue known as the uninformed response bias.[2] Research has found that people willingly provide opinions on fictitious brands and government departments and even give directions to places that don't exist. Giving people the opportunity to say "don't know" reduces, but doesn't eliminate, the issue.

Furthermore, there is evidence that these uninformed responses are not just random noise but are biased – influenced by related knowledge and cues that are available to the respondent.[3] For example, on average people rated a fictitious brand of cheese more highly if the brand name sounded French.[4] In response to the opening question, people might draw on the messages they have heard in the media. The key implication is that some of the information gathered is misleading or, at best, of little value.

Utilities engage with customers on many topics using a variety of methods. There is increasing use of deliberative processes whereby a panel of customers are given additional time and information to respond to questions. However, as elaborated below, there are limits to the effectiveness of deliberative panels. Furthermore, a lot of engagement is still conducted using surveys or one-off sessions without chance for deliberation and often the findings are provided to the deliberative panels to consider.

There is evidence that much of the common forms of customer engagement is not meaningful. In 2020, CCW (a consumer group for water customers in England and Wales) commissioned research[5]

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[1] The literature can be found by searching for the term 'economic level of leakage'.

[2] Graeff, T. R. (2002). Uninformed response bias in telephone surveys. *Journal of Business Research*, *55*(3), 251-259.

[3] Dunning (2011, pp. 257-258) describes the process that people use as follows "The process is that people take cues from the social situation they are in and their general world knowledge to cobble together enough apparent information to form an impression. That is, people reach back or around to any knowledge they have that might appear to be relevant, and then use it to impose some meaning on the questions they are asked and then to form a judgment." Dunning, D. (2011). The Dunning–Kruger effect: On being ignorant of one's own ignorance. *Advances in experimental social psychology*, 44, 247-296.

[4] See note 2.

[5] Blue Marble Research (2020) *Engaging water customers for better consumer and business outcomes*. Accessed 18 Aug 2024 at

that involved recruiting customers to assess the meaningfulness of anonymised real examples of customer engagement. The findings are sobering but not surprising. Having reviewed the topics and methods, most participants struggled with the research questions or concluded that, because they were unqualified, the questions were best answered by experts. Based on a review of the customer engagement practices in the UK and Australia, I expect similar research in Australia would deliver similar findings.

Why engage?

So why does such engagement occur and is it possible that it is useful? To answer this, it is helpful to consider why utilities engage with their customers and the broader community.

In the last two decades regulators, particularly in Australia and the UK, have increasingly required and/or incentivised utilities to have a greater customer focus.[6] An apparent motive was to address the perception that consumers were not being effectively included in regulatory decision-making.[7] It has led to significantly more customer engagement, and for the most part the key stakeholders seem happy.[8] The customers appear to appreciate being consulted and the utilities are happy to engage (so long as they can recover their engagement costs). Furthermore, shifting the focus of utilities to answering to their customers, may have reduced the tensions between utilities and their economic regulators.

There are good reasons for wanting utilities to engage closely with customers. I categorise these as relating to:

- **Stakeholder management.** Utilities need the trust and cooperation of their customers and community to deliver many of their services. Stakeholder management is important in developing infrastructure[9] and it is critical that the community trusts their utility to provide quality drinking water and to dispose of wastewater appropriately. The water utility also needs the community's cooperation in reducing consumption during drought and will need the community's acceptance for purified recycled water for drinking should it be introduced.
- **Information gathering.** Utilities need to gather information that can only be obtained from customers and the community. For example, the optimal investment in preventing disruptions depends on the cost of disruptions to customers – something that can only be fully understood by asking customers that have experienced a disruption. If a utility wants to spend more to provide a higher-than-mandatory service level, it needs to provide evidence to the regulator that its customers will value the higher service level. By engaging with people with different experiences and

https://www.ccw.org.uk/publication/engaging-water-customers-for-better-consumer-and-business-outcomes/

[6] Hahn, R., Metcalfe, R., & Rundhammer, F. (2020). Promoting customer engagement: A new trend in utility regulation. *Regulation & Governance*, *14*(1), 121-149.

[7] Decker, C (2013) The Consumer Knows Best: Involving Consumers in Regulatory Processes and Decision-making, *Network*, Issue 49, December 2013, 1-8.

[8] Stakeholder support for the increased focus on customer engagement can be found in a review of the 'PREMO' water pricing framework that applies in Victoria. See Farrier Swier Consulting (2019) *Victoria's water sector: The PREMO model for economic regulation*. 28 March 2019. Accessed 18 Aug 2024 at https://www.esc.vic.gov.au/water/how-we-regulate-water-sector/premo-water-pricing-framework

[9] Consult Australia *Valuing Better Engagement: An economic framework to quantify the value of stakeholder engagement for infrastructure delivery.* Accessed 17 Aug 2024 at https://iap2content.s3-ap-southeast-2.amazonaws.com/marketing/Resources/Reports/Valuing-Better-Engagement-Economic-Framework.pdf

perspectives, utilities can gain greater understanding and insights into issues and opportunities to improve services.

- **Review and challenge.** Decision making in the interest of customers may be improved by using customer representative groups (commonly in the form or citizen juries, or customer challenge panels) to address selected questions and/or independently review and challenge utility proposals. With regulator backing, such groups can provide a countervailing power to the utility and provide an independent perspective to the utility who may be blindsided by their groupthink. Using customers for this purpose can be relatively cost-effective, ensures a customer focus and can enhance trust in the utility.

The issues and risks of engaging with the uninformed

Based on the public reports it appears that utilities are frequently seeking opinions from customers insufficiently informed on topics that would typically involve detailed analysis. Such engagement can be found in the water and energy sectors and even on common issues such as depreciation, the value the utility provides, and the investment in smart meters, cyber-security and net-zero activities.

Engagement can involve a considerable cost, which is paid by the utility but ultimately borne by customers through higher charges, and a non-trivial amount of time and effort by participating stakeholders.

There are reasons why engagement can add value even with seemingly uninformed stakeholders.

Sometimes we want uninformed responses. For example, for a controversial change – such as introducing purified recycled water for drinking – understanding the uninformed response will be important in assessing the proposal's social acceptability and guiding the communications strategy. In such cases it can be important to explore how people react to different messaging and how views change as more information is provided.

Some responses will not be fully uninformed but rather reflect other information of interest. For example, opinions on leak prevention spending may reflect concern over affordability or the impact of restrictions.

There can be value to any engagement in building trust with stakeholders and gathering different perspectives that people hold.

However, these arguments do not appear to be explicit in engagement strategies and do not appear to explain much of the engagement that is undertaken. Regardless, for the last two points, it is preferable to design the engagement to obtain informed responses (e.g., in the case of leaks by directly asking about affordability and restrictions).

A potentially more significant, concern is that utilities may misinterpret the information to justify decisions that are not in the customer interests. In their responses, people draw upon cues such as how questions are framed. Consequently, a utility enthused about a project may find, through issues with framing or interpretation, evidence for customer support for its project.

This concern became prominent in a recent dispute between Ofwat (the economic regulator of water companies in England and Wales) and some water companies it regulates.[10] The companies

[10] Ofwat. (2020). *Reference of the PR19 final determinations: Introduction and overall stretch on costs and outcomes – response to cross-cutting issues in companies' statements of case.* Accessed 17 Aug 2024 at https://assets.publishing.service.gov.uk/media/5eb15fa

argued that Ofwat had 'not adopted preferences indicated by their customers'. In response, Ofwat sought to clarify the role of customer engagement in the price review process, stating:[11]

> *…customer engagement was not intended to replace either the role or judgement of Ofwat …*
>
> *…there are areas where customers are not best-placed to determine whether a company's business plan is appropriate*
>
> *…customer research varies in quality and can only ever imperfectly capture customers' actual preferences*

Ofwat concluded by emphasising that customer and community support for a project is not enough to justify the project:[12]

> *Accordingly, broad indications of customer preference obtained as part of an engagement process should certainly serve to shape company business plans. But they do not relieve the companies of the need to evidence either the need for or efficiency of their proposed expenditure.*

Another concern relates to the engagement used to support project business cases. Customer and community engagement is often necessary in valuing 'non-market' outcomes, such as improved river health, that cannot be valued using traditional methods. This typically involves surveys to elicit people's willingness-to-pay (WTP) for the outcomes of interest. While there are established techniques for undertaking such analysis, there are also substantial challenges and the regulators in Victoria[13] and NSW[14] have commissioned research that has been strongly critical of some of the WTP studies undertaken.

The risk of uninformed responses is a key issue for WTP research. To get an informed and non-biased assessment, a WTP study needs to seek views on outcomes that people care about and understand. For example, people should be engaged on their WTP for outcomes such as improved river health rather than additional water recycling[15] as the utility is better able to determine how a recycling project affects these outcomes.

Yet another risk is that important options are not considered and analysed because utilities and regulators over-rely on the customer engagement process to identify priorities and options. Stakeholders can't express support for an option that is not presented. Furthermore, bad options can be made to look good if they are only compared to worse options, and good options can be made to look bad if they are not appropriately presented.

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[11] *Ibid (pp. 44-45).*

[12] *Ibid (pp. 44-45).*

[13] Rose, J. (2021). *Water Pricing Submission Review: Response (UTS CRICOS 00099F).* Business Intelligence & Data Analytics (BIDA) Research Centre. Accessed 17 Aug 2024 at https://www.esc.vic.gov.au/sites/default/files/documents/Melbourne-Water-price-review-2021-Prof-John-Rose-advice-on-willingness-to-pay-study-20210512.pdf

[14] Gillespie Economics. (2020). *Consultant report by Gillespie Economics—Assessment of Hunter Water and Sydney Water Customer Willingness to Pay Surveys.* IPART. Accessed 17 Aug 2024 at https://www.ipart.nsw.gov.au/Home/Industries/Water/Reviews/Metro-Pricing/Prices-for-Sydney-Water-Corporation-from-1-July-2020/24-Mar-2020-Consultant-report-by-Gillespie-Economics/Consultant-report-by-Gillespie-Economics-Assessment-of-Hunter-Water-and-Sydney-Water-Customer--1

[15] The NSW Independent Pricing and Regulatory Tribunal developed best practice principles for WTP surveys including the principle that 'The non-market outcomes (external benefits) in the survey are expressed in terms of outcomes that people directly value. (e.g., people should be asked about willingness-to-pay for the environmental improvements brought about by increases in water recycling, rather than for increases in water recycling in and of itself)'. *Ibid* p. 7

The risk of the best options being missed is high for options that require technical knowledge and/or involve change that utilities themselves would prefer to not consider. For example, the option of using financial incentives to reduce demand during drought to avoid restrictions and supply augmentations is rarely presented to customers – and when it is, it more likely to be presented as increasing prices rather than reducing bills for those who save more. This is not a small issue – in 2008 the net benefit of using financial incentives over restrictions to manage water demand during drought was estimated at around $150 per household per year in Sydney.[16]

Using customer challenge panels and other deliberative engagement can help to mitigate the above issues. But there are limits to what can be effectively achieved through such deliberative processes. Customer challenge panels, whose members may have expert knowledge, are established (as the name suggests) to challenge proposals and not as processes for gathering customer information and proposing options.

Deliberative panels (commonly 'citizen juries') are often used to consider selected questions and topics. The deliberative process, which may involve multiple meetings over a period of several weeks, enables the panel to become better informed and carefully consider options. However, such processes are relatively time-consuming and expensive when the issues are technical. They are best suited for issues which cannot be resolved by sector experts because, for example, they involve moral judgements.[17] It is also impractical for such deliberative processes to replace the normal practices of gathering and presenting evidence on costs and benefits. Consistent with Ofwat's guidance the evidence needs to include an evaluation of the merits of any proposal and not rely on customer sentiment.

The way forward

The increased focus on utility customer engagement over the last two decades has clearly been well received by stakeholders. However, there also appears opportunities for improvement with a more nuanced and considered approach that recognises the limitations of customer engagement.

The engagement might be improved with greater consideration of the uninformed respondent bias. A simple test for any topic is to question whether the respondents are likely to be sufficiently informed. For utilities, this test should be easy to apply. We should not expect customers to provide an informed response if the utility's staff themselves don't feel sufficiently informed to answer the question.

It would also help to increase consideration of the purpose of engagement. That is, whether engagement is required for information gathering, for stakeholder management and/or for reviewing and challenging proposals.

For example, we might consider how each of these purposes apply to the opening question on the level of investment in leak prevention. From an information gathering perspective, customers (or even a deliberative panel) are unlikely to provide an informed answer, but they could, and are needed to, provide information and insights on the

[16] The $150 per household estimate can be found in Grafton, R. Q., & Ward, M. B. (2008). Prices versus rationing: Marshallian surplus and mandatory water restrictions. *Economic Record*, 84, S57-S65. There are number of other estimates of the costs of restrictions. See for example, Cooper, B., Burton, M. & Crase, L. Willingness to Pay to Avoid Water Restrictions in Australia Under a Changing Climate. *Environ Resource Econ* 72, 823–847 (2019). https://doi.org/10.1007/s10640-018-0228-x

[17] Solomon, S., & Abelson, J. (2012). *Why and When Should We Use Public Deliberation?* The Hastings Center Report, 42(2), 17–20. https://doi.org/10.1002/hast.27

costs of disruptions, how the utility manages the impact to customers and how the utility's response is perceived.

From a review and challenge perspective, customers and their representative customer challenge panels may rightly question how the utility has determined the level of investment in leak prevention. From a stakeholder management perspective, utilities might find that the customers want transparency over how the investment is determined, the opportunity to express their concerns, and comfort that the optimal level is being selected.

Such engagement planning is not necessarily hard, but it requires rigour and discipline to ensure the engagement is fit-for-purpose. It involves utilities investing more in analysing topics, identifying the outcomes that customers understand and care about (and what they don't), and determining how to engage with customers on these topics.

This may drive changes in what, and how, topics are discussed. There would be greater focus on engaging on outcomes that directly affect customers (such as disruptions) and less focus on engaging on activities (e.g., cyber security investment). There would also be greater focus on identifying those who can provide an informed opinion; for example, customers who have experienced disruptions are better targets to provide an informed view on the impact of a disruption. If pricing reform is to be considered, it will be necessary to have deeper and more meaningful engagement on what is fair and acceptable change.

However, engagement with those insufficiently informed on topics of interest may be a symptom of a deeper and more significant issue. In some cases, (as Ofwat found) customer engagement may be displacing more rigorous analysis of proposed investments. That is, because utilities can gain support from customers who aren't sufficiently informed on a topic, the appropriate analysis is not being undertaken, with the ensuing risk that investments are proceeding that are not in the customer interest.

Such a problem might be addressed by stronger guidance and oversight by economic regulators. Customer challenge panels might also play a stronger role in questioning the customer research put before them. More attention could be paid to defining the purpose of each engagement. Ironically, a simple starting point might be to ensure that the key stakeholders (regulators, utilities, and customer challenge panels) are better informed about the problem of uninformed response bias.