Chapter 13

Retail Controls

Summary

This chapter brings together the retail elements of the business plan. It sets out our retail strategy for AMP7 (part of which is also explained in Chapters 8 and 9), the promises we are making to customers about retail services, and how we will deliver these at an efficient level of cost.

We have engaged customers to understand their views and priorities on retail services. We have also reflected on our past performance, scrutinised our costs, and benchmarked our performance against the best performers in the water sector and across a range of industries.

Working with our customers, we have redesigned our customer experience propositions and performance commitments (PCs) for AMP7. In addition to the Customer Measure of Experience[1] (C-MeX), we have set stretching PC targets in other areas supported by our customers.

Our new AMP7 retail delivery model will help reduce costs and deliver above average industry performance for C-MeX. We will do this by working with expert service partners to improve the level and consistency of customer service and increase operational efficiency. This will be a significant challenge, but, based on improvements in AMP6, we are confident that we can achieve this.

In AMP6 we have focused on improving our internal processes and our service when customers need to make direct contact with us, fixing the basics on our way to becoming ***brilliant at the basics***.

In AMP6 we improved our Service Incentive Mechanism[2] (SIM) score each year and are now closer to the water sector average. We increased our UK Customer Satisfaction Index[3] (UKCSI) score by 6% in 2016/17, the largest increase in the sector. However we recognise that, historically, we have been among the lowest performers in the industry on SIM and that we have more to do to improve our performance. (See Chapter 9 Great Customer Service.)

Chapter headlines at a glance

We want our customers to benefit from a refreshingly easy customer experience

In AMP7, we are committing to ensuring that our customers will find us easy to deal with, they will be able to contact us through channels of their choice and they will experience a consistent, supportive and inclusive service.

Our customers, regulator and stakeholders expect us to further improve our service while reducing costs

We have improved our understanding of our customers and the way their expectations are changing, driven by evolving needs and their experience of other service industries. Our customers want a simple and easy service, at a cost that is affordable.

Starting now in AMP6 and continuing through AMP7, we have jointly created with customers five propositions that will significantly improve the experience that they receive:

1. **Reach & Support**: a cross-regional, partnership approach to supporting customers in vulnerable circumstances (See Chapter 8 Helping Customers who need our Support.)
2. **Make it Count:** improves the overall service delivery, focussing on the customer experience in every interaction, speed of resolution and proactivity of keeping our customers informed
3. **Solutions:** provides a tailored service to our customers' individual needs and preferences, offering choice about how they receive and interact with our services
4. **Spring:** builds on offering better information and advice to our customers and new products and services to give them more control of their water usage
5. **Valuing Water*:*** a community outreach and investment proposition centred on redefining the value of water across the South East.

We have listened to our customers and redesigned our PCs focusing on the things that are important to them

We have developed a more focused set of AMP7 PCs which are supported by customers. These have stretching targets to hold us accountable for delivering on our promises. For example our commitment to supporting customers requiring financial assistance will see at least 90% of customers receiving assistance continue to maintain a payment arrangement with us.

Our retail operations have improved during AMP6 and we aim to reach the efficient frontier level of cost in AMP7

In 2017/18 we reduced our retail cost base by 11%, largely driven by a £14 million reduction in bad debt as we implemented our debt management improvement plan, which focused on tailoring our collection journeys for customers and proactive debt advice. We forecast approximately 19% and 11% cost reductions in 2018/19 and 2019/20 respectively as we benefit from our retail transformation programme.

We expect efficient costs for AMP7 to be between £225 million and £239 million, a £30-44 million reduction from our PR14-funded allowance and a £123-137 million reduction on our forecast AMP6 retail cost. We have faced a significant cost challenge in AMP6 and are acting now to deliver at the efficient frontier level of cost in AMP7.

Through working closely with our expert customer service and debt management partners we will transform our retail delivery model so we can achieve an efficient level of cost and still deliver our strategy. We expect to reduce our total AMP6 retail cost by 34% in AMP7 and deliver more for customers, at a lower cost.

We are not submitting any cost adjustment claims for retail costs. We propose to accept an unchanged net retail margin of 1%.

13.1 Key metrics of our retail plan

Table 1: Key metrics to consider for this chapter

Key cost metric	£m, outturn	£				
PR14 funded retail allowance	AMP6 total	£269m				
AMP6 forecast retail cost	AMP6 total	£362m				
Our PR19 efficient cost frontier view	AMP7 total	£225m – 239m (includes legacy AMP5 depreciation)				
PR19 retail cost proposal	AMP7 total	£221m (£238m is the total AMP7 retail cost including depreciation)				
	£ per customer	£				
AMP7 cost-to-serve	Average AMP7 – not adjusted for economies of scope (EoS)	£23.6				
Retail customer numbers	# customers	15/16	16/17	17/18	18/19	19/20
PR14 FD household (HH) customers	Millions	1.886	1.901	1.917	1.933	1.948
PR14 actual and forecast HH	Millions	1.882	1.895	1.905	1.920	1.944
		20/21	21/22	22/23	23/24	24/25
PR19 forecast HH	Millions	1.972	1.998	2.021	2.044	2.066
PR19 forecast non-HH	Southern Water does not operate a non-HH retail business	-	-	-	-	-

13.2 We have listened to our customers and they have been clear about what retail service they expect

We have undertaken a comprehensive programme of customer engagement to shape our retail outcomes, PCs, incentives and delivery plan.
(See Chapter 4 Customer and Stakeholder Engagement and Participation and TA.4.1.)

Triangulation of customer engagement findings tell us that customer service should be one of our highest priorities. Customers value operational service delivery (water and wastewater services) highest and expect this to be our main focus, minimising issues and disruptions. Customers do not expect us to put significant investment into innovations found in other retail sectors and instead expect a high standard of basic service.

Operational contact

When or if there are interruptions to supply, customers want us to:

- **proactively identify issues** – before they arise
- **respond with a quick and efficient solution** – 75% of customers felt that dealing with problems quickly and efficiently was essential for delivering great customer service
- **be easy to deal with** – 79% and 86% of customers found it easy to resolve their water and wastewater issues respectively
- **communicate clearly and proactively** – only 53% of non-contact customers were satisfied with general local service updates.

Retail contact

In addition to the above, customers want us to:

- **provide simple to understand bills** – 52% of customers believed providing simple to understand bills was essential for delivering great customer service
- **help them use water wisely** – to keep costs low and ensure bills are affordable – only 53% of surveyed customers felt we met their expectations
- be contactable through a **channel of their choice**
- **provide tailored and personalised** information and service
- **resolve queries quickly** – we have failed to meet 25% of our customers' expectations, mainly around speed with which we resolve queries
- **keep our promises** – 18% of customers say we haven't kept our promises.

Customers requiring additional help and support

71% of customers on our Priority Services Register felt the support we provide satisfied their requirements. Our wider customer base have told us they are willing to pay an additional £4 on top of the current £2 bill increment to help to provide a social tariff for customers who struggle to pay their bills[4].

(For more information, see Chapters 4 Customer and Stakeholder Engagement and Participation and 8 Helping Customers who need our support.)

Cross-sector analysis

We have learnt from good practice in other sectors such as financial services, telco, energy and other retailers. There are six customer needs and expectations that consistently feature in cross-sector (retail) research that can be readily applied to the water sector. Specifically, customers want:

- to be empowered to control and be informed on the service they are receiving
- transparency in complaints handling
- clear bills
- promises made to be delivered
- speedy responses
- a service that is personal to them.

13.3 Our retail performance has been mixed in AMP6 so far but we are improving

PR14 retail PCs

Nine retail PCs were set at PR14 and performance against these to date has been mixed.

Table 2 below summarises performance to date and forecast performance to the end of the AMP against the targets set out in our PR14 final determination. The table also shows where further detail on past performance can be found in this Business Plan. These areas of the Plan include analysis on key learnings, what we are doing to improve from now until the end of AMP6 and how the PR14 PCs and our performance against them is important in formulating our AMP7 plans.

Table 2: Performance against our PR14 performance commitments

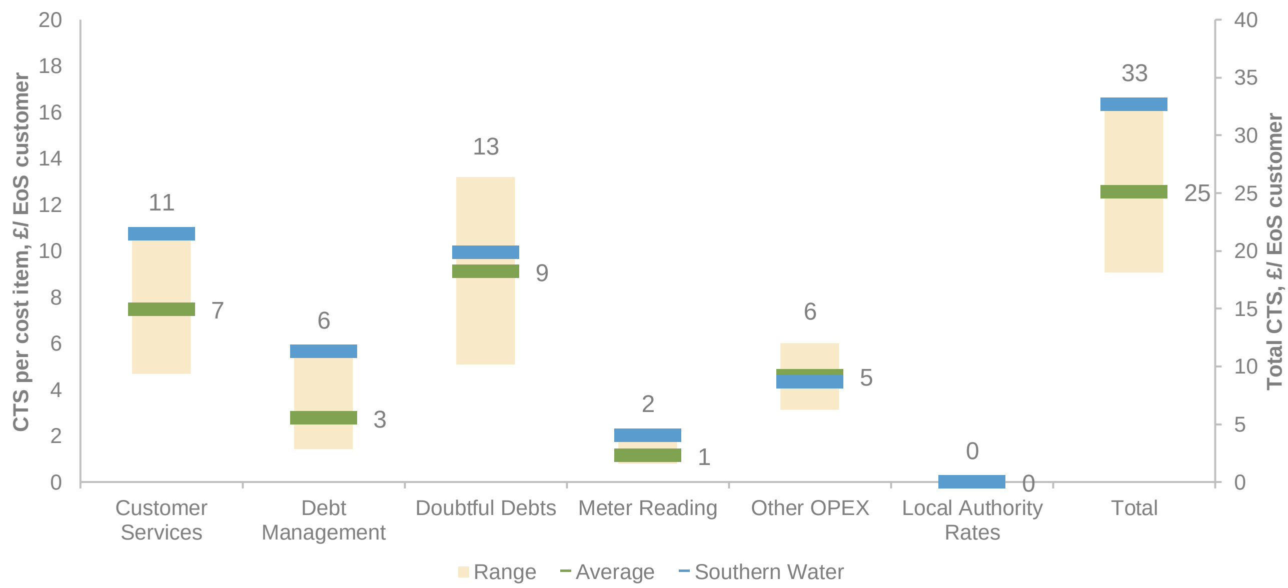
Performance commitment	Target 2017/18	Actual 2017/18	Target 2019/20	Forecast 2019/20	For further detail and analysis see
Service Incentive Mechanism (SIM) (out of 100). As per Ofwat's PR14 guidance.	n/a	79.3	2018/19 79.3	2018/19 81	
Billing queries. Number of customer queries related to the understanding of their bills.	49,000	181,361	25,000	151,200	Chapter 9, Chapter 17, and TA 17.1
First Contact Resolution (FCR, %). The proportion of customer contacts resolved first time.	81%	67%	81%	69%	
Take-up of assistance schemes. The number of customers who are receiving support through one of our financial assistance schemes.	172,300	229,843	217,100	260,000	
Value for money (%). The proportion of customers who feel they get value for money from our services.	61%	55%	61%	57%	Chapter 8, Chapter 17, and TA 17.1
Meeting individual and community needs (%). The proportion of customers agreeing with the statement that we "dealt with their individual needs and those of their community".	76%	64%	76%	66%	
Where your money goes (%). The percentage of customers with awareness of "where your money goes".	60%	56%	60%	59%	Chapter 17, and TA 17.1
Awareness of water hardness measures (%). The percentage of customers with awareness of how to deal with hard water.	57%	55%	57%	57%	

Comparison with our peers

The cost trajectory is improving across our retail activities, but we recognise that our historic and current cost-to-serve is too high relative to our peers.

Figure 1 below shows our 2017/18 operating costs compared to other water and sewerage companies (WASCs). We have the highest total cost to serve per economies of scope (EoS)-adjusted customers among WASCs. We also have the highest debt management, customer services and meter reading costs compared to the industry. Our doubtful debt and other Opex performance is broadly in line with the WASC average.

Figure 1: 2017/18 Operating cost data benchmarking vs other WASCs [£/EoS customer][5]

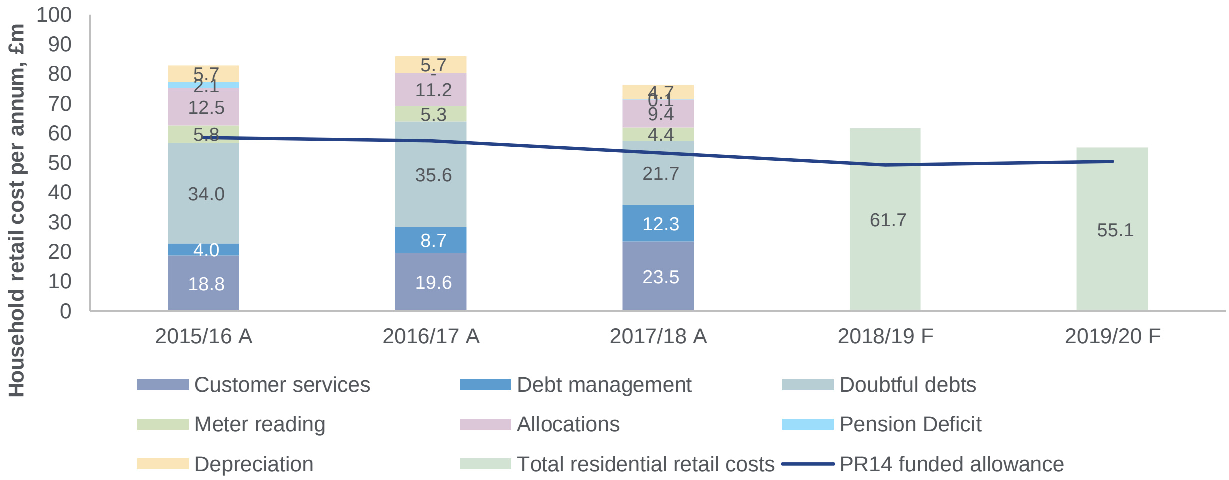


Overall AMP6 retail cost performance and retail transformation programme

In October 2016 we launched a retail transformation programme, focused on fixing the basics for our customers, becoming more efficient and increasing operational performance. The programme is delivering improved operational performance and efficiency across all our retail activities.

The transformation programme involves some spending now, which will result in savings later. As seen in figure 2 below, total costs increased by £2.9 million in 2016/17 (compared to 2015/16) as a result of the programme. Despite continuing the spend programme in 2017/18, total costs reduced by £6.9 million (compared to 2015/16). We expect further £14.5 million and £6.6 million savings in 2018/19 and 2019/20 as the changes mature. We also expect to realise additional benefits in 2018/19 and 2019/20 from the changes we are making to our retail delivery model.
(See 13.6 Delivery, below.)

Figure 2: AMP6 cost performance compared to PR14-funded allowance[6]



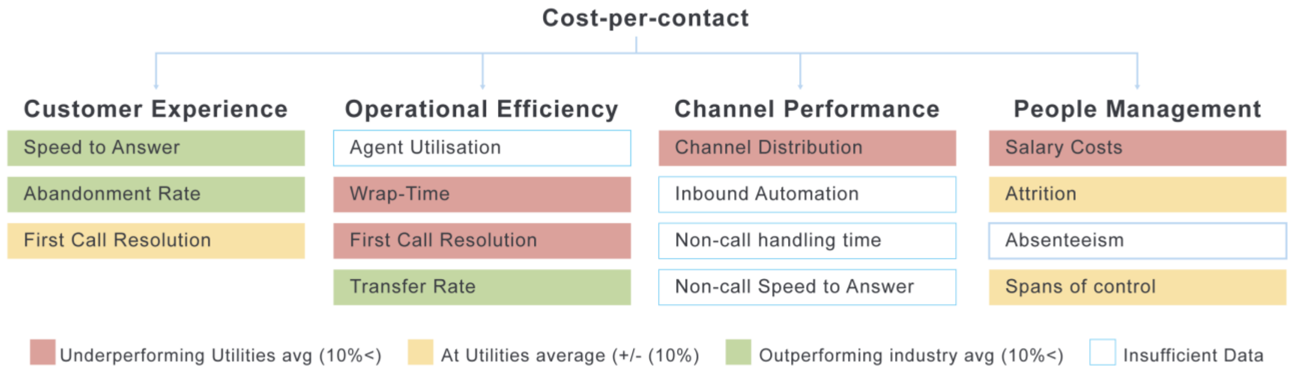
Customer services costs and cost review

We understand our cost drivers and have implemented changes to reduce them. This is leading to improvements and we are confident that costs will reduce in the future.

On an adjusted customer basis, our customer service costs were 31% higher than the industry average in the first year of AMP6. These costs have increased since then, from a total of £18.8 million in 2015/16 to £23.5 million in 2017/18. This increase has been driven by the transformation costs noted above.

Figure 3 below summarises our benchmarked cost-per-contact against the water sector and other sectors. From this, we see how we compare to other sectors on key drivers of cost to enable us to focus on operational improvements and ultimately reduce our customer service cost.

Figure 3: 2016/17 Cost-per-contact benchmarking to shape our retail transformation programme



(Source: internal analysis)

From our internal cost review and cross-sector benchmarking, we consider that the following factors have contributed to higher costs:

- **inbound contact:** we had a high volume of inbound calls. They have mostly been driven by complaints and unwanted billing queries
- **operational efficiency:** our wrap-time (the time taken to close the customer contact after the call is finished) and average handling time were significant drivers of higher cost-per-contact. Our calls lasted approximately 2.5 minutes longer than industry average, and a disproportionate amount of this call was spent on wrap-time (42%)
- **channel maturity:** our customer contact channels offering lagged behind other industries, with online adoption being low and more expensive contact methods being used, such as phone contacts
- **current delivery model:** we operated with multiple service providers, contributing to a higher number of hand-offs, increased labour costs and overheads.

Our customer service cost review helped shape and prioritise activities within our retail transformation programme. Cost reduction activities that have been implemented include:

- a **new retail operating model** with more specialist and skilled teams to resolve issues more quickly (for key customer journeys, such as home moves, complaints, operational contacts), with improved service and fewer hand-offs between teams
- **joint billing** for around 500,000 customers, working with South East Water, to drive operational efficiencies and provide customers with a single bill for water and wastewater
- improvements in our **digital services**, by expanding our online portal and delivering our service at a lower cost where customers choose to interact with us through digital channels
- moving from four service providers to a **single customer services delivery partner**.

We also expect to see the cost benefits from our customer service delivery model transformation as we prepare for the cost-efficiency challenge in AMP7. (See 13.6 below.)

The R1 data table shows the significant customer service cost benefits we expect in the final two years of AMP6, driven by these changes.

Doubtful debt and debt management cost review and cost drivers

In the first year of AMP6, our doubtful debt costs were 99% higher than the industry average on a per-customer basis. These costs represented more than 50% of the difference between our overall cost-to-serve and industry average in 2015/16. Our debt management costs were 9% below industry average.

We analysed and benchmarked our debt management practices and identified that the following drivers contributed to our high level of doubtful debt[7]:

- debt management operations were fragmented across both in-house and outsourced providers, which resulted in duplicated effort
- reliance on multiple debt collection agencies (DCAs) that were not delivering a consistent customer experience, resulting in higher costs
- limited investment in debt management capabilities from 2012 through to 2017, resulting in below-maximum industry debt management costs, but the highest level of doubtful debt
- payment systems and processes were not of the highest standard, resulting in an inability to capitalise on the benefit of tailored collections on doubtful debt
- propositions were not tailored to customers' needs and as a result we were not applying the best processes to recover customer debt
- internal KPIs were not driving the right behaviours – they were focused on the volumes and call-related metrics, as opposed to outcomes for customers
- credible consequences were not in place for customers who could afford to pay but chose not to and were disengaged from the payment process.

Doubtful debt and debt management AMP6 changes to improve cost performance

We have significantly improved our debt management practices by implementing a number of initiatives. These initiatives, set out in table 3 below with their mapping to Ofwat's view of best practice, have helped reduce doubtful debts by 39% in 2017/18.

Table 3: Best practice debt management programmes commenced during AMP6

Ofwat best practice guide	AMP6 initiatives (commenced or fully implemented)
Move to more frequent or even advance billing.	**Increased the frequency of our bills, tailored to customers' needs:** ▪ Piloting our new Discount Framework, with bill reductions to customers who use self-service channels ▪ Introduced tailored billing which enables improved rates of collection and faster detection of non-payment, and prevents issuing of infrequent large bills beyond levels of affordability. Proactively **identify incorrect billing and nullify the associated debt.**
Proactively manage customer data.	Started to use demographic data to develop **behavioural segmentation of customers**. This enables us proactively to identify customers who are entitled to extra support and deliver more effective management of their payments. Established a more **robust process for managing change of occupancy** to increase the recovery rate of former debt.
Tailored collections paths leveraging customer segmentation and behavioural economics principles.	**More targeted use of litigation for delinquent debtors** that are employed or who have assets, such as homeowners. **Introduced targeted outbound campaigns** to improve collection rates and reduce the value of debt that ultimately becomes delinquent. **Improved collections rate** by tailoring the content, communication method and timing of recovery activity.
Improve the availability of affordability schemes and increase take up.	**Proactive identification and contact to offer financial support and debt advice** to increase payment potential. (See Chapter 8.) **Proactively contact customers if their bills are above a defined range** to pre-emptively resolve issues.
Provide real consequences to address payment avoidance.	Delivery of a **step change in litigation processes** where other collection options are exhausted.
Other.	**Debt Collection Agency (DCA) contract model consolidation** - reducing the number of DCAs and implementing new collection strategies to incentivise performance and customer behaviours.

We also expect to see the cost benefits from our debt management delivery model transformation as we prepare for the cost-efficiency challenge in AMP7. This transformation will accelerate the implementation of debt management initiatives as we set out to exceed Ofwat's guidelines on best practice. (See 13.6 below.)

Meter reading costs review and cost drivers

In the first year of AMP6, meter reading costs were 121% above industry average on a per customer basis.

This was due to several factors, including:

- higher than average meter penetration. In AMP5, our Universal Metering Programme targeted a significant increase in water meter installations in approximately 90% of our unmetered portfolio in our supply area. This significantly increased the proportion of metered customers by 2017.

- the independent and non-aligned operation of Visual Meter Readings (VMR) and Automatic Meter Readings (AMR) assets. Our VMR (35% of all devices) service was carried out by our meter reading partner, and AMR (65%) was operated internally. Meters were originally operating on different management platforms, duplicating costs and creating inefficiencies
- legacy contract pricing associated with our VMR portfolio.

Meter reading AMP6 changes to improve cost performance

During AMP6 we have implemented a series of initiatives to reduce our annual meter reading costs by £1.4 million in 2017/18 compared to 2015/16. We expect the full effect to be realised by 2019/20 saving an additional £1.0 million per year compared to the 2017/18 level.

These initiatives include:

- re-tendering our meter reading services to reflect the change in our VMR portfolio
- combining operations and management platforms of our VMR and AMR portfolios
- joint billing with South East Water covering meter readings for around 500,000 Southern Water customers in overlapping operating areas, reducing our overall meter reading and data costs.

13.4 External factors have influenced our AMP7 plan

Beyond the need to respond to our historical performance on retail cost and service, there are other external factors that have influenced our AMP7 plans. The summary areas are noted below, with more detail provided in Chapter 9 Great Customer Service.

Learning from the opening of the non-household retail market to make our retail services resilient

There were over 156,000[8] supply point switches in England and Wales since the market opened (~5.8% of the market). While it is early days, we are starting to better understand, through switching data, industry reports and talking to industry participants, how business customers make choices about their retailer.

There is evidence that their decisions are driven by the opportunity to:

- reduce tariffs
- consolidate multi-site billing
- take advantage of flexible payment options
- secure assistance with water efficiency measures.

We have used this intelligence to shape our delivery plan so that our retail offering is resilient to changes, such as competition in the non-household market. This information is consistent with what we have learned from our customer engagement and have taken into account for our household service, described in section 13.6 below.

Emerging technologies are continuing to transform the expectations of our customers across industries

Emerging technologies are impacting customers' expectations about how products and services are delivered. Digital interactions are increasingly important to our customers, and website and online communication channels are essential supplements to other customer service options. There are also opportunities to use big data analytics to create a more accurate picture of customer needs and desires, more personalised services, and proactive customer engagement.

13.5 Our AMP7 goal is to deliver a significantly improved experience for our customers at an efficient level of cost

We have drawn on the insight gained from customers through our operations and our PR19 customer engagement research, past performance, as well as external drivers of change.

To achieve this goal, we will:

- Improve service for customers: in AMP7, we aim to deliver an experience that is refreshingly easy. Driven by findings from our engagement with customers, this means customers will;
  - find us easy to deal with
  - be able to contact us through channels of their choice
  - receive clear and proactive communication
  - be made aware of problems before they arise
  - receive speedy and efficient resolutions to issues
  - be billed accurately, with simple billing at a frequency of their choice
  - be empowered to control the service they receive.

- Provide more support for customers who need additional help: customers will receive a service that is accessible and inclusive. We are transforming the support we provide to customers in vulnerable circumstances, including those who move in and out of vulnerable situations and those who struggle to pay their bills. We aim to deliver support that is tailored to the needs of individual customers and achieve consistency in support across our region. Customers are willing to pay a total of £6 over a 12 month period on their dual service bills for us to provide a bespoke social tariff, and we will work with expert partners to deliver this and our wider support.

- deliver at an efficient level of cost: our goal is to deliver our retail plan at a cost which is within our range for the efficient frontier (see section 13.7 below). This represents an ambitious yet achievable 34% reduction in total cost from AMP6 and builds on the significant improvements to our cost-to-serve that have already commenced in AMP6.

Performance Commitments

We have developed five stretching PCs to be accountable for delivering our AMP7 goal.

These stretching and ambitious PCs for AMP7 are outlined in Table 4 below. They are aligned to our customers' priorities and reflect a greater level of maturity in our understanding of our customers' views and of the underlying drivers of our business performance. Further detail on these commitments is included in this table and in the chapters of this Business Plan referred to in the right hand column.

Table 4: AMP7 PCs to measure delivery of our retail plan

Performance commitment	Description	Target by 2025	Delivery incentive	Chapter(s) for further PC detail
C-MeX.	Ofwat defined. (See also the paragraph below this table.)	Above industry average by the end of AMP7	Financial	Chapters 6 and 9
Effectiveness of financial assistance interventions.	Proportion of customers that pay their bills following the receipt of financial assistance.	90%	Reputational	Chapters 6 and 8
Customer satisfaction with vulnerability support.	Proportion of customers that have received non-financial support that believe Southern Water addresses their specific requirements and needs.	90%	Reputational	Chapters 6 and 8
Void properties.	Number of household properties that are classified as void, and are therefore not billed, as a percentage of total household connected properties.	2.1%	Financial	Chapter 6 and section 13.6 below
Gap sites.	Monitoring of success of tackling household gap sites.	1.25% annual improvement from 2nd year of AMP.	Financial	Chapter 6 and section 13.6 below

Ofwat commissioned a C-MeX pilot in July 2018. On average, we ranked 15th (out of 17) in the industry across the scales used when combining customer service and customer experience with equal weighting. It will therefore be a challenge to improve to reach the average. However, we are confident in our customer-driven delivery propositions and seek to achieve above-average industry performance in C-MeX by the end of AMP7.

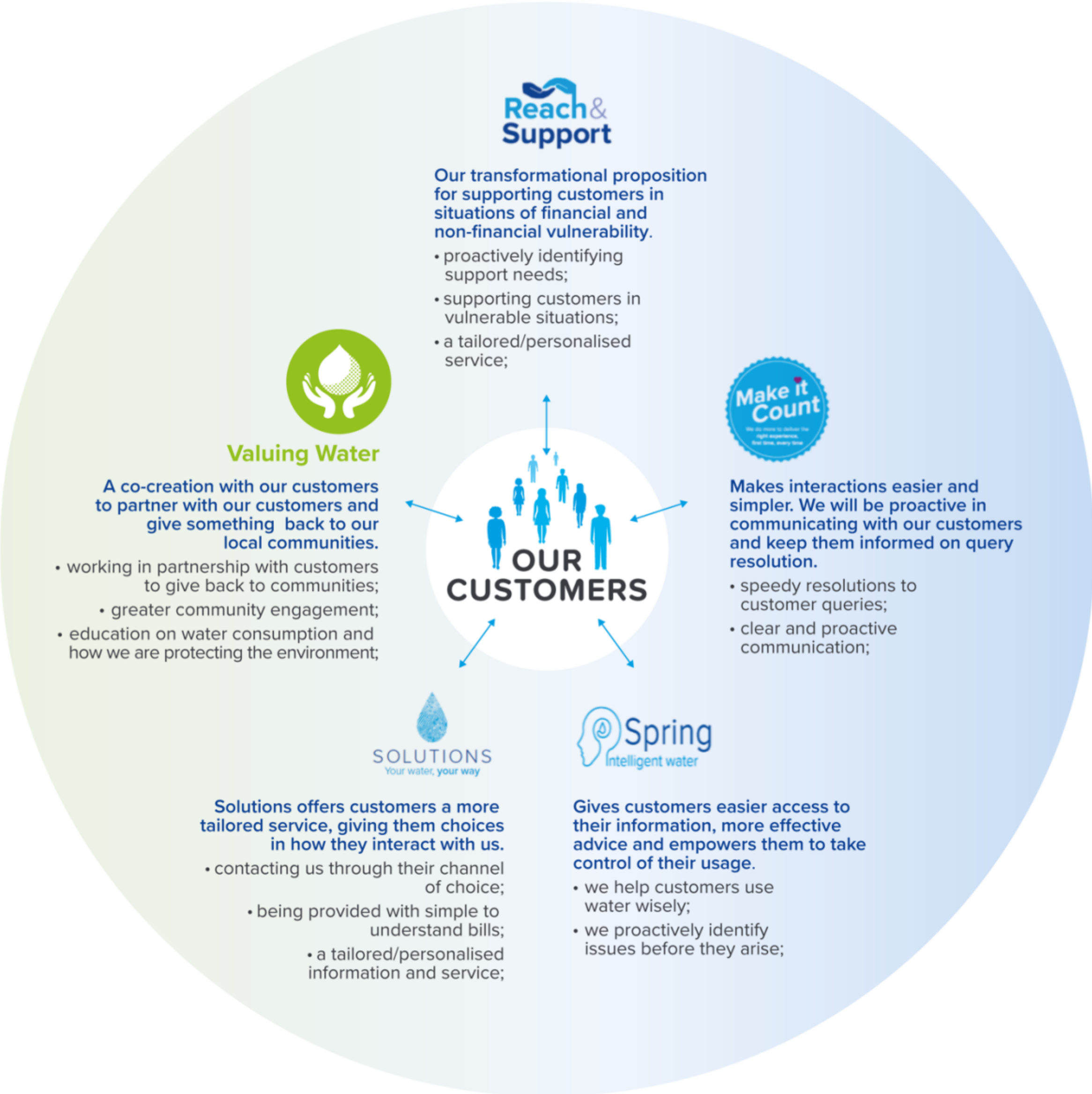
13.6 We will deliver a refreshingly easy customer experience for retail services

We are already starting to deliver retail propositions in AMP6 to prepare for AMP7. Much of the cost and benefit associated with delivery is being secured in the remaining two years of AMP6 with performance continually improving during AMP7.

Customer experience propositions for AMP7

We will deliver what our customers have told us they want and need through the five customer experience propositions set out in the diagram below.

Figure 4: Our five customer experience propositions



(For more detail see Chapter 9 Great Customer Service and TA 9.1)

New customer service delivery model

Evaluation of a new delivery model

Meeting the cost challenge in AMP7 will require more than incremental business improvement. We therefore identified and evaluated a number of alternative transformational retail models with the potential to enable delivery of our plan within our estimated efficient frontier range.

The alternative models analysed were:

1. Work closely with delivery partners across our retail activities
2. Develop our internal capabilities to deliver retail services ourselves
3. Work with a service delivery partner across retail activities.

Evaluation showed that the first option, namely, working more closely with delivery partners, is the best solution. This will allow us to retain control over the customer experience, be ***brilliant at the basics***, and will drive the largest step change in cost over AMP6 and AMP7.

There are a number of reasons why proactively engaging with our customer service and debt management delivery partners will enable multiple customer and cost benefits. These include:

- using economies of scale to reduce our delivery cost
- greater control of delivery activities through a single provider
- improved and more consistent training for all customer service agents
- providing a consistent and complete customer experience across all customer journeys
- leveraging our partners' cross-sector expertise, knowledge and process efficiency to drive cost-to-serve and customer experience benefits
- engaging with mutually-beneficial contractual arrangements to incentivise the right behaviours that increase customer satisfaction and reduce volumes
- maintaining operational agility to adapt to changes in consumer behaviour and preferences.

We are developing new capability in supplier and partnership management, quality and customer experience to ensure that our delivery partners have shared goals and incentive models to deliver a complete experience for our customers at an efficient level of cost.

Key aspects of the new model

The largest cost benefits of our new retail delivery model will be in **customer services**, **debt management** and **doubtful debt**. We are also exploring initiatives to **reduce meter reading costs**. These are explained below.

Customer services: consolidating customer service supply chain

We are consolidating a number of customer service activities which have historically been managed by four service providers, by moving to a single service provider from 2018/19. In this model, we are retaining the key customer journeys (home move, complaints and operational contacts) that make the biggest impact to customer experience. Our partner already provides services to companies ranked within the top 30 in the Institute for Customer Services (ICS) league table[9] and is commercially incentivised to provide stretching levels of customer performance.

Consolidating and re-incentivising our supply chain will accelerate the realisation of benefits from our retail transformation programme.

Our analysis has highlighted £13-16 million of customer service cost savings across AMP7 by achieving the following operational Key Performance Indicators, in which we will:

- increase First Contact Resolution (FCR) to upper quartile utilities performance
- reduce Average Handling Time (AHT) to the utilities average
- reduce our transfer rates to the public sector average
- achieve 70% digital transaction rate by 2025.

Given our delivery model transformation and continuation of process efficiencies we are confident we can reduce our total customer service costs by £20.0 million over AMP7 to take costs to an efficient level.

Customer services: combining operational and billing contact centres

We have consolidated our operational and billing contact centres to create a single centre of excellence for customer services. This is expected to realise £0.6 million in savings per year from 2018/19, by reducing facilities and operations costs, as well as reducing hand-offs between teams, thereby improving the customer experience. Combining operational and billing contact centres will also contribute to accelerating the operational benefits of our retail transformation programme.

Improving debt management

The past performance section (13.3 above) outlines a number of debt management improvements that were implemented in AMP6, resulting in an £8.4 million increase in debt management cost and a £12.3 million decrease in doubtful debts since 2015/16. However, we still have one of the highest levels of doubtful debt in the industry and this is a key area for accelerated improvement.
We are continuing to shape our debt management practices through the remainder of AMP6 and into AMP7 as customer behaviours change and existing programmes are refined and mature.

We will build on our AMP6 transformation to deliver best practice debt management, and reduce our doubtful debt charge to 1.2% of revenue by 2024/25, which will result in a c.£67.3 million cost reduction across AMP7 compared to AMP6, continuing the realised benefits in 2017/18. To do this, we are transforming the activities delivered through our debt management delivery partners from 2018. Through this model we are targeting WASC upper quartile debt management to doubtful debt performance by 2020/21, delivering a c.£16.2 million saving across AMP7. (See TA 13.1.)

We expect to benefit from working with our partners who have cross-sector expertise, mature systems and insight, which will enable us to improve our own debt management capabilities. We will gain better data and analytical capabilities and efficiently implement tailored collections journeys to target doubtful debt performance comparable with other sectors, adjusted to account for different requirements to continue delivering services for non-paying customers. (See TA 13.1.)

Table 5 below outlines additional programmes (beyond those listed in table 3 in section 13.3 above) that we are implementing in the remainder of AMP6 and moving into AMP7. This will help us to exceed Ofwat's best practice guidelines and allow us to meet both customers' needs and the ambitious debt management and doubtful debt targets explained above, from the beginning of AMP7.

Table 5: Continuing delivery of best practice debt management programmes[10]

Ofwat key area	AMP6 and AMP7 debt management programmes
Move to more frequent or even advance billing.	As well as the tailored billing initiative, we will jointly create new billing models with customers.
Proactively-manage customer data.	**Improve tracking of homeowners who move and have not paid off their debt** through enhanced analytics. Identify unidentified 'move outs' among **customers that have not made a payment in recent years** to facilitate re-engagement. **Nullify debt through gap site[11] and void[12] identification.** As set out below and in TA 13.2, we will improve our gap site and void identification to calculate debt more accurately. **Reduce the threshold where high consumption bills are reviewed,** to enable early identification of leakage and early engagement of those with genuinely high consumption charges. Offer **greater flexibility on payment dates, proactively engage and communicate** with customers whose direct debit (DD) fail. Fewer customers will fall off DD, and greater flexibility regarding missed instalments will result in higher penetration and recovery. **Further improve former debt matching through improved data capture** and refine the debt- matching algorithm.
Tailored collections paths leveraging customer segmentation and behavioural economics principles.	**Pilot a new tariff for customers in arrears.** Pilot an Engage Tarff which offers a 20%, time-limited discount to those disengaged customers who re-engage. We expect this to encourage payments, prevent doubtful debt and result in continued re-engagement. **Continue to improve campaign management activity** using segmentation and behavioural analysis to prevent debt and encourage prompt payment.
Improve the availability of	**Review payment plans that are below customers' affordability** to identify opportunities to increase instalment amounts for customers that have the financial means to do so.

affordability schemes and increase take up.	See Chapter 8 for a description of the support we provide to customers who struggle to pay in the short and long term.
Provide real consequence to address payment avoidance.	**Full consumer credit information sharing for our customers.** This will provide payment incentives though late payment credit rating penalties.
Increase the level of customer prepayments.	Undertake a feasibility study to determine if billing new customers in advance of consumption can be delivered fairly and cost effectively. This will seek to **further understand the effect of offering favourable deals or terms and conditions for prepayment.**
Enabling/ supporting activities	**Leverage technology** e-Billing in AMP6 produced benefits in billing and collections and reduced our costs. In AMP7, we will also leverage our technology and delivery partners' systems. We are developing our remote meter reading technology, enhancing our digital customer payment platforms to support pull payments, and optimising the use of automated digital notifications around payments. **Data enhancement** Building on our data cleanse, capture and validation processes from AMP6, we are continuing to develop our data capabilities, using Credit Rating Agency (CRA) data and better engagement with customers to deliver further improvements to data quality. **Our enhanced data strategy will enable other debt management activities** set out elsewhere in this table, such as segmentation, tailored collections, former debt matching, recovery strategies, debt sale and affordability. **Debt sale** We will initially look at the sale of non-performing former debtors who have now moved out of our area, as we consider these are the most straightforward ones to sell. Given the expected improvements in debt quality we expect that over time we will be able to demonstrate good data quality which will allow us to gradually increase the price we get for these assets.

Debt management: refining gap sites and voids strategy to improve revenue recovery and fairness

Being the wholesale provider for household (HH) and non-household customers (NHH), we have refined our gap sites and voids strategy to drive customer benefits such as:

- more accurate bills: as we identify more properties consuming water we will raise more bills that accurately reflect consumption, meaning wholesale revenues are collected from more properties, thus reducing bills for all bill-paying customers
- fairness: identifying and billing gap sites and void properties ensures everyone who consumes our services are billed accurately and fairly. Bill-paying customers will pay for their consumption only, without subsidising others.

(See TA.13.2)

Household and non-household gap sites

Operational processes and engagement with developers will be strengthened to place greater assurance and controls for the process of adding new properties to our systems, helping to minimise the risk of new gap sites occurring.

Existing gap sites will also be addressed by working with a third party provider to carry out an initial desktop data validation exercise to provide an indication of the number of addressable gap sites in our HH portfolio. Based on this we will conduct a pilot exercise to inform our future approach.

We have set a PC to monitor our success in tackling HH gap sites.

Household voids

We have set a PC to reduce our overall level of void properties to 2.1% of all HH connections by 2025. To deliver this, we will address existing incorrect voids and minimise new voids through three main activities:

- Further-aligning meter reading activity with visits to nearby void properties, thus minimising additional effort specific to voids and creating an effective and cost-efficient approach
- Working closer with water-only companies (WOCs) in our operating area and developing a data-sharing strategy to identify incorrect voids where there are discrepancies in occupancy status
- Improving processes around the 'Move In Move Out' (MIMO) stage of the customer journey to ensure identification and validation of customer data, better data capture, usage analysis and proof of ID for new customers.

Non-household voids

Although the primary responsibility to ensure NHH voids are correctly recorded is with the NHH retailer, we recognise that partnering with NHH retailers is in the best interests of our wholesale business and our HH customers. We piloted an approach in which a third-party service provider undertook a desktop exercise to identify incorrect voids. This pilot generated around £120,000 in additional revenue based on a cost of £10,000[13], with the result that we intend to roll this out through a regular audit of NHH voids, using a third party provider.

Meter reading efficiencies

While we have a market-tested, third-party contract delivering meter reading services, we will explore a number of initiatives to reduce our meter reading costs. We will explore opportunities to:

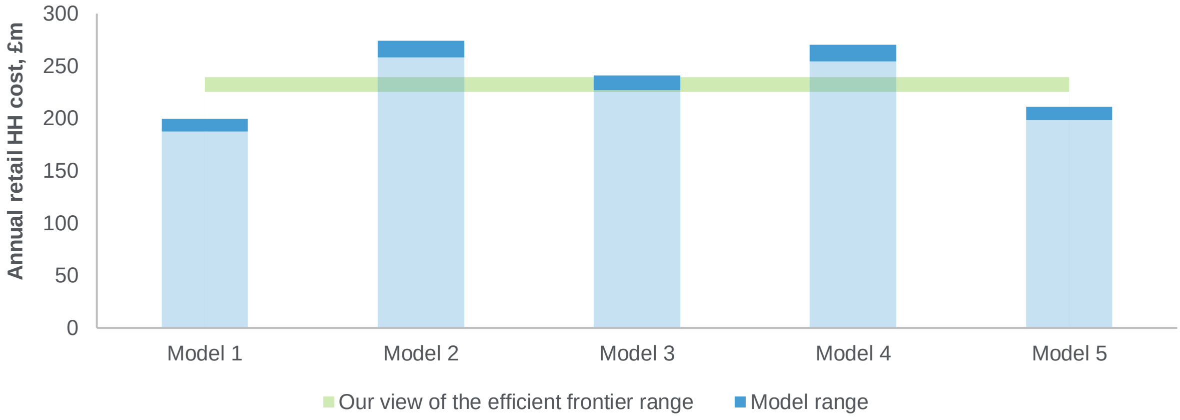
- partner with local councils to deliver some of our meter reading requirements for considerably less, and use the opportunity to engage more closely with local communities
- incentivise customers to self-read through our new customer discount model
- re-engage with WOCs, given the PR19 focus on efficient costs, to reduce the shared cost of meter reading based on their PR19 cost allowance.

13.7 Our plan delivers retail services for a cost within our efficient frontier range

Our view of the efficient frontier draws on a range of models. Figure 5 below specifies the output from these models. Models 1 and 5 are based on efficient cost-to-serve (ECTS) approaches. Models 2, 3 and 4 are based on econometric models specified by Ofwat and a range of companies as part of the modelling consultation.

In each case, we calculated a current efficient cost for retail services, and applied projections of potential future efficiency improvements to establish a view of the efficient frontier in AMP7. The dark blue boxes represent the efficient frontier range of each of the models. To form a consolidated view of the AMP7 efficient frontier, we used an averaging of the various models, shown in green below. The models include legacy AMP5 depreciation.

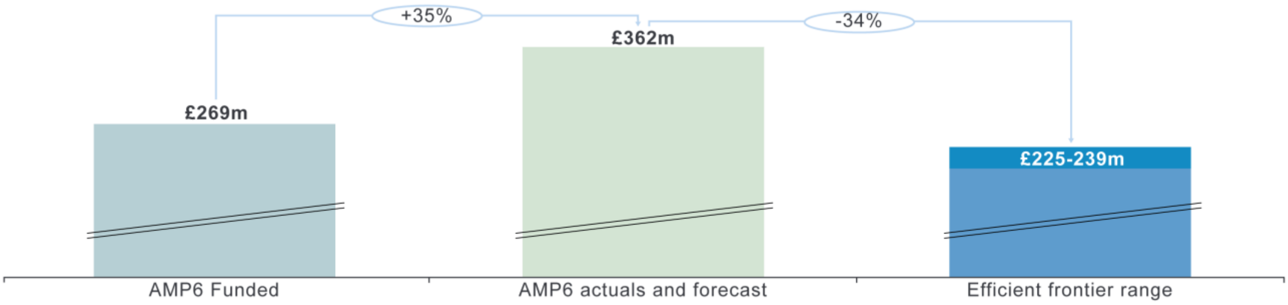
Figure 5: Output from the efficient cost analysis and our view on the efficient cost frontier range



We recognise that looking outside the water sector to form a view on the efficient frontier of cost is important. We have found that the provision of strong comparable cost data across a range of industries is difficult to rely upon and therefore have taken account of cross-sector operational metrics, for example digital sign-ups and average handling time, to drive our delivery plan for how we will reduce customer service cost. These operational metrics are discussed in section 13.3 above. Our cost proposal is set out later in this chapter.

It will be a significant challenge for us to meet the (estimated) efficient frontier. Figure 6 shows we are estimating a 34% gap between AMP6 actual cost and the top of the estimated AMP7 efficient frontier range. Our AMP7 plan delivers our retail services for a cost within our range of the efficient frontier, as explained in detail below.

Figure 6: AMP6-funded retail allowance, AMP6 actuals and forecast and efficient frontier range for AMP7



Our shareholders have funded c.£93.2 million of overspend through AMP6. But as already noted in section 13.3 above, this falls mainly in the first three years of AMP6 and our costs are on a downward trajectory.

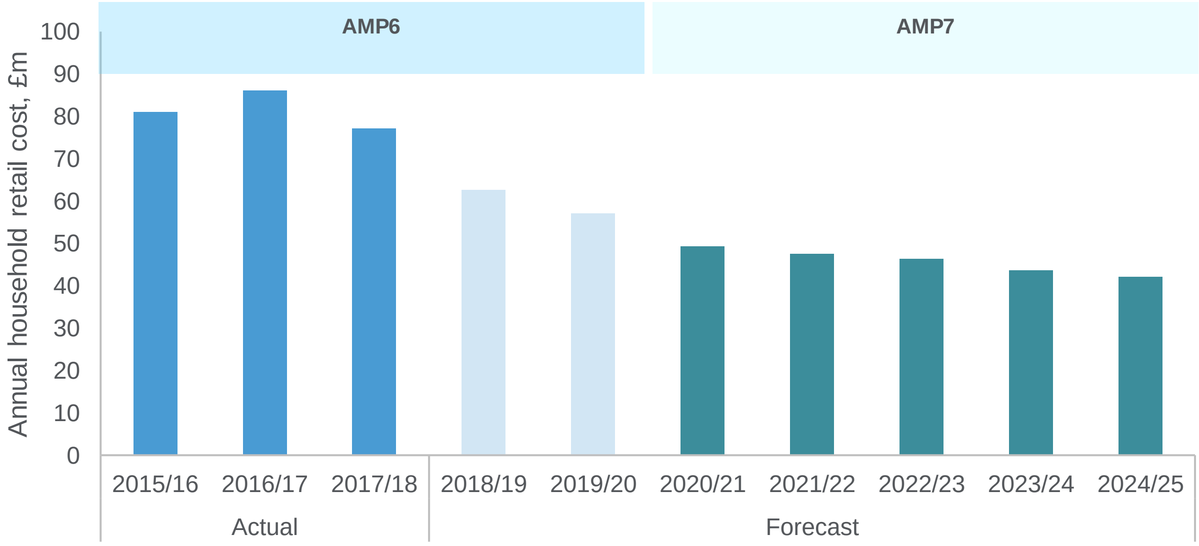
13.8 We are challenging ourselves to deliver retail services at a signficantly lower cost than before

Retail cost projection

Our PR19 retail cost projection is £220.8 million[14]. Consistent with Ofwat guidance, this excludes legacy depreciation which is funded through the wholesale price control. Overall, we are challenging ourselves to deliver retail services in AMP7 at a total cost of £237.9 million[15] including the legacy AMP5 depreciation. This is a £124.4 million decrease compared with AMP6 and falls within our efficient frontier range of £225-239 million, including legacy depreciation.

We are expecting the largest cost savings to be realised within customer services, debt management and doubtful debt – these will be the areas most affected by the change in delivery model. Figure 7 below sets out annual retail costs across AMP6 and AMP7. A full breakdown of costs is set out in the R1 data table.

Figure 7: AMP6 “run rate” and AMP7 retail cost projection



Our retail cost projection assumes we will be operating at an efficient level of cost from the start of AMP7. We are not assuming any glide path through AMP7. However, given the current position, doubtful debt will not be at an efficient level by the start of AMP7. Our annual costs in AMP7 reflect this by showing a declining level of doubtful debt and related debt management activities at a greater rate than efficiency gains alone.

Net retail margin

We propose a 1% net retail margin. All costs referred to in this chapter exclude the proposed net retail margin.

No retail cost adjustment claims

We do not propose any cost adjustment claims for retail costs in AMP7.

Cost allocation methodology

Our allocation methodology is consistent with Ofwat’s cost allocation methodology set out in “RAG 2.07 – Guideline for classification of costs across price controls”. Assurance over cost allocation has been provided by our auditors, Deloitte, as part of their review of financial data tables.

Depreciation costs – investments in digital and data capabilities

Our Capex spend and depreciation costs are increasing in AMP7 due to additional investment in digital and data to drive our retail strategy. These key investments aim to:

- build our digital capabilities to ensure a seamless and consistent customer experience across all channels of communication for all customers in all categories
- develop the functionality of our online portal to increase the range of transactions available on digital platforms and self-identification for additional support requirements
- improve data capture, storage, cleansing and analytical capabilities to drive forward our debt management strategy
- enhance CRM, interfacing and data sharing with our delivery partners
- upgrade our telephony system for greater volume as we share platforms with partners.

Our investment appraisal is built on maximising customer and cost benefit in AMP7. In line with customers' preferences, these investments do not constitute a net positive spend; rather, we are building capabilities to reduce cost, improve customer experience and reduce bills for customers. Legacy depreciation from a large AMP5 investment in an enterprise resource planning upgrade restricts our ability to reach WASC upper quartile performance for depreciation cost in AMP7.

13.9 Our retail plan is ambitious and our cost model has been independently assured

As part of our risk-based programme of assurance, Deloitte provided assurance over our retail cost model. No material exceptions were identified. Chapter 2 Trust, Confidence and Assurance and TA 2.3 set out further detail on the assurance work undertaken.

Our goal is to deliver a significantly improved experience for our customers at an efficient level of cost. We will deliver a service experience that is refreshingly easy, one where every interaction with our service is a positive experience.

We aim to deliver a flexible and tailored response to each individual customer's situation, and to provide more support for customers who need additional help. Our customers will be able to contact us through channels of their choice and they will experience a consistent, supportive and inclusive service.

We will deliver our customer goal for a total cost of £237.9 million in AMP7. This is a stretching 34% reduction compared to AMP6 and falls within our range for the efficient cost frontier.

Technical Annexes:

TA.13.1	Doubtful debt and debt management.docx	Delivery strategy and target performance for doubtful debt and debt management
TA.13.2	Management of gap sites and voids.docx	Our approach and target performance to managing gap sites and voids

References:

[1] Customer Measure of Experience (C-MeX) is Ofwat's new incentive mechanism in PR19 for water companies in England and Wales to provide better customer service to their retail customers.
[2] The Service Incentive Mechanism (SIM) is Ofwat's incentive mechanism designed to encourage water companies in England and Wales to provide better customer service. SIM is being superseded by C-MeX in PR19.
[3] UK Customer Satisfaction Index (UKCSI) is a national measure of customer satisfaction. It measures over 30 measures of the customer experience in 13 sectors for over 200 organisations.
[4] The £4 increment refers to dual service bills, with this being split between water and wastewater charges.
[5] Annual Performance Reports 2017/18
[6] For a full cost breakdown, including 2018/19 and 2019/20 by cost type see the R1 data table.
[7] For detailed findings see TA.13.1
[8] As of June 2018. Source: MOSL.
[9] Institute of Customer Service
[10] For further information on our approach to debt management and doubtful debt see TA 13.1
[11] A gap site is a property where water and/or wastewater services are being consumed, but the property is not on a water company's system and is therefore not billed.
[12] Voids are properties classed by water companies as being vacant. However, some voids are actually occupied, so they may be erroneously billed, that is, either too little or nothing at all.
[13] Internal analysis
[14] This figure is net of any retail margin and is a summation of annual costs in a nominal price base.
[15] This figure is net of any retail margin and is a summation of annual costs in a nominal price base.