TA 13.1 Doubtful Debt and Debt Management Technical Annex

September 2018
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Contents

Navigation: TA 13.1 – *Doubtful debt and debt management*

Purpose:

This technical annex provides information and analysis to support the doubtful debt cost forecasts included Chapter 13 - Retail controls and to address Ofwat's expectations regarding the features of high quality (efficient) retail plans as well as explaining the ambition and deliverability of our efficient doubtful debt[1] forecast.

The table below summarises the Ofwat tests that are addressed in this Annex. It should be read in conjunction with Chapter 13 - Retail controls.

Table 1 - Relevant Ofwat tests

Ref	Ofwat test		Comment
Primary Focus Areas			
CE3	How well evidenced, efficient and challenging are the company's forecasts of retail expenditure, including bad debt costs?	High quality plan: The company will have an effective approach to managing and reducing doubtful debt and improving revenue recovery. High quality plan: This will include identifying current barriers to revenue recovery, benchmarking with best practice outside the sector and how these barriers will be addressed in PR19 Ambitious and innovative plan: the company will present strong evidence of sector leading cost efficiency. Plans should outline how the approach to debt management will enable the company to become more efficient in the recovery of revenue and delivery improvements for customers	Our forecasts of retail expenditure (including doubtful debt costs) are set out in Chapter 13 (Retail Controls). This Annex explains: Current barriers to revenue recovery and benchmarking with best practice outside the water sector to develop a strategy to overcome these barriers Our efficient and challenging approach to managing and reducing doubtful debt and improving revenue recovery.
Secondary Focus Areas			
EC1	Customer-engagement		
CMI1	Targeted controls markets and innovation		

[1] In this paper we use 'doubtful debt' as the name for the bad debt charge that appears on our retail profit and loss statement. This aligns with the nomenclature in the R1 data table.

Introduction

In order to improve the efficiency of our debt management processes, and to reduce doubtful debt and debt management costs, we have undertaken a substantial amount of research and analysis. We have sought to understand what is driving our customers to get into debt, our AMP6 performance and water sector and cross sector best practice.

Understanding barriers to revenue recovery

Our customer research has assisted us in formulating our debt management and doubtful debt strategy. The key sources we have drawn upon are in Table 2 below.

Table 2 - Key pieces of relevant research/insight[2]

Research/insight source	Purpose
Relish Research Barriers to payment exploration, June 2018	To understand the causes of payment default, what happens at payment default and what can be done to minimise barriers to payment within our customer base.
Echo Counting the cost of debt recovery, 2018	A cross sector review into customers' awareness and prioritisation of household bills, level of general debt and perceptions of debt management practices.
Ofwat/ PwC Retail services efficiency benchmarking, September 2017	To assess water company performance in doubtful debt and customer service costs and compare with other relevant sectors.
Market insight	A cross-market review used to determine our new debt placement and collection model
External consultancy / benchmarking	To benchmark the performance and maturity of Southern Water's internal debt management practices against cross sector and 'best in class' comparators

This research provides a better understanding of:

- The main drivers for non-payment of bills.
- Customers' behaviour when they realise they are in payment default, and how to re-engage customers in the payment process.
- The key findings and learnings from each of these are explained below.

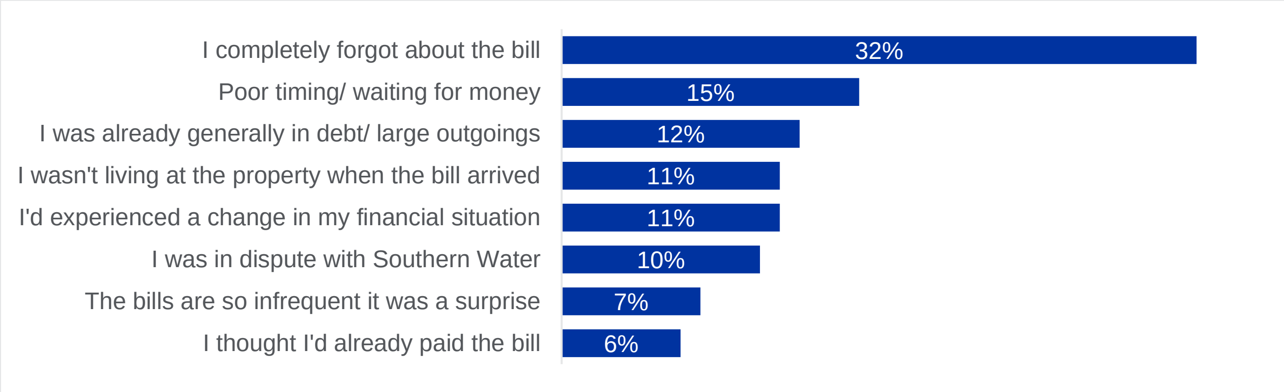
The main drivers for non-payment of bills

We surveyed customers who had missed a payment of their water bill in the last six months. The main reasons for non-payment are:

1. Customers **forgetting** to pay
2. Customers **confused** around the payment process
3. Customers struggling to afford to pay.

[2] TA4.4

Figure 1 below breaks down these three main reasons further and shows that there is a high proportion of customers debt that does necessarily relate to affordability issues e.g. they may have forgotten to pay their bill. This highlights the importance of understanding other reasons and barriers to payment and thus being able to develop a comprehensive approach to debt management to reduce our costs that go onto customers' bills.



Source: Relish, "Barriers to payment exploration", June 2018.

Figure 1: Customers reasons for not paying their water bill3

We considered our debt management and collections processes against the three main categories driving non-payment. The findings are outlined below.

Forgetting to pay

Research highlighted that the water bill is often the only household bill not paid through a direct debit. This is important as customers who have a direct debit are less likely to end up in debt as direct debits have the dual benefit of spreading payments over time and preventing customers from forgetting to pay.

The infrequent nature of water bills meant they were often forgotten about, or were too high in value to pay. Furthermore, many customers where the water bill is the only household bill not on direct debit are not in the habit of having to manually pay their bills. Processing bills requires organisation, time and routine which eludes some customers whose busy lives get in the way making them easy to forget.

Water generally isn't linked to a monthly contract or plan like mobile phones and entertainment packages that require direct debits. Furthermore, reasons such as issues around estimating usage for the direct debit amount or monthly payments being set prohibitively high were cited as reasons for direct debit not initially being set up.

Response: Our direct debit penetration is currently 64% and we are working to increase this rate through initiatives such as our model customer discounts whereby customers receive a discount for behaviours such as paying via direct debit. This forms part of our Discount Framework which will be in place by 2020.

Confused about payment process

Research shows us that when customers are not very engaged they tend to be unaware of what to look out for e.g. leaks that can lead to unexpectedly high bills. They might ignore issues such as standing water in gardens or constantly flushing toilets, without realising their level of water consumption and consequential cost. Therefore, when they receive an unexpectedly high bill it's confusing and they resort to non-payment while issues are resolved.

[3] Relish, "Barriers to payment exploration", June 2018. Response to the question, "as best as you can, what would you say were the reasons you weren't able/ didn't pay the amount that resulted in the overdue bill?"

A lack of awareness of how much water costs can lead customers to enter into disputes, even if a high bill is down to high usage. Many customers have no real understanding of how much water different appliances and activities use, such as a shower or dishwasher. Customers have told us that the resulting bills can be unclear on what they have paid, what is due and what it's for.

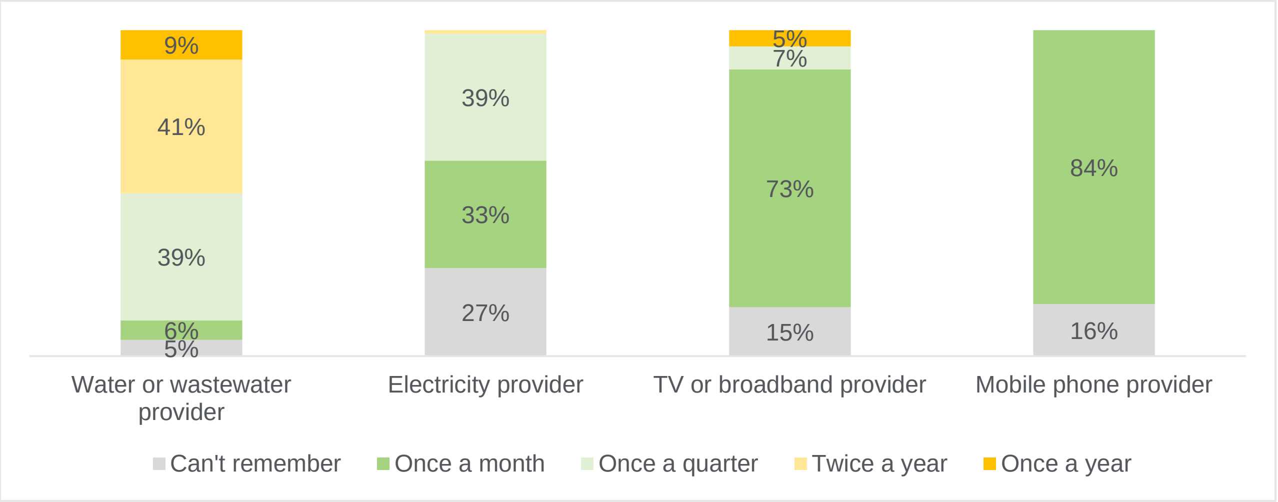
Separate bills for clean water and waste can further increase confusion, especially if one is on direct debit and the other isn't. Some customers are not clear what they have paid, if the charge is fair or even if they have paid or not which generates confusion, queries and delayed payments.

Moving home can trigger bill payment issues through lack of clarity and complexity:

- Issues with account transfer can confuse and complicate billings, especially with inherited debt;
- Lack of clarity over responsibility for payment between new and previous residents;
- Increasingly complex lines of responsibility between landlords, letting agents and tenants can lead to issues taking more time to resolve before bills can be paid.
- **Response:** As part of our retail transformation programme we established a dedicated home move team to minimise the confusion and repeat contacts that customers experienced during the transition. This is already decreasing the volume of repeat customers due to account transfer and home move issues. We plan to continue with this team in place in AMP7.

Struggling to afford bills

Figure 2 below shows that water bills issued are far less frequent than those received by other service providers. Infrequent billing can mean customers are unprepared for or not expecting a water bill. Sometimes payment problems are simply cash flow issues such as bad timing around an event or awaiting income. However, a water bill can also be accrued over many months and become unaffordable when unexpected. The water bill often ends up de-prioritised due to customers' awareness that supply cannot be cut off.



Source: Relish, "Barriers to payment exploration", June 2018

Figure 2: Our customers' bill frequency across service providers[4]

Response: We have developed a comprehensive strategy to support customers who are struggling to afford their bills. This is set out in Chapter 8 - Helping customers who need our support. We are also offering customers increased flexibility around payment options and billing frequency – this is set out later in this document.

4

Key learnings from our research into non-payment of bills that we are taking forward into our plan

- **Forgetting to pay:** Raising awareness of outstanding bills proactively and improving the effectiveness of payment processes as well as giving more notice around bill dates and increasing billing frequency can reduce customers' propensity to forget to pay. In addition, increasing Direct Debit penetration can reduce forgetfulness and increase cash collection.
- **Confusion about payment process:** improving knowledge of processes e.g. when moving home, making the cost of water consumption tangible and flagging issues such as high bills can reduce confusion and increase timely payment.
- **Struggling to afford bills:** helping those not on direct debit spread payments, improve payment terms, potentially extending payment window, and being conscious about cash flow crunch points e.g. Christmas, could reduce non-payment of water bills.

The infrequent and unexpected arrival of bills underpins all of these issues, suggesting increasing billing frequency and providing customers with reminders and a clear billing schedule could go a long way to avoiding many defaults and improve revenue recovery.

We address these learnings across our Reach & Support programme and debt management improvement initiatives

Customers' behaviour in situations of payment default

Research shows that 61% of our customers proactively contacted us to explain the reason for payment default, make a payment or arrange a convenient solution if they are unable to pay all of their bill. However, 29% of customers avoid engaging with us as they know they can't pay and expect to be pressurised into paying or agreeing to a payment date if they do contact us. These customers generally can't afford to pay their bill and as a result tend to build up debt. Our strategy to engage with those seriously struggling to pay is covered in Chapter 8 - Helping customers who need our support.

Below we set out the research we have undertaken on customer behaviours in non-payment, and levels of engagement.

Customers who avoid contacting us do not expect a supportive response but are surprised and appreciative of the available support when they do contact us.

After receiving communication about an overdue bill, 9% of our customers felt reassured help was available, 55% didn't react as they knew they could pay and 36% felt negative emotions including anxiousness, anger and panic.

Customers told us that the available help we provide for customers was not being clearly communicated:

- Payment letters often appeared aggressive in tone and caused panic. If help was signposted in the letter it was often missed due to the focus of the letter being on debt outstanding;
- Voicemails were not sympathetic and often failed to correctly direct customers towards the appropriate support;
- The wait on the phone was more than a few minutes and resulted in customers hanging up.

However, once customers do pick up the phone they are surprised and appreciative of the caring tone and sympathy of our agents and the support available. Anxiousness, guilt or embarrassment around not contacting us is replaced with relief that the situation is resolved in a way that works for them. Providing more information on the support available may encourage customers to seek help sooner.

Positive call centre engagement and the resulting outcome can be undermined by a lack of follow through and account management in the process.

Customers often felt misled by the caring and personalised support they received during the call centre interaction:

- 'Aggressive' chasing letters after they had spoken to us led customers to doubt the legitimacy and authenticity of the support they had been offered on the phone;
- A lack of information regarding their case when calling back, and the need to repeatedly explain themselves, undermined their confidence that the issue was being resolved;
- A lack of update notifications on progress of their payment issue reduced customer confidence in the process; and
- When someone else needed to interact with us on their behalf, such as a landlord or live-in partner, obstacles were faced organising this making customers feel like they were not being treated with flexibility and understanding.

Response: We are starting to adopt a highly personalised and tailored call centre interaction. For example, our new Home Move experience. This must be equally matched by personalised account management to keep customers engaged in the process (and this is something we are starting to do with greater consistency).

Once re-engaged, tariffs and payment plans work well to incentivise customers to pay.

According to our Debt Advice Visit partners, many of our customers were surprised to find out that such help is available as they do not associate tariffs and schemes with water and wastewater. They expected a 'one size fits all' approach as water services are low profile and undifferentiated at present. As such, most customers who we offer a tailored scheme or tariff to take up the offer and re-engage with their payments.

For full details on our tariffs and schemes, see Chapter 8 - Helping customers who need our support.

Key learnings from understanding customer behaviour and reaction to payment default that we are taking forward into our plan:

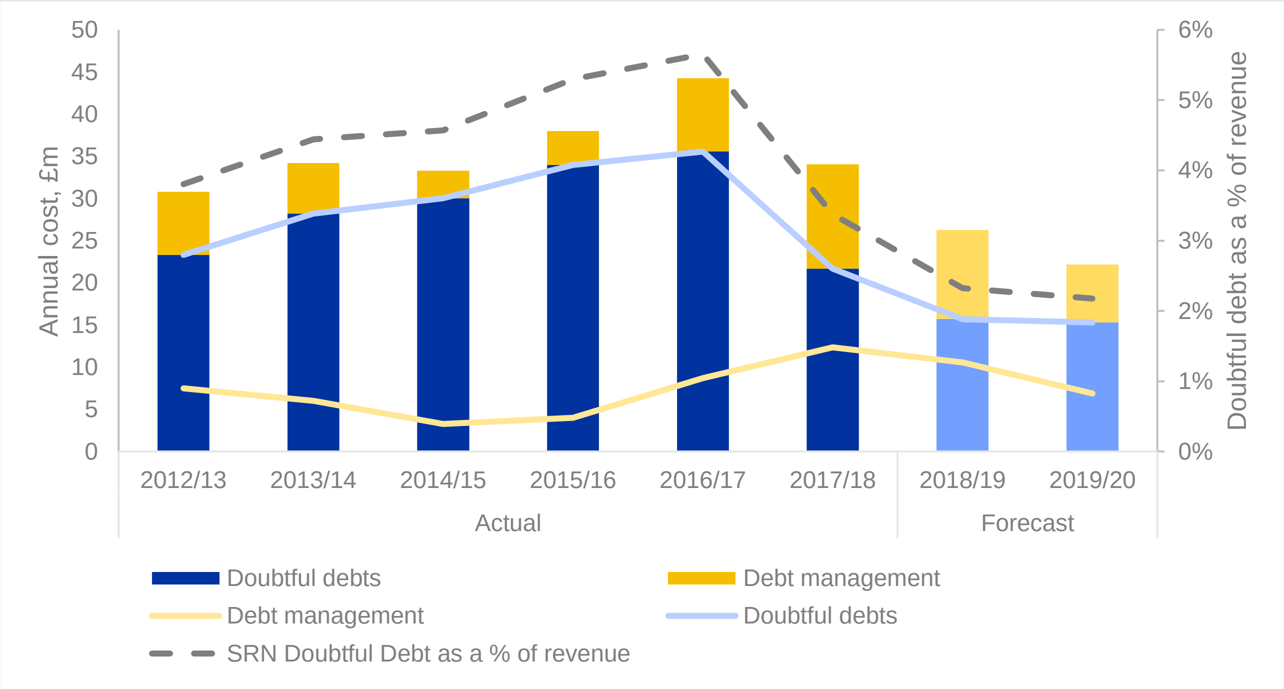
- **Make it easier for customers to access any contact channel.** This could reduce debt and increase re-engagement as phone calls most often lead to debt resolution. For example make connection quicker, offer call-backs, offer more flexible hours etc.
- **Providing a supportive tone and approach across all customer contact points** and communications, as delivered by call agents, can encourage customer engagement and relieve unnecessary anxiety for customers.
- **Increasing signposting to available support** in all channels of communication. Customers generally want to resolve their situation and directing them towards the available support can resolve their issue before it becomes a problem.
- **Account management to improve the debt resolution follow-up process** can ensure a consistently supportive, flexible and personalised approach across all customer touchpoints to prevent future disengagement.
- **Increase publicity around social tariffs and payment plans.** Making clear these are no longer available once debt collectors get involved can increase engagement and revenue collection, prevent future debt accruing and reduce the doubtful debt charge.

- **Increasing education on the support available to customers** may encourage them to reach out to us if they find themselves in a position of debt. If they are aware of the options we can provide, they are more likely to seek assistance.

Current doubtful debt performance

Figure 3 below summarises our doubtful debt and debt management cost performance from 2012/13 to 2017/18 and forecast performance for 2018/19 and 2019/20. We reduced cost and underinvested in debt management capabilities from 2012-2016 which resulted in a sharp increase in doubtful debt with the total doubtful debt and debt management cost increasing by 23% over that period.

In October 2016 we launched a retail transformation programme, focused on fixing the basics for our customers, becoming more efficient and increasing operational performance. Part of this included a significant spend to save debt management improvement programme. Figure 3 highlights the investment we made in 2016/17 and 2017/18 to deliver new debt management initiatives, see *AMP6 debt management improvement initiatives section below.* We are moving towards best practice debt management, establishing new ways of working and improving the way we leverage technology and customer data to drive down our doubtful debt costs. The graph shows that as debt management cost increased by 209% between 2015/16 and 2017/18 has been offset by our 39% reduction in doubtful debt between 2016/17 and 2017/18. The key barriers to payment and customer behaviour when realising payment default has allowed us to deliver effective debt management initiative to increase revenue recovery.



Source: R1 data table, line 2 and 3.

Figure 3: Our 2012/13 to 2019/20 doubtful debt and debt management cost performance

AMP6 debt management improvement initiatives

Table 4 below summarises the activities that we have already initiated as part of our debt management improvement programme. The cost of implementing these can be seen in Figure 3.

In September 2017, Ofwat set out six key areas of focus for companies looking to improve in debt management. These six were based on the outcome of a report produced by PwC to Ofwat on Retail Services Efficiency. Table 3 shows how our debt management improvement initiatives (in AMP6) align to Ofwat's six areas of focus and our understanding from the *Understanding barriers to revenue recovery* section. The table also aligns our debt improvement initiatives to what our customers have said are the main reasons for non-payment, or whether the initiative is to identify debt that can be paid but hasn't.

Table 3 - Actions to address Ofwat best practice and customer payment barriers

Ofwat best practice guide	Non-payment reason/ identify debt	AMP6 initiatives (commenced or fully implemented)
Move to more frequent or even advance billing	Forgetfulness/ confusion	**Increase the frequency of our bills, tailored to customers' needs:** ■ 'Implement flexible billing in conjunction with our new Model Discount Framework, with bill reductions to customers who provide self-meter readings, direct debit payment, or interact online ■ Tailored billing will enable improved rates of collection, faster detection of non-payment, and stop infrequent large bills beyond levels of affordability.
	Identify debt	Proactively **identify incorrect billing and nullify the associated debt** to reduce the potential incorrect doubtful debt charge.
Proactively manage customer data	Struggling to pay	We have started to use demographic data to develop **behavioural segmentation of customers**. Increased proactive contact has allowed us to increase our contact volumes and collect more data through a greater number of channels. These increased data volumes have enabled us to improve performances and will enable us to continue to proactively identify customers who are entitled to extra support and enable a more tailored, efficient and effective management of their payments.
	Confusion	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	Identify debt	**More targeted use of litigation for delinquent debtors** that are employed or who have assets, such as homeowners.
	Identify debt	**Targeted outbound campaigns** to improve collection rates and reduce the value of debt that ultimately becomes delinquent.
	Forgetfulness/ confusion	**Improve collections rate** by tailoring the content, communication method and timing of recovery activity.
Improve the availability of affordability schemes and increase take up	Struggling to pay	**Proactive identification and contact to offer financial support and debt advice** to increase payment potential. See Chapter 8 - Helping customers who need our support for more details.
	Struggling to pay	**Proactively contact customers if their bills are above a defined range** to resolve any potential issues before they arise.
Provide real consequence to address payment avoidance	n/a. Consequences	In cases where all other collection options had been exhausted, we have provided a step change in our **litigation** procedures.
Other	n/a. Delivery of initiatives	**Debt Collection Agency (DCA) contract model consolidation –** reducing the number of DCAs and implementing new collection strategies to incentivise performance and customer behaviours**.–**

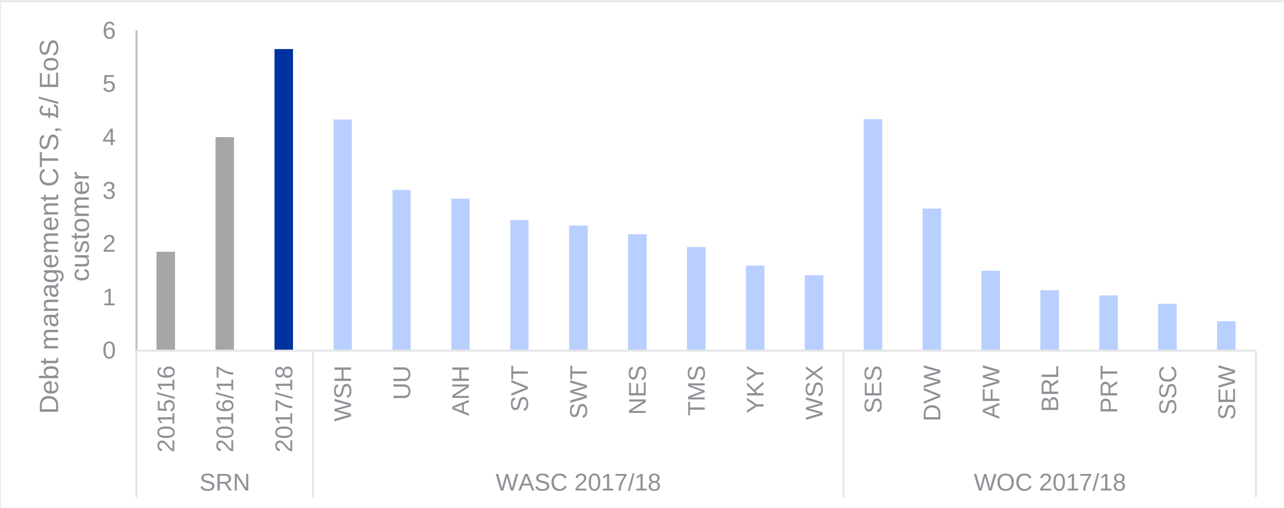
Benchmarking debt management and doubtful debt costs

To understand our current performance and identify areas for improvement moving forward we benchmarked our debt management and doubtful debt cost performance against data from the water sector and cross-sector. We reviewed doubtful debt and debt management cost to serve (CTS) within the water sector and doubtful debt as a percent of revenue across relevant sectors focusing on the period 2012-17 where comparative data is available. This analysis has helped us to confirm the areas that we are targeting for improvement in AMP7.

This analysis shows that we have historically performed near the bottom end of the industry in doubtful debt cost, measured as a percent of revenue and mid sector performance in debt management cost. However, in the second half of AMP6 we have invested heavily in our debt management activities to reduce our doubtful debt. The activities driving this are outlined in the *Current doubtful debt performance* section earlier in this document. These have increased our collection rates and reduced customers falling into debt. This has set us on a path to bring about sustainable change for the future, as seen by the 39% reduction in doubtful debt in 2017/18.

Below are the headline findings from the benchmarking analysis, which we have taken into account when developing our plan and setting our level of ambition for more effective and efficient doubtful debt and debt management performance.

Water sector debt management cost benchmarking



Source: Annual Performance Reports 2017/18

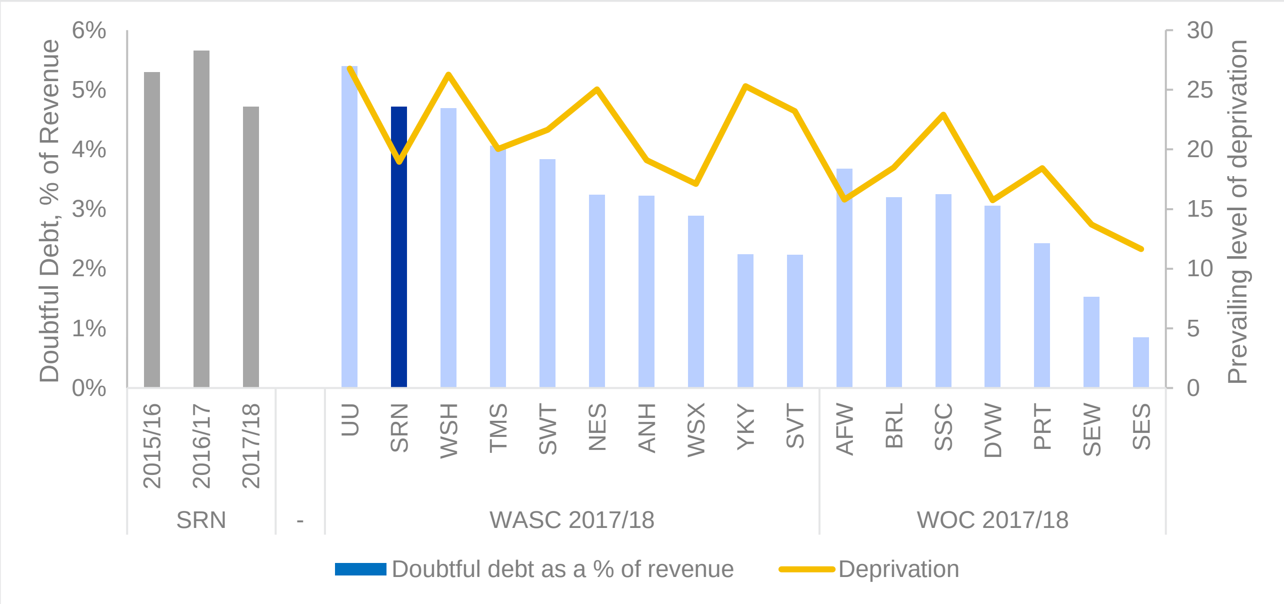
Figure 4: Our debt management CTS from 2015 – 2018 compared to the water sector in 2017/18

Our debt management CTS has increased from one of the lowest among WASCs in 2015/16[5] to the highest in the industry in 2017/18. Limited investment in debt management capabilities between 2012 and 2016 resulted in low debt management costs but high levels of doubtful debt, as seen in Figure 4. The 209% increase in debt management costs between 2015/16 and 2017/18 have been driven by the implementation of our debt improvement programme, see *Current doubtful debt performance* section.

Water sector doubtful debt cost benchmarking

[5] From 2015/16 water company annual reports

We had the highest level of doubtful debt in the water sector in 2016/17[6]. Figure 5 shows our doubtful debt CTS reduced by 39% in 2017/18[7] meaning we now have the fourth highest doubtful debt CTS in the sector. The debt management initiatives implemented to drive this performance improvement are explained in the *Current doubtful debt performance* section. To look at absolute doubtful debt performance against the water sector, we have analysed doubtful debt as a percent of revenue in figure 5 below.



Source: Annual Performance Reports 2017/18; Retail services efficiency benchmarking, Ofwat, September 2017

Figure 5: Our doubtful debt CTS from 2015 – 2018 compared to the water sector in 2017/18

Despite the improvement in 2017/18 in doubtful debt performance, we recognise that we are still underperforming against the water sector when looking at doubtful debt as a percentage of revenue.

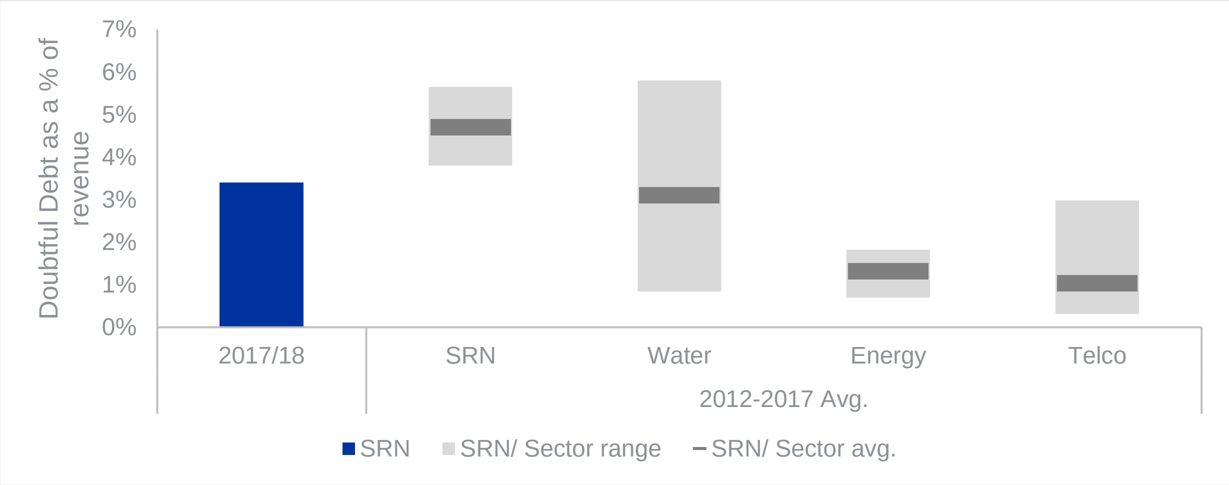
The c*ross sector best practice debt management* section below highlights our relative immaturity in debt management practices which is a driver behind our doubtful debt underperformance and identifies areas to improve doubtful debt.

Cross sector doubtful debt cost benchmarking

Doubtful debt as a percentage of revenue

Doubtful debt as a percentage of revenue is an indicator of doubtful debt performance and enables comparison across sectors. Figure 6 shows our 2017/18 doubtful debt performance against our own, the water, energy and telco sectors 2012-17 performance.

[6] From 2016/17 water company annual reports.
[7] From 2017/18 water company annual reports.



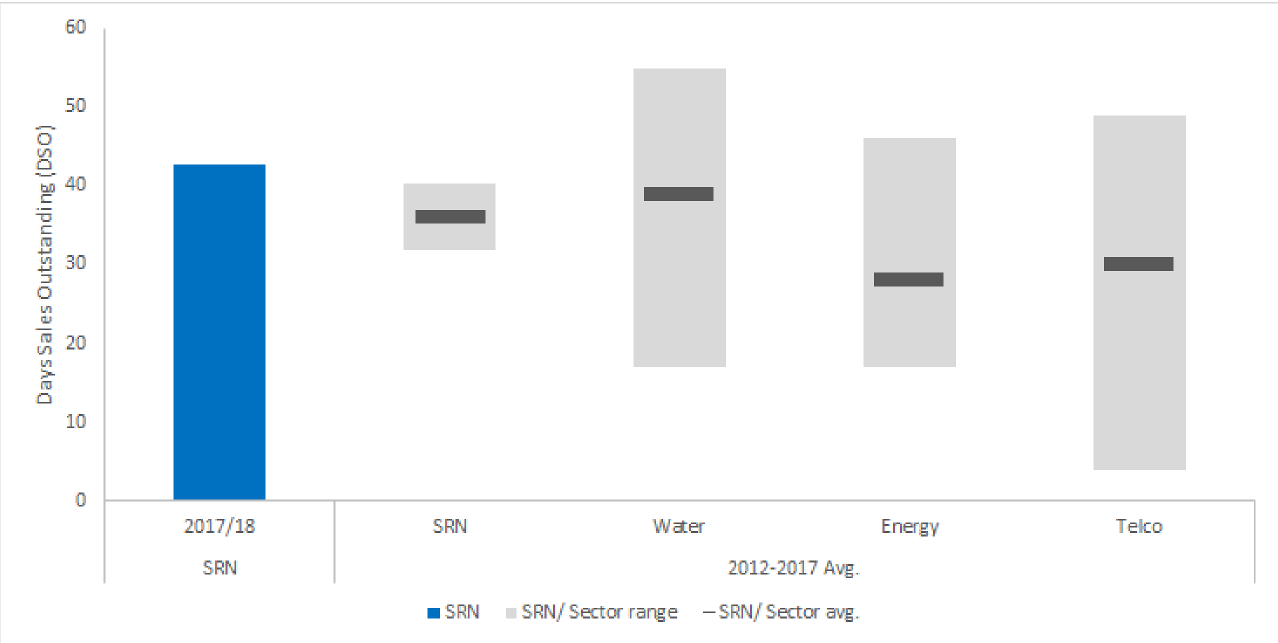
Source: Ofwat, 'Retail services efficiency benchmarking', September 2017

Figure 6: Our 2017/18 and 2012-2017 doubtful debt as a % of revenue

Over the 2012-17 period, we had one of the highest levels of doubtful debt across the benchmarked sectors at 4.7% of revenue. Our 2017/18 doubtful debt to revenue performance of 3.4% brought us in line with the water sector 2012-2017 average. However, the water sector average and our level of doubtful debt as a percent of revenue is three times higher than the average seen in the energy and telco sectors. Despite regulatory differences between water and other utility sectors explained in the *Cross sector regulatory differences are a key factor behind the variable doubtful debt performance across sectors* section, this further suggests doubtful debt is an area for accelerated improvement.

Average Days Sales Outstanding (DSO) across sectors

DSO provides an indication of how long it takes our customers to make their payment, the higher DSO indicates lower likelihood of recovering outstanding debt. Our average performance from 2012-17 (36 DSO) suggests that we are slightly above the average performance across the water sector. However, the Ofwat Retail Services Efficiency report suggests that due to the common convention of billing in arrears after 6 months in the water sector that a realistic target for a highly performing water company should be set at between 30 and 35 DSO.



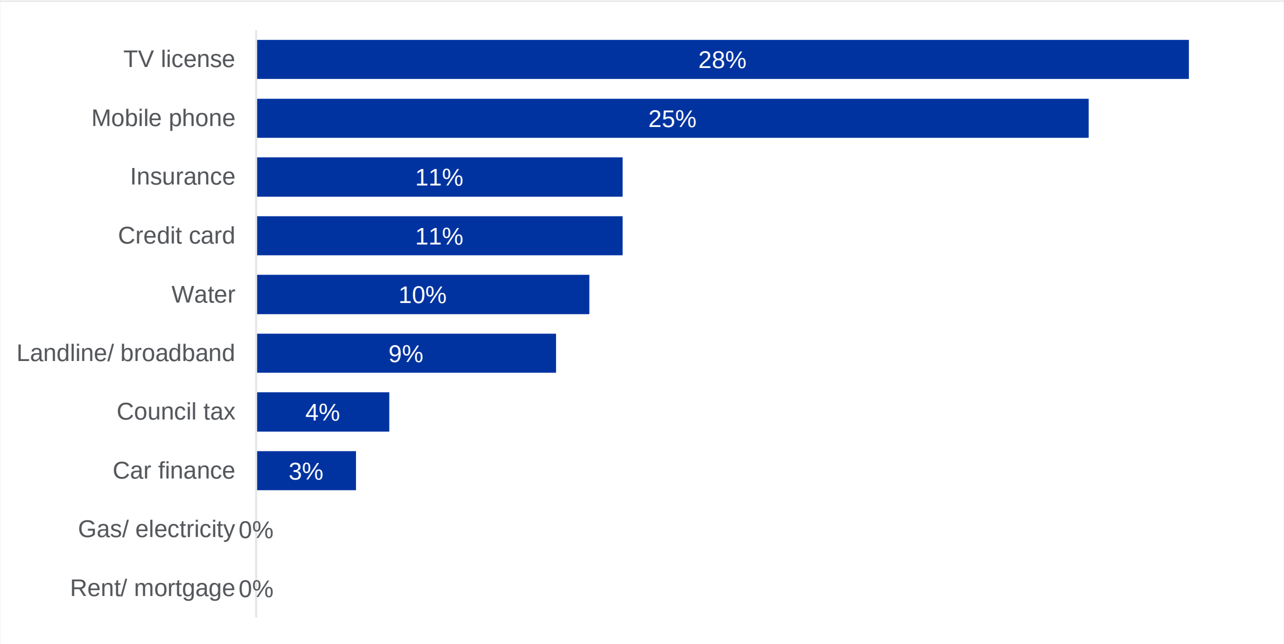
Source: *Ofwat, 'Retail services efficiency benchmarking', September 2017*

Figure 7: Our 2017/18 and 2012-2017 days sales outstanding compared to the water, energy and telco sectors' 2012-2017 average

Despite one of the highest levels of doubtful debt in the industry we have below average DSO. One key factor that is likely to impact DSO is the proportion of our sales that are paid via Direct Debit. A higher take up of DD improves collection rates as it is a more reliable means of securing on-time payment. This will result in higher cash receipts, lower DSO and ultimately lower levels of bad debt. Therefore, we are incentivising customers to pay via DD to improve our rate further.

Cross sector regulatory differences are a key factor behind the variable doubtful debt performance across sectors

Not all bills are equal. When household finances are squeezed, customers' prioritise various bills differently. Figure 7 shows that 10%[8] of people surveyed regard paying their water bill as their lowest priority among regular household bills while this was 0% for Gas / electricity.



Source: Echo Managed Services, "Counting the cost of debt recovery," 2018.

Figure 8: Household bills customers would least prioritise[9]

When drawing the comparison between the water and gas / electricity sector there are two key regulatory differences contributing towards this:

- The Water Industry Act 1999 removed water companies' right to disconnect domestic customers for non-payment of bill as gas/ electricity companies can. Thus making tangible consequences for non-payment harder to implement and providing less incentive for customers to engage with water companies.
- As a monopolistic industry, the household water sector has no competition like the gas/ electricity. This means dissatisfied customers can continue to not pay their bill and still receive the service as opposed to gas/ electricity customers who can choose an alternative provider.

Other differences include:

[8] *Echo Managed Services, "Counting the cost of debt recovery," 2018.*
[9] *Echo Managed Services, "Counting the cost of debt recovery," 2018.*

- Water has even lower engagement than other utilities, in part due to the monopoly status of water companies not competing for custom and differentiating their service
- For many it is put in the same category as Council Tax i.e. a payment they have no choice or control over
- In the UK water is too often taken for granted as water rationing rarely happens and a plentiful water supply is just expected
- Many, especially younger customers, see water as their ‘human right’ and are aware that water companies cannot cut off its supply
- Water bills are usually the cheapest of all household bills, which creates another reason to forget about them.

Key learnings from our cross sector best practice debt management benchmarking:

- One of the highest doubtful debts in the water sector accompanied by lower than average DSO and deprivation suggests we are underperforming against water sector companies due to our own operations, not external factors. Doubtful debt is a key area for accelerated improvement.
- Customers’ prioritisation of bills and regulatory differences do not explain the full difference between the gas/ electricity and telco sectors. We must focus on implementing best practice debt management practices to shift towards doubtful debt performance seen in those sectors, notably frequency of billing and direct debit penetration.
- The key to improved debt performance is better operational practices and a company culture that prioritises cash collections.

Cross sector best practice debt management benchmarking

We have analysed debt management from across sectors and benchmarked our performance. Table 5 assesses the maturity of our debt management activities against cross sector best practice.

Table 4 - Benchmarking our debt management activities maturity against cross sector best practice

	#	Activity	Basic performance	SWS Maturity (RAG and 1-4) →	Advanced performance
Encouraging prompt payment	1	Data Accuracy	Poor data; high volumes of "unmatched" customers	●	Dynamic validation Data sharing; extensive use of data search and append
	2	Approach to segmentation	No segmentation	●	Early behavioural segmentation
	3	Billing frequency, timing & accuracy	For maximum efficiency, many estimates; Highly speculative billing	●	Aligned to customer segment. Few estimates; No speculative billing
	4	Payment methods & timing	Low DD & self-serve CC penetration. 1 date per month; monthly payments	●	Extensive DD and self-serve penetration. Active targeting. Flexible payment day. Weekly DDs offered
	5	Nudge marketing	No concept of behavioural change	●	Active campaigns by customer types
	6	Sharing success	None	●	Success published internally and externally
	7	Pre dunning contact	None	●	Tailored to customer types; incl. e-comms

Supporting customers in need	8	Identify customers in need	Only at later stages of recovery			●	Use of advanced segmentation. Field visits
	9	Tariffs	Limited. Reactively encouraged; Limited marketing		●		Actively encouraged & moved. Staff incentivised; Targeted marketing
	10	Working with other parties	Only reactive– responding to agencies		●		Proactive Field support to agencies/ charities
	11	Repayment plans	No formal policy		●		Dynamic plans, actively monitored & reviewed
	12	Direct DWP deductions	Limited use of Water Direct		●		Actively encouraged. Staff incentivised. Supplier applications used extensively
	13	Bursary/ trust schemes	No scheme available	●			Actively encouraged. Staff incentivised
Address poor payment practice	14	Follow-up & escalation	Monthly. No apparent escalation			●	Tailored to segment
	15	Clarity of purpose & direction	Consequences are not telegraphed			●	Tailored to specific customer types. Threats followed through
	16	Debt collection pathways	One size fits all dunning process		●		Tailored to customer segment
	17	Decisive recovery	Only internal recovery			●	Good use of internal/ external options including enforcement
	18	Consequence	No tangible consequence for late/ non payment			●	Ingrained into tailored recovery processes
	19	Persistent/ unyielding	W/O at predetermined point. No trace & collect		●		W/O when all options exhausted. Extensive trace & collect. Debt sale used
	20	Culture	Little focus on cash			●	Comprehensive monitoring, targeting, incentivisation

Key learnings from our cross sector best practice debt management benchmarking

Despite recent improvements, we are still less mature than best practice seen in other sectors and have areas to improve:

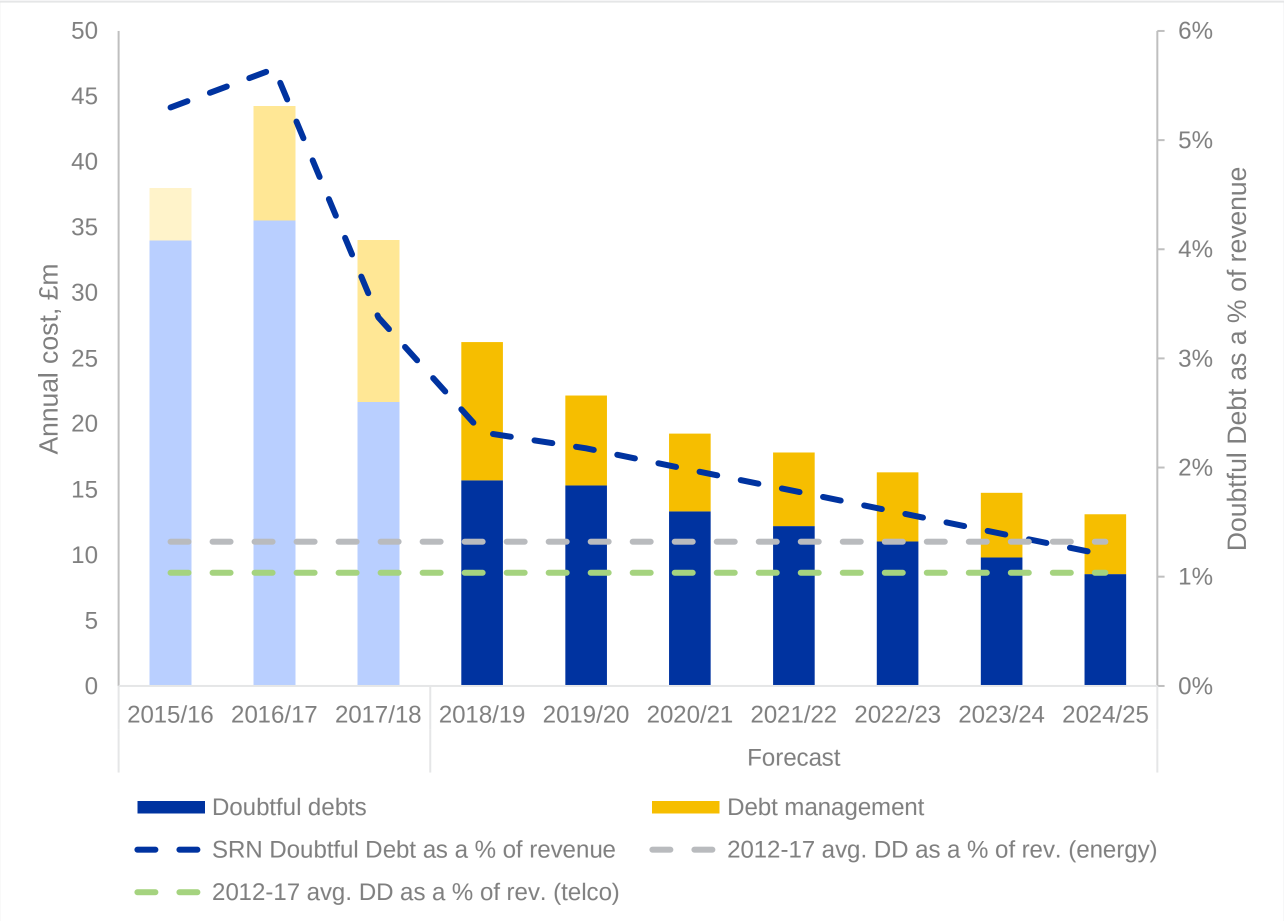
- Our approach to billing and collections scores as 'Basic' in our assessment, consistent with a lower quartile performing water company
- Our approach to billing and collections is un-dynamic and lacks decisive recovery action. Tangible consequences for late/ non-payment are also limited and affected only certain types of customers
- While Affordability options are available, the number of customers on such tariffs is low compared to the levels of affordability in our region
- Systems, organisational structure and culture are contributing to poor collections performance
- KPIs and processes are not customer-centric, nor focusing on key metrics that improve cash collection. They are rewarding internal and external resources for the wrong behavior.

Our ambition

In AMP 7 we aim to achieve a level of performance for debt management and doubtful debt that is consistent with the local socio economic conditions that prevail in our area and which is comparable with that seen in the energy and telco sectors.

The index of multiple deprivation (IMD) allows for comparison of deprivation within areas in the UK, including factors such as; income, employment, health deprivation and disability[10]. See TA.8.1 - Tackling affordability and vulnerability for more detail on this metric and its implications. It is a useful indicator in understanding both financial and non-financial vulnerability within our region.

We have considered performance seen in the energy and telco sectors, the regulatory differences in these sectors compared to water and our debt management maturity assessment in developing our AMP7 doubtful debt ambition. Figure 9 outlines our AMP7 ambition. We will reduce our doubtful debt charge to 1.2% of revenue by 2025 resulting in a c.£67.3m cost reduction across AMP7 compared to AMP6.



Source(s): R1 data tables, Retail services efficiency benchmarking, September 2017

Figure 9: Our AMP7 doubtful debt and debt management ambition against AMP6 performance and the 2012-17 energy and telco doubtful performance

Our forecast doubtful debt of 1.2% of revenue by 2025 is between the 2012-2017 average for the energy and telco sectors. Considering our latest 2017/18 performance, this represents a £13.1m, or 61% decrease in the annual doubtful debt charge and is both stretching and ambitious.

[10] Methodology: 22.5% Income; 22.5% Employment; 13.5% Education; 13.5% Health; 9.3% Crime; 9.3% Barriers to housing and services; 9.3% Living environment

Considering the regulatory differences between the water and energy and telco sectors, we do not see upper quartile performance achieved in these sectors as a realistic ambition. However, we take confidence in the telco sector where customers prioritise their mobile phone bills less yet still achieve an average doubtful debt charge of 1.04% of revenue. Moving toward best practice debt management that is prevalent among top performers in the telco sector will help us reduce the difference in performance.

The *AMP7 approach to effective debt management* section below explains the debt management initiatives we are implementing to reduce barriers to payment and increase revenue recovery to deliver on our AMP7 ambition.

AMP7 approach to effective debt management

Our AMP7 plan includes two components:

- Continuing to build and refine existing initiatives commenced in AMP6, as outlined in the *Current doubtful debt performance* section;
- Delivering new initiatives in the remainder of AMP6 and early AMP7 which are in line with most recent market, technological and business conditions.

As we move into AMP7 we will continue to deliver, refine and develop the initiatives set out in Table 6 below. We have identified learnings from best practice debt management across sectors. We have also analysed the maturity of our own debt management process. We have used this insight to identify areas where we might continue to improve in AMP7. A summary of activities we plan to implement in the remainder of AMP6 and AMP7 is set out below. We will keep these under review.

Table 5 - Debt management activities for the remainder of AMP6 and AMP7

Ofwat key area	Non-payment reason/ identify debt	Our AMP6 and AMP7 initiatives
Move to more frequent or even advance billing	Forgetfulness/ confusion	As well as the tailored billing initiative, we will jointly create new billing models with customers.
Proactively manage customer data	Identify	**Improve the internal trace process to track homeowners who move and haven't paid off their debt.** We will enhance our data analytics to enable us to accurately track customers with debt at a previous property to their current debt accounts and ensure collections are maximised.
	Identify	We will try and identify potential unidentified 'move outs' among **customers that have not made a payment in recent years,** so we re-engage with them to reduce outstanding debt.
	Identify	**Nullification of debt through gap site[i] and void[ii] identification.** Incomplete customer data, incorrect details, gap sites and void properties result in errors in calculating the level of debt. We plan to address this through our gap sites and voids strategy in AMP7, see TA.13.2 - Management of gaps sites and voids.
	Struggling to afford	We will **reduce the threshold where high consumption bills are reviewed,** enabling the early identification of possible leakage and the early engagement and collection of genuine high consumption charges.
	Forgetfulness	We will offer **greater flexibility on payment dates, proactively engage and communicate** with customers whose direct debit (DD) fails and offer greater flexibility over repayment of missed instalments. Fewer customers will fall off DD, enabling higher penetration and recovery.
	Identify	**Further improve former debt matching through improved data capture.** We expect to achieve improved matching of former debtors to current debtors. In addition, we expect to refine the debt matching algorithm to enable us to validate a greater proportion of our former debt book.

Tailored collections paths leveraging customer segmentation and behavioural economics principles	Struggling to afford Struggling to afford/ forgetfulness	**Piloting a new tariff for customers in arrears.** We are piloting a time-limited Engage tariff, which offers a 20% discount on bills for customers who have become disengaged with the company. We expect this tariff to encourage payments, reduce the accumulation of doubtful debt and target these customers for additional collections engagement.
Improve the availability of affordability schemes and increase take up	Struggling to afford Struggling to afford	**Review payment plans that are below customer's affordability** to identify opportunities to increase instalment amounts for customers that have the financial means to do so. See the Chapter 8 - Helping customers who need our support which explains the strategy to help customers with transient and long-term affordability issues, through a range of schemes and tariffs that will reduce doubtful debt.
Provide real consequence to address payment avoidance	n/a. Providing consequences	We will have **full consumer credit account information sharing (CAIS) for our customers.** This will incentivise customers who can pay to pay on time by penalising late payment through a negative impact on their credit rating. We will be **proactive and transparent in our communications** with customers to ensure that they fully understand the consequences of payment default.
Increase the level of customer prepayments	Struggling to afford/ forgetfulness	We will 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 initiatives	n/a. Enabler of other initiatives n/a. Enabler of other initiatives n/a. Enabler of other initiatives	**Leveraging technology** e-billing in AMP6 produced benefits in billing and collections and reduced our debt management and doubtful debt costs. Moving into AMP7, leveraging this technology, and our delivery partners' system capabilities, is key to our debt management strategy. 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 Agencies (CRA) data and better engagement with customers to deliver further improvements to data quality. **Our enhanced data strategy will enable debt management initiatives 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.

To deliver the new initiatives explained above we expect to benefit from our partners cross-sector expertise, mature systems and insight to improve our own debt management capabilities. We will gain better data and analytical capabilities to accelerate the implementation of cross sector best practice debt management.

Through this model we are targeting upper quartile WASC debt management operational efficiency from 2020/21 to deliver a c.£16.2m debt management cost reduction across AMP7 compared to AMP6.

[i] 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.

[ii] 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.