

Service incentive mechanism (SIM) for 2015 onwards – response from Northumbrian Water Limited

Introduction

We are pleased to have the opportunity to comment on Ofwat’s consultation on the ‘Service incentive mechanism (SIM) for 2015 onwards’. Ofwat has provided a very useful document setting out the key aspects of the changes required to the application of SIM during 2015-20 and the options for changing elements of the design.

We welcome the opportunity to influence and comment on the future detail of the application of SIM in the period 2015-20. We are supportive of SIM as a means of driving the required focus on the delivery of customer service across the water industry. We believe this supports the move from a heavily regulated industry to one with lighter regulation focussed on delivering services customers want, in the way they want them. We support the continuation of SIM as the prime incentive and comparator of service provision across the household retail sector for 2015-20.

Our aim is to achieve great customer service not only within the water sector. However we do believe SIM will take the industry to an excellent standard.

As we all know, only a minority of customers find themselves having a direct contact experience with their water company, most customers use our services daily and take them for granted. We are interested in all these customer service experiences in order to further inform our relative performance both in our own industry and in the wider field of service industries. We have established a set of ‘measures of success’ which include SIM, a domestic customer tracking survey and, to further track progress across all of our customers groups, a Net Promoter Score.

In considering whether to recommend that SIM be expanded to include these additional measures, which we feel are critical to our wider vision of excellent service, we have concluded that it adds a complication to the regulatory process which is not necessary. SIM should be able to take the industry to an excellent standard and the information it collects can allow Ofwat to comprehensively benchmark customer service across companies.

Response to consultation questions

Q1 *To inform the extent of the range for rewards and penalties, we invite views on:*

- (a) our proposition that the SIM should continue to incentivise service improvements in companies operating below the frontier; and*
- (b) whether, and if so in which areas, further service improvement by frontier companies should be incentivised – and the benefits of doing so.*
- (c) Given the timing of this consultation, we would also consider evidence from any company outcomes beyond SIM.*

Our view is that SIM should continue to incentivise service improvements. SIM measures the 'joined up' focus to customer service delivery across the different functions of our business and helps us to track that the customer is at the forefront of everything we do.

We believe it is important to continue to recognise and incentivise the frontier companies. While the financial reward and penalty can be material so can the reputational impact of performance. We put the customer at the heart of all we do and while we see ourselves as industry leaders in many of the measures that Ofwat records and publishes, we believe that customer service is the primary indicator of leader status.

It is important to recognise the 'frontier' companies to ensure that customer service is driven to be leading edge. The danger of only incentivising the less well performing companies, and not those that are frontier, is that companies may be indirectly incentivised to provide a 'middle of the road' customer experience, i.e. companies just doing enough to avoid penalty. As such we believe the current approach of rewards and penalties for frontier and less well performing companies respectively provides sufficient incentive at an affordable level to promote great customer service.

SIM only measures the level of service across a population of people who have cause to contact us. In our drive to be the leading water and waste water company we have established a set of 'measures of success' which measure our service across all of our customer population and also enables us to measure our service against a range of companies in different service industries. In addition to SIM we currently have a domestic customer tracking survey which measures 'overall satisfaction'. This covers all customers, some of whom will never have made contact with us and some who will. To further track progress we are extending our use of the Net Promoter Score across all of our customers groups. This measures the loyalty that exists between us and our customers by asking how likely it is that they would recommend us to a friend or colleague.

The environment of customer service is fast moving and the expectations of our customers change all the time. As such, service improvements will be driven forward as technology and customer expectations change. This coupled with the advent of retail competition will continue to drive service enhancements – not only in what, but how and when we do what we do. To maintain frontier company status a company must respond to their customer's expectations requiring continual investment. The cost of such investment is difficult to forecast. Some will be self financing and some will simply involve changing behaviours as service culture evolves.

We already compare ourselves with companies outside of the water industry and beyond the utility sector as we wish to ensure we learn and change to deliver leading customer service at an affordable price.

The 'carrot' and 'stick' approach is considered to be fair and any removal of the 'carrot' may well be seen as a backward step and may drive other companies to move back into the 'pack' and as such not deliver the service customers deserve from the water industry.

Q2 *We consider that the SIM should continue to incentivise service quality throughout the value chain, and not just those elements under the sole control of retail businesses. The implication is that retail businesses would be exposed to the full financial risk of the SIM, which we expect to be passed on to wholesale businesses as appropriate.*

We invite views on:

- (a) the proposition that the SIM should continue to be used to incentivise service improvements throughout the value chain, rather than being focused entirely on 'retail' activities;*
- (b) how these incentives (and financial risks and rewards) might be passed through from retail to wholesale businesses; and*
- (c) the proposition that we should leave companies to develop internal 'contracting' arrangements as they see fit, rather than be subject to any prescribed arrangements.*

Currently customer outcomes and efficiency are dependent on many parts of the business structure and their effective integration of service provision. To ensure great customer service, as we establish separate wholesale and retail businesses, it is vital that we move from joined up structures to joined up behaviours. There are customer touch points throughout wholesale and retail.

The value chain will vary according to the customer journey, e.g. Billing or Operational, and related contact type. We believe it is now even more imperative that the benefit of a 'joined up' approach is retained as we move forward with different organisation structures.

We strongly believe that the retailer alone must be accountable to the customer for providing a high quality level of service. We will wish to have service level agreements with wholesale businesses and use these to mitigate financial risks and share rewards.

The apportionment of reward should reflect the ability to influence the service outcome. This could be gauged by retail and wholesale measuring component service provision through key milestones of the service journey.

The detail of the financial arrangements between the retailer and the wholesaler will require careful consideration to ensure they are fair and reflective of the responsibility and effect of the respective parties, e.g. wholesale operations can have a big impact in the delivery of water supply services not only in what service is delivered but how it is delivered. 'How' service is delivered is the differentiator of service provision and this provides the experience for the customer, while the 'what' is essentially the bare service provision.

We agree with your view that companies should be left to develop internal 'contracting' arrangements as they see fit, rather than be subject to any prescribed arrangements.

Q3 *Design issue 1 – symmetric or asymmetric incentive?*

The options we are consulting on are:

- option 1** *retain current asymmetric structure;*
- option 2** *remove upside potential entirely (for example, no upside; retaining the downside of up to 1% of revenue); or*
- option 3** *move to a symmetric incentive (for example, upside and downside Both up to 1% of revenue).*

We believe option 3 to be the best option moving forward as this provides an incentive to drive those companies behind the frontier to improve performance while also providing sufficient reward and recognition for those at the frontier.

We recognise and expect that in time the difference between the frontier and less well performing companies will reduce. When this economic performance frontier materialises it may be appropriate to revisit the structure of the incentive mechanism to ensure it remains fair, appropriate and reflective of true service provision.

Q4 *Design issue 2 – magnitude of financial incentive*

Our current preference is to broadly maintain the current magnitude of financial exposure under the SIM in the range of +0.5% to -1.0% of total appointee revenue. (Dependent on responses to questions 1 and 2.)

Do you agree with this approach?

Following Ofwat's recent comments on the absence of high powered incentives we feel it would be entirely consistent with this position to seek more positive rewards on SIM. This argues either for symmetry at 1% or increasing both reward and penalty to say 1% and 1.5% respectively.

Q5 *Design issue 3 – balance of qualitative and quantitative measures*

The options we are consulting on are:

- **option 1** *retain the current 50/50 weighting;*
- **option 2** *shift the balance more towards qualitative measures (for example, 75% qualitative/25% quantitative);*
- **option 3** *remove the quantitative measures entirely;*
- **option 4** *shift the balance more towards quantitative measures (for example, 25% qualitative/75% quantitative); or*
- **option 5** *remove the qualitative measures entirely.*

The quantitative measure captures service failing across the business every day of the year. The coverage and measurement of unwanted phone contacts, written complaints, escalated written complaints and CCWater investigated complaints enables significant service failings and trends to be captured which may not be picked up from the qualitative survey of satisfaction.

The qualitative measure is considered to be more about the outcome of the whole customer journey whereas the quantitative element is considered to be only one part of the whole customer experience. It is considered inappropriate to be overly focussed on the quantitative measure unless it can be stated that the data is all being handled consistently across the water industry. This is difficult to do with such large amounts of data being handled by different systems and companies.

Subject to the how the quantitative measure is formed we would advocate a move to weight the qualitative element at a higher level. Currently we believe an increased weighting of the qualitative measure in the range of 60% to 75% of the total SIM is appropriate. We believe in time it may be appropriate to move to a 100% qualitative based SIM. However until sufficient confidence in the consistency and robustness of application of the qualitative measure is achieved it is recognised that it is important to retain a degree of

quantitative measurement. Any shift to additional weighting on Qualitative SIM should be done in conjunction with an increase in survey sample size.

While it is recognised that the quantitative element is important our belief and experience is that you cannot achieve robust, sustainable and high qualitative scores if the quantitative elements are not addressed. Such factors as Customer Ease and First Time Resolution are key to the delivery of a quality service.

Q6 *Design issue 4 – detailed design of the qualitative and quantitative measures*

Please provide your views on the various options presented in detail in section 4.4.

The different approach to the collection and allocation of ‘unwanted’ contacts across the industry is an area of concern. The recording and reporting of all other ‘media’ contacts will need further consideration and should not include anonymous contacts or should only count if the contact can be confirmed as being from a customer of the company and be attributable to an actual account.

Both Option 2 and 3 are considered to be reasonable steps forward and will address any concerns with regard to any inconsistency of service delivery performance throughout the year. With regard to written complaints it is now considered incorrect to differentiate between an unwanted telephone contact and a written complaint received via email or ‘social media’. We believe that the allocation of contact points to unwanted telephone contacts and written complaints received through an electronic [digital] medium should be considered equal in value.

We also fully support the streamlining of the Customer Experience Survey and would advocate an approach similar to that promoted by the UKWIR benchmarking project. The current survey is considered to be long, cumbersome and overly reliant on one question. The length of the survey can also have a negative impact on the customer potentially resulting in answers designed to end the survey rather than provide a response truly reflective of the service provided.

The make up of the customer experience survey could also benefit from development, with the billing sample benefiting from an increase to negate the requirement to weight the scores across the billing and operational areas. This could be achieved by doubling the billing sample and maintaining the sample sizes for operational contacts.

With respect to Option 2’s survey approach we support the removal of the notice period however a timescale for provision of the week’s data would be required. An instant turnaround is not considered to be realistic as we have to confirm the ‘resolved’ status. Option 3’s survey approach could be provided in a shorter timescale as the assurance of ‘resolved’ status would not be required to be validated.

In the publication of the full years SIM qualitative scores by McCallum Layton we were surprised to see, for at least three companies, what appeared to be a very small number of resolved contacts being submitted for survey. Although there can be a delay between a customer contact and resolving a dispute, it is safe to say that the average number of resolved contacts in a year (less OFWAT allowable omissions from the survey) should be almost the same as the average number of contacts received. As there are four weeks

'resolved contacts' submitted for survey during the year we would expect a company, over the four waves, to submit 4/52 or 7.69% of their annual contact. This will be lower after allowed omissions are removed. Any sample submitted below approximately 6% must be questionable. We would suggest that companies should be required to send a reconciliation statement with their survey data showing the relationship between contact submitted for survey, total contact and allowed omissions.

Q7 *Design issue 5 – use of absolute or relative performance*

We invite views on:

- **option 1** *retaining the current relative incentive structure; or*
- **option 2** *using absolute performance levels to set rewards and penalties (with suggestions of how we might set these).*

We believe SIM would benefit from a greater degree of transparency in terms of the allocation of reward or penalty incentives. This could be afforded by a balance of absolute thresholds for reward and penalty based on a percentage performance of the frontier company(s) with the safe guard of an absolute minimum set as at a suitably stretching level to assure customer service standards.

Q8 *Design issue 6 – non-household SIM design for Wales*

We are seeking views on two options for the incentive comparator for the Welsh company non-household SIM:

- **option 1** *to compare the non-household SIM score against the household SIM scores for England and Wales; or*
- **option 2** *to compare the non-household SIM score against an absolute threshold level.*

We invite comments on any additions or modifications that would be appropriate to the household SIM methodology for its use for non-households, including dealing with sample size issues from smaller customer bases.

We believe that option 1 would be the best approach, assuring a comparable service provision for the customers of Welsh Water and agree with your plans to use the same set of qualitative and quantitative measures as in the household SIM. We also support your proposals on sample size.