

This paper sets out South East Water's views in response to Ofwat's consultation 'Service incentive mechanism (SIM) for 2015 onwards'.

## 1 GENERAL COMMENTS

We are supportive of the SIM as an incentive mechanism. The mechanism has resulted in considerable customer service improvements in South East Water and the industry. As well as the considerable reputational incentive, the magnitude of financial incentive has been sufficient to deliver these improvements.

In particular, the inclusion of a measure of satisfaction brings a change in culture and improves the relationship with our customers. For this reason we have developed outcomes that directly relate to customers' satisfaction on the service they receive, in our business plan for 2015 to 2020. While this is a different approach compared to the historical method of measuring either activity or service failures, the approach will allow us to use a wide ranging set of actions to improve customers' satisfaction, not just focusing on the traditional output but engaging with customers in a more effective way as well.

Section 2.4 of the consultation briefly touches on generating comparable information. We agree any methodology changes need to ensure performance can be compared. However, we think the consultation is lacking any debate on the ambiguity of the current guidance or seeking feedback from companies where the guidance could be improved. Given the subjectivity around the classification of complaints and the reliance on 'any dissatisfaction' as a classification tool, this area of guidance could be improved.

The definition of a written complaint is one area of the guidance that needs some attention. The medium used by the customer should not matter. As technology moves on more communication will be through social media channels and mobile devices, channels like text messaging will be hard to classify as 'contacts'. We suggest that written complaints should be defined as letters sent via post, all other complaints through whatever medium should be reported under the complaint contact category.

## 2 CONSULTATION QUESTIONS

### 2.1 OVERALL DESIGN OF THE INCENTIVE

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

- *our proposition that the SIM should continue to incentivise service improvements in companies operating below the frontier; and*

- *whether, and if so in which areas, further service improvement by frontier companies should be incentivised – and the benefits of doing so.*

*Given the timing of this consultation, we would also consider evidence from any company outcomes beyond SIM.*

Response: The SIM should continue to incentivise all companies, those at frontier and those companies operating below frontier.

As stated above, given the considerable customer service improvements made to date, we are supportive of the continuation of the SIM as an incentive mechanism for the whole industry.

Customer expectations change over time and new technologies and innovations develop. Customers may be satisfied today but companies cannot be complacent to think that this will be maintained if they do not continue to deliver good customer service. Therefore there is still a place for SIM to incentivise this delivery.

*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:*

- *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;*
- *how these incentives (and financial risks and rewards) might be passed through from retail to wholesale businesses; and*
- *the proposition that we should leave companies to develop internal ‘contracting’ arrangements as they see fit, rather than be subject to any prescribed arrangements.*

Response: We agree with the proposal to continue to incentivise service improvements throughout the value chain. Customer satisfaction is driven by the whole value chain, therefore the mechanism should measure and incentivise both the retail function and wholesale function.

We have included SIM as a performance measure on our ‘Customers consider their direct interaction experience to be positive’ outcome in our business plan. This outcome and measure is shared between both retail and wholesale. Our analysis of contacts and complaints showed an appropriate split between retail and wholesale was 60:40 respectively.

While retail will own this outcome and have primary responsibility for delivering it, there will be internal arrangements and performance measures for retail to track wholesale performance and where appropriate pass on 40% of the reward or penalty.

Other companies may determine an alternative percentage share and incentive transfer arrangements based on their own performance and circumstances. Therefore these arrangements should be designed and operated by companies rather than be subject to any prescribed arrangements.

## 2.2 DETAILED DESIGN QUESTIONS

### **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).*

Response: We support option 1, retain current asymmetric structure. The effectiveness of the upside incentive is as effective as the downside. The current structure also forms a key component of our risk and reward package of incentives proposed in our business plan.

### **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?*

Response: We agree with this approach and have proposed the retention of this magnitude of financial incentive in our outcome delivery incentive package in our business plan.

It should also be noted that the incentive is applied to the full five year appointed revenue number, which makes the magnitude even more significant than the headline +0.5% to -1.0%.

### **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.*

Response: We support a move towards option 2.

As stated above, we have developed outcomes that directly relate to the customers' satisfaction on the service they receive in our business plan for 2015 to 2020. Our early thinking led us to begin discussions with a wide group of stakeholders on our proposal to move almost entirely to customer satisfaction based outcomes, measures and incentives. Whilst we received considerable support for this approach, not least from our Customer Challenge Group, there was some acknowledgement that it might be more appropriate to create a mix of satisfaction and output based measures, given the concerns for both the customer and the company if incentives were solely measured by satisfaction. As a result our outcome performance measures are a mix of satisfaction and more traditional output measures.

However we believe over time more weighting can be placed on satisfaction as actual service outputs have a direct impact on customer satisfaction. As set out in our business plan appendix 16 'Outcomes and Incentives', within our outcomes research we tested with customers if they had a different satisfaction score, based on their direct and indirect experience of a failure of our service. The theory being that direct experience of a service failure e.g. for interruptions, would produce a lower satisfaction score when compared to customers who had not had such an experience. The research showed there was a much lower level of satisfaction for those customers who had experienced a particular failure in aspects of our service, for example, a temporary interruption to their water supply, to those who had not, confirming the clear correlation between actual performance and customer satisfaction.

Greater weighting on the qualitative measure would drive companies to focus further on the service customers receive as opposed to concentrating on reducing numbers.

Inclusion of an 'all customers' qualitative measure should also be considered. We have introduced a performance measure in our business plan to track customer satisfaction with all customers, not just those who have contacted us. Irrespective of whether they have contacted us, all customers have received contact from us via billing and other literature. The satisfaction of these customers is not currently considered or incentivised. In the absence of this category within SIM we have included an additional measure in our plan, if SIM is amended to include all customers we would amend our performance measures accordingly.

#### ***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.*

Response: We support the preferred approach to adopt option 2.

With companies increasing communication channels customers are using alternatives to the telephone therefore we would support the inclusion of all contact routes in the unwanted contacts measure. However guidance on 'all media types' would need to be very explicit.

We would support the removal of the all lines busy measure on the basis that there is limited variability in performance in this area and if performance deteriorates

companies would experience an increase in other metrics included in the mechanism. However we believe calls abandoned should remain as this could influence behaviours on call handling.

We suggest a further amendment would be to include a mix of resolved and unresolved contacts in the qualitative survey. This would reduce companies ability to influence the sample and the sample could then be compared to total contacts to ensure they are all being accounted for.

#### ***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).*

Response: We support the adoption of option 1. The use of a relative incentive structure is a more appropriate mechanism to mimic the impact of competition. The difficulties in determining what an acceptable or target level of performance should be outweighs the potential disadvantages of a relative approach.

However we suggest there could be some performance capping where penalties would not be incurred. For example if all of the industry is reporting qualitative scores above 4, customers are either satisfied or very satisfied. However a company with a score below industry average could still be penalised. While there is still room for improvement a relative incentive is appropriate, but as performance for all companies reaches a level that is deemed acceptable the mechanism should be flexible to react to this.

#### ***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.*

Response: In our business plan the retail incentive will be shared between household and non-household, based on the criteria set out in our non-household customer business plan. Whilst we recognise that Ofwat have stated that they do not expect outcome delivery incentives to be applied to non-household customers we believe they should be offered the benefits up until the market opens effectively and we have detailed this approach in the non-household customer business plan.