Putting water consumers first – the service incentive mechanism
About this document

This document explains the new service incentive mechanism (SIM) which we will introduce from April 2010. We have taken account of responses to our consultation and the pilot work carried out during 2008-09. Our consultation paper, the responses we received and a report on the pilot consumer experience survey are available on our website.

The SIM is designed to encourage the water and sewerage sectors in England and Wales to improve the quality of service they provide. It will form one element of the package of incentives that apply to companies for 2010-15.

When we next set prices, we will make financial adjustments to reflect companies’ performance against the SIM in 2011-12 to 2013-14. We will consult again on the detail of how we intend to apply financial adjustments in the overall context of our approach to setting future price limits, taking account of the impact of any structural changes in the sectors.

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1. Introduction

1.1 Background

This document provides further information about the service incentive mechanism (SIM). It should be read alongside our document ‘Putting water consumers first – how can we challenge monopoly companies to improve’.

The SIM is a new mechanism that aims to incentivise the companies to improve the quality of service and value for money they offer consumers.

The SIM addresses the limitations of the current incentive mechanism, the overall performance assessment (OPA). It also goes further by focussing more on the quality of service provided to consumers. We will introduce the SIM from April 2010.

1.1 About the OPA

We have used the OPA mechanism since PR99. Each company gets an overall ‘OPA’ score. We determine the OPA by measuring performance against a number of service indicators. We then weight these to reflect consumer priorities. Performance against each indicator is combined to produce the OPA score.

Each year, we publish a league table that ranks the companies according to their OPA score. This has allowed us to monitor and compare the quality of the overall service consumers receive. It also provides information to consumers and other interested parties about their local water company’s performance compared with other water companies.

The OPA gives each company a financial incentive to improve and maintain its services. This is because we take account of their relative performance when we set price limits. A company that provides particularly good service is allowed to charge its consumers a little more than it could otherwise have done, while a company providing poorer service must charge less. Along with our other regulatory tools, the OPA has been successful in delivering improved services to consumers over the past two decades.

Although the OPA has been successful, we consider that there is now a need for a new approach. We have outlined the reasons for this in chapter 2.
In March 2008, we published PR09/09, ‘Ofwat’s review of the OPA and regulation of service to consumers’. This announced our intention to replace the OPA with a new mechanism focusing on the quality of service.

We then worked with stakeholders to develop and pilot our approach and in August 2009 published a consultation on our proposals for a new customer service incentive. The conclusions set out in this document take account of the responses to that consultation and views expressed at a stakeholder workshop during the consultation period. Respondents agreed that the OPA had been valuable, but now needs replacing.
2. Why a new incentive mechanism is required

2.1 The need for change

There are a number of reasons why we now need a new approach to measuring and incentivising customer service.

- In general, although most consumers are satisfied with the basic aspects of the service they receive\(^1\), about 6% of consumers are not. The companies and the Consumer Council for Water (CCWater) continue to receive a significant number of complaints about the quality of service.

- Many of the current OPA measures focus on companies’ reliability and response times. They do not measure the quality of the company’s response. There has been a consensus among stakeholders for some time that we need to incentivise qualitative aspects of service.

- The OPA is less effective than it used to be in driving further improvements by making comparisons between companies. This is because in most cases performance across the sectors has reached acceptable levels (except where a company has a particular failure in any one year).

- The measures previously used in the OPA assess performance against specific defined aspects of service. While this is appropriate when checking that companies are meeting required service standards, it does not reflect and can even limit innovative service improvements. We now want new measures that capture how well companies adapt to meet consumers’ changing expectations. Responses to our consultation agreed that the SIM should allow and encourage greater innovation than the OPA.

- Our pilot of the consumer experience survey showed that the sectors as a whole compare well with external benchmarks such as the energy sector. However, consumers’ satisfaction with individual companies’ handling of their issue ranges from between 60% and 90%.

\(^1\) Each year CCWater surveys consumer views. Its 2008 survey showed that 5% were dissatisfied with the service provided by their water and sewerage company. [http://www.ccwater.org.uk/upload/pdf/r7561_CCWater_report.pdf](http://www.ccwater.org.uk/upload/pdf/r7561_CCWater_report.pdf). Our research showed that 6% of respondents were dissatisfied with the service provided by their water and sewerage company. [http://www.ofwat.gov.uk/pricereview/pr09phase3/pap_rsh_pr09quantrshsumm.pdf](http://www.ofwat.gov.uk/pricereview/pr09phase3/pap_rsh_pr09quantrshsumm.pdf).
Our approach to regulation has changed. One of the purposes of the OPA was to provide comprehensive performance information to consumers and other stakeholders. We now do this in our annual ‘Service and delivery’ report. This document draws together different aspects of performance in a way not previously done and allows us to secure basic service levels. As a result, we can now focus our incentive more specifically on improving the quality of service. We will continue to work with the quality regulators, the Drinking water Inspectorate and the Environment Agency, to ensure that companies continue to deliver the good drinking water and environmental standards that consumers expect.

We are reviewing our approach to compliance and the regulatory information that we collect. We will make sure that consumers are properly protected. However, we expect the companies to take ownership of and responsibility for their performance monitoring and reporting. We will focus our routine monitoring on key areas and aim to reduce the regulatory burden on companies wherever possible. The SIM’s broader performance measures allow us more flexibility to review the need for current regulatory requirements. We discuss this in more detail in section 3.4.4.

Both the recently published Cave report\(^2\) and the Walker review\(^3\) report supported the need for a new incentive mechanism that focuses more on the consumer experience. They also made recommendations that, if implemented by the Government and Welsh Assembly, would change the structure of the industry and extend consumer choice. Our approach to regulation needs to be able to adapt to such changes.

This paper sets out the policy framework and scale of financial incentives for the new service incentive between 2010-11 and 2013-14. During this period, we will review our approach to future price setting in light of potential changes such as retail separation or the extension of competition. We will consult on this in due course.

As part of this package, we will set out more detailed proposals for applying the financial adjustments arising from the SIM. We will also consider whether the service incentive is required in the longer term, and how it might need to adapt to structural changes in the sectors when the timetable and detail of such changes becomes clearer.

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\(^2\) [www.defra.gov.uk/environment/water/industry/cavereview/final-report.htm](http://www.defra.gov.uk/environment/water/industry/cavereview/final-report.htm)

\(^3\) [http://www.defra.gov.uk/environment/quality/water/industry/walkerreview/final-report.htm](http://www.defra.gov.uk/environment/quality/water/industry/walkerreview/final-report.htm)
2.2 What we seek to achieve through the service incentive mechanism

A key principle of good service is that the company should meet its consumers’ expectations. If it fails, it should put the matter right quickly. We know that many consumer contacts could have been avoided by getting things right first time.

Therefore, the companies must be incentivised to do the following.

- **Get things right first time.** In general the best and cheapest way for a company to deal with any interaction with its consumers is to meet the consumer’s need at the first contact between them. If this is not possible then meeting their need with the fewest contacts after that is the next best option.

  Consumers become frustrated when they have to have repeated contact with their company in order to resolve seemingly simple issues. The dissatisfaction that results may have other consequences for the company. For example, the consumer may withhold payment or raise other issues for the company to deal with. Poor service also increases demand for a company’s services (this is known as ‘failure demand’). Our pilot consumer experience survey showed that only 63% of consumers had their issue resolved with a single call while 5% said they needed to make at least six calls.

- **Resolving complaints quickly and effectively.** It is not always possible for companies to get things right first time, so complaints are inevitable. However, consumers will be less dissatisfied if their complaint is dealt with quickly and effectively. Doing so not only improves a company’s reputation with its consumers, but also reduces failure demand.

Reducing failure demand and resolving more complaints first time can result in significant savings for companies and their consumers through lower bills. Research has shown that repeat calls are costly⁴.

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3. The service incentive mechanism

Over the past two years, we have worked with a stakeholder group to develop and pilot new measures of service to replace the OPA.

We have developed two new ways to measure the consumer experience. Together with the incentives we discuss in chapter 4, these ‘consumer experience measures’ form the SIM.

- The ‘quantitative measure’ reflects the number of complaints and telephone contacts that the companies receive. It measures the number of complaints at different stages of the complaints process – from a consumer making an initial phone call to their company, to the consumer asking CCWater to investigate a complaint. It also takes account of whether or not the company resolved the consumer’s problem the first time.

- The ‘qualitative measure’ reflects how satisfied consumers are with the quality of service they receive from their company. It is based on a survey of consumers who have had direct contact with their company – either to request a service or make a complaint. The survey asks consumers how satisfied they were with the way the supplier resolved their billing or operational issue (such as a report of sewer flooding).

In general, respondents to our consultation agreed that these measures would effectively capture the experience of those contacting the company to request a service. However, our approach would not capture the views of those consumers who do not contact their supplier.

We accept that the proposed experience survey does not take account of the views of those who have no reason to engage with their supplier. This is intentional.

General satisfaction surveys can represent the views of the ‘silent majority’. They tend to show that most consumers are satisfied with the overall service they receive. They can also capture views on broader issues, such as value for money and the environment, which are clearly important to consumers. However, our experience survey is designed specifically to give companies an incentive to get things right first time and to deal well with those who need a service or have a complaint. These are the issues that companies need to address in order to deliver further improvements in general satisfaction.

If we are to compare the companies’ performance, it is important that the data is robust. In their responses to our consultation, the companies raised a number of
technical issues. They were also concerned that more time was needed to achieve comparability. We will introduce the new experience measures as formal regulatory requirements from 2010-11 and will publish the results. However, as explained in section 4.2.4, we accept that more time is needed before financial incentives are applied.

We will expect the companies to take the necessary steps to ensure they are able to comply with our reporting requirements, and most have already committed to doing this. We will also put in place procedures to check the companies’ processes and data. We will take action, including enforcement action if necessary, if the companies’ reporting falls short of what we expect.

We describe below how we intend to use the new experience measures to calculate a score for the services that consumers experience. There is more information on this and on our responses to detailed points raised by respondents to our consultation in appendix 1.

3.1 Determining the score for the quantitative measure

The number of complaints each company gets will vary according to its size and the services it provides. Some companies provide only water, whereas others provide both water and sewerage services. Therefore, to make meaningful comparisons between the companies, the data for each part of the quantitative measure needs to be adjusted (or ‘normalised’). We will do this by dividing each element of the quantitative measure by a denominator to make them comparable.

We will then weight each element of the measure to reflect the increasing impact on consumers, and the cost, of failing to deal effectively with a complaint first time. These factors both increase as a complaint is escalated first through the company’s complaints process and eventually to CCWater. The weightings are set out below.

Table 1 Weighting of individual measures

<table>
<thead>
<tr>
<th>Element</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>All lines busy/calls abandoned</td>
<td>1</td>
</tr>
<tr>
<td>Unwanted telephone contacts</td>
<td>1</td>
</tr>
<tr>
<td>Written complaints</td>
<td>5</td>
</tr>
<tr>
<td>Escalated written complaints</td>
<td>100</td>
</tr>
<tr>
<td>CCWater investigations</td>
<td>1,000</td>
</tr>
</tbody>
</table>
A number of companies suggested that email complaints were closer to telephone contacts and should be distinguished from other written complaints. However, evidence from the experience survey pilot and discussions with the stakeholder group suggests that emails currently make up only a small proportion of contacts (about 4%).

While we agree that the companies should not be discouraged from using emails, we do not think that the added complexity of reporting them separately is necessary. Nor do we think most companies have systems to track emails separately from other written complaints within the DG7 measure. However, we will keep this issue under review should the volume of emails become more significant.

The companies also considered that lower importance should be given to cases that CCWater investigated, but where the companies’ decision was upheld. We have discussed this with CCWater who assure us that they do not accept any cases for investigation where it does not appear that the complaint has been poorly handled. Therefore, we do not propose making such a distinction. CCWater will ensure that the regional offices apply consistent policies when deciding which cases to investigate.

Finally, we will bring the elements together to produce a single score for the quantitative measure. Appendix 2 contains a worked example of how we will calculate the quantitative score.

### 3.2 Determining the score for the qualitative measure

The consumer survey includes questions that are designed to take the individual back through their experience of dealing with their supplier – from the first contact with the company to the point where the issue is resolved (or the company thinks it is). The questionnaire serves two main functions.

- It provides valuable insight into the reasons why the consumer is satisfied or dissatisfied.

- It allows the most benefit to be gained from improvements to the companies’ policies and practices.

We will calculate the qualitative measure score from consumers’ overall satisfaction with their billing or operational experience. Consumers will be asked how satisfied they were with the way their company dealt with their billing or operational issue.
They will rate this on a scale of 1 to 5 (where 1 is very dissatisfied, 5 is very satisfied).

In line with the recommendation from the pilot study, we will use the average satisfaction score for each company. This is calculated by adding together the satisfaction score of each consumer questioned and dividing by the number of consumers surveyed. This will reflect properly the distribution of satisfied and dissatisfied views.

The two different types of contact (‘billing contacts’ and ‘operational contacts’) will be given equal weighting in the qualitative score. Although this will over-represent the actual number of contacts concerning operational issues, it will mean that the relative importance of these issues for consumers is taken into account. We think this is appropriate given the importance to consumers of issues such as drinking water supply and sewer flooding. Most respondents to our consultation agreed with this approach.

The experience survey also includes questions that will allow us to benchmark companies’ performance against that of other sectors. We will not use this to calculate the SIM score. However, it is valuable to understand how consumers rate the water and sewerage sectors against others, including those where consumers have a choice.

### 3.3 Producing a combined consumer experience measure

We will weight the quantitative and qualitative elements equally to produce the combined consumer experience measure. We will then use this combined score to compare performance. For reasons of transparency, we will also publish each company’s quantitative and qualitative measure scores when we publish performance information.

The quantitative measure captures the overall volume of complaints and unwanted contacts.\(^5\) It will reflect the number of household and non-household consumers who are sufficiently unhappy with the service they receive to contact the company or refer their case elsewhere.

The qualitative measure reflects the views of a representative sample of those consumers, who have had direct dealings with a company on billing or operational issues. This sample will include both household and non-household consumers, but

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\(^5\) Unwanted contacts are those which a consumer would not need to make if he had no issues with his bill or water or sewerage service.
it will be smaller than the overall number of consumers and the number of contacts made.

However, the survey will cover all aspects of the suppliers’ business. It will also give a rounded view of the service experienced by those who have direct contact with their suppliers. If non-households make up a small proportion of total contacts, there may be a relatively small number of business consumer contacts within the survey sample. However, the survey will give us an insight into those issues that most concern non-household consumers. In the event that all non-household consumers are able to choose their supplier, we will decide whether the survey still needs to capture their views.

3.4 Impact on our information requirements

Stakeholders requested that we continue to publish key measures currently used in the OPA. We will continue to do this to give an overall picture of the companies’ activities. We also note and welcome that some companies now publish key service indicators in their own annual reports and when they announce their financial results.

We will review the regulatory information that we collect routinely as part of a wider review of our approach to compliance. Introducing the new experience measures may enable us to collect less detailed information from the companies. For example, we will no longer require the current DG9 survey once the experience survey is established, while other aspects of telephone service will be incorporated into the new quantitative measure.

Nor do we expect to continue the ‘assessed customer service’ element used for the OPA, except to ensure compliance with statutory or other requirements. This will allow us to carry out more focused investigations of specific aspects of service or issues emerging from the experience measures. It may be that other elements of our current regulatory information requirements can also be reduced or withdrawn. We will consider this as part of our compliance project.

3.5 Maintaining current standards of service

The SIM is not intended to act as a safeguard of basic service levels. We have other ways of doing this, including defining the outputs the companies need to deliver and taking action, including enforcement action, against them if they fail to do so.
We and other regulators will continue to monitor the key service attributes that the OPA currently covers. We will publish regular performance information to demonstrate how each company performs on these key service attributes and how this compares with other the companies.

Several stakeholders commented that the SIM will not incentivise the companies explicitly to improve important aspects of service such as the environment, which are important to consumers. While we agree the importance of such issues, we have separate mechanisms in place for considering and funding environmental improvements when we review price limits. Such investment is generally driven by legal requirements, is often costly and can have a significant impact on consumers’ bills.

Therefore, it is therefore appropriate that specific schemes are developed and challenged to ensure they are cost-beneficial. We will continue to work with the quality regulators and consumer representatives to ensure consumers’ views are properly taken into account when investment programmes are developed and scrutinised. We will also support the quality regulators in ensuring that companies deliver the work consumers are paying for.

Appendix 3 shows how we will continue to protect key services after we stop using the OPA.
4. The role of incentives

4.1 The reputational incentive

The companies have told us that they value being recognised as leaders in their sector. This is evidenced by the references they make to their OPA performance in their publications and financial announcements, and in the responses to our consultation. We expect the SIM to provide a similar reputational incentive.

We will collect and publish a comparative assessment of the companies’ performance against the two consumer experience measures to reinforce the SIM. This will enable consumers and other stakeholders to identify which companies offer the best and worst levels of service. Non-household consumers will be able to use this information to inform any choices they are able to make about their preferred supplier. Other consumers and their representatives will be able to use it to apply pressure on the companies to improve.

We will look for ways to strengthen this reputational impact. This may involve us, or the companies, publishing performance levels more frequently during the year. In any case, the companies will be aware of their individual performance through the year and will be in a position to tackle areas of concern.

4.2 The financial incentive

4.2.1 Is a financial incentive appropriate?

When we next set price limits, we will make a positive or negative adjustment to each company’s price limit based on their performance against the new experience measures. However, we will not apply financial incentives to performance in 2010-11. This is to allow sufficient time to ensure that comparisons are robust.

Most respondents agreed that a reputational incentive on its own, although powerful, would need to be supported with a financial incentive. This would then drive the improvements in consumer experience that we seek. A few thought the reputational incentive and potential efficiency gains were strong enough motivators.

Although some companies disagree, it could be argued that reputation can never be as powerful an incentive for a monopoly supplier as it is to one operating in a competitive environment. In a competitive market, consumers are likely to opt for or
stay with a supplier that offers them a good experience once they are satisfied with the basic service that the company offers. Those experiencing bad service may switch supplier.

For example, when British Gas experienced difficulties in transferring consumers to its new billing system in 2006, the level of complaints trebled between April and October. At the same time, its market share dropped from 52% to 47%, compared with an average drop of 1% to 2% a year in the five previous years.6

In a competitive market, companies that provide good service are likely to retain their existing consumers and may be able to charge more. In comparison, those that lose consumers through poor service will face lower revenue and reduced profits. Replacing consumers will also generate additional costs.

In a regulated monopoly situation, any financial incentives must be applied through regulation. In the past three price reviews, we have adjusted prices to take account of the service that each company provides. Based on the OPA, we allowed the companies providing better service to charge up to 0.5% more than they otherwise could. Those providing worse service were required to charge up to 1% less than they could otherwise have done. We applied these price adjustments in such a way that the rewards accrued to, and the penalties had an impact on, shareholders.

We have considered the pros and cons of applying a financial incentive to the SIM and have examined the impact of other regulatory incentives on the companies. By giving the companies an incentive to get things right first time, the SIM is expected to result in lower operating costs over time.

Our approach to price setting allows the companies to retain the benefits of outperforming our efficiency assumptions until the next price review. At that point, the benefits of improved efficiency are passed to consumers through lower prices. Therefore, the companies may receive some financial benefit to the extent that reducing failure demand helps them to become more efficient.

However, the companies may need to make cultural or other changes to the way in which they operate in order to improve consumer experience. We consider that a financial incentive could help to drive the mindset needed to deliver such changes in those companies that are not already consumer focused.

6 Domestic Retail Market Report, Ofgem, June 2007.
4.2.2 The relevant revenue

Given the potential changes in the structure of the sectors in the coming years, we will need to make sure that any price adjustments are applied to the relevant revenue. For example, if all non-household consumers were able to choose their supplier, it might not be appropriate to apply a financial adjustment to the revenue they generate.

Our approach could be adapted so that we only use SIM where consumers do not have a choice of supplier. Or we could continue to measure and publish the quality of service to household consumers without applying the financial incentive. This would allow them to make informed decisions when choosing a supplier.

Our decision on price adjustments will need to take account of the structure of the sectors when we make our decisions in 2014. We will review the longer-term need for and approach to the SIM, and potential financial adjustments, as we develop our approach to future price setting.

4.2.3 The range of the financial incentive

We still consider it appropriate to apply a range of potential incentives equivalent to that established for the current OPA. Therefore, the proposed price adjustments would range from +0.5 to -1.0 percentage points. As with the OPA, adjustments would be applied in the first year of the next period for which we will set prices, that is in 2015-16.

In their responses, some companies thought that the financial incentive should be increased or should be symmetrical. CCWater suggested that a bigger but asymmetric financial incentive (+1 to -3%) may be appropriate. Most respondents noted the need to stay within the bounds of what consumers were willing to pay for the potential improvements, particularly in areas where bills were already high.

The financial incentive will include both rewards (positive financial adjustments) and punishments (negative financial adjustments).

A **positive financial reward** will encourage the better performing companies to strive for further improvement. We agree with stakeholders that value for money and willingness to pay are important issues. We believe that upwards price adjustments should be modest, given:

- consumers’ concerns about price increases;
• the lower priority and low willingness to pay for improved handling of consumer contacts found in consumer research; and
• the potential efficiency gains for companies (our view of the potential benefits from improving first-time resolution is set out in more detail in our draft impact assessment in appendix 4).

We consider that potential negative price adjustments are appropriate. We also consider that they should exceed the potential rewards. This mimics what would happen in a competitive market where even successful companies must continually strive to outperform their competitors.

Research by Ofgem in 2008\(^7\) showed that 24% of consumers switched energy supplier in the previous year. Although the primary driver of switching was price, approximately 1% of consumers switched because of poor service.

Our joint research with CCWater also suggested that price would be the main driver of potential switching. Given a hypothetical choice, about 4% to 7% of household consumers thought that poor service might cause them to switch supplier\(^8\).

Consumers who were dissatisfied with their current water supply were more likely to say they would be likely to switch if it were possible. The consequence of losing consumers in a competitive market would be the loss of the relevant revenue. This loss of revenue would be reduced if other consumers switched in or the company’s performance improved.

Any financial incentive related to service needs to be reasonable when set against the other financial incentives in the regulatory context. Therefore, we have considered the SIM in relation to the:

• capital expenditure incentive scheme (CIS);
• capital efficiency incentive; and
• operating efficiency incentive.

### 4.2.4 The period of the financial incentive

We initially proposed to apply financial incentives from 2010-11. CCWater agreed with this. However, the companies did not agree. They argued that they needed more time to establish the new measures and ensure that comparisons were fair. On balance, we have agreed with this. Therefore, we will only apply a financial incentive

\(^7\) ‘Consumer Engagement Survey Report’ prepared for Ofgem by Ipsos MORI in August 2008.

\(^8\) Ofwat/CCwater ‘Research into household customers’ views on competition in the water and sewerage industry’ and CCWater annual tracking survey 2007-08.
to performance from 2011-12 onwards. This should not reduce the benefit to consumers significantly since the availability and publication of consumer experience data will provide a strong reputational incentive.

4.3 How we will decide the financial incentive each company receives

We will base price adjustments on a comparative approach during the first period in which the new measure operates.

While the price adjustments in our final determination of price limits for 2010-15 were based on a combination of absolute and relative performance, setting any sort of expectation for absolute performance levels is difficult for the new experience measures. This is because:

- we do not yet have reliable industry data on which to base an absolute scale or benchmark;
- we do not know what a 'good' score is, particularly for the quantitative measure;
- the survey measures performance against consumers' expectations, which are likely to change over time – therefore setting an absolute scale could be misleading; and
- setting regulatory performance bands risks distracting the companies' focus from their consumers’ needs.

Therefore, we expect to compare all the companies against each other. We will base our comparisons on each company’s average performance between 2011-12 and 2013-14 as we have done for the OPA.

A number of water and sewerage companies considered that they would be systematically disadvantaged if compared directly with water only companies. They argued that they were more likely to receive complaints as they provided two operational services. They also argued that it was more difficult to meet consumers’ expectations in relation to sewerage services. Others argued that we should take account of the level of metering, particularly if compulsory metering was implemented.

We have considered these points carefully. However, all companies have had the opportunity to set out water and sewerage investment plans for 2010-14 that they consider will meet their consumers’ expectations. They have also set out the levels and types of metering which they consider necessary or desirable. The companies’
proposals have been included in price limits if they can demonstrate that they are cost-beneficial. It is now for the companies to deliver their investment programmes and to communicate effectively with consumers.

In the pilot experience survey, the best performer was a water and sewerage company, with several water only companies comparing poorly. We have had the data analysed and have concluded that there is no systematic bias in the qualitative measure.

When considering the quantitative measure, we found that data for written complaints and unwanted telephone contacts shows that sewerage operations currently account for only about 10% of cases. We also found that sewerage cases are only slightly more likely to be escalated than others.

As we are using the SIM to assess each company’s ability to meet its consumers’ expectations, we consider it fair to compare water and sewerage companies and water only companies alongside each other. This simple comparison is transparent and gives consumers and other stakeholders a clear indication of relative service levels across the sectors.

We could analyse comparisons simply by ranking the companies. However, this approach risks creating artificial distinctions, which would not form a robust basis for price adjustments. Therefore, we propose to use performance bands. These will reflect the distribution of performance across the sectors. They will reward those companies that are better than average, and give those below average a negative adjustment. We will look at the distribution of results before making a final decision about which average is most appropriate to use.

A purely comparative approach does carry a risk of rewarding the least poor companies – rather than rewarding good service. We consider that we can mitigate this risk by publishing emerging company performance on a regular basis. This will allow the companies (and stakeholders) to see how their performance compares with others, and improve as necessary.

Some companies were concerned the good ones may be penalised if their peers out-perform them. However, this reflects what would happen in a competitive market.

We will consult further in the context of our approach to future price setting. However, we expect any decision we take on financial adjustments to reflect the following principles.
• The companies should compete with each other to receive a reward and avoid a penalty – as would happen in a competitive market.

• Any company performing below the industry average over the three years from 2011-12 to 2013-14 should expect a negative adjustment.

• We would avoid making artificial distinctions between companies when making decisions about price adjustments.

• To provide transparency and reduce the risk of performance deteriorating across the water and sewerage sectors, we will publish regular information on consumers’ experiences.

We will consult again on the detail of our approach to making price adjustments when we consult on our approach to setting future price limits and in future draft determinations.
5. Impact assessment

We have considered the impact that introducing the SIM will have on relevant stakeholders and published a draft assessment when we consulted in August 2009. We set out our revised impact assessment in appendix 4. This takes account of the comments received in response to our consultation and further evidence from our pilot of the experience survey. Our analysis shows that the considerable benefits for consumers outweigh the cost of introducing the new service measures and incentive mechanism.
6. Next steps

- We will update the reporting requirements for 2010-11 to include the experience measures.

- We will continue to work with the industry and stakeholder group to ensure data is sufficiently consistent and comparable to support financial adjustments from 2011-12.

The companies should now take the necessary steps to put in place systems and processes which will enable them to deliver survey sample and regulatory data which complies with the requirements of the SIM.

We will not publish an OPA for 2009-10.

Our 2011 service and delivery report will include company-specific data for the SIM in 2010-11.
Appendix 1  The new experience measures

The SIM will be based on two consumer experience measures.

- The first is a quantitative measure based on the number of complaints and unwanted contacts a company receives.

- The second is a qualitative measure (one based on the quality of the experience) derived from a consumer experience survey.

These two measures aim to capture both the number of times a company fails to meet the expectations of its consumers, as well as the experience of those consumers.

A company that offers a good level of service would expect to not only receive fewer unwanted contacts, but to deal with any contacts received in a manner that satisfies their consumers.

The quantitative measure

This aims to measure the number of times consumers contact their company because of its failure to meet their expectations. It acts as a broad measure of ‘failure demand’. This is the extra demand placed on a company because of service failures, such as:

- work not being done properly;
- work not being done at all;
- failing to keep a consumer informed; or
- prioritising targets which do not reflect consumers’ needs.

The measure combines the following five individual separate measures of performance.

1. **All lines busy and calls abandoned.** The ‘all lines busy’ category measures the degree of difficulty consumers experience in being able to connect with a company agent or automated system. The aim of this category is to capture the total number of callers who abandon their call before it is substantively answered by the company.
2. **Unwanted telephone contacts.** This is where a caller has experienced some degree of annoyance (however mild) which has prompted them to make contact.

3. **Written complaints.** This is any written communication from a consumer or their representative alleging that a service or lack of service by the company has fallen short of their expectations.

4. **Written complaints not dealt with at the first stage of a company’s complaint procedure.** This is defined as a second complaint from a consumer relating to the same issue that, in accordance with the company’s approved complaints procedure, is reviewed by a person or persons not involved in providing the response to the consumer’s first complaint.

5. **Complaints not resolved by a company and accepted for investigation by CCWater.**

The number of complaints each company gets will vary according to its size. To make meaningful comparisons between companies, the data for each part of the quantitative measure therefore needs to be adjusted (or ‘normalised’). We do this by dividing each element of the quantitative measure by a denominator to make them comparable. We intend to use the total number of connected properties (as reported in the companies’ June returns to us each year). This gives the number of contacts per 1,000 properties connected.

Although some companies thought this approach would disadvantage companies providing both water and sewerage we think this approach, which was considered carefully with the stakeholder group, is reasonable. Each company is ‘contracted’ and funded for providing a service to consumers regardless of the number of services provided. The weighting is straightforward and easy to understand. The evidence does not support the idea that consumers receiving both water and sewerage are twice as likely to complain. We think the loss of transparency from moving to an alternate weighting is not justified.

Each of the measures listed above captures the number of complaints at a different stage of consumer contact. Complaints are escalated to different stages if they remain unresolved. Complaints referred to CCWater are the severest form of complaint.

In calculating the quantitative measure, each of these individual measures will be weighted according to the severity of the complaint. The weightings reflect the quality of service offered to consumers and the escalating demand that failure places on a
company’s systems and processes. As cases escalate, costs increase as more senior staff are involved and wider consultation is needed to gather the case history and a more detailed response is necessary.

The weighting elements will remain fixed for the five-year price review period. This is to give clarity, stability and transparency.

The table below sets out the weightings we will use.

**Table 3  Weighting of individual measures**

<table>
<thead>
<tr>
<th>Element</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>All lines busy/calls abandoned</td>
<td>1</td>
</tr>
<tr>
<td>Unwanted telephone contacts</td>
<td>1</td>
</tr>
<tr>
<td>Written complaints</td>
<td>5</td>
</tr>
<tr>
<td>Escalated written complaints</td>
<td>100</td>
</tr>
<tr>
<td>CCWater investigations</td>
<td>1,000</td>
</tr>
</tbody>
</table>

Our justification for the weightings is as follows.

- Written complaints require more effort by the consumer. They often follow an inadequate telephone contact. They also require more effort on a company’s behalf to resolve than a telephone contact. However, because emails are included within the written complaints figure, we have set the weighting of written complaints to reflect that emails sit between a phone call and a letter in terms of severity.

- We do not intend at this stage to differentiate between written and email complaints. We feel that this would add an extra layer of complexity without a commensurate benefit while the volume of email complaints is low. We acknowledge that emails may be a less formal, perhaps conversational, means of communication, but the measure only counts emails that are considered to be complaints. The companies should deal with these as fully and carefully in their first response as other written complaints. However, we will keep this issue under review.

- Escalated complaints and CCWater investigations have a high weighting. This reflects the fact that a company will have had at least one opportunity, or possibly more, to resolve the consumer’s issue before it gets to this stage.

- We agree with CCWater that their assessments of how companies handle complaint cases can help to improve companies’ performance and ensure
that companies escalate cases appropriately. However, we do not think that means the assessment should included as part of the performance measure. We will involve CCWater when we review and reapprove companies’ complaints procedures.

- CCWater investigations have the highest weighting because they can only begin once a consumer has exhausted the company’s complaints procedure. This reflects the extra effort a consumer has to go through, as well as the extra cost to the company. Cases are examined in greater depth and incur costs to the companies in co-operating with CCWater as they ascertain the events surrounding the case.

- We do not intend to distinguish between CCWater cases that are upheld after investigations and those that are not. If a consumer needs to make the extra effort to involve CCWater, there has been a perceived service failure at some point, regardless of the final outcome. CCWater already filter out complaints that have no apparent merit to prevent groundless complaints being investigated, or complaints that the company has already thoroughly investigated and taken appropriate action. This is to a large extent dependent upon the information provided by companies as to what action has already been taken, and so is within their control to influence. We look to CCWater to ensure that its regional offices operate consistently.

- The weightings place a real onus on the companies to do as much as they can to ensure a consumer does not feel the need to approach CCWater. It also gives consumers confidence that their company will deal with the issue effectively. This is in the best interests of both the consumer and the company. It also reflects the fact that significant costs will have been incurred by an investigation irrespective of the conclusion.

Appendix 2 illustrates how the weightings work in practice.

The current measures focus on specific interactions between individual consumers and their water company. As such, the measures do not at present include newer forms of communication, such as social networking sites or blogs. There is room for companies to innovate in this field, as effective use of new media could lead to a reduction in overall unwanted contacts and improved satisfaction levels. Proactive communication with consumers through such media is not currently captured within the SIM. We would not want to inhibit companies from exploring such approaches and would therefore consult further before extending the scope of the SIM beyond the current scope of written and telephone contacts.
The qualitative measure

The qualitative measure aims to gauge how a consumer feels about a specific, actual interaction with their company. It will seek views on the consumer’s experience from first contact to resolution of the issue.

It will be obtained from a consumer experience survey, carried out on our behalf by an external contractor.

The companies will be asked to provide a data set to the contractor at times we determine on a regular, quarterly basis. The data set will consist of the appropriate details of all consumer contacts that the company resolved in a defined previous period. From the data set, the contractor will randomly select contacts to survey until set quotas are reached. The sample size will take account of the pilot work we are carrying out with the companies. This will be sufficient to provide robust annual comparisons between the companies.

In order to ensure all aspects of a company’s operations are covered, the interviews will have a quota of equal splits for billing related contacts, contacts relating to water operational matters, and where appropriate contacts relating to sewerage operations.

Billing contacts are those related to consumers’ bills. Operational contacts relate to other aspects of a company’s work, such as leaks, water quality or sewerage. We recognise that the vast majority of a company’s contacts are about billing. However, we feel that it is the operational contacts that have the greatest impact on consumers (such as sewer flooding). Therefore, it is essential that we capture these in sufficient numbers. Dealing with operational issues more effectively is also likely to deliver the biggest benefits in terms of reduced costs.

For each company, the survey will seek to establish consumers’ views on the:

- company’s handling of their contact or service issue;
- outcome of the contact or service issue;
- level of satisfaction with overall experience; and
- reasons for dissatisfaction or satisfaction.

The survey will also ask consumers to compare their company with the service they have received from similar organisations. This will enable comparisons between the water and sewerage and other sectors in terms of consumer satisfaction.
Putting water consumers first – the service incentive mechanism

The survey will cover the different forms of communication and stages a consumer has been through as their issue is addressed. It is likely that for some issues, the company and the consumer will have used different forms and combinations of communication, for example a mixture of telephone calls, written correspondence/or emails, or visits from company representatives or contractors.

The survey will cover contacts that have been resolved. ‘Resolved’ means that all necessary actions have been completed. For many contacts, such as requesting a leaflet or changing account details, this will be when the final, substantive reply is sent by the company. However, this will not be the case for all contacts, such as when investigation or a capital scheme is required.

We expect that the companies will not be given advance warning of when they will be asked to provide the data set. The companies will be asked to provide all contacts that have been resolved in a previous period. For the large companies, one week will provide a sufficient sample. Because some of the smaller water only companies do not generate a sufficient number of resolved operational contacts in a single week, they may need to provide all resolved operational contacts over a longer period. Such companies will need to provide data over a four week period. We will work with companies to make sample collection as practicable as possible.

Consumers will be asked to rate their overall satisfaction with how the company dealt with their issue, from the first contact to the final resolution. The possible scores range from 1 (very dissatisfied) to 5 (very satisfied). The mean score of total responses to this question will form the company’s qualitative measure score.

In order to ensure comparability between water and sewerage companies and water only companies, the mean score for the qualitative measure will be weighted so that 50% of it will be made up from billing contacts and 50% from operational contacts.
Appendix 2 Worked example of composite quantitative measure

Any water company

**Step 1:** The company submits data to us as part of their annual regulatory return.

<table>
<thead>
<tr>
<th>Element</th>
<th>Reported data</th>
<th>Denominator</th>
<th>Normalised data per 1,000 properties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total properties connected</td>
<td>1,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>All lines busy and calls abandoned</td>
<td>10,000</td>
<td>1,000,000</td>
<td>10</td>
</tr>
<tr>
<td>Unwanted telephone contacts</td>
<td>200,000</td>
<td>1,000,000</td>
<td>200</td>
</tr>
<tr>
<td>Written complaints</td>
<td>7,000</td>
<td>1,000,000</td>
<td>7</td>
</tr>
<tr>
<td>Written complaints not dealt with at the first stage of a company’s complaint procedure</td>
<td>300</td>
<td>1,000,000</td>
<td>0.3</td>
</tr>
<tr>
<td>Complaints not resolved by a company and accepted for investigation by CCWater</td>
<td>20</td>
<td>1,000,000</td>
<td>0.02</td>
</tr>
</tbody>
</table>

**Step 2:** We will then normalise the data to allow it to be compared with the data from other companies.
Step 3: We will then weight the data for individual measures.

<table>
<thead>
<tr>
<th>Element</th>
<th>Normalised data</th>
<th>Weighting</th>
<th>Weighted data</th>
</tr>
</thead>
<tbody>
<tr>
<td>All lines busy and calls abandoned</td>
<td>10</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>Unwanted telephone contacts</td>
<td>200</td>
<td>1</td>
<td>200</td>
</tr>
<tr>
<td>Written complaints</td>
<td>7</td>
<td>5</td>
<td>35</td>
</tr>
<tr>
<td>Written complaints not dealt with at the first stage of a company’s complaint procedure</td>
<td>0.3</td>
<td>100</td>
<td>30</td>
</tr>
<tr>
<td>Complaints not resolved by a company and accepted for investigation by CCWater</td>
<td>0.02</td>
<td>1,000</td>
<td>20</td>
</tr>
</tbody>
</table>

Step 4: We will then use the weighted data to calculate the quantitative score for the company.

<table>
<thead>
<tr>
<th>Element</th>
<th>Weighted data</th>
</tr>
</thead>
<tbody>
<tr>
<td>All lines busy and calls abandoned</td>
<td>10</td>
</tr>
<tr>
<td>Unwanted telephone contacts</td>
<td>200</td>
</tr>
<tr>
<td>Written complaints</td>
<td>35</td>
</tr>
<tr>
<td>Written complaints not dealt with at the first stage of a company’s complaint procedure</td>
<td>30</td>
</tr>
<tr>
<td>Complaints not resolved by a company and accepted for investigation by CCWater</td>
<td>20</td>
</tr>
<tr>
<td>Total</td>
<td>295</td>
</tr>
</tbody>
</table>
## Appendix 3 Maintaining service levels after OPA is discontinued

<table>
<thead>
<tr>
<th>Measure used in existing OPA</th>
<th>How service is protected</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water supply measures</td>
<td></td>
</tr>
<tr>
<td>• Low pressure – DG2</td>
<td>• Defined outputs for DG2, DG3 and serviceability in final determinations</td>
</tr>
<tr>
<td>• Supply interruptions – DG3</td>
<td>• Statutory standards in guaranteed standards scheme (GSS)</td>
</tr>
<tr>
<td>Drinking water quality</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Drinking water standards and DWI enforcement powers</td>
</tr>
<tr>
<td>Sewerage service</td>
<td></td>
</tr>
<tr>
<td>• Sewer flooding incidents and properties at risk – DG5</td>
<td>• General supply duty in s94 of Water Industry Act</td>
</tr>
<tr>
<td></td>
<td>• Defined outputs for DG5 and serviceability in final determinations</td>
</tr>
<tr>
<td></td>
<td>• Statutory standards in GSS</td>
</tr>
<tr>
<td>Security of supply</td>
<td></td>
</tr>
<tr>
<td>• Leakage – DG4</td>
<td>• General supply duty in s37 of Water Industry Act</td>
</tr>
<tr>
<td>• Security of supply index (SoSI)</td>
<td>• Statutory water resource plans</td>
</tr>
<tr>
<td>Consumer service</td>
<td></td>
</tr>
<tr>
<td>• Speed of handling billing contacts and written complaints – DG6, DG7</td>
<td>• Defined outputs for DG6, DG7, DG8 and DG9 in final determinations</td>
</tr>
<tr>
<td>• Bills based on meter reading – DG8</td>
<td>• GSS standards for responding to written complaints and certain billing contacts</td>
</tr>
<tr>
<td>• Handling of telephone calls – DG9</td>
<td>• Approved codes of practice and complaints procedures</td>
</tr>
<tr>
<td>• Other assessed consumer service</td>
<td>• Ofwat guidelines on dealing with consumers in debt and those with special needs</td>
</tr>
<tr>
<td>Environmental performance</td>
<td></td>
</tr>
<tr>
<td>• Pollution incidents</td>
<td>• Statutory environmental requirements and regulatory powers</td>
</tr>
<tr>
<td>• Sludge disposal</td>
<td>• Specified serviceability outputs in final determinations</td>
</tr>
<tr>
<td>• Sewerage works compliance</td>
<td></td>
</tr>
</tbody>
</table>
Appendix 4 Impact assessment

Summary of intervention and options

<table>
<thead>
<tr>
<th>Department: Ofwat</th>
<th>Draft impact assessment of the new service incentive mechanism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage: Final</td>
<td>Version 1</td>
</tr>
</tbody>
</table>

What is the problem under consideration? Why is intervention necessary?

Water companies are vertically integrated monopoly suppliers with exclusive privileges to serve consumers in their region. Because consumers have no choice, there is a risk that the companies have no incentive to provide good service, or to outperform their peers. Protecting consumers is at the heart of what we do. Therefore, intervention to incentivise such good service is necessary and has been in place for some time.

We introduced the existing service incentive, the overall performance assessment (OPA), at the 1999 price review to mimic the impact of consumer choice in a competitive market. We have used the OPA through three price review periods – it has contributed to significant service improvements and the leveling up or “bunching” of performance across the sectors.

Given the bunching of performance on the historic measures that comprise the OPA, and rising consumer expectations from their monopoly suppliers, it is appropriate that we review and update the existing incentive to better reflect consumers’ priorities. In particular, the OPA now needs to evolve to address the quality of consumers’ experience. We set out the reasons for this in chapter 1.

The government-commissioned independent Cave and Walker reviews have supported the need for an incentive reflecting consumer experience. CCWater and the companies have supported our work and participated in a working group to develop and pilot the new experience measures. Consumer Focus, in its ‘Rating Regulators’ report, welcomed this work as innovative.

What are the policy objectives and the intended effects?

The primary policy objectives are to incentivise continued improvements in the quality of service and value for money consumers receive from the monopoly water and sewerage suppliers until such time as they are able to choose their supplier.
This will be achieved by encouraging the companies to understand and take responsibility for delivering what consumers, rather than the regulators, expect, as would be the case in a competitive market.

A secondary policy objective is to simplify the regulatory regime, removing duplication where possible. By refocusing the OPA on consumer experience, it will no longer duplicate those aspects of service where standards and other enforcement tools are already applicable. Appropriate standards secured by regulatory or enforcement mechanisms would protect core services.

The intended effects include the following.

- Consumers receive better service and value for money.
- Consumers are better informed about the quality of service provided by their supplier.
- The companies focus on consumers’ expectations.
- The companies are better able to identify failure demand within their business and improve first-time resolution, which will contribute to more efficient operations. The efficiency savings will lead to lower prices for consumers when prices are next set.

What policy options have been considered? Please justify any preferred option

We have considered the following.

- **Option 1.** Continued use of the existing OPA incentive mechanism.
- **Option 2.** Introducing an updated incentive mechanism that focuses on the quality of consumer experience.
- **Option 3.** No incentive mechanism.

Our preferred option is number 2, to implement the SIM. This option brings greater benefits compared with its costs as detailed below.

We do not consider option 3 (no incentive mechanism at all) to be viable in an environment where consumers have no choice and are served by monopoly companies.

Our primary duty under section 2 of the Water Industry Act 1991 is to promote the consumer objective, wherever appropriate by promoting competition. Our strategy states that we will:
Putting water consumers first – the service incentive mechanism

- make sure that our work reflects consumer priorities; and
- set challenging service standards that aim to deliver what consumers would choose in a competitive market.

Until consumers are able to choose their supplier, we cannot achieve these aims without some mechanism to incentivise quality of service to consumers above the minimum standard. Therefore, we have not considered option 3 any further in this analysis. We will however keep this option under review as the shape of the industry develops.

If needed, when and how will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The impact of the SIM on service to consumers will be measured and published annually in our ‘Service and delivery’ report. We will first publish performance data in 2011.

The future need for and application of the SIM will be reviewed in the light of the changing structure of the sectors as we consider our future approach to regulation before we next set prices in 2014.

Summary of analysis and evidence

Policy option 1
Description: Change nothing. Continue to use the existing overall performance assessment to measure company performance.

Costs

Description and scale of key monetised costs by “main affected groups”

Regulatory requirements remain the same. Quantified costs are associated with continuing to run the annual DG9 surveys of approximately £60,000 per year for a further five years.

Total cost (Present Value): c £280,000
Other key non-monetised (qualitative) costs incurred by each of the “main affected groups”

Companies

- No comparative measure of end-to-end consumer experience.
- Lack of sector-wide comparability on qualitative consumer service issues.
- Continued focus on regulator’s expectations rather than what the consumer expects.
- Risk of targeting resources and improvements in areas that do not offer value to consumers.
- No incentive to innovate to deliver exemplary consumer service in the sector.
- Costs associated with failure demand and issue resolution are not visible.
- Continued overlap of regulatory provisions and sanctions.
- Potential disincentive to innovate in consumer service provision.

Consumers

- Consumers receiving service significantly better than the sector will see prices increase by up to 0.1% a year over a five-year price review period (applied as 0.5 in year 1 of the five-year period). The precise revenue impact depends upon each company’s performance over the five-year period. The price increase would be applied in 2015-16.
- Slow or limited improvement in consumer experience.
- No comparative information on quality of service to inform consumers or their representatives.
- Slow or limited improvement in first-time resolution of consumer issues.
- New services or service levels that consumers might choose in a competitive market not delivered.
- Potential for a lack of focus in areas which matter most to consumers.
- Potential loss of efficiency gains from first-time resolution of problems.
- Potential loss of communication and innovation in consumer service provision.

Regulators

- Continued staff costs of analysing annual OPA for limited further benefit to consumers.
• Costs to the DWI of continuing the produce its overall performance index (OPI) which they no longer use and only produce for our OPA.
• Costs of reviewing and consulting on outdated elements of the OPA.
**Benefits**

**Description and scale of key monetised benefits by “main affected groups”**

None

Total benefit (PV): £ n/a

**Other key non-monetised (qualitative) benefits experienced by each of the “main affected groups”**

- Provides consumers and other stakeholders with a comparison of company performance (excluding consumer experience) across the sector.
- Limited benefit to consumers in terms of further service improvements since OPA now operates more as a sanction for poor service than an incentive for improved service.
- Consumers receiving comparatively poor service may see prices decrease by up to 0.2% a year over a five-year price review period (applied as a 1% reduction in the first year). The exact revenue impact depends upon each company’s performance over the five-year period.
- Regulatory burden on companies remains the same.

**Key assumptions/sensitivities/risks**

This option assumes it is appropriate to continue with the OPA in its current format. We do not believe this to be the case.

- The current OPA does not contain what we might now regard as the most useful suite of measures to reflect the range of consumer expectations.
- Some measures used in the OPA have been overtaken:
  - The DWI no longer uses the OPI index we have used for the OPA – so this aspect would need to be reviewed.
  - The Environment Agency has changed the way it regulates and interprets some of the measures currently in the OPA – this aspect would also need to be reviewed.
- The OPA does not contain elements which we would now consider important aspects of a company’s overall performance, for example:
  - carbon footprint; and
  - serviceability.
• The OPA, because it reflects specific quantitative measures of customer service (for example speed of response) may deter companies from improving quality or innovating in their communication with consumers.

If continued, the old OPA would require a review, diverting resources which would deliver more benefit for consumers if focused on implementing the proposed new service incentive mechanism.

<table>
<thead>
<tr>
<th>Price base year</th>
<th>Time period (years)</th>
<th>Net benefit range (NPV) £</th>
<th>Net benefit (NPV/best estimate) £</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>5</td>
<td>[280,000]</td>
<td>[280,000]</td>
</tr>
</tbody>
</table>

Policy option 2
Description: Introduce the service incentive mechanism

Costs

Description and scale of key monetised costs by “main affected groups”

Average annual cost of the ongoing survey is c £300,000 a year over five years.

Total cost (PV): £1.4 million

Other key non-monetised (qualitative) costs incurred by each of the “main affected groups”

• Consumers receiving service significantly better than the sector will see prices increase by up to 0.1% a year over a five-year price review period (applied as 0.5 in year 1 of the five-year period). The precise revenue impact depends upon each company’s performance over the five-year period. The price increase would be applied in 2015-16.

• Costs for the companies associated with modifying systems, where necessary, to report robust and accurate data in a form suitable for the new consumer experience measures. The new measures have built on data already collected and developed to be compatible with the companies’ systems where possible. The companies are currently developing systems and processes during the pilot phase and have not indicated that the costs are a matter for concern.
Company reporters will be required to understand the new measures and analyse company data annually. However the ongoing costs will be largely offset by discontinuing work on the current survey of telephone service (DG9).

Opportunity cost of our and company resources focused on development of the new measures.

Minimal cost of communicating the new approach to stakeholders.

Small cost in time for consumers who are surveyed partly offset by discontinuation of the DG9 survey.

Benefits

Description and scale of key monetised benefits by “main affected groups”

Potential ongoing annual cost saving of £50,000 to £70,000 realised if DG9 survey is amalgamated with consumer experience survey.

Visibility of failure demand gives the companies the potential to make significant efficiency savings rewarded through our efficiency incentives and subsequently passed to consumers through reduced prices.

To illustrate (on conservative assumptions):

- Reduction of failure demand – a total of c £10 million to £50 million across the sectors could be saved by reducing avoidable operational contacts by 10% in one year.

- On a conservative estimate, a total of up to £4 million a year across the sectors could be saved by reducing incoming complaints by 10% and escalating 10% fewer at each stage

Total benefit (PV): £100 million - £385 million illustrative

Some companies argue that they are already working to reduce failure demand. However the pilot experience survey confirmed that there is still a significant level of repeat contact and other failure demand in companies.
Other key non-monetised (qualitative) benefits experienced by each of the “main affected groups”

Consumers

- Consumers receiving comparatively poor service may see prices decrease by up to 0.2% pa over a five-year price review period (applied as a 1% reduction in the first year). The exact revenue impact depends upon each company’s performance over the five-year period. The price adjustment would be applied in 2015-16. Companies will be incentivised to take an interest in what matters to consumers and to focus on providing a good level of service.

- In the quantitative measure escalated complaints carry the greatest weighting, so there will be considerable incentive on companies to resolve consumer issues as quickly as possible.

- Consumers and other stakeholders are provided with a comparison of company performance across the sector. This may be of particular benefit to commercial consumers.

- The emphasis is placed on recognising what is important to consumers rather than solely satisfying the regulators’ expectations.

- Service to household and business consumers can be measured separately.

- Cost savings through improved first-time resolution should lead to lower bills in the future.

- Prices will decrease for consumers of companies providing poor service.

- Core services will continue to be protected, so there would be no cost to consumers for discontinuing the existing OPA.

- Guards against the companies using their monopoly position to ignore customer service.

Companies

- Increased awareness and visibility of failure demand.

- Increased awareness of their consumer’s experiences.

- Sector wide comparability and benchmarking across industries.

- Ability to target improvements that have the potential to make significant savings.

- High performing companies will be recognised.

- Companies will have a clearer indication of the costs associated with unwanted contacts through the quantitative measure.

- Improving failure demand will result in more effective use of staff time.
• Increased staff morale.

Regulators

• Support us in meeting our strategy.
• More consistent with retail separation than the current OPA and reduces future costs which would necessarily arise from structural changes.
• Recognised as innovative regulation.
• Consistent with Cave and Walker recommendations.
• Consistent with better regulation principles.
• Removes the cost to DWI of producing OPI.
Consumer organisations

- Fewer complaints to deal with.
- Better targeting of resources at particularly difficult cases.

Key assumptions/sensitivities/risks

Assumptions are conservative.

- Costs savings would not accrue until 2014-15 – in practice the companies are already beginning to respond to the incentive.
- Benefits would continue over 10 years to 2024 – in practice the benefits of increased efficiency should continue in perpetuity. However, given potential structural changes we have used a shorter period consistent with Green Book guidance.

Company performance will be measured against the new SIM during 2010-11 to 2014-15 (although no financial incentive will be applied to the first year’s data). Resulting price adjustments would be decided when prices are next set in 2014.

The Cave review has recommended changes to the structure of the water industry. The new incentive mechanism can be more easily adapted to changes in the industry such as separating retail from other parts of the value chain or expanding competition for business consumers. The new incentive mechanism will apply to performance during 2010-11 to 2013-14. We will apply any price adjustments to the relevant revenue, taking account of the industry structure at the time we set price limits. We will review the need for the SIM or any other incentive as we consider our future approach to regulation in a changing industry.

<table>
<thead>
<tr>
<th>Price base year</th>
<th>Time period (years)</th>
<th>Net benefit range (NPV) £</th>
<th>Net benefit (NPV/best estimate) £</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-10</td>
<td>15</td>
<td>£100 million to £385 million</td>
<td></td>
</tr>
</tbody>
</table>
## Summary of analysis and evidence

**Policy option 1**  
**Description:** Change nothing. Continue to use the existing overall performance assessment to measure company performance.

<table>
<thead>
<tr>
<th>What is the geographic coverage of the policy/option?</th>
<th>England and Wales</th>
</tr>
</thead>
<tbody>
<tr>
<td>On what date will the policy be implemented?</td>
<td>OPA already in place but would need modification if continued.</td>
</tr>
<tr>
<td>How will the policy be enforced?</td>
<td>We will collect and publish company performance data each year. Price adjustments will be made when we set prices in 2014. The companies have statutory and licence requirements to report their performance in accordance with our reporting requirements. We have powers to fine companies which misreport.</td>
</tr>
</tbody>
</table>
| How is the proposal consistent with best regulatory practice? | **Transparent**  
The current OPA is well established but outdated. It also duplicates areas where other we and other regulators have other powers or sanctions.  
**Accountable**  
The OPA uses measures defined by the regulator’s rather than consumers’ expectations.  
**Proportionate**  
The OPA focuses on core services. The range of price adjustments used is well established. However, the OPA is now producing limited benefits for consumers.  
**Consistent**  
A financial incentive has been applied to the OPA over three price reviews period but because of diminishing benefits and changing regulatory context it needs to evolve. |
<p>| Which stakeholders are impacted?                     | Water and sewerage companies, Water only companies, consumers, Ofwat, quality regulators, CCWater, consumer organisations, Water UK, the Government. |</p>
<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>How will the proposal further and comply with our primary duties (including the consumer objective and competition) as set out in section 2 of the Water Industry Act 1991 (WIA91)?</td>
<td>The existing OPA is no longer delivering significant service improvements for consumers. The OPA is not readily applicable to a changing industry or the structural changes needed for extending competition.</td>
</tr>
<tr>
<td>How does the proposal further our section 2 WIA91 secondary duties, including the duty to contribute to the achievement of sustainable development?</td>
<td>The OPA is not required for the achievement of sustainable development. We and other regulators have other tools to secure delivery of environmental outputs.</td>
</tr>
<tr>
<td>What is the impact on carbon footprint (value of changes in greenhouse gas emissions)?</td>
<td>At present there is no incentive for the companies to focus on consumer experience by targeting first-time resolution, consequently the carbon footprint of the companies and consumers is not reduced because the same level of activity is required to resolve issues.</td>
</tr>
<tr>
<td>Is the proposal consistent with race, disability and gender equality?</td>
<td>Yes, in so far as the constituent measures cover service to all consumers.</td>
</tr>
<tr>
<td>Impact on regulatory burdens:</td>
<td>The regulatory burden remains the same. The OPA duplicates other sanctions available to us and other regulators.</td>
</tr>
<tr>
<td>• data requirement (increase/decrease/net change)</td>
<td></td>
</tr>
<tr>
<td>• cost of additional regulatory burden (£ – specify annual one-off etc)</td>
<td></td>
</tr>
</tbody>
</table>

### Policy option 2
**Description:** Introduce the service incentive mechanism.

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the geographic coverage of the policy/option?</td>
<td>England and Wales</td>
</tr>
<tr>
<td>On what date will the policy be implemented?</td>
<td>The new performance measures will be implemented from April 2010 and financial incentives applied from April 2011.</td>
</tr>
<tr>
<td>How will the policy be enforced?</td>
<td>We will collect and publish company performance data each year. We will make price adjustments when we set prices in 2014. The companies have statutory and licence requirements to report their performance in accordance with our reporting requirements. We have powers to fine companies which misreport.</td>
</tr>
<tr>
<td>How is the proposal consistent with best regulatory practice?</td>
<td><strong>Transparent</strong> The new SIM will increase transparency by removing overlaps with other regulatory sanctions available to us and other regulators. We began consulting on this issue in October 2007, published outline proposals in March 2008 (PR09/09) and worked with a sector working group to</td>
</tr>
<tr>
<td>Which stakeholders are impacted?</td>
<td>Consumers, water and sewerage companies, water only companies, Ofwat, quality regulators, CCWater, consumer organisations, Water UK, the Government.</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>How will the proposal further and comply with our primary duties (including the consumer objective and competition) as set out in section 2 of the WIA91?</td>
<td>The proposal acts as a proxy for competition in the absence of consumer choice. The SIM is more adaptable to structural changes in the sector, including extending competition to more business consumers. By focusing the companies on meeting consumers’ expectations, the SIM protects consumers’ interests. It will give more weight than previously to the views of those dissatisfied with service and will capture consumers’ views on how service can be improved. The survey can be used to check that different consumer groups are accessing the companies’ services.</td>
</tr>
<tr>
<td>How does the proposal further our section 2 WIA91 secondary duties, including the duty to contribute to the achievement of sustainable development?</td>
<td>The SIM will encourage the sectors to improve service, innovation and technology. By providing evidence to enable resources to be focused on meeting consumers’ expectations, it will produce outcomes which are socially and economically sustainable.</td>
</tr>
<tr>
<td>What is the impact on carbon footprint (value of changes in greenhouse gas emissions)?</td>
<td>The SIM will drive improved efficiency which will reduce the carbon footprint of companies</td>
</tr>
</tbody>
</table>
Putting water consumers first – the service incentive mechanism

Is the proposal consistent with race, disability and gender equality?

We have included classification questions in the consumer experience survey to check that different ethnic groups, disabled consumers and different gender consumers are accessing the companies’ services and are represented in the sample. Early results from the pilot questionnaire confirm this is the case.

Impact on regulatory burdens:
- data requirement (increase/decrease/net change)
- cost of additional regulatory burden (£– specify annual one-off etc).

There may be one-off and ongoing annual costs to ensure the companies can properly classify consumer contacts and generate a sample for the consumer survey. But we expect these to be offset in the long term by the efficiency savings that the SIM will incentivise and a possible reduction in other reporting requirements. We do not wish to simply add another layer of complexity to our regulatory approach. Consistent with our strategy the SIM should hold companies accountable and help minimise the volume of regulatory information reported to Ofwat. We will consider where we can further reduce the data reported to Ofwat while still protecting consumers as part of our regulatory compliance project.

Evidence base for summary sheets

Overview

This impact assessment is part of our consultation on introducing the new service incentive mechanism.

Protecting consumers is at the heart of our strategy. We are committed to keeping consumers at the heart of what we do, keeping companies accountable and regulating effectively in the absence of competition.

It is with those goals in mind that we have evaluated the existing overall performance assessment, and developed the service Incentive mechanism, as described in the consultation paper.
Putting water consumers first – the service incentive mechanism

The impact assessment demonstrates that introducing the new mechanism will bring tangible benefits to consumers (and the companies) while still being proportionate and not unduly burdensome on the companies.

Wherever an NPV is calculated, we have used a discount rate of 3.5 consistent with Green Book guidance.

Identifying the options

In developing and identifying our preferred solution, we considered several options:

1. Retain the existing OPA incentive scheme.
2. Introduce a new service incentive mechanism that focuses on the quality of service.
3. Have no service incentive mechanism at all.

Analysis of the options

Sections 1 and 2 set out our analysis of the options. This section records the background evidence and assumptions we have used to inform our assessment.

Option 1 – Retain the existing OPA incentive scheme

This option is to continue using the existing overall performance assessment.

Chapter 1 describes the successes achieved by the OPA. It also sets out the reasons why we feel it is no longer sufficient. In addition to those reasons, the old OPA does not contain what we might now regard as the most useful suite of measures.

- Some measures have been overtaken.
  - The DWI no longer produces the index we have used for the OPA – so this aspect would need to be reviewed.
  - The Environment Agency have changed the way they regulate and interpret some of the measures currently in the OPA – this aspect would likewise need to be reviewed.

- The OPA does not contain elements which we might now consider important aspect of a company’s overall performance, for example:
  - carbon footprint; and
  - serviceability.
Retaining the old OPA is thus not feasible without a significant exercise to review it, which would not be a good use of resources.

**Description and scale of key costs by main affected groups**

**Consumers**

Costs incurred by the companies or regulators are reflected in the bills charged to water and sewerage consumers.

The existing OPA includes a measure of consumers’ satisfaction with the way their company handles telephone calls. Based on the current contract, continuing this would cost approximately £60,000 a year. However, this contract expires this year and will have to be retendered if continued.

Our NPV calculation of costs assumes the survey would continue at the same cost through the next price-setting period (2010-11 to 2014-15). We have not included any costs for retendering the work.

NPV over five years is thus c £280,000.

**Companies**

The impact on the companies will be as it is under the existing OPA. Because the companies are already familiar with the OPA, continuing the current measures will disrupt them less but also have less benefits than if the new SIM were in place. Individual companies might consider the consumer experience but would gain no recognition and have no access to cross-sector information. Neither would they benefit from the increased transparency resulting from removing the overlaps between the OPA and other sanctions available to us and other regulators.

**Regulators**

This option does not enable us to deliver our strategy or meet our duties as well as the other options. It requires us and other regulators to undertake work to update the OPA to no further benefit for consumers. It constrains rather than supports innovation and is not readily adaptable to structural changes in the sector or the extension of competition.
Description and scale of key benefits by main affected groups

There are no real benefits to retaining the OPA other than the lack of disruption caused by change. Neither consumers nor companies will gain beyond what is currently being delivered.

Option 2 – Introduce a new service incentive mechanism that focuses on the quality of service

Having established in consultation with stakeholders that the OPA needed to evolve, we explored how to do this. We worked with a stakeholder working group to develop the approach we now propose. We explain this process in section 2 of the consultation paper.
Description and scale of key costs by main affected groups

Consumers

The cost of regulation is passed on to the companies through the licence fee and reflected in consumers’ bills.

We anticipate the annual costs of the new experience survey to the sectors to be approximately £300,000 a year. (We have already paid the one-off cost of piloting the survey during 2009-10.)

Based on our experience of consumer research and the pilot study, we estimate the NPV of carrying out an ongoing experience survey for the period 2010-11 to 2014-15 to be c £1.4 million.

However, we anticipate these costs will be partly offset by savings from discontinuing the current survey of satisfaction with telephone call handling as the new experience survey is established.

Companies

The new experience measures on which we will base the SIM have been developed in consultation with the sector. Where possible, we have built on established regulatory measures. We have also taken account of the companies’ systems and processes to ensure the regulatory burden is proportionate.

The companies already have many of the necessary reporting systems in place. Additional costs may arise in two particular areas.

- Refining telephone handling systems so that the companies can identify the causes of calls and accurately classify them as wanted or unwanted.
- Developing systems for identifying, extracting and collating resolved consumer cases and associated telephone numbers to provide a data set for the experience survey.

All the companies are currently developing and piloting the new measures and have not argued that the costs are excessive.

The regulatory burden for companies may increase in the short term as companies dedicate resources and make system changes to provide the necessary data for the new measures, but the potential efficiency savings will outweigh. Any costs that the companies incurred up to 2008-09 will have been included in price limits.
Ofwat

The ongoing costs of administering the new incentive are neutral. These will be offset by savings made from discontinuing the OPA and telephone call handling survey.

Description and scale of key benefits by main affected groups

Consumers

The benefits to consumers will be improved quality of service and in the longer term, lower bills.

When we make price adjustments under the incentive mechanism, prices may decrease by up to 1.0 K points in 2015-16 for consumers who receive comparatively poor service. It is not possible to quantify the cross-sector revenue impact because the actual effect will depend on how individual companies perform over the price review period.

The SIM will incentivise lower failure demand and improving first-time resolution. This will generate operating cost savings, which will lead to lower bills when prices are next set in 2014. This is explained in more detail below.

Companies

The SIM should contribute to minimising the regulatory information routinely reported to Ofwat. As part of the upcoming regulatory compliance project we will review where we can reduce the data reported to Ofwat while still protecting consumers. We have already signalled that the current DG9 survey would be redundant if the SIM were introduced.

The service incentive mechanism will incentivise the companies to make significant operating cost savings in two areas.

- Reducing failure demand.
- Improving first-time resolution.
**Failure demand**

Failure demand is the extra demand placed on a company’s resources because of service failures – for example if a consumer has to contact a company a second time because promises have not been kept, or the consumer has not been kept informed. In effect, a company has to deal with a single issue multiple times. Every time they do so, they incur unnecessary and avoidable costs.

Costs relating to failure demand can be significant. As such, there is considerable scope for savings. The service incentive mechanism encourages companies to look at this aspect of their service, and incentivises them to make improvements.

Operational contacts can be particularly expensive for a company to resolve. It therefore makes sense to resolve these contacts in the most efficient way, that is one visit to a property rather than multiple visits.

The fact that the sector does not currently have a clear picture of the level of failure demand and the costs involved is one of the drivers for introducing the new measures. As such, it is has been difficult to establish precise costs. However, discussions with the companies that have started to look at this area have allowed us to estimate a figure of about 40% to 50% for current failure demand in operational contacts. We have also been able to establish some figures for the costs involved at each stage of the process for dealing with operational contacts.

This has enabled us to calculate potential savings of between £10 million and £50 million to the sector in one year, by reducing the amount of avoidable operational contacts from 45% of all contacts to 35% of all contacts. The precise level of savings will differ between the companies and different areas of the business, depending on their current performance. Discussions with the companies have led us to believe that such an improvement is not unrealistic. Results from the consumer experience pilot survey show that a figure of about 40% to 50% for current failure demand in operational contacts is a realistic estimate. This is illustrated in appendix B.

**First-time resolution**

More savings can be achieved by improving the handling of contacts once they have been received – improving first-time resolution. That means resolving issues at the first opportunity rather than the consumer having to escalate their complaint. The most fruitful area in this regard is complaint handling, where companies have a real ability to prevent complaints escalating to more expensive tiers. A conservative estimate of savings, given a 10% reduction in total complaints coupled with
escalating 10% fewer complaints at each stage, suggests savings of about £4 million could be achieved in one year.

**NPV calculation**

We have used conservative assumptions to calculate the NPV of these potential efficiency benefits. We assume that the 10% saving will only arise in 2015-16 and that the benefits will only last for ten years. In practice they should continue in perpetuity. Given the potential changes in the sectors we think ten years is a reasonable assumption and consistent with Green Book guidance.

We have not included any valuation of the reduced carbon footprint nor of the value of service improvements to consumers. Neither have we made any assumption about any improvement in consumers’ propensity to pay their bills when satisfied, although anecdotal evidence suggests there is a link. All these factors would serve to increase the potential benefits form the SIM.

**Illustrating an improvement in first-time resolution**

In its fourth annual benchmarking study, the Ascent group\(^9\) evaluated first call resolution (FCR) performance and measurement in more than 100 companies from 14 industries, representing 19 countries.

The research identified that most companies actively measuring first call resolution are experiencing improvement. 60% of companies measuring FCR performance for more than one year reported improvement in their performance. Those reporting improvement ranged from 1% up to 30%, with an average annual gain of 2%.

This research supports our assumption that the companies will be able to improve their first time resolution performance, and consequently achieve cost savings as a result. Using this information and water industry data from tables 5 and 5a of the June return 2008, (number of telephone complaints, written complaints, second stage written complaints and cases accepted by CCWater for investigation), we can illustrate the potential affect on costs that improving first time resolution could have on the overall cost of handling complaints and the potential savings.

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\(^9\) Achieving First Call Resolution 2009, a new research report published by the Ascent Group, Inc.  
http://www.ascentgroup.com/research/sum_fcr.html
To make assumptions on the cost of handling a complaint at each stage measured quantitatively, we have used research by the National Audit Office\textsuperscript{10} examining how three agencies of the Department for Work and Pensions handle complaints (Jobcentre Plus, The Pension Service and the Disability and Carers Service). The departments’ complaints process escalates in three tiers, each of which is more resource intensive than the last, and therefore similar. If a complaint is not resolved after the third tier, it can be referred to an Independent Case Examiner. This is an external complaint handling body and is roughly analogous to CCWater’s role. The table below gives the complaints the department handled in 2007-08:

### Estimated cost of recorded complaints

<table>
<thead>
<tr>
<th></th>
<th>Jobcentre Plus</th>
<th>The Pension Service</th>
<th>Disability and Carers Service</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of complaints</td>
<td>Cost £</td>
<td>Number of complaints</td>
</tr>
<tr>
<td>Tier 1</td>
<td>26,000</td>
<td>260,000</td>
<td>12,000</td>
</tr>
<tr>
<td>Tier 2</td>
<td>17,000</td>
<td>700,000</td>
<td>8,000</td>
</tr>
<tr>
<td>Tier 3</td>
<td>3,216</td>
<td>1,100,000</td>
<td>2,066</td>
</tr>
<tr>
<td>Independent Case Examiner costs</td>
<td>239</td>
<td>430,000</td>
<td>100</td>
</tr>
<tr>
<td>Agency staff costs</td>
<td></td>
<td>240,000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>46,000</td>
<td>2,740,000</td>
<td>22,000</td>
</tr>
<tr>
<td>Total for all agencies: £4.7 million</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:**
National Audit Office (cost figures include employee contributions and pensions).

**Note:**
Tiers 1 and 2 complaints are rounded to the nearest 1,000; costs are rounded to the nearest £10,000. Numbers in the table may not add because of rounding.

The National Audit Office concluded that complaints resolved successfully at tier 1 are 40 times cheaper to the department than those resolved at tier 3. From the above table, the cost ratio of complaints is approximately 1:4:40:180:100. While the exact process and costs will differ, the ratios are a sensible starting point. CCWater were unable to disaggregate the costs of dealing with investigated complaints.

\textsuperscript{10} Department for Work and Pensions: Handling Customer Complaints (23 July 2008),
For the water sector, we have used a base cost of £5 to handle a telephone complaint. This has been derived from a case study of a water company that stated that to deal with the consumer at the first point of contact in the call centre and solve their problem costs between £2 and £8. For our purposes, we have used an average of £5\(^1\). We can therefore assume the following:

- A telephone complaint costs £5 to handle.
- A written complaint costs £20 to handle (4 x 5).
- A second stage written complaint costs £200 to handle (5 x 40).
- A case accepted by CCWater for investigation costs £900 (5 x 180).
- Additional cost for the company to co-operate with CCWater = £500 (5x100).

We recognise that the complaints process for water companies is not linear, and that a telephone complaint will not always precede a written complaint. However, it may be that more than one response is made at each stage before escalation, and so if anything the model may under-represent the costs involved. We consider that this model is a reasonable approach to take.

Having established the costs for each type of complaint, we can calculate the current cost of dealing with complaints for the sector and the potential savings improvements in first resolution could bring. The table at appendix A shows the financial effects of a 10% improvement in resolution.

In a competitive water market, consumers would be likely to switch suppliers to save costs or because of receiving poor service. Although there are no plans to introduce competition to household consumers, it should be noted that first time call resolution alone usually improves consumer retention. Research conducted by the Ascent group suggests that repeat calls are costly to the bottom line and to consumer satisfaction. According to a recent ACSI study, half of consumers with unresolved issues are at risk of defection, or have already decided to leave\(^1\). This illustrates that it is beneficial for companies to improve first time resolution to satisfy those consumers who would be hypothetically likely to switch.

**How does this proposal promote competition?**

The SIM does not directly affect competition. Rather it acts as a proxy for competition until consumers can choose their water or sewerage supplier. Consumers in competitive markets will choose a supplier that provides a perceived

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\(^1\) Achieving First Call Resolution 2009, a new research report published by the Ascent Group, Inc.

http://www.ascentgroup.com/research/sum_fcr.html
level of service that matches their expectations at the right price. We want to introduce an incentive which delivers services and service levels that consumers might choose in a competitive market.

At present only the largest commercial consumers can choose their supplier. The recent Cave review recommended that this should be extended to more business consumers. However, household consumers are unlikely to be able to choose their water or sewerage company in the near future.

The proposed SIM facilitates competition and is adaptable to potential changes in industry structure, such as retail separation. Once business consumers can choose their supplier, they could be removed from the regulatory measures. Alternatively the consumer experience could be measured separately for business consumers until an effective competitive market is established, or to provide information for consumers wishing to switch supplier.

The old OPA constrains innovation and cannot readily be applied to changing industry structures. It includes specific measures of performance at different points in the value chain. While the new SIM covers all aspects of the business experienced by consumers, it is measured at the retail end, making it more adaptable.

In there are significant changes to the industry structure over the next five years we will need to make sure that any price adjustments are applied to the relevant revenue.

**Proforma: specific impact tests – checklist**

Use the table below to demonstrate how broadly you have considered the potential impact of your policy options.

Ensure that the results of any tests that have an impact on the cost-benefit analysis are contained within the main evidence base. Other results may be annexed.
### Types of testing undertaken

<table>
<thead>
<tr>
<th>Types of testing undertaken</th>
<th>Qualitative (Y/N)</th>
<th>Quantitative (Y/N)</th>
<th>Results in evidence base? (Y/N)</th>
<th>Results annexed? (Y/N)</th>
<th>Any other comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competition assessment</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Primary duties pursuant to section 2 WIA91</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Secondary duties pursuant to section 2 WIA91</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Carbon assessment</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td></td>
</tr>
<tr>
<td>Race, disability and gender equality</td>
<td>Y</td>
<td>Y</td>
<td>N</td>
<td>N</td>
<td></td>
</tr>
</tbody>
</table>

### 2008-09 industry figures

<table>
<thead>
<tr>
<th></th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
<th>2008-09 industry figures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential telephone complaints</td>
<td>2,120,988</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2,120,988</td>
</tr>
<tr>
<td>Actual telephone complaints received</td>
<td>2,120,988</td>
<td>£5</td>
<td>£10,604,940</td>
<td>1,908,889</td>
<td>£9,544,446</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total written complaints</td>
<td>222,826</td>
<td>£20</td>
<td>£4,456,520</td>
<td>180,562</td>
<td>£3,611,237</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of complaints escalating to 1st written contact</td>
<td>10.51%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total number of complaints escalating to 2nd written contact</td>
<td>20,691</td>
<td>£200</td>
<td>£4,138,200</td>
<td>15,097</td>
<td>£3,019,355</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of complaints escalating to 2nd written contact</td>
<td>9.29%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total number of complaints investigated by CCWater</td>
<td>1,418</td>
<td>£900</td>
<td>£1,276,200</td>
<td>931</td>
<td>£837,645</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% of complaints investigated by CCWater</td>
<td>6.85%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost to companies to support CCWater investigated complaints</td>
<td>£500</td>
<td>£709,000</td>
<td>£465,358</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2,365,923.00</td>
<td>£21,184,860</td>
<td>£17,478,040</td>
<td></td>
<td></td>
<td></td>
<td>£3,706,820</td>
<td></td>
</tr>
</tbody>
</table>

**Total saving (£)**: £3,706,820
Failure demand as illustrated by the consumer experience survey

The table below shows results from the pilot consumer experience survey. The full survey is available on our website.

How many times in total did you telephone them in relation to this particular enquiry or event?

<table>
<thead>
<tr>
<th>Wave 1-3</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>(5,758)</td>
<td></td>
</tr>
<tr>
<td>Once</td>
<td>63</td>
</tr>
<tr>
<td>Twice</td>
<td>18</td>
</tr>
<tr>
<td>3-5 times</td>
<td>13</td>
</tr>
<tr>
<td>6-10 times</td>
<td>3</td>
</tr>
<tr>
<td>More than 10 times</td>
<td>2</td>
</tr>
<tr>
<td>Can’t remember but more than once</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Wave 1-3</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(5,758)</td>
<td></td>
</tr>
<tr>
<td>Once</td>
<td>63</td>
</tr>
<tr>
<td>Twice</td>
<td>18 (18x1)</td>
</tr>
<tr>
<td>3-5 times</td>
<td>26 (13x2)</td>
</tr>
<tr>
<td>6-10 times</td>
<td>15 (5x3)</td>
</tr>
<tr>
<td>More than 10 times</td>
<td>18 (2X9)</td>
</tr>
<tr>
<td>Can’t remember but more than once</td>
<td></td>
</tr>
</tbody>
</table>

Total number of calls 177
Number of original events 100
Failure demand 44%

Base: All first contact by telephone

This illustrates the current level of failure demand in first time telephone contact. Assuming that 100 consumers contact their company with an enquiry or to report an event, 63 have their enquiry or issue resolved first time and do not call again.

- Eighteen consumers have to phone their company a second time to resolve their issue, this is an additional 18 telephone calls.
- Thirteen consumers have to phone their company between three and five times to resolve their issue; this is a minimum additional 26 telephone calls (13x2).
- Three consumers phone their company between six and ten times to resolve their issue; this is a minimum additional 15 telephone calls received by the company (5x3).
• Two consumers have to phone their company more than ten times to resolve their issue; this is a minimum additional 18 telephone calls (2x9).

To resolve 100 issues, making a conservative estimate, required 177 telephone calls. Therefore, 77 additional telephone calls were made with most being potentially unnecessary illustrating the current level of failure demand at approximately 44% for the industry.