

Service incentive mechanism (SIM) for 2015 onwards – conclusions

About this document

In October 2013, we published our consultation about the design of the incentive properties and measures for the service incentive mechanism (SIM) for 2015 onwards. The consultation has now closed.

This document provides a summary of consultation responses received and views expressed during two stakeholder workshops.

We also include an update on the small company service incentive following a stakeholder workshop.

Appendix 1 sets out the SIM measures for all companies and the plan for their testing during 2014-15.

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1. Introduction

We consulted on:

- the application of the SIM incentives to the price controls set for 2020 onwards (based on the performance during 2015-20); and
- the design of the SIM measures for 2015-20.

We said we expected to use the year 2014-15 to test the conclusions the consultation reached on the SIM measures.

Appendix 1 of this document confirms the SIM measures and the programme for testing them. This includes a trial of measures for the small company service incentive.

We have already set out our conclusions on the SIM incentive properties in '[Setting price controls for 2015-20 – pre-qualification decisions](#)', where we confirmed that the SIM for 2015-20 will be similar in structure and form to the current incentive, but with more weight on the qualitative versus quantitative measures (3:1). We did this to enable pre-qualified companies to make informed decisions about the SIM incentive contribution to their risk and rewards and to provide maximum certainty for 2015-20. We confirmed this would apply to both the household SIM for companies in England and Wales and the non-household SIM for companies in Wales. This document also includes these conclusions for completeness.

2. Incentive design

2.1 Form of incentive

We consulted on whether SIM for 2015 onwards should be used to incentivise:

- further improvements in the service that the best performing companies in the sector offer (the ‘frontier’);
- improvements by the less well performing companies in the sector, while maintaining frontier performance at current levels; or
- some combination of both.

In our consultation, we said that the case for using the SIM in a form similar to the current incentive to continue to drive improvements in less well performing companies appears to be strong. So, we said that it should continue to incentivise service improvements in companies operating below the frontier. We also said that we should only incentivise further frontier improvements if there is compelling evidence that the benefits of doing so exceed the additional costs.

We received mixed views on this issue in response to our consultation, although most companies argued that SIM should be used to incentivise all companies, not just improvements among those that are performing less well. But respondents provided little evidence to show that the benefits of doing so exceed the additional costs, although some noted that innovation to meet changing customer expectations was needed to both maintain and improve service provision.

We conclude that we will use the SIM for 2015 onwards in a form similar to the current incentive to continue to drive improvements in less well performing companies while continuing to encourage frontier companies to maintain or improve their position.

2.2 Symmetry of the incentive

We also consulted on whether the SIM going forward should involve a symmetric or asymmetric incentive. The current SIM incentive is asymmetric – that is, there is greater downside risk (maximum penalty of 1% of revenue) than upside potential (maximum reward of 0.5% of revenue).

Most respondents favoured retaining the current asymmetric structure because of the successes of the current SIM. Some supported a symmetric approach but others expressed concerns over customer willingness to pay for rewards. We have decided to retain the current asymmetric structure of the SIM incentive. This is also consistent with the conclusions reached for the form of incentive set out in section 2.1.

2.3 Magnitude of financial incentive

We consulted on whether the current scale of the SIM financial incentive (+0.5% to -1% of revenue) should be changed for 2015 onwards. We outlined our preference to broadly maintain the current magnitude of financial exposure under the SIM for 2015-20 as this will continue to drive improvements in service delivery.

Most respondents favoured retaining the current level of incentive as this has proven to be effective in improving the level of customer service across the sector. So, we will retain the financial magnitude of the current SIM (that is, the range of -1.0% to +0.5% on total integrated revenues), but will express this in terms of household retail revenues (+6% reward to -12% penalty).

Our consultation sought views on the practicalities of the reward/penalty being applied to the retail business. Respondents considered that this approach would continue to encourage all of the business elements that needed to work together to do so. Customers need a joined-up service and SIM has helped to do this. Companies also considered that the internal incentives/contracts they may use to encourage the required service delivery were for them (not Ofwat) to manage.

2.4 Use of absolute or relative performance

We consulted on the basis for determining rewards and penalties under the SIM.

Specifically, we consulted on whether:

- companies should continue to be penalised or rewarded according to their ranking against other companies in the sector; or
- we should move to a system of rewards and penalties against an absolute performance level.

Most companies favoured retaining the current relative system. They thought that an absolute performance level risked not keeping pace with customer expectations of service and that the competitive nature of the SIM would be lost. As a result, we will retain the current relative performance approach of penalising/rewarding companies according to their relative performance against others in the sector.

2.5 Balance of qualitative and quantitative measures

Finally, we consulted on the balance between the quantitative and qualitative components of the SIM score, which are currently evenly weighted (50/50).

Specifically, we consulted on:

- retaining the current 50/50 weighting;
- shifting the balance more towards qualitative measures (for example, 75% qualitative/25% quantitative);
- removing the quantitative measures entirely;
- shifting the balance more towards quantitative measures (for example, 25% qualitative/75% quantitative); or
- removing the qualitative measures entirely.

We said that our initial preference was to retain both types of measure, with some re-balancing over time to rely more heavily on qualitative measures to place greater weight on customers' views on satisfaction as may be appropriate.

We received mixed views on this from respondents. Some favoured retaining the current 50/50 weighting, while others favoured reducing the weight given to the quantitative measures. And some favoured removing the quantitative measures altogether. So, given the preference we set out in the consultation and responses we received, we will shift the balance of measures for 2015 onwards more towards qualitative measures (75% qualitative/25% quantitative).

3. Measures design – household SIM (England and Wales)

3.1 Detailed design of the qualitative and quantitative measures

We set out three broad options, which we have summarised below.

- **Option 0** – current design (do nothing option).
- **Option 1** – make the minimum changes necessary to reflect the separation of household/non-household price controls. Specifically:
 - count only households in the quantitative metrics; and
 - where this is not possible, pro rata results by the proportion of household/non-household customers.
- **Option 2** – option 1 plus a number of other detailed design changes. Specifically:
 - include all contact routes in the unwanted contact measure (not just phone contacts);
 - remove phone availability measures (not easy to measure consistently);
 - shorten the qualitative survey by removing most ‘transactional’ questions; retain questions on experience drivers and satisfaction; and
 - keep survey sample as resolved contact, but remove notice period for surveying.
- **Option 3** – variation on option 2 (and one of the options identified by the UKWIR benchmarking). Specifically:
 - where the qualitative measures are reduced to counting only complaints received (by any contact media); and
 - where the qualitative measures are changed to a survey of contactees (regardless of stage/resolution of contact), modifying survey to use indicators like ‘net promoter score’, ‘customer effort’ and ‘service quality’.

We noted our preferred approach was **option 2**. This is because removing phone availability metrics will help improve reporting accuracy of the quantitative data, while simplifying the qualitative survey will help focus the companies on overall customer satisfaction with the service they receive. Keeping the resolved contact criteria will continue to give views of the complete service received rather than views of the stage or status of the issue. Removing the notice period will encourage call centres to give the same service every day since they would not know when they will be sampled for the survey.

Table 1 Summary of qualitative measure consultation options, responses and recommendations

Options on which we consulted	Consultation responses	Recommendation	Rationale
<p>1. No change to existing survey (except to household only).</p> <p>2. Streamline survey, more focus on customer satisfaction with service – fewer or no questions about the transaction detail.</p> <p>3. Views on survey design tests from UKWIR project.</p>	<p>Support for a shorted more focused survey.</p>	<p>Develop and test new survey using:</p> <ul style="list-style-type: none"> • the UKWIR research test findings; and • information about key drivers of customer satisfaction from four years of current SIM survey. 	<p>The detail in the current survey has served its purpose to help companies understand the views customers were expressing – and also to provide trust in the overall scores. There is now a view to move to a shorter survey.</p> <p>The main benefit of this is it is less onerous on the customers being surveyed and cheaper to run. Companies can still do more in-depth studies if they wish.</p> <p>Opportunities for benchmarking with other sectors can be kept in mind as the survey is designed.</p>
<p>4. Remove any notice period for survey.</p>	<p>Supported.</p>	<p>Remove notice period and consider survey frequency in designing.</p>	<p>Encourages companies to deliver the same service every day (and not to do something different in SIM week).</p>

Options on which we consulted	Consultation responses	Recommendation	Rationale
5. All contacts or resolved contacts and extend to newer contact channels.	Mixed views. 'Resolved contact' feels more logical, but it is difficult to be sure of consistent interpretation. 'All contact' avoids this.	Survey sample from 'all contact'. Consider how (and when) to include newer contact channels.	Simple to deliver – requiring no interpretation or sample editing. Deals with company concerns about disincentives for innovation – eg, only include new contact channels when they are used by a significant proportion of customers.

Table 2 Summary of quantitative measures consultation options, responses and recommendations

Options on which we consulted	Consultation responses	Recommendation	Rationale
1. Remove phone availability from SIM measures. Alleviates data burden issues with data separation and if customers do complain about phone availability, it would be picked up by other measures.	Supported by most respondents, including the Consumer Council for Water (CCWater).	Remove as proposed.	Preferred option supported.

Options on which we consulted	Consultation responses	Recommendation	Rationale
2. Unwanted phone contacts – either keep or restrict to complaints only.	Support for both of these, provided the companies can apply clear guidance consistently.	Keep the unwanted contacts measure; review guidance as companies separate to measure household only.	Overriding concern is for consistency. Testing can be designed to look at this further and demonstrate the sensitivity of this component (which has in any case reduced with the reduced quantitative weighting).
3. Extend unwanted contacts to all forms of contact media.	Not supported, because companies consider usage is not embedded yet (and not all companies are using anyway).	Seek further information from companies about contact rates/volumes compared with other media types.	We expect company and customer use of different types of contact media to increase; we need to be ready to include this in customer measures if and when appropriate.
4. Continue to include written complaints, escalations and CCWater investigations).	Supported.	Continue to include as proposed.	Preferred option supported.

4. Measures design – non-household SIM (Wales)

In ‘[Setting price controls for 2015-20 – final methodology and expectations for companies’ business plans](#)’ (our ‘final methodology statement’), we committed to strengthening the protection for non-household customers in Wales by introducing a separate non-household SIM for companies who operate wholly or mainly in Wales.

In our consultation, we considered what would be appropriate to use as comparators of service. As there will be only two large Welsh non-household retail businesses, it would not be appropriate to rank these against each other to determine which should receive a reward and which should be penalised. We sought views on the following options.

- **Option 1** – to exclude the Welsh non-household SIM scores from the determination of household incentive payments, but to determine the incentive payments for the non-household businesses by reference to how they rank alongside the household SIM businesses.
- **Option 2** – to set an absolute performance level for the Welsh non-household businesses, and trigger rewards and penalties on the basis of performance against that level.

We also consulted on the appropriateness of using the same set of qualitative and quantitative measures as in the household SIM.

Most respondents did not comment on the questions specific to Welsh measures. Those few that did offered a range of opinions. The Welsh Government’s response was supportive of continuing with an incentive approach broadly similar to the current SIM, and with continuing with a comparative approach (rather than absolutes).

On 28 February 2014, we met with [Welsh stakeholders](#) to consider relevant consultation responses and develop a way forward for the measures for their non-household services.

4.1 Measurement of service and benchmarking

The key issues we sought to resolve in selecting measures of service were as follows.

- Data collection is proportionate to the relatively small number of non-household customers – especially in Dee Valley Water area.
- Collecting data that can be benchmarked.
- Compatibility of measures with any company business plan proposals for customer service outcomes, in particular the financial incentive Dŵr Cymru has proposed for its non-household customer service delivery.

We considered a sensible solution was to measure non-household customer service using complaints statistics. Below, we set out the benefits and issues we considered.

Benefits of this approach

- No additional data burden for any company (in England or Wales).
- Data will be collected and published (by CCWater).
- Non-households in Wales can be benchmarked to non-households in England, and to households in England and Wales.
- Complaints data has been collected for a number of years, allowing tracking of company trends independent of the two different legislative positions.
- Allows company choice in qualitative measures and incentives (as Dŵr Cymru has proposed).

Potential issues and mitigation

- This could be seen as a lower level of data collection for non-household than for household (since we will still collect ‘unwanted contacts’ for household). But this approach is more proportionate to customer numbers, and closer to the approach being taken for non-household in England where we are relying on the Guaranteed Standards Scheme (GSS). Should we suspect underlying issues from complaint data or other intelligence, we can still seek further information from the companies as we do now.
- It could also seem disproportionate compared with the trial of using ‘unwanted’ contacts’ measures for small companies (as described in chapter 5). But it could be difficult to track and compare the small number of written complaints small companies receive from year to year. Provided the data collection is not too onerous, contact rates as measured by ‘unwanted contacts’ could be more representative and useable as a comparator between small companies.

5. Small company service incentive

In our final methodology statement, we confirmed that we would consider the development of a small company service incentive. This is because:

- none of the small companies have been subject to a service incentive;
- this lack of information from small companies creates a risk that we have no sight of underperformance; and
- we have no concrete data or evidence on customer complaints for small companies, although small companies are subject to GSS Regulations.

So we argued that including a service incentive for small companies can help to drive improvements in customer service and is necessary to provide a route to redress for unhappy customers.

On 26 November 2013, we held a [small company workshop](#) to discuss the options for a small company service incentive. A number of options were discussed, including some that were variants on the SIM. We presented our preferred option – to adopt a modified version of SIM based on quantitative data only (because of the low number of customers that small companies serve, which would compromise the statistical robustness of any qualitative data/measures). It was proposed that all small companies collect and report data on the following quantitative measures of customer service that feature under SIM.

- Unwanted phone contacts.
- Written complaints.
- CCWater investigated complaints.

Small companies would publish these data and submit them to us; we would then publish the service incentive scores for all small companies.

At the workshop, small companies expressed their support for introducing a small company service incentive. They were supportive of including the proposed complaints measures ('written complaints' and 'CCWater investigated complaints'), and also suggested that 'escalated complaints' be added to this. But there were some concerns regarding the measure of unwanted phone contacts (for which further clarity was sought) and on comparing companies (for which it was suggested that this should not occur initially until companies have had a 'test year' of collecting and reporting the data). The plan for this testing is set out in appendix 1.

Appendix 1: Summary of SIM measures and testing

A1 Summary of SIM measures

The table 3 below summarises the measures set out in this document and how they apply to each company and customer served.

Table 3 Summary of SIM measures

Customers served	Quantitative measures	Qualitative measures	Incentive
Households in England and Wales (served by the 18 largest companies).	Unwanted contacts, written complaints, escalations and CCWater investigations (25% of SIM total).	Survey of customers who have been in contact with their company (75% of SIM total).	Financial and reputational – comparison to other companies' household service.
Non-households (served by Dee Valley and Dŵr Cymru, who operate mainly in Wales).	Written complaints, escalations and CCWater investigations.	Company choice – for example, Dŵr Cymru's non-household customer satisfaction measure.	Financial and reputational – comparison to other companies' non-household service (and any company chosen outcome delivery incentive).
Non-households (served by largest 16 companies in England).	Written complaints, escalations and CCWater investigations.	Company choice.	Reputational comparison through CCWater complaints reporting (and any company choice).
Customers served by small companies.	Written complaints, escalations and CCWater investigations. Unwanted contacts – subject to testing.	Company choice (but probably impractical for the smallest customer numbers).	Reputational comparison with other small companies.

A2 Testing of qualitative measures

We will procure the qualitative survey, which will be tested with household customer data from each company. Companies (apart from small companies) will need to update their systems to be ready to provide a sample of all contacts without any notice period.

Small companies are not required to take part in the qualitative survey.

The survey design will draw on:

- key information from the last four years of the SIM survey; and
- the findings of a recent research project, which UKWIR will publish in due course.

The testing will consider how readily household contacts and non-household contacts can be robustly separated – for example, is this best done by the company or a screening question in the survey?

A3 Testing of quantitative measures

The quantitative measures will be tested over the first six months of the year from April to September 2014.

Companies will:

- update systems to enable unwanted contacts from household customers to be identified from all contacts;
- update systems to keep separate counts of household and non-household written complaints and escalations (CCWater have introduced this on a voluntary basis for the 2013-14 data collection);
- keep records of contact rates/volumes of all contact channels to help inform the decision on when and how to include new contact channels in service incentives; and
- provide Ofwat with six months of data in October 2014 (unwanted contacts, complaints and escalations, contact rates for other channels).

Small companies will:

- continue to keep records of written complaints and escalations (keeping a separate count of household and non-households);
- provide Ofwat with six months of complaint data, in October 2014; and
- consider how readily Ofwat guidance on unwanted contacts could be applied to their customer contact systems and processes; including how these differentiate between households and non-households.

We will:

- run a clarification process where companies can air practical issues encountered as systems are updated, sharing the ‘answers’ with all companies;
- hold discussions with small companies as they consider the ‘unwanted contacts’ guidance and how it applies to their systems and processes;
- analyse the results from the measure testing; and
- update guidance and confirm the measures that will apply from April 2015 onwards.



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April 2014

ISBN 978-1-908116-70-3

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