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Trust in water

Delivering more of what matters to customers on bad debt

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Ofwat

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Introduction

Good afternoon everyone.

Thank you for coming today to our Bad Debt and residential retail service efficiency event – and the launch of the report we commissioned from PWC.

Before we hear from PwC, I want to explain why we commissioned the report and highlight how I see the report in the broader context of our work on customer service and affordability and how in relation to PR19.

Bad debt affects all water customers, not just those who do not or cannot pay

First a little bit of context on why we commissioned this report. Bad debts or uncollected revenue form a significant element of customers. When the cost of bad debt is taken into account, including the cost of uncollected debt, associated financing costs and debt management costs, it amount to around £21 on the customer bill. This is significant and higher than utilities.

We all pay when companies fail to collect charges from some households. Bad debt is part of the cost of retailing, an increase in the allowed cost of bad debts, means that companies increase bills for those who do pay in order to cover the shortfall. It takes money out of the pockets of all paying customers and can have an even bigger impact on those who are already struggling to pay.

One in five households across England and Wales feel that their household bills are unaffordable, and 11% of households spend more than 5% of their income on their water bill

Bad debt and affordability are linked and interact. Bad debt cost leads to higher bills and increased pressure on affordability, while those struggling to pay may fall into arrears and add to the bad debt problem.

Earlier in the month, the Financial Conduct Authority reported that unsecured personal debt in the UK had reached £200bn, levels not seen since the financial crisis of 2008. Utility debt was specifically cited as a problem that had been increasing and adding to this problem.

The ‘gig’ economy and zero hours contracts mean that people’s incomes are less predictable than before, and as a result people are finding it harder to balance their household budgets.

There is clear message on need to act on bad debt and affordability in the UK strategic policy statement for us. The SPS states

“We expect that companies will share best practice on the management of bad debt. We also expect companies to take steps to significantly reduce bad debt and that Ofwat’s regulatory framework will incentivise this.”

We also know this is something the Welsh Government is supportive of.

At the same time – as you may have heard Cathryn Ross say last week – the basis of provision of some of our essential public services is coming under a level of scrutiny it hasn’t experienced in 30 years. Customer legitimacy has never been more important. And issues like bad debt – with its direct links to affordability and perception of fairness – goes to the very heart of that debate.

So managing and mitigating bad debts and the related issue of support for those who most need it is important for all customers and company performance in this area is critical issue. A bad debt cost of £21 extra on the bill calls into question company performance on what might seem to be an elementary issue.

As part of our approach to PR19, we have signalled that we are no longer content just to benchmark companies by best practice in this sector, but that we will look to best practice in other sectors. The report from PwC today is an input into this, providing a snapshot of how the sector compares with other sectors and the scope for gains by adopting better practice.

I expect and hope companies see today’s report as an opportunity. Yes, challenge to the findings are welcome and we expect findings to be debated. But it is also intended to prompt learning and action by companies to tackle bad debts. The report will help inform our efficiency challenge to retail at PR19. It is also worth saying what the report is not – it’s not about setting out a view on an individual company bad debt allowances at PR19. Yes, it has comparative information on the level of bad debts in the sector and yes it suggest that some companies have further to go than others in addressing the issue. But we are not setting out views on allowed levels of bad debt for PR19 – that is something for PR19 determinations.

Water companies need to deliver more of what matters

So that's why we commissioned report. But what does it say?

In summary, there are huge opportunities for all companies to improve approach to bad debts which will benefit customers. The sector could do more to tackle bad debt and the sector lags others such as energy and telecoms in the level of debt it writes off.

PwC will set out more details shortly, but the report identifies a number of specific areas for companies to improve: from the way companies manage customer data, tailoring collection paths, approach to billing, improving the way availability of affordability schemes and providing real consequences to address payment avoidance. Better practice in collecting revenue and management of debt can lower levels of bad debt and benefit all customers.

We've seen some companies make great strides towards getting to know their customer base and toward supporting people to pay their bills. These examples illustrate what can be achieved.

Firstly, it worth touching on some of the changes that we made in the 2014 price review to address affordability and promote retail efficiency and address bad debt.

In PR14, we separated the retail services of water companies from the wholesale services and set separate price limits to retail services. The separate retail controls provided much greater transparency of costs to highlight opportunities for delivering better services, bearing down on costs – or both. In particular, it helped identify that bad debts were significant proportion of the costs of retailing - this brings both retail and bad debt efficiency into sharp focus. For the benefit of customers.

In PR14, we used an average cost to serve approach, setting the benchmark based on average cost to the sector. The benchmark was average cost as we recognised that this was the first time we were setting retail controls and we signalled we would expect to see more demanding efficiency benchmarks in future reviews.

On affordability at PR14, companies were required to provide evidence of the affordability of their plans as a whole as well as measures to address customers struggling with bills including social tariffs where companies were required to demonstrate evidence of customer support for proposed tariff.

Earlier this year, we published our customer data report—which highlighted the potential opportunities for companies in using insight from customer data effectively to target service and reduce demand. The PwC report echos many of these themes as means of reducing bad debts.

As part of our PR19 methodology we expect companies to deliver more of what matters to their customers. Particularly in four key areas:

- great customer service
- long-term resilience
- affordable bills for all
- innovation in delivery.

While today's discussion has the most implications for affordability, it has relevance for the other themes too.

Tackling bad debt can help the most vulnerable and deliver more affordable bills for all

We see three key dimensions to affordability at PR19:

- Overall affordability – this means low and value for money bills for everyone.
- Long-term affordability – low and value for money bills for everyone over the long term
- Affordability for those struggling to pay their bills – effective and efficient assistance to help customers most in need

In terms of **overall and long term affordability** –

- We will be expecting companies to evidence the affordability of their plans and to think about how they can significantly improve efficiency at PR19.
- In our draft methodology, we note the scope to use comparisons with other sectors to set stretching efficiency benchmarks. The retail area is one area where we see considerable scope for benchmarking with other retailers, both in terms of cost and service quality.

The PwC report has two interesting findings in this regard:

- the utilities cost-per-contact exceeds comparable sectors indicating the retailing cost, leaving aside bad debts, looks inefficient relative to other sectors
- the bad debt cost and more generally the approach to debt management lags other sectors.

In our methodology, we proposed to use econometric approaches to set the efficient cost benchmark, taking account of potential links between deprivation and bad debt costs. We do not propose to allow glidepaths as companies have had 5 years during PR14 to reach efficient cost levels. The will allow us to step up the efficiency challenge from PR14. So we see real scope for more efficient retail service to improve affordability for customers at PR19.

In terms of helping these struggling to pay their bills – our focus is on effective and efficient assistance to help customers most in need.

In terms of **affordability for those struggling to pay**, in PR14, companies introduced social tariffs and a number of other methods for supporting customers struggling with affordability. The latest report from CCWater states that around while 260,000 are on social tariffs, while another 120,000 receive help through Watersure. This is good news, although it needs to kept in context – CCWater believe around 3 million customers are struggling to pay their bills.

For PR19, it is not just about having a social tariff, but demonstrating that assistance is efficient and effective and has support of customers.

We are proposing to include vulnerability as an explicit part of the price review for the first time in PR19. We will be looking for companies to ensure that they provide sensitive, well-designed and flexible support and services for those of its customers in a state of vulnerability.

As our affordability and vulnerability reports last year made clear, there is plenty of scope for companies to improve here. For example, working more closely with customer representatives and charities to gain greater insight of customers' needs – and targeting solutions at particular groups.

While this report has most relevance for affordability, it has implications for innovation and customer service.

We want to see more innovation in tackling bad debt, delivering retail services and customer services

Innovation – this is a key enabler for PR19, helping companies to deliver more for less. The challenges facing companies collecting revenue and managing debt suggest innovation may be required to really improve performance, particularly for leading companies. Yes, there is scope to learn from leading practice in other sectors and we expect this to happen, but it is also likely that the particular characteristics of the water sector will call for new approaches adapted for these circumstances in the sector.

Tackling bad debt can help deliver a real improvement in the customer experience

A key theme for PR19 is improving customer service in the water sector.

An aspiration of a number of companies is to pursue differentiated service for PR19. This recognises that not all customers are the same or want interact with their supplier in the same way. Differentiation is essential to address customers in vulnerable circumstances, but is relevant for all customers.

The PwC report notes that many household customers are billed on a six monthly basis and while companies may offer a range of payment options, I question whether a default approach of six monthly billing reflecting financial circumstances and cashflows of their customers?

Another aspect, is knowing your customer, differentiation is about recognising differences between customers, but if you don't know the identity of your customer, you can't even start on the differentiation journey.

So even some elementary differentiation and recognition of the cashflows of customers could have powerful impact on the bad debt issue.

Summary

- So in summary.
- As we approach the next price review period, we expect water companies' business plans to demonstrate clearly how they will improve retail efficiency and bad debt management in the years 2020-25.
- We hope today's report provides interesting reading and that it will prompt companies to think carefully how they can tackle bad debt.
- This is one of the areas, when we review companies' plans from next September, where we'll be challenging companies to push new frontiers and make a step change reduction in the level of bad debts.