



In hot water

Utilities - good credit practice is the answer

Carlo Pegna MICM, winner of the Credit Professional of the Year Award at the *icm07 Awards*, addresses the challenges presented by unpaid charges in the utilities sector, and underlines the need for first class credit management

... the cost of litigation far outweighs the actual debt

Running water and a heated, powered home are no longer seen as a luxury, but as a basic necessity for every British citizen, no matter what their personal circumstances. New European legislation on human rights has underpinned and consolidated this belief, and utility companies in the UK have had to react to these changes and the many challenges they bring, not least in relation to their credit management policy and procedures.

The 1999 introduction of the Water Act in the UK marked a new era in the collection of water companies' debts. As of 1 July 1999, water could no longer be disconnected in residential properties as a result of unpaid bills. With the threat of disconnection therefore removed, water companies have had to find other ways of recovering their debts - to the tune of £779m according to the independent water regulator OFWAT.

In non-domestic (i.e. commercial) properties, water companies still have the right to disconnect, and are more aggressive with the collection of commercial debt, using the threat of disconnection to their advantage. Indeed commercial bills have a tendency to be higher and so the threat of disconnection plays a crucial role in ensuring that bills get paid- as it did in domestic properties prior to the new regulations. According to OFWAT, 13,211 commercial properties were disconnected in 2004-2005.

While other utilities such as electricity and gas are to date unaffected by the new European legislation, it is seen by many as being only a matter time before these utilities too will be prevented from cutting off the supply of power to their customers. Therefore these companies must also be 'switched on' to ensure that the highest possible amount of debt is collected.

Since the privatisation of utility companies in the 1990s, they now have profit margins and shareholders just like any other Plc, and so there is an obvious need for these companies to recover what debts they can. However, since various factors contribute to the non-payment of debt in residential properties, collecting a debt is not necessarily as straightforward as it may first sound. Thus a key decision for utility companies

is whether or not to take legal action for the non-payment of bills, given that in many cases the cost of litigation far outweighs the actual debt owed. Additionally the companies must be sure that the customer has the funds to pay the bill if legal action is taken. It is clear that this decision is not taken lightly by utility companies given the complex factors and risks involved.

The first challenge for a utility company is to decide whether a customer is lacking the financial means to settle a debt, or whether they are indeed capable of paying their debt but deciding not to. Whether this decision is reached in-house by specialist divisions within the utility company, or outsourced to a debt collection company varies from company to company, but in both cases the companies typically use a credit information system and risk assessments to decide which debts to take legal action on. In this way companies seek to identify customers who "can't pay" and solve the problem, and collect from customers who "won't pay", taking action against them if necessary.

The level at which debt initially goes to litigation varies from company to company, as there is no standard procedure across the sector, but given the high cost of court proceedings, in many cases the debts can typically reach around £700 before action is considered.

Growing financial hardship is often the reason for a customer not to pay their bill and can present difficulties to the utility companies, since in many cases those with outstanding debts are clearly not in a financial position to repay what they owe. As UK debt continues to grow at a rate of 10.2% per annum according to Bank of England figures- and the average household debt in the UK is £7,776, it is apparent that many households would be unable to pay their bills even if they wished to. According to OFWAT, the average household water bill is £142 for 2006/07, in addition to the average power bill of £495 for gas and £327 (OFGEM) for electricity - a figure set to increase given rising fuel prices- and can account for a large chunk of a household's income in low-income families.

If financial hardship can be proved, and the customer would be unable to pay the debt and the court costs, the case cannot go to litigation.

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This is however a complex issue given that there is no nationwide consolidated legal definition of financial hardship, and therefore the onus lies with the utility companies themselves to make their own policies. In many cases it is difficult to determine whether a customer is suffering genuine financial hardship.

OFGEM and OFWAT both have their own guidelines as to what constitutes fuel poverty. According to OFGEM's consultation paper, "A strategy to define and prevent the disconnection of vulnerable customers" fuel poverty is defined as being when more than 10% of a household's income is spent on all household fuel use. DEFRA (Department of Environment, Farming and Rural Affairs) also has its own guidelines which define water poverty as households which spend more than 3% of their income on water services. According to Thames Water, by this definition more than 24% of households in Wales are 'Water Poor', and so it is clear that the problem is widespread.

Currently, unpaid water charges are carried by the paying population, adding on average between £10-£12 to every paying customer's water bill. However, the utility companies have introduced various initiatives to overcome the obstacle of financial hardship. Many companies have established charitable trust funds, offering grants to successful applicants to help pay their bills.

These initiatives and low-income assistance programmes can be highly beneficial to the Utility companies in the long term. According to Thames Water figures, more than 60% of customers accepted onto the Customer Assistance Fund continue to pay their charges even once they stop being supported. Such activities are not just limited to the water utilities, and energy companies -for example EDF and the EDF energy trust- have set up fund schemes for similar purposes.

Initiatives are also in place for those with financial hardship and claiming Income Support to help pay their bills. Through a new government directive, Job Centre Plus (Department for Work and Pensions) is able to make small payments directly in installments towards the utility bills of applicants through 3rd party debt orders.

However financial hardship is not always the reason for non-payment of a bill, and it is all too evident that since the consumer has been freed from the threat of disconnection, and credit rating is not affected by non-payment of a bill (unless the result of non-payment follows a CCJ that has not been settled within the time frame set by the court), the payment of a water bill is no longer ranked as high priority. Perhaps surprisingly, the demotion of water bills to 'low priority' is not limited to consumers but also repeated by bodies including the Citizens Advice Bureau - whilst they say the payment of water bills remains high priority, they concede that 'outstanding and overdue water debts' are not ranked as priority debts. This apathy is also mirrored in the energy sector, with some experts noting that in many cases debtors consider the payment of a Sky or cable TV bill to be of greater importance than the payment of an energy bill- a little paradoxical given that energy is needed to power the television in the first place!

There is a clear demographic of customers who are most likely to not pay their bills, with tenants, young people and single adult households significantly more likely to

be debtors. According to some Focus Group data, many people are unaware that they must pay utility bills, with one bemused participant asking "What's a water bill?" Given this ignorance, it is clear that steps need to be taken to re-educate consumers and raise the profile of utility bills.

In order to achieve this, some companies have introduced initiatives to encourage customers to pay, such as donating a percentage to charity if the bill is paid promptly. One such example is my own firm, the business services and debt collection company Master Collections, which donates 1% of its collection fee to Clic Sargent 'Caring for Children with Cancer' charity when the bill is settled within a certain time frame. This gesture was shown to lead to a small increase in the prompt settlement of bills.

However, it is not just the consumer that is hesitant to pay the bills. Given the mantra of today's consumer driven society "the customer is always right", companies too are highly reluctant to upset customers with disconnection and legal action. Since the privatisation of energy companies, the market has proven to be highly competitive, with customers willing to switch provider if they feel unsatisfied or upset with the service they receive.

Conversely, as monopoly suppliers, the UK Water companies have a statutory duty to supply domestic customers. Since there is no customer contract there is little opportunity to establish terms and conditions, and therefore it is no surprise that many customers see water supply as a basic given rather than a service they must pay for.

On the whole, water companies have been criticised for reacting too slowly to the new changes and challenges facing them. The concern is too that energy companies may be unable to react quickly to changes, if legislation does come into place prohibiting the disconnection of electricity for non-payment of bills. Given the rising levels of debt in the UK, the challenge for utility companies is therefore to react to financial hardship by continuing and pioneering new initiatives to support debtors who can't pay, and to find alternative ways (other than disconnection) to encourage and promote the payment of utility bills amongst those who no longer see it as high priority.

Philip King, Director General of the Institute of Credit Management, confirms that whilst the principles might be similar, the demands of credit management vary from business to business, industry to industry, and sector to sector. "The water industry epitomises this", Philip says "with its unique situation."

"There is now a recognition that credit management is considerably more than just sending out chasing letters. It is a skilled, dynamic, and essential part of every business, requiring a similarly dynamic, flexible and responsive approach to the whole cycle, starting before supply and extending to payment, litigation and/or - at worst- insolvency.

"Credit management professionals can be invaluable in resolving debt problems as they bring a range of qualities and expertise that stretch across the whole business spectrum, including risk management, data analysis, customer services and strategy.

"It is imperative that professionals are equipped to deliver best practice and to meet the varied and increasing challenges faced by businesses", Philip concluded.