

RECOMMENDATIONS TOWARDS PRICING AND DEBT MANAGEMENT IN WATER SERVICES DELIVERY

**Report to the
Water Research Commission**

by

Arcus GIBB (Pty) Ltd

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This report is the third report of a series of three reports that investigated pricing and debt management within municipalities. The reports consist of the following:

- Report 1: A Literature review on Pricing and Debt Management of Water Services (WRC Report No. 1811/1/10)
- Report 2: A Gap Analysis on the state of Water Services Debt Management (WRC Report No. 1811/2/10)
- Report 3: Recommendations towards Pricing and Debt Management in Water Services Delivery (WRC Report No 1811/3/10).

The information contained in report 3 should be considered in conjunction with the other reports.

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EXECUTIVE SUMMARY

BACKGROUND

Cost recovery for basic municipal services including water has not always been the policy of national and local government in South Africa (McDonald, 2002: 20). Apartheid policies of separate development ensured that municipal services were delivered along racial lines, with black South Africans receiving inferior and inequitable services, or no services at all (Smith and Green, 2005: 435).

User fees, tariffs and property rates charged by the apartheid regime, had little relevance to the marginal cost of providing them. During the 1970s and 1980s, white suburbs and industries received per capita infrastructure investments on par with or even higher than most European and North American countries through heavy government subsidies (McDonald, 2002: 20).

Black townships and 'Bantustans' also received subsidies for municipal services, although smaller in relative and absolute terms than those of white areas.

During the apartheid period, rates and rent boycotts were used as a form of political protest action against the regime. Despite boycotts, the apartheid government continued to provide services in fear of political fallout for not doing so, hence there was a *de facto* subsidisation of township services (McDonald, 2002: 20).

The post apartheid South Africa, however, continued to witness non-payment of municipal services and researchers alludes to number of contributing factors to this phenomenon. Cost recovery has only been isolated as an explicit and widespread policy objective in the mid 1990s after the end of apartheid.

Consistent with prevailing prescriptions from international development agencies, a Water Supply and Sanitation White Paper, (1994: 21) called for the recovery of at least the recurrent (operation and maintenance) costs of water services through direct user charges. The subsequent Strategic Framework for Water Services (SFWS), approved by Cabinet on 17 September 2003, set out as part of its goals the equitable, affordable, effective, efficient, gender sensitive and sustainable provision of water services to all people living in South Africa. Cost recovery initiatives should in accordance with the SFWS, balance the rights and responsibilities in terms of provision and reasonable use of basic water services to ensure sustainability and safeguard the financial viability of the water services provider.

The International Conference on Water and the Environment (ICWE), from which emerged the Dublin Statement, provided the major input for water to the United Nations Conference on Environment and Development held in Rio de Janeiro in June 1992. The fourth guiding principle of the Dublin statement recognizes that water has an economic value in all its competing uses and should be recognized as an economic good and also that it is vital to recognize the basic right of all human beings to have access to clean water and sanitation at an affordable cost.

The equity concept in water use and management has been recognized as a central theme in the debate on water issues discussed at the global level, notably in the sixth edition of the United Nations Commission for Sustainable Development (UNCSD, 1998), in the Ministerial Declarations of the Hague (2000) and Bonn (2001), and in the definition of the Millennium Development Goals (UN, 2000), (UNDESA, 2003: 326).

Arguments for and against cost recovery in water services have been presented in a number of studies throughout the world. In a bid to develop guidelines on pricing and debt management for municipalities, cost recovery strategies employed by various authorities and utility companies are first studied.

For any debt recovery policy to be effective, a service provider must be able to measure the consumption of a particular service by an individual household regularly and accurately, however the most accurate measurement and pricing systems in the world mean little if the service provider cannot collect the monies owed for service rendered. The focus of this report is to discuss potential solutions with regard to water pricing and debt recovery problems.

RECOMMENDATION FOR FUTURE RESEARCH

The recommendations for future research include the following:

- Research on the segment of customer database
- Policy research to standardise water tariffs in South Africa

It the study that describes the nature of the water pricing and debt recovery problems and secondly it make international comparisons with other countries with respect related issues and challenges. Lastly, the current revenue enhancement strategies are outlined in order to inform the proposed intervention strategy.

CONCLUSION

In Summary, the study proposes certain interventions to address water pricing and debt management problems in South Africa. The strategy focuses on 7 strategic interventions, namely:

- Policy
- Regulatory
- The customer
- Billing system
- Payment
- Incentives
- Legal action

Each intervention requires an action plan as reflected in the report. To ensure the successful implementation of this intervention strategy certain institutional and financial resource requirements were identified.

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1 INTERVENTION STRATEGY FOR WATER PRICING AND DEBT RECOVERY

Cost recovery for basic municipal services including water has not always been the policy of national and local government in South Africa (McDonald, 2002: 20). Apartheid's policies of separate development ensured that municipal services were delivered along racial lines, with black South Africans receiving inferior and inequitable services, or no services at all (Smith and Green, 2005: 435).

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Arguments for and against cost recovery in water services have been presented in a number of studies throughout the world. In a bid to develop guidelines on pricing and debt

management for municipalities, cost recovery strategies employed by various authorities and utility companies are first studied.

2 NATURE OF THE WATER PRICING AND DEBT RECOVERY PROBLEM

This section describes the nature of the water pricing and debt recovery problem. The section is divided into the following:

- Water pricing problems
- Debt recovery problems

2.1 The Water Pricing Problem

Three aspects will be addressed in this section namely:

- Concepts relevant to water pricing
- Administered Prices of Water
- Current Water Tariffs

2.1.1 Concepts Relevant to Water Pricing

Urban water supply services have at least four features that affect the manner in which water services are provided to the community (as adapted from: Western Australia Economic Regulating Authority, Water Pricing: Concepts and Principles presentation to the IIR Water Pricing Conference Sydney, 25 October 2006). Firstly, water services have characteristics of “natural monopolies”, that is, significant infrastructure is required to store, treat and deliver water. Much of this infrastructure may be provided at least cost if it is provided by a single business and without duplication of infrastructure. However, a consequence of this is that there is a lack of competition in service delivery, and a lack of competitive incentives for efficiency in provision of the services.

Secondly, market-determined prices are often not reflecting the relative scarcity of water resources, especially in water scarce countries such as South Africa. Under “normal” (read economic market conditions of supply and demand) market conditions, resources that are capable of being traded would attract a price that reflects the scarcity of the resource relative to demand. However, urban water supplies have historically been treated as “community resources” that are reserved for urban use and that are not traded in markets. As such, prices for water most often only reflect the infrastructure and operational costs incurred in the provision of water services, but do not necessarily reflect the scarcity of water at particular locations to the extent that this might exist.

Thirdly, provision of water services is often characterised by environmental impacts – most of which are classed as “externalities”. These are impacts that are not automatically factored into water supply, water consumption and wastewater disposal decisions because they are costs borne by society that are not reflected in costs incurred by the water businesses and the prices charged for the services. For example, the effect of extraction of groundwater on local ecosystems is a common external cost arising from the use of groundwater resources – a negative externality

Finally, water services are regarded as essential services, both in terms of ensuring ready and affordable access to these services and requiring the use of these services for reasons of public health.

Government or regulatory intervention (remember South Africa does not have a water regulating authority) in the setting of prices for water services may therefore be necessary to achieve multiple policy objectives such as:

- Delivering water services at prices that reflect the cost of providing the services;
- Enhancing the efficiency of service delivery in the absence of a competitive market through incentive-based pricing mechanisms that allow water providers to recover the costs of efficient service delivery and earn a commercial rate of return on capital;
- Providing signals to water users of the relative scarcity of water supplies – which may arise due to infrastructure constraints or limited water supply – so that relative scarcity is taken into account in demand and consumption decisions;
- Reflecting the net cost of environmental externalities, with the aim of either recovering costs associated with meeting environmental standards, or reducing consumption of water so as to avoid future environmental impacts and costs; and
- Setting tariff structures to meet policy objectives relating to the accessibility to clean water and the affordability of water (the free water policy of the SA Government is a case in point)

It should be noted that the pursuit of these objectives may involve trade-offs. The overall goal, however, should be one of economic efficiency, including efficiency in achieving distributional and social policy objectives, to the extent that this is possible given administrative practicalities, requirements for revenue stability, customer acceptability and transparency.

In conclusion it is important to take note of the general observations and characteristics of tariffs (The World Bank, 2002):

- Tariffs are complex issue that require understanding of consumer demand and willingness to pay, and of utility cost structure.
- Getting the tariff level and the tariff structure right helps all consumers, including the poor.
- Subsidize access not consumption.
- Subsidy delivery mechanisms should be targeted, transparent, and triggered by households indication of demand.
- New information is often required to evaluate whether a proposed tariff or subsidy will hurt or help poor households.
- Tariffs and subsidies require modifications over time. Decisions must be made about how social equity concerns will be incorporated in the tariff and subsidy revision process.
- Properly designed tariffs are powerful management tools.
- Comparisons of all alternative designs can be complex.
- No single design fits all circumstances. The poor are important consumers who are willing to be valid customers.
- Increasing block designs, though widely used, have many disadvantages

2.1.2 Administered Prices of Water

A study was commissioned by National Treasury concerning Administered Prices of Water in South Africa. According to the study the regulatory framework for water services tariffs (retail prices) are regulated by legislation (Water Services Act and Municipal Systems Act). This legislation only provides high level principles and as a consequence little guidance is provided on the practical application of these tariffs. Retail water pricing is regulated by

WSA (local government), and the focus is on self-regulation. This aspect is supported by Van Basten (2007: 29) who contends that there is no independent water regulator and regulation is basically done by Water and Forestry Affairs and then by water boards and local authorities, where the players actually become referees. In addition to this it was found incentives for efficient retail water services are weak. Retail prices may in many instances be too low.

General findings of the study include (Eberhard, undated):

- Individual water charges vary widely across South Africa.
- Regulatory incentives for cost reductions and efficient prices are weak at all levels of the activity chain.
- Strong municipal and broader political pressure to limit retail water tariffs leading to a cost squeeze, which generally translates into insufficient investment and under maintenance.
- Efficient regulation and reliable assessment of pricing efficiency is dependent on the ring-fencing of water operations at local government so that better information can be made available.
- Consideration should be given to the establishment of an independent regulator.

From the above it is deduced that from an administrated-prices-perspective the nature of the problem is ascribed to the varied nature of water tariffs in South Africa.

2.1.3 Current Water Tariffs

The above discussion alluded to the fact that water prices vary widely across South Africa. The tariffs from a number of municipalities were obtained during interviews conducted. In this regard a selection of tariffs is reflected in the table 2.1 below.

Table 2.1: Selection of municipal water tariffs

Municipality	Scale	Tariff R/kl
City of Tshwane	7-12 kl	R5.40
Ekurhuleni Metro	7-15 kl	R6.40
Matjhabeng Municipality	6-50 kl	R10.27
Breedevallei	6-20 kl	R4.62
Midvaal	7-20 kl	R11.66
Mosselbay	7-30 kl	R3.61
Makana	>10 kl	R4.27

From the above table it is clear that there is no consistency concerning water tariffs in South Africa. It is further deduced that in certain instances the large urban areas have lower tariffs than some of the smaller municipal areas.

2.1.4 Concluding Remarks and Focus of Intervention

From the above discussion it is concluded that water pricing problems relate to the following:

- The diversified nature of water tariffs
- The focus on self-regulation with regard to water tariffs
- The probability that retail prices may be too low.

With this in mind the interventions should focus on the following solutions:

- Development of detailed guidelines for efficient pricing
- The establishment of an independent economic regulator

2.2 South African perspective on Non-Payment Problem

2.2.1 Introduction

The problem with the non-payment of water debt to municipalities is underlined by the water debtor days. This aspect is discussed below.

2.2.2 Municipal Water Debtor Days

Table 2.3 reflects the water debtor days by province for South Africa. Detailed age analyses for each province are provided in Annexure A. Annexure B provides additional information local government revenue and expenditures for water and other services.

Table 2.3: Water Debtor Days by Province

	Water Debtor Days Age Analysis									
	0-30 Days		30-60 Days		60-90 Days		Over 90 Days		Total	
R thousands	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Province										
Gauteng	668 964	7.61	564 457	6.42	347 975	3.96	7 208 376	82.01	8 789 772	100.00
Eastern Cape	153 333	13.14	77 563	6.65	35 163	3.01	900 472	77.19	1 166 531	100.00
Free State	111 362	8.54	71 335	5.47	54 545	4.18	1 066 909	81.81	1 304 151	100.00
Kwazulu-Natal	206 237	11.47	91 996	5.12	69 151	3.85	1 430 225	79.56	1 797 609	100.00
Limpopo	22 840	6.01	18 501	4.87	15 149	3.98	323 719	85.14	380 209	100.00
Mpumalanga	38 120	9.05	24 594	5.84	18 283	4.34	340 292	80.77	421 289	100.00
Northern Cape	9 398	6.38	9 406	6.39	4 272	2.90	124 196	84.33	147 272	100.00
North West	69 984	6.74	45 342	4.37	44 221	4.26	878 941	84.64	1 038 488	100.00
Western Cape	299 321	12.81	103 887	4.45	81,583	3.49	1 850 999	79.25	2 335 790	100.00
Total	1 579 559	9.09	1 007 081	5.79	670 342	3.86	14 124 129	81.26	17 381 111	100.00

(Source: National Treasury, 2009)

On average South Africa has very high debtor days with more than 81% of water billed outstanding for more than 90 days. Almost all provinces show the same pattern with around 80% debtor days 90 days and older. It is apparent that the problem is extensive with more than R14 billion being owed to municipalities for longer than 90 days. From a cash flow perspective any business will be hard pressed to continue operating if more than 80% of its cash is tied up in debtors for 90 days and longer.

2.2.3 Summary of Revenue Related Problems Faced by Municipalities

Municipalities generally face significant revenue collection challenges (not just water debt related). The following is a summary of such challenges being faced by municipalities:

- Municipal services arrears affect the overall viability of municipalities (see Table 2.3 above which shows that more than R14 billion is owed to municipalities for water bills 90 days and older);
- Some municipalities make an effort to address the issue of service arrears or debt;
- Some municipalities experience challenges in implementing free basic services;
- Some municipalities experience problems with the identification of indigent households;
- Information collected from municipalities confirmed that no standardized measure or policy for debt collection exist;
- Information obtained from certain municipalities indicate water debt collection has decreased over the past 5 years;
- Residential households seem to be the biggest contributors to water debt at municipalities;
- Municipalities have ineffective revenue administration processes/teams;
- Many municipalities have poor metering systems, unreliable customer information, inadequate billing systems, non user friendly municipal invoices, unreliable postal service, inaccessible payment and enquiry facilities, tampering with meters, problems with the justice system, political opportunism, lack of incentives and sanctions to encourage good payment, and high government arrears.

The challenges faced by municipalities are many and serious, on all fronts not just water debt. The extent of water debt to the overall situation is highlighted in the next section.

2.2.4 Understanding the Consumers

In order to understand the consumer's attitude towards the water services it is required to consider the National Baseline Study that investigated the non-payment of municipal services. The most important findings with regard to water services are summarised below:

- Water is only third most important household expenditure priority.
- Access to financial services, especially in rural areas, contributes to the problem.
- Approximately 90% consumers receive municipal accounts, while the additional 10% does not reach the consumers.
- Reasons for non-payment are largely ascribed to affordability (about 90%).
- Approximately 75% of respondents take steps to arrange with municipality to repay debt.
- Approximately 90% of customers prefer cash payment.
- 33-38% of customers question the accuracy of accounts for water.
- 30-40% of customers state that account for water is difficult to understand.
- 75% state they will start paying their accounts if they find employment/income and only 6-9% if tariffs are reduced.
- More than 70% of customers will cut back on other expenses if they are forced by court of law to pay.
- Suggested actions for local government – 32% suggested negotiated arrangement and another 30% suggested punitive actions (disconnections).
- Inability to pay versus the non-payment of water services will remain a problem.

2.2.5 Concluding Remarks and Focus of Intervention

From the above discussion it is concluded that water debt recovery problems relate to the following:

- Not all the customers receive water accounts.
- The complexity of water accounts.
- Water services are not seen as the highest priority for payment of debt by households.
- The high debtor days associated with water bills.
- The fact that residential households are the biggest contributor to water debt at municipalities.
- No differentiation is made between urban and rural consumers.
- The escalating problems of debt recovery at municipalities.
- No standardized measure or policy for debt collection exists.
- The consumers' perception on the accuracy of water accounts.
- The affordability issues for many non-payers.
- The seemingly ad hoc approach by municipalities regarding actions for non-payment.

With this in mind the interventions should focus on the following solutions:

- a) Differentiate between rural and urban (categorize consumers).
- b) Focus on free-riders, namely those able but unwilling to pay.
- c) Payment method must be changed. Entice implementation of debit orders as a possible incentive.
- d) Implement a marketing campaign that will promote water as a priority service.
- e) Increase accuracy/understanding of accounts by simplifying it.
- f) Improve process for negotiated arrangement.

3 INTERNATIONAL PRACTICE IN WATER DEBT MANAGEMENT

3.1 Introduction

This section deals with international practices in water debt management. Two countries have been selected for this section, namely:

- United Kingdom
- Australia.

3.2 Water Debt and Water Debt Management in UK

The aspects to be addressed in this section include:

- Debt position in UK
- Industry reaction to debt, with specific reference to Ofwat
- Conclusion

3.2.1 Debt in the UK

The relevance of this discussion is to determine, firstly, whether water debt recovery problems are similar to those experienced in South Africa; and secondly, whether the solutions proposed are applicable to the water debt recovery problems of South Africa.

The number of households in the UK in terms of water debt is around 4.3 million. This compares with around 1.1 million for electricity and 0.8 million for gas, despite the higher bills for energy. Also the levels of debt in the energy sector are much lower. Water debt in 2006-07 in the UK was £930 million, compared to £223 million for electricity and £179 million for gas. (Water UK website www.water.org.uk).

The costs of collecting water debt together with the loss of capital and the costs of debt write-off add around £11 to every customer's bill. Research in 2006 showed that the debtors can be grouped as follows:

- **20%** of debtors owed 70% of the total water debt.
- **46%** of debtors are in the highest 10% credit risk category.
- **34%** of debtors are likely to live in rented accommodation.
- **23%** of debt is 'leaver debt', where water companies cannot trace defaulting customers.

There is also a core of high worth debtors, namely:

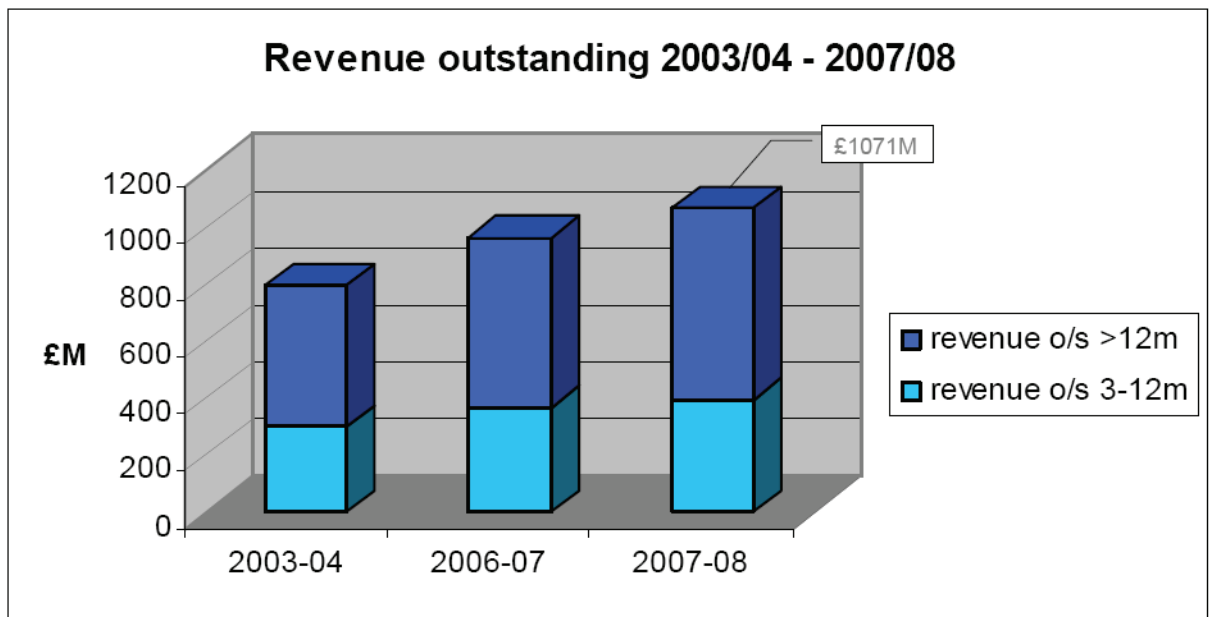
- **4%** of debtors have credit scores in the top 25%.
- **4%** of debt is accounted for by 'affluent singles and couples in exclusive urban neighbourhoods'.

Table 3.1 provides further information on the current debt position in the UK.

Table 3.1: Debt Position in the UK (2007)

Debt Aspect	Value £
Household revenue outstanding (>3 months)	£1071m
Household revenue written off	£104m
Number of households with revenue outstanding	5m
Household revenue outstanding (>12 months)	£674m
Operating expenditure on collection (Δ 10%)	£71m

The situation regarding revenue outstanding to Water UK is further reflected in Figure 3.1.



(Source: Water UK, 2008)

Figure 3.1: Revenue Outstanding to Water UK: 2003-2007

The figure shows that revenue outstanding between 2003/04 and 2007/08 has risen by about 40% to more than £1 billion. An important fact in terms of the non payment is that tenants (lessee) of property account for 44% of debt in the UK.

The situation regarding water debt and water debt management in the United Kingdom can be summarised as follows:

- According to Water UK water debt is increasing in the UK (statement made at a Utility Week Consumer Debt Conference held by Water UK in October 2008).
- Water affordability is a growing issue.
- The focus on debt management is to identify the liable person.
- Those unable to pay will get support from the industry.
- Those able to pay but unwilling needs to be sanctioned, but it is accepted that the industry will need help to achieve this.

3.2.2 Water Industry's Reaction to Debt

Water UK has seemingly adopted the following approach to water debt management:

- Providing measures to help the vulnerable and those struggling to meet their water bills

- Tackling those that can pay but do not pay – through the court service
- Lobbying for legislative change to reduce the debt burden and working with consumer bodies to improve help with water affordability

In support of the above approach Water UK has tabled a number of proposals, namely:

- Proposal 1: Adopt the “liable person approach” in Council Tax legislation for private rented properties.
- Proposal 2: Requirements for residents, owners and managing agents to supply information to the water company to identify who is the liable person for the property.
- Proposal 3: Owner liable for specific classes of properties (e.g. flats).

The industry is prepared to help those willing, but unable to pay. The same does not apply for those able but unwilling to pay.

3.2.3 Office of Water (Ofwat)

Ofwat (Office of Water) is the Water Services Regulation Authority in England and Wales. The company is the economic regulator of the water and sewerage companies in England and Wales (refer to the discussion in section 2.1.2 concerning the water regulator for South Africa). One of the regulatory functions performed by Ofwat is the setting of water tariffs that water supply companies may charge consumers. In this section the guidelines drafted by Ofwat for the management of water debt by the water companies are presented. These guidelines cover what Ofwat considers to be the main debt recovery issues, detailing the various approaches which companies may take and exposing Ofwat’s expectations for water company operations. They take account of the fact that companies are now more likely to make use of debt collection agencies (this is also an option that is used by South African municipalities) and court procedures such as garnishee orders and charges on property for the collection of debt, and reflect the wider range of methods used in attempting to contact customers.

PRINCIPLE 1: Companies should be proactive in attempting to contact customers who fall into debt before proceeding to court action.

Current practice: Water companies report that their main problem in obtaining payment is making contact with the customer. Once they have made contact it can be relatively easy to agree a payment arrangement. Some companies have developed computerised billing systems which identify customers who have a record of late payment. They use these systems to contact the customer if payment is not made promptly, to attempt to arrange payment rather than issue a claim.

Systems have been developed to analyse customers’ payment habits and tailor the type of correspondence sent to customers: for example, if the customer normally pays on receiving a solicitor’s letter, the company can omit one or more of the items of correspondence which it would send before that letter. Alternatively the time between letters may be shortened, as the customer is unlikely to respond to them.

Timing can be a factor in achieving contact. Companies which attempt to contact customers outside of normal office hours, (in the evenings or at weekends) and vary the times at which they try to contact any one customer report improved contact rates. Water company experience suggests that innovative approaches to debt recovery, are often most effective when they are new, and not expected by the customer. Once

customers have become used to a set procedure, it becomes less effective and they are more likely to ignore reminders or letters. Customers are more likely to open a letter they receive outside of the usual recovery timetable, or to respond to an unexpected telephone call or visit. Companies should also consider whether they can use new technology to maximise the opportunities for contacting customers. This could include the use of faxes, emails or cellphone message facilities.

A strategy which can incorporate changes in the ways in which customers are contacted may be more effective in the longer term than one which remains static. Customers who are in debt may be reluctant to open mail which appears to have been sent by the water company. Companies report that customers may be more likely to open correspondence which is sent in an unmarked (i.e. no company logo), hand written envelope. A number of companies have set up in-house collection debt collection agencies, which operate under names not directly linked to the water company and use separate headed stationery. Companies report that these can be successful in establishing contact with customers.

Expectations: Generally Ofwat would expect to see companies adhere to the following:

- Normally two prompts to contact the company sent before issuing a claim.
- Normally the first reminder sent no sooner than 21 days after issuing the bill, unless the company can show that a different timescale is justified for the individual concerned by their payment history.
- Each reminder should set out what will happen and when action will be taken if the customer fails to respond. The various actions the customer can take should be clearly set out.
- An effective debt recovery strategy will involve a combination of communication methods (telephone, mail, visiting and so on). The timing of attempted repeat visits and telephone calls will be varied where possible.
- The timing and manner of such contacts should not be oppressive or threatening, and conform to accepted good practice, such as suitable hours for attempting telephone contact.
- Any new approaches or systems should not reduce opportunities for customers to approach the company and that literature continues to encourage customers to communicate effectively with their supplier.

PRINCIPLE 2: Companies should provide a reasonable range of payment frequencies and methods, for all customers. The entire range of options should be properly and widely advertised to ensure that customers can select the arrangement which best suits their circumstances.

Current practice: Each company sets out the range of payment options it offers in its Charges scheme, which the Director General approves every year. This includes the methods by which customers can make payments and at which locations, as well as the frequency of installments which the company will arrange. All companies offer a variety of options, although the range available varies across the industry. We ensure through the approval of charges schemes that all companies offer at least a satisfactory range of payment options.

It is important that companies offer installments for customers who prefer to pay more frequently: usually fortnightly or weekly. Options are now available for swipe card payments run through local shop networks (such as PayPoint and Payzone) where the customer can pay as frequently as he wishes, deciding on the amounts himself, but with set amounts to be paid off by certain dates. These options tend to be more popular

among customers who need to budget for shorter periods of time; often those on lower incomes or state benefits.

Customers are more likely to make regular payments if the locations for payment are easily accessible. Companies have traditionally offered customers the chance to pay at banks and post offices, although the closure of isolated and small branches in recent years has reduced the number of available locations for payment. Local shop payment networks, such as PayPoint can offer alternatives. Many companies already offer payment options where the transaction cost is subsidised or free at selected locations.

Some companies also keep an open mind to other possibilities for payment, outside of the usual range offered, which customers may suggest. Where a customer offers to pay by a method which the company does not usually offer, the company will consider accepting the offer, in the interests of establishing a payment habit for the customer.

For customers who are in debt and in receipt of certain benefits it is possible to arrange for payments to be deducted directly from such benefits. All water companies currently offer this option. Ofwat are pressing for water payments to be given a higher priority when these arrangements are set up.

Companies currently advertise the range of payment options in a variety of ways. All companies send some form of payment option information on or with the initial bill. Some detail the full range in a separate leaflet which customers can request, or which they send to those who have fallen into debt, along with reminders or other correspondence.

Expectations: To meet this principle Ofwat would generally expect companies to:

- Review their network of payment locations at least once every two years to ensure that all customers have reasonable access to the network. They will need to take account of the number and geographical distribution of locations. The network of available locations at which the customer can pay must accommodate both rural and urban customers.
- Consider whether there are any charges for making payments at the network of locations offered and offer a reasonable range of locations at which customers can make payments free of charge. This should include frequent payments, in cash, for customers who prefer to pay weekly or fortnightly.
- Allow measured and unmeasured customers to pay at least at the following frequencies annual/half yearly/quarterly as appropriate on receipt of the bill, monthly, fortnightly/weekly.
- Offer installment payments by cheque, cash, and Direct Debit.
- Continue to offer customers who are in debt and in receipt of eligible benefits the option to make direct payments.
- Properly advertise payment options on or with the initial bill so that the customer can choose the option which best suits his circumstances. Companies should also take advantage of further opportunities to draw customers' attention to the range of options available. They should flag options again in further correspondence sent to customers in debt, either in the text of letters or enclosing a separate leaflet. Where companies can identify an installment option which may suit a customer better than the one they currently use, they should proactively offer the option.

PRINCIPLE 3: Literature and letters or notices sent to customers should be written in a non-threatening style but should clearly set out the action which the water company will take if the customer fails to make payment or contact the company.

Current practice: Water companies use standard letters and notices to advise customers that they have missed an instalment or failed to pay their bill. Notices set out what action the company will take if the customer does not pay within a specified time, and invite the customer to contact the company. They can also detail what the consequences of such action might be for the customer (for example a Court Judgement may damage the customer's credit rating for a number of years).

All companies are required to make a Code of Practice, approved by Ofwat, available to customers. It will set out how the company deals with customers who fall into debt. Some companies produce this Code in the form of a customer friendly leaflet which can be used to advise the customers of their options. Standard letters are usually available for each stage of the process. Some companies have developed a suite of letters or notices applying only to domestic customers; others have letters which can apply to either domestic or commercial customers and cover the action which could be taken against each group.

Water companies make literature and correspondence available to customers in formats which they are able to use. Companies are usually able to offer customers with sight impairments large print or Braille bills where appropriate so that they are able to read their bills and notices.

Expectations: Ofwat will generally expect companies to meet this principle in the following ways:

- Letters and reminders to customers who have fallen behind with payment should be clear about what will happen if the customer does not pay. To be constructive, it is also important that they contain information about the customer's options.
- Companies will not threaten to disconnect a domestic property for non-payment, as disconnection is no longer legal. There should be no implication of action which the company could not take in relation to that customer. (For example, it would be easy for a household customer to infer incorrectly that he might be disconnected from a common notice sent to commercial and domestic properties which stated that "you may be taken to court or have your supply disconnected".)
- The customer should be given a clear indication of the length of time he has in which to act before the company takes its next step.
- If the customer is at risk of being subject to post-judgement court proceedings, the company should explain them simply and fully. Many companies are now using post-judgement proceedings or orders such as garnishee orders, charges on property, oral examination in court and attachment of earnings. Some customers may not understand the meaning of these terms and need a simple explanation of the process and consequences of the action the company proposes to instigate. They may not be aware that court action could jeopardise their credit rating in the future or that some actions may involve contacting their employer.
- If notices or letters themselves do not list the customer's options for payment arrangements, they should be accompanied by literature which does, or should clearly detail where the customer can obtain this information.
- Companies should ensure that their debt code approved by Ofwat is kept up to date, which may require approval more frequently than the maximum three-year interval.

PRINCIPLE 4: When agreeing payment arrangements with customers in debt, the customer's ability to pay should be taken into account.

Current practice: A payment arrangement which takes account of the customer's ability to pay is more likely to be effective in securing regular payments than one which aims to recover more money more quickly through installments which are unsustainable. Companies report that customers can be inclined to agree to payments set higher than they can reasonably afford, believing that this is more likely to satisfy the company.

When estimating the customer's ability to pay, it is important that all the customer's circumstances are looked at where possible – not just their income. Companies advise that many customers who are in debt to the water company will also be in debt to other utilities and third parties. The level of a customer's commitments to other creditors will affect their ability to pay the water company.

Ofwat recognises that finances are a personal issue and that some customers will not wish to reveal their circumstances to water company staff. However, it is important that companies make an attempt to take account of the customer's ability to pay. This could be through a telephone enquiry, if contact has been made by telephone, or an invitation in correspondence to talk through how much the customer can afford. Companies will need to train staff to make these enquiries appropriately.

Water companies often set up payment arrangements to cover current charges year the debt of someone who has had payment difficulties for some time. In these circumstances the company may take a long term view in the light of the customer's ability to pay. The level at which direct payments from benefit are being set can be a useful guide to setting an appropriate payment arrangement for some customers.

One of the aims of a payment arrangement is to enable the customer to establish the habit of making regular payments. When a number of installments have been missed, many companies cancel the payment arrangement and take action to recover the full amount due. Where the customer has multiple debts companies can advise that it may benefit the customer to talk through their situation and review their payment obligations with a debt counsellor. A number of companies have established links with local Citizens Advice Bureaux and Money Advice Centres and will refer customers who appear to be in multiple debt to them for advice. Some have set up arrangements to subsidise these local offices and will communicate with them about the level of a customer's payment arrangement. They will also accept recommendations on the level of installment plan payments. Where the customer is clearly unable to pay, a referral to a charitable trust may help if one is available.

Some companies have set up incentive schemes which enable the customer to get into the habit of making regular payments. These generally involve arrangements whereby the company will either match payments made by the customer or discount part of the debt if agreed regular payments are maintained.

Expectations: To meet this principle companies will generally be expected to:

- Make enquiries as to the customer's ability to pay when setting up installment arrangements and to take account of the information given. Their records should demonstrate that this was done. Repayment levels should be realistic and sustainable given the customer's circumstances, and action taken when installments are missed should be appropriate.

- Tell the customer, where appropriate, that he or she may be able to reduce their future charges either by switching to a water meter, applying for the vulnerable group tariff or implementing some water efficiency measures. It should offer information about this.
- Where appropriate, treat the current year's charges separately from the customer's debt when setting up an installment plan. This would be in line with current National Association of Citizens Advice Bureau guidelines which treat current bills as a higher priority than debt, but aim to ensure that current charges are paid. Where possible an installment plan will aim to ensure that the customer pays off the current year's charges before the next year's bill is received, and pays something towards the accrued debt. Companies may need to take a long term view of the period over which customers can clear their debt, based on their knowledge of the customer's circumstances. Where possible they should try to avoid allowing the debt to increase unless they are convinced that in the customer's situation it is appropriate to accept any small amount in order to encourage a payment habit.
- Accept any reasonable offer of payment made by a customer. However, in cases where the customer has multiple debts, liaison with local advice agencies can be useful.
- Establish and maintain good relationships with local advice agencies and recommend customers consult these agencies where appropriate.
- Where a charitable trust or a restart scheme is in place, companies should tell customers about them where appropriate. Companies which do not have such schemes should consider the value of establishing them independently or jointly with other companies or utilities.

PRINCIPLE 5: Customers whose accounts are managed by debt recovery agents should receive a similar level of service and care to those whose accounts remain with the water company.

Current practice: It is common practice for some companies to refer the accounts of indebted customers to debt collection agencies. From this point on (which may be before or after court action is taken) the customer is unlikely to have direct contact with the water company, but will deal instead with the agency. Agencies usually work on a commission basis and it is in their interests to arrange payment installments which the customer can maintain. Some debt collection agencies offer doorstep collection services to encourage customers to make the agreed payments. The agent, rather than the water company, will now send out literature and correspondence.

Debt collection agents work under a service agreement governing the level of service customers will receive and setting out the agent's relationship with the water company. Reputable companies will operate under a Code of Practice such as that approved by the Credit Services Association. The level of access the company retains to records of contact with customers and their accounts will vary according to the service agreement between the company and the agent. Good practice allows the water company to monitor the handling of its customers' accounts and to know what payment arrangements have been made.

Expectations: To meet this principle companies who use debt collection agents are generally expected to:

- Ensure that they engage a reputable company abiding by an industry Code of Practice. The agent should be aware of the water company's own Code of Practice on debt recovery and should abide by it.

- Be able to verify that their customers are sensitively dealt with through a robust audit process. This may include regular reports from the agent on the progress of customers' accounts and payments. To satisfy themselves that their customers are receiving the appropriate level of service, water companies would be expected to hold copies of standard correspondence and literature sent by debt collection agents and ensures that these conform to the standards expected of the water companies themselves.
- Ensure that customers whose accounts have been passed to debt collection agents do not find themselves in a position where it is harder to agree payments than if they were dealing direct with the water company.
- Retain access to the management of the customer's account, should the need arise, as the debtor remains the customer of the water company. When operating best practice water companies will be able to obtain access to the customer's account and details such as the amount which a customer has agreed/been asked to pay, should they be approached direct by the customer or by third parties acting on behalf of the customer, such as debt advisers.
- Ensure that customers who are unhappy with the way the agent has dealt with them are able to raise their concerns with the water company. In some cases it may be appropriate to treat a customer's current charges separately from debt as the company may wish to agree payment terms for the current bill direct with the customers while leaving the collection of debt in the hands of the agent. The company should not normally refuse any reasonable offer of payment from the customer, unless it can show justification for doing so in the case of the individual concerned.

3.2.4 Thames Water

Thames Water is the UK's largest water and Sewerage Company, serving 13.6 million customers across London and the Thames Valley. (www.thameswater.co.uk)

In order to reduce the overall level of debt and age of debt, and therefore the cost of working capital, it is important for relevant parties (utility companies in the UK and Municipalities and even the 15 Water Boards in South Africa) to understand the cost to collect debt at a detailed level for all customer types and introduce agility into the process to manage the costs down and encourage quicker payment.

Relevant parties should aim to understand (and minimise) the cost of all the processes that contribute to collecting revenue at each stage of the debt collection process from bill to cash. The customer base should be segmented and the profitability of each segment understood so that less profitable customers can be identified and the debt collection process changed accordingly for that segment.

Minimising customer debt while strengthening customer ties presents several challenges to any utility. Many utilities (this is certainly the case with South African Municipalities) have a debt collection process that does not distinguish among different customer types and is limited to customer contact through traditional means, such as written correspondence and call center interactions. Debt collection is sometimes split across disparate IT systems and includes costly manual process steps. Changing any part of the process can require lengthy and potentially risky system development, with the eventual outcome uncertain.

The benefits that can be realized through debt management process improvement do however make the undertaking worthwhile. Typical benefits include:

- Cutting the cost of debt significantly;

- Reducing payment cycle times;
- Reducing the amount of non-value added work in billing and collection processes, thereby increasing efficiency and further reducing costs;
- Increasing the performance of the debt collection function, by more efficient use of outbound dialing facilities, or text messaging, for example;
- Doubling the billing and collection enquiries resolved during the first phone call.

Debt management process improvement is based upon an understanding of the cost to collect at a detailed level for all customer types and an agile debt collection process that manages the costs down and encourages quicker payment. The following 5-step approach to cost reduction has been implemented by Thames Water. By treating customers differently according to segment and past payment behavior, Thames Water are not only able to be more efficient at the collection process, they are also providing a better service to their customers.

Step 1: Understand the cost to collect

Utilities need to identify the processes that contribute to collecting revenue and evaluate the cost of each process. A simplified debt collection process can be broken down into the following sub-processes as reflected in Figure 3.2 below:



(Source: Boone, K and Roberts I, 2005)

Figure 3.2: Simplified debt collection process

Each of these sub-processes will have an associated cost that must be understood. Cost reductions may be possible for each sub-process but those that can be realized with the least effort in the shortest timeframe should be tackled first.

Activity Based Costing (ABC) can be used to allocate all costs (direct and indirect) in the debt collection process and calculate a total cost of collection. The first stage maps out the high-level processes and begins to identify the real cost drivers of the business. The second stage gathers information concerning actual activities and the time spent on each activity, as well as the interactions between different departments. These activities can be joined together to form a full process map with the appropriate cost allocations.

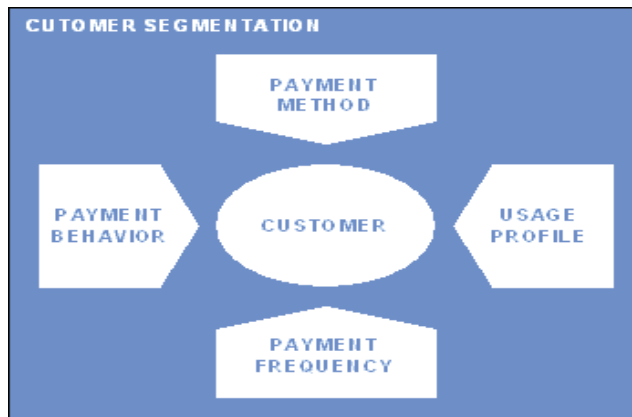
Step 2: Segment the customer base

Segmentation helps to differentiate between customers who can't pay, who can be handled more sensitively, and customers who won't pay, who can be fast-tracked to the appropriate debt recovery process. Also, in this way, costly debt collection steps can be avoided for small debt amounts.

The cost to collect and thus profitability of each customer type can be used to drive segmentation and the debt collection process can be changed to fit each segment. Debt collection tactics can vary depending on a range of criteria such as payment behavior, payment method, payment frequency and usage profile, etc.

The risk profile of each customer can be understood by mapping the customer segment by its propensity to default (see Figure 3.3). Specific initiatives, within regulatory constraints, can be applied that maximize collections in each customer segment, e.g.:

- High risk (can't pay) – prepaid meters (seemingly not allowed in South Africa)
- High risk (won't pay) – fast track to disconnection (the South African equivalent would be flow restriction measures)
- Medium risk – encourage direct debit uptake
- Low risk – payment channel cost reduction with appropriate incentive.



(Source: Boone, K and Roberts I, 2005)

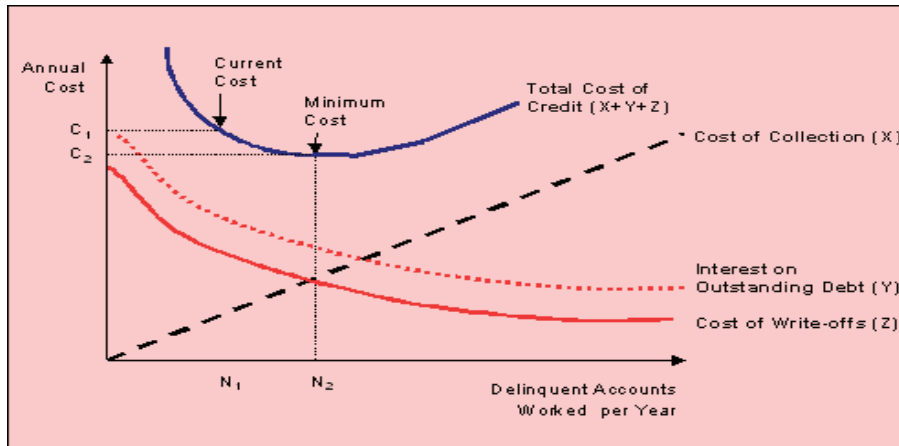
Figure 3.3: Customer Segmentation

Risk assessments need to be re-applied to customers on a regular basis to ensure that changes in customer payment performance are recognized within the system and that customer risk data is up to date. Changing the process for those customers who migrate to lower risk categories through proactive segmentation can further reduce costs.

Step 3: Manage the cost to collect

Having segmented the customer base, customers who are not profitable can be identified and the cost to collect for those customer types can be managed down to a minimum. To do this, the process costs must be mapped against each segment to provide the overall cost to collect. This identifies the breakeven point for a particular customer type and, by minimizing or removing costs in the process the overall cost to collect can be reduced.

The following figure (Figure 3.4) depicts the tradeoff between the cost of collection and the savings from reduced debt. Increased debt collection that reduces the cost of write-offs and the interest on outstanding debt will usually increase the total cost of credit.



(Source: Boone, K and Roberts I, 2005)

Figure 3.4: Tradeoff between Collection Costs and Savings

The total cost of credit equals the cost of collection plus the cost of write-offs plus the interest on outstanding debt. The total cost of credit has a minimum cost point and an optimal number of delinquent accounts to be worked. An efficient debt collection process will deliver the minimum cost point for an increased number of target accounts. If an organization is currently working N_1 delinquent accounts per year its total cost of credit is C_1 . By increasing debt collection activity and working more delinquent accounts, the cost of write-offs and interest on outstanding debt will be reduced but the cost of collection will be increased. N_2 is the number of delinquent accounts that provides the minimum cost point C_2 .

Step 4: Develop Innovative Processes

There are a number of tactics that can be adopted to introduce agility in the debt collection process. The goal is to optimise the process based on customer type or past behavior by:

- Introducing new techniques such as outbound dialing or text messaging
- Using predictive modeling to preempt behavior and maximize call center effectiveness
- Progressing through steps more rapidly for some customers
- Using collection agencies at the breakeven point
- Improving reporting across the process.

These tactics can enable management to target potential defaulters and initiate proactive contact to discuss issues with customers before problems occur.

Step 5: Review and refine the process

Debt collection process improvement is a continuous activity that must be regularly reviewed and refined. The lifetime evolution and costs of customers must be monitored on an ongoing basis to ensure that the initial benefits continue to be delivered. The actions that influence customers to pay quickly must be identified and where possible they must be moved earlier in the process for certain customer types.

Comprehensive reporting across the whole process is an important part of the end-to-end solution. Earlier write-off for non-profitable customers can also be considered by reviewing debtors on a regular basis.

3.3 Western Australian Water Utility Service Standards

3.3.1 Issues with Regard to Debt Management Practices

The issues discussed hereunder are based on the proposal by the Western Australian Water Utility Service concerning the 2001 review of its service standards (WACOSS, 2001).

Hundreds of community organisations provide services to thousands of clients every year who are experiencing financial hardship and facing the prospect of water restrictions or further financial difficulties due to the unfair and insensitive debt management and customer service practices of their Water Service Provider. The resultant social cost of water restrictions and unreasonable payment demands is immense and should be of great concern to all Western Australians. The current service standards do not include any framework for Water Service Providers in relation to debt management practices. In particular, the standards in relation to Customer Service are insufficient and superficial in their current form.

A summary of issues regarding water identified by Emergency Relief Agencies and Financial Counsellors is outlined below:

- Debts in relation to water are attached to the land and current landowner rather than to the person / people who accrued the debt.
- The lack of existence or availability to the public of clear policies, procedures and guidelines in relation to the Water Corporation practices, particularly in the area of debt management, results in the removal of the right to natural justice and procedural fairness for customers who have had adverse decisions made against them.
- Lack of availability or provision by the Water Corporation of information in relation to current complaints processes either internal to the Water Corporation or via the Office of Water Regulation.
- Inconsistency between different Water Corporation Officers responses in relation to the management of outstanding debts.
- The use of water restrictions as a debt management practice is unacceptable in terms of its impact on low income families and individuals. There are often reports of families who are unable to send their children to school due to the fact that water restriction has left them without water to maintain their children's personal hygiene, washing or feeding.
- Unrealistic expectations of the Water Corporation in relation to the repayment schedule that can be maintained by those with outstanding debts. There are continual reports of the Water Corporation demanding large payment amounts that would constitute a large percentage of a person's income.
- The Water Corporation has not yet implemented participation in the Centrepay scheme, which provides a convenient, voluntary direct debit payment arrangement assisting those in receipt of Centrelink benefits to maintain their payment schedule.
- Increasing referrals to Emergency Relief agencies by the Water Corporation as a debt recovery method. Water Corporation Officers are aware that Emergency Relief Agencies have, in certain circumstances, paid clients outstanding Utility bill to prevent disconnection and have informed customers with outstanding accounts of this fact. This creates an expectation by clients, which Emergency Relief agencies are, in fact, able to assist in all cases, which is beyond the capacity of Emergency Relief agencies.
- In 1999/2000 Emergency Relief Agencies reported that approximately \$830,000 per year was being paid by welfare agencies to Utilities to cover clients' outstanding accounts. Whilst the Utility may not see an issue in the welfare agency providing

payment for the clients' bill, there is significant opportunity cost to those in poverty. In other words, the money paid to Utilities to prevent restriction or disconnection is desperately needed to feed hungry children of families living in poverty.

- Lack of information and education provided to the public regarding concession eligibility.
- Unreasonably high interest rates are applied by the Water Corporation on outstanding debts. Whilst we now understand that the Water Corporation has the power to vary or remove the interest rate, this information is not widely available and Emergency Relief agencies report that they have never seen this occur. We understand that the reduction of interest is applicable in cases of extreme financial hardship; however the power to make this decision is completely discretionary at this stage. The practice of applying unreasonably high interest and the Water Corporations failure to waive the interest in relation to debts accrued by poor families and individuals is unconscionable. This practice represents a punitive attitude towards those least able to pay and most likely to suffer as a result.
- The format and layout of bills provided by the Water Corporation is confusing for many people.
- The absence of independent meter testing impacts on the consumer's ability to be able to challenge the Water Corporation in relation to the account even where they suspect it is not accurate.
- Lack of provision of consumption bill directly to the tenant who accrued the bill where the property is a rental premises.
- Outstanding sewerage and drainage rates incurred by the owner of rental premises resulting in tenants suffering water restrictions.

3.3.2 Proposed Strategies

Suggestions for improvement which are relevant to the development of further Service Standards include:

- The provision of easier to read billing information, including the provision of bi-monthly account statements for rates and charges other than consumption.
- Separation of sewerage / drainage account from consumption account.
- Allowance for tenants to register with the Water Corporation as the tenant of the premises and receive consumption bill directly at the property.
- Removal or reduction of interest rate on outstanding debts to the Water Corporation with the encouragement to waive interest in circumstances of hardship.
- Introduction of automatic waive or reduction of interest where debtor is a Health Care Card holder.
- Abolition of the use water restrictions as a debt management tool.
- Increased awareness of social impact of debt management practices in particular water restrictions.
- Participation in the Centrepay Scheme and any other program that enhances the ability of customers to repay their debt.
- Provision of Water Corporation policies, procedures and guidelines, free of charge, and available.
- Provision of information and education to customers regarding concession eligibility.
- Abolition of policy, which removes concession eligibility if current account not paid within the year and the outstanding debt, is reconverted to the full non-rebated amount.
- Immediate cessation of practice whereby concession eligibility is cancelled for the year where the customer has been unable to pay the rebated amount in full within that year.
- Removal of the compulsion on the tenant to enter into a debt repayment schedule on deferred amounts before being eligible for rebate on the current account.

3.4 CONCLUDING REMARKS ON WATER DEBT RECOVERY

This section summarises the debt problem as well as the approaches towards debt recovery.

3.4.1 Typical Debt Problems

The debt problems in the UK and Australia can be summarised as follows:

- Water debt is becoming an increasing problem in the UK.
- Identifying the person liable for the water account remains a challenge (debt related to property owner as opposed to user).
- A number of high worth individuals are not paying their water accounts.
- How to assist those that are unable to pay.
- Lack of clear policies with regard to water debt management.
- Inconsistencies on how to approach outstanding debts (Australia).
- Use of water restrictions to address water debt is seen as unreasonable (Australia).
- The confusing nature of the format and layout of water bills (Australia).
- Absence of independent meter reading where the accuracy of water accounts are questioned (Australia).
- Geographic location of pay-points, especially for those paying cash.

3.4.2 Approaches to Debt Management

In summary the following approaches are followed or recommended:

- Removal of water restrictions as a debt management tool.
- Make enquiries as to the customer's ability to pay when setting up installment arrangements and to take account of the information given.
- The focus on debt management is to identify the liable person.
- Those unable to pay should get support from the industry.
- Those able to pay but unwilling needs to be sanctioned.
- Recommended 5-step process:
 - Understand the cost to collect
 - Segment the customer base
 - Manage the cost to collect
 - Develop innovative processes
 - Review and refine processes
- Introduction of concession for certain customers.
- Provision of information and education to customers regarding concession eligibility.
- Abolition of policy, which removes concession eligibility if current account not paid within the year and the outstanding debt, is reconverted to the full non-rebated amount.

4 APPROACH TO DEBT MANAGEMENT

This section discusses the approach to debt management for South Africa. Current revenue enhancement strategies will be discussed prior to the developing the actual intervention strategy for South Africa.

4.1 Introduction

Whilst there are some very well run municipalities, the overall current state of local government in South Africa is precarious characterized by increasing debtors, financial statements not being timeously submitted to the Auditor-General, qualified audit reports, poor systems, poor long term planning, huge service deliver backlogs, increasing salary bills, unfunded mandates, government debt, concerns about sustainability, and greater demands and expectations by all stakeholders. In view of this, the optimum collection of revenue (not just water debt) is essential.

The main sources of operating income for Metros in South Africa are assessment rates (18%), Electricity (34%), Water (14%) and Grants (13%), which shows that it is imperative that municipalities improve on their water debt collections.

4.2 Revenue Enhancement Strategies

In an attempt to address the revenue related problems municipalities one of the strategies adopted by municipalities has been to use outside service providers to perform the revenue collection tasks on their behalf. This section provides a summary of such service providers and what they offer. There are a number of solutions in the market that attempt to achieve the following results:

- Improved and sustainable revenue collection
- Improved and updated property valuation rolls and records
- Reduction of services debt or arrears
- Extension of services, particularly free basic services
- Improvement of service delivery, and
- Streamlining access to resources.

Information on the following service providers were obtained to understand the services they offer to municipalities regarding revenue improvement (as adapted from the following report: DBSA, 2004, Municipal Revenue Improvement Project
An Investigation of Existing 'Finance-Centred' Approaches in the Market):

- Public Service Utilities (PSU)
- Price WaterHouse Coopers (PWC)
- Deloitte and Touché (D&T)
- Accenture

4.2.1 Public Services and Utilities (PSU) International

PSU utilises a Basic Sustainability Model that assists municipalities build and develop a relationship between the municipalities and the customer. The municipality provides services and bills the customers, who then pay for the services provided. The success of the model depends on the municipality's ability to deliver holistic customer oriented services and the efficiency of managing their customers.

The Utility Revenue Services/ Products are in the following areas:

- Revenue Management
- Audits
- Information Technology
- Capacity Building and Training
- Network Management and
- Customer Care.

The revenue management service provides:

- Tariff calculations
- Prepaid service management
- Debtor management
- Financial reporting
- Centralized processing facilities.

PSU uses a network management service and customer care which incorporates the following:

- Meter reading
- Water balancing
- Network monitoring
- Community liaison
- Customer services, and
- Service level management.

To support the utility revenue services and products are the audit, information technology and capacity building and training services. The audit product and services consists of electronic data washing, as well as social, meter, service, customer and human resources services and products. PSU is a Microsoft certified partner. Its products include customer information as well as financial solution software. PSU provides IT consultancy to municipalities requiring this service.

In assisting municipalities, PSU employs the following process:

- Preliminary investigation
- Service audits
- Implementation of utility revenue services and
- Benefits evaluation.

The investigation focuses on community liaison, determination of level of services being provided and received, assessment of the accuracy of data, determination of community expectations and the completion of an investigation report. The service audit serves as a base to ensure an accurate database and establishment of accurate information, site inspection and ensuring accurate municipal maps. The implementation phase focuses on

the customer care policy, customer care centre, the establishment of revenue collection procedures, project management and co-ordination, installation of information systems as well as network and service controls. The process is completed with an evaluation to assess the benefits of PSU's interventions.

4.2.2 Debtpack

Debtpack (a member firm of PriceWaterhouseCoopers) provides the Debtpack Solution Set that assists municipalities convert their credit policies into credit solutions. The company also offers consulting services that provide the following assistance to municipalities:

- Structure a strategic framework for granting credit
- Help understand and limit the risk attached to granting credit
- Agree to terms for credit
- Implement systems and resources to manage credit, and
- Maximize cash contributions in the collection process.

The Solutions offered to municipalities deals with credit control and debt management, in order to assist municipalities deliver affordable services. It also assists municipalities balance various funding mechanisms for effective service delivery.

Debtpack uses the following processes:

- Indigent Management,
- Debt Management,
- Compliance Management,
- Contract Management and
- Consumer Management.

Indigent Management maximizes access to and distribution of equitable share and grants. It also collates demographics. It further manages consumer access to grants and subsidization via applications, verifications, approval, notification and appeal processes.

The Debt Management process standardizes and automates the input, output and diary based process thereby maximizing the time spent on 'promise to pay' management. The Compliance Management enables the municipality to establish debt management processes and the enforcement of steps stipulated in a credit control protocol. The Contract Management service maximizes the reliability of the contractual base upon which services are rendered. It enables the management of large volumes of standard contracts as required by the Municipal Systems Act 32 of 2000. The consumer management maximizes corporate adherence to payment on due date, informs corporate clients via SMS or email what the due amount and date is, and reply on pay date, amount and method.

4.2.3 Deloitte and Touché (D&T)

D&T utilizes a Basic WA Wina Model that assists municipalities build and develop a relationship between the municipalities and the customer on payment of arrears. It facilitates the implementation of the approved Credit Control Policy and Arrears Recovery Programme for the Rustenburg Municipality. This model has an 'out reach' section with staff that updates municipal records, addresses arrears, identify individual needs, clarifies whether account holder is tenant or owner, assesses indigence, interrogates data and centrally uploads on Municipal database.

WA Wina creates awareness through using entertainment, road shows, radio shows and other events to motivate the communities to pay for arrears. It also has service restriction and terminations as part of its strategy for revenue collection. The process for this solution is as follows:

- Status quo investigation at the Municipality
- Report to Council
- Manage change to processes, procedures and policies
- Credit Control Policy to allow for the splitting of current debt to arrears and real and tangible incentives
- Existing Software adapted
- Staff and Councilor training
- Communication strategy developed and implemented
- Media contracting
- Promotion Implemented

4.2.4 Accenture

Accenture is a global firm with 83 000 professional worldwide in 48 countries, namely Africa, America, Asia/ Pacific, and Europe/ Middle East. The revenue management experience of Accenture is in revenue collection, debt management, customer care and indigent policy formulation.

- The Revenue Management consists of the following components:
- Devices Management and consumption
- Work Management
- Billing Consumption
- Services
- Payment and accounts management

This assists in re-aligning processes used by municipalities to ensure an efficient and effective Meter to Cash cycle. The City of Cape Town appointed Accenture to assist with its revenue turnaround programme.

The Debt Management focuses on the current debt position and activities and initiatives of the municipality, including:

- Analysis of the current debt by days outstanding and customer classification
- Segmentation of the debt and defining attack plans for each category such as commercial vs. domestic
- Managing current collections to ensure that the buildup of new debt is minimised.

The Customer Care consists of the following:

- An integrated call centre for the citizens to log queries pertaining to general service faults.
- The call centre has approximately 100 seat and fields approximately 2500 to 3500 calls per day.

The Indigent Policy Frameworks key components are as follows:

- The package of services to address needs of indigents
- The tax, tariff and grant structure

- Implementation and enforcement in particular, meter reading, accurate property information etc.
- Legitimacy

4.3 Constraints to Improved Debt Collection

These are some of the factors that currently impact on the ability of a municipality to improve on its revenue collection in general and water debt in particular:

- The issue of accurate pricing versus the affordability of water tariffs.
- Non payment by consumers due to poverty and unemployment. The current economic climate in terms of rising fuel and electricity costs and job losses are eroding the value of household incomes. This must in turn have an adverse impact on the level of payments, even from those willing to do so.
- Budget and tariff increases must be within the macro limit set by National Treasury. However, tariffs cannot be below inflation. In fact, to eradicate the inherited backlog of services, tariffs should be 2% above CPI.
- Little or no growth in the rates base.
- The absence of strong credit control, tariff and rates policies that are strictly applied.
- The courts inability to handle a large number of debt collection cases.
- Illegal electricity and water connections and meter tampering.
- Water and electricity loss in distribution, mainly due to poor infrastructure.
- Outstanding accounts with regard to other spheres of government.
- Increased electricity tariffs.

4.4 Improvement Measures

4.4.1 Effective debt collection

To achieve this, the following measures need to be implemented by municipalities:-

- An effective billing and cash receipting system is required.
- Ensure consumer databases are accurate and up to date.
- Consider segmentation of consumer database into different categories of consumers likely to pay or not.
- Consider different approaches to different categories of client.
- Introduce alternative pay methods and pay-points to make it easier for customers to pay utility accounts.
- Introduce incentives for early payment as well as payment for outstanding debt.
- Credit control and debt collection policies need to be strictly adhered to.
- Accurate meter readings need to be taken.
- Accurate accounts that are simple to understand must be distributed as early as possible.
- Must ensure the close monitoring of debt levels with timeous action being taken where debts have become overdue. Action must be taken prior to the debt getting out of control.
- Introduce a facility that allows debtors to enter into arrangements to pay.
- Consolidate water and electricity accounts with rates accounts to provide leverage to encourage the payment of rates accounts by disconnections.

- A good Debt Management Strategy needs to be in put in place. This strategy should include an emphasis on the monitoring of the Top 100 debtors (based on 80-20 principle); the pursuance of government debt with possible intervention by National Treasury in terms of deducting outstanding amounts from the relevant equitable shares; addressing the issue of returned mail, using rates clearance certificates to ensure that all outstanding debt is collected; debtors are closely monitored, adequate deposits are held in respect of errant customers; and develop customer consciousness by fast action and effective communication.
- Sanctions for non-payment should include, credit bureau listings, water flow restrictions, consolidation of debt, selling of properties in the High Court (sale-in-executions), sale of movables in the Magistrates Court, and the removal of meters.
- Other world practices include the attaching of bank accounts, attaching lease or rental income, creating a bylaw to off-set debt against payments due by Council, communicating with the Receiver of Revenue to attach any tax refunds due, refusal of approval of building plans, assisting with getting bonds increased to settle arrears, creating a bylaw to attach vehicles, withholding vehicle licenses, and the most controversial being the blocking of sewerage pipes!

4.4.2 Minimising Distribution Losses

There is currently significant loss in distribution due to illegal connections, meter tampering and water infrastructure not being properly maintained. Water losses are worrying with distribution losses of 10% to 40% being common. In a Council with water income of about R20 million (such as Matjhabeng), a 15% distribution loss will result in income loss of about R3 million per annum.

One way to help address this issue is to introduce zonal meters for water. There also needs to be a focus on achieving a reduction in the water loss over a period of 5 to 10 years with clearly defined targets. This should include the metering of unaccounted water. Cost benefit analyses must be done before any possible solution is implemented. In the Ethekwini Municipality they are looking at replicating the Electricity Loss in Distribution model in Water as this model has proven to be very successful.

4.5 Towards an Intervention Strategy for Water Pricing and Debt Collection in Municipalities

4.5.1 Introduction

As stated previously the focus of the interventions strategy is primarily aimed at water debt collection, however, it is contended that this may not prove successful unless water pricing is also addressed. The intervention, for water pricing and debt management, is based on a 7-pronged approach or strategic interventions, namely:

- Policy
- Regulatory
- The customer
- Billing system
- Payment
- Incentives
- Legal action

The relevance of each of these strategic interventions will now be discussed.

Policy

The policy intervention is based on the need for a standardised pricing or tariff policy for water services. The differentiated nature of current water tariffs at municipalities were discussed in sections 2.1.2 and 2.1.3. In addition to this, the fact that there is no standardised approach to water debt collection in South Africa as reflected in the selected interviews with municipalities in the report entitled “Guidelines on Pricing and Debt Management for Municipalities: Stakeholder Feedback and Gap Analysis Report, October 2009”, requires intervention. As reflected in section 2.2.4 no standardized measure or policy for debt collection exists for municipalities.

Regulatory

The need for the introduction of an independent economic regulator for water services was identified in the study on administered water prices (section 2.1.2). The relevance for this economic regulator was underlined by section 3.2.3 – the discussion on the international practice – where the regulatory role of Ofwat was discussed in some detail. It is anticipated that this regulator will regulate the pricing and policy interventions as discussed above.

The Customer

Understanding the customer is key to the water debt recovery solution for South Africa. Section 2.2.5 provided a summary of customer issues with regard to water services. The international practice, as discussed in section 3, also focused on the customer. Section 4.3 underlined the affordability issues relevant for customers. Adequate information on the customer must include:

- Proper contact details of person responsible for water account
- Payment history
- Payment method
- Customer location
- Education and economic profile of customers

This database will help to identify those unable but willing to pay; as well as those able but unwilling to pay. Understanding the customer will also enable policymakers to ensure policy proposals are inline with customer requirements. This will also assist with the segmentation of consumers (refer to section 4.4.1).

The Billing System

The need for a proper billing system is underlined by the fact that both local (section 2.2.5), as well as international practice (section 3.3) identified the need for more simple water accounts. The confusing nature of the format and layout of water bills adversely influence the payment of water accounts. In addition to this the mere fact that some consumers question the accuracy of water accounts exacerbates the water debt problem due to the subsequent payment delays.

Payment

Understanding the preferred payment method (refer to section 2.2.5) is of importance to any debt collection intervention strategy. In South Africa it is clear that cash payment is the preferred option. This implies that geographical considerations of those consumers should be considered (also refer to section 3.2.3). Options may include the provision of pay-points close to the consumers. In addition to this it is required to provide guidelines for those wishing to make alternative payment arrangements (see section 4.4.1).

Incentives

The introduction of incentives for early payment of water accounts; and even for those with outstanding debt that make arrangement for repayment requires inclusion in the intervention strategy. Section 2.2.3 provided information on the extent of the debtor days applicable to water accounts. Section 2.2.5 underlined the fact that the payment for water debt was not the highest priority for many consumers. The introduction of incentives may reorganise payment priorities.

Legal Action

The legal action should be focused on those able, but unwilling to pay. This approach is also followed in the UK (refer to section 3). Section 4.3 alluded to the courts inability to handle a large number of debt collection cases. In addition to this it is also required to manage the cost of debt collection.

The above strategic interventions will be collated into the intervention strategy.

4.5.2 Proposed Intervention Strategy

Table 4.1 below reflects a proposed approach to general debt collection (with a particular focus on water) in municipalities. The approach is based on international best practices as well as the methodologies offered by the service providers to municipalities.

Table 4.1: Proposed Intervention Strategy for Water Pricing and Debt Collection

Strategic Intervention	Action	Relevance	Requirements	Remarks
Policy	Develop policy to standardise water tariffs	<ul style="list-style-type: none"> Water tariffs are diversified across SA. Tariffs vary in price and scale 	Differentiate between categories of consumers	Consider pricing efficiency versus affordability
	Develop Debt Collection Strategy	No standardised policy	<ul style="list-style-type: none"> Decision on external debt collectors or internal function Must be a comprehensive strategy and in line with national guidelines Decide on cost model for debt collection Relevant by-laws need to be developed Debt write-off policies and procedures need to be developed Integrated billing system developed Incentive schemes to solicit payment 	<ul style="list-style-type: none"> Cost of recovering debt should not be more than debt so recovered. In line with DWA Guidelines

Regulatory	Introduce independent economic regulator for water services	Various studies in SA alluded to the need. The UK has an independent economic regulator.	Need to regulate: <ul style="list-style-type: none"> • Access to services • Technical standards • Quality of service • Pricing • Investments • Efficiency of service 	Current practice allows municipalities to referee their own pricing and debt policies
Customer	Segmentation of customer data base	<ul style="list-style-type: none"> • 10% of consumers do not receive accounts due to improper info. • Urban and rural consumers differ 	<ul style="list-style-type: none"> • Decide on customer types • Develop Indigent policy • Cleaning of database 	<ul style="list-style-type: none"> • Customer types to have at least the following broad categories: willing to pay, but unable - willing to pay and able; - Unwilling to pay - Indigents • Re-organising into segments and ensure that database is accurate and complete.
Billing	Adapt billing system according to customer requirements	<ul style="list-style-type: none"> • 33-38% of customers question the accuracy of accounts • Customers do not understand the accounts 	Develop user friendly invoices	Simplify the water accounts
Payment	Develop understanding for preferred method of payment	90% of customers prefer cash payment	<ul style="list-style-type: none"> • Increase pay options • Provision of pay-points at geographic locations 	Some progress in this regard has already been made with payments possible at Supermarket Chains
Incentives	Implement incentives for payment of water accounts	80% debtor days 90 days and older	<ul style="list-style-type: none"> • Incentives for outstanding debt payments • Incentives for early payment 	Promote payment of water debt to first order priority
Legal action	Dedicated enforcement	<ul style="list-style-type: none"> • Focus on those able but unwilling to pay • 70% of customers will cut back on other expenses if they are forced by court of law to pay 	<ul style="list-style-type: none"> • Trained teams • Dedicated enforcement according to guidelines 	There must be a political will to collect debt, not just lip service

5 RECOMMENDATION TOWARDS PRICING AND DEBT MANAGEMENT IN WATER SERVICE DELIVERY

5.1 Introduction

The intervention strategy for water pricing and debt management must be implemented in order to improve the problems discussed above. In this regard the implementation of the intervention strategy requires the following actions:

- Institutional responsibilities
- Resource requirements

5.2 Institutional Responsibilities

Table 5.1 summarises the action items as well as the institutional responsibilities.

Table 5.1: Institutional Responsibility for Water Interventions

Action Item	Implementation date	Duration	Responsibility
Develop policy to standardise water tariffs	2011	1 year	DWA & WSA
Develop Debt Collection Strategy	2011	1 year	DWA & WSA
Introduce economic regulator for water services	2012	2 years	DWA
Segmentation of customer data base	2010	Ongoing	Water service authorities
Adapt billing system according to customer requirements	2010	Ongoing	Water service authorities
Develop understanding for preferred method of payment	2010	Ongoing	Water service authorities
Implement incentives for payment of water accounts	2010	Ongoing	Water service authorities
Dedicated enforcement	2010	Ongoing	Water service authorities

The importance of the water services authorities is clearly shown in the above table.

6 SUMMARY

SUMMARY OF MAJOR RESULTS AND FINDINGS

- The diversified nature of water tariffs
- The focus on self-regulation with regard to water tariffs
- The probability that retail prices may be too low.

With this in mind the interventions should, inter alia, focus on the following solutions:

- Development of detailed guidelines for efficient pricing
- The establishment of an independent economic regulator

The research identified important actions in terms of water debt management, namely:

- Removal of water restrictions as a debt management tool.
- Make enquiries as to the customer's ability to pay when setting up installment arrangements and to take account of the information given.
- The focus on debt management is to identify the liable person.
- Those unable to pay should get support from the industry.
- Those able to pay but unwilling needs to be sanctioned.
- International best practice support a 5-step process on debt collection:
 - ▣ Understand the cost to collect
 - ▣ Segment the customer base
 - ▣ Manage the cost to collect
 - ▣ Develop innovative processes
 - ▣ Review and refine processes

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