



Growing the Economy - Bridging the Gap

Presidential Review Committee on State-Owned Entities


Volume 2 Main Report



THE PRESIDENCY
REPUBLIC OF SOUTH AFRICA



PRESIDENTIAL SOE REVIEW COMMITTEE



**In this report, we make
recommendations for
State-owned Entities to be
reshaped and made relevant
to the developmental needs
of South Africa.**

This report is the outcome of the work of the Presidential Review Committee (PRC) on State-owned Entities (SOEs). The members of the committee are:

Ms Mangwashi Victoria Phiyega (Chairperson)
Mr Glen Mashinini (Deputy Chairperson)
Ms Dawn Marole
Mr Deon Crafford
Ms Gugu Ngcobo
Prof Mbulelo Mzamane
Ms Nombulelo Mkhumane
Mr Pramod Mohanlal
Dr Simo Lushaba
Ms Swazi Tshabalala
Dr Oupa Monamodi

With the support of the PRC Secretariat, consisting of:

Ms Dinao Lerutla
Ms Gildah Tshukutswane
Mr Mandla Madi
Adv Rebaone Gaoraelwe
Ms Mabothokgong Mathole
Mr Bongani Gigaba
Dr Bheki Mfeka

PRC and Presidency Steering Committee members include:

Ms Mangwashi Victoria Phiyega (Chairperson)
Mr Glen Mashinini (Deputy Chairperson)
Minister Collins Chabane
Dr C Lubisi (DG)
Adv Bonisiwe Makhene

The following persons were also members of the PRC Committee but resigned during the review process:

Dr Takalani Madima
Mr Mafika Mkhwanazi
Mr Lumkile Mondli

DISCLAIMER

This report has been produced independently by the PRC as commissioned by the President of the Republic of South Africa.

The review of SOEs in South Africa was not a micro audit or review of individual SOEs, but a macro review of all SOEs and their environment. Every consideration and care was taken by the PRC to consult stakeholders and gain insight into SOEs in different spheres of Government and various categories of SOEs in order to inform the macro perspective findings and recommendations presented in this report.

The information, commentary and statistical data have been prepared by the PRC and supplied by service providers appointed by the PRC. The use of such data by the PRC in this report is without prejudice to the SOEs and other stakeholders that participated in the different studies concerned.

Information supplied to the PRC is assumed to be factually correct and complete as the PRC could only work with the information provided.

This report is secret and confidential and is intended only for the President of the Republic of South Africa.

FOREWORD

GROWING THE ECONOMY –
BRIDGING THE GAP

The review of State-owned Entities (SOEs) in South Africa took place at a time that was characterised by enormous challenges and great opportunities. The economy is in a fragile period, in which growth and development plans of the country is threatened. Societal challenges such as poverty, unemployment, skills development, and job creation demands attention. Infrastructure development plans are being marshalled to contribute to inclusive development and growth of the economy. Demands for improved service delivery are pronounced Government is hard at work charting the country’s long-term development plan.

The PRC on SOEs was appointed to review ALL State entities and make recommendations on aligning these entities at all spheres of Government in order to achieve the developmental objectives and aspirations of South Africa.

The PRC understood its task as primarily that of making recommendations that would ensure that reforms are affected for SOEs to be more efficient and effective in accelerating the country’s growth and development aspirations. The committee’s enormous task entailed 21 terms of reference and was executed by a committee of 12, which was assisted by a limited secretariat team. It had very limited resources and had to complete its mandate within a short time frame. The team that was brought together was dedicated, professional and possessed expertise in diverse fields, making the review work possible.

In this report, we make recommendations for South Africa’s State-owned Entities (SOEs) to be reshaped and made relevant to the developmental needs of South Africa.

Traditionally, Governments of large and emerging economies have depended on the performance of the private sector and SOEs to drive their economic

agendas and enhance competitiveness of their countries. With regards to the private sector, the Government’s role has generally been to reduce red tape, encourage investment including foreign direct investment, provide stable tax, legal and statutory environments to drive growth, as well as support and facilitate activities of the private sector.

The SOE environment is an area where the Government as key stakeholder and in some instances sole shareholder should be able to drive the country’s national strategic economic agenda. In pre-1994 South Africa, the Government’s approach to SOEs was instrumental in propping up the apartheid State to survive sanctions and embargoes and to continue to grow the economy, albeit to the benefit of a minority and detriment of the majority.

Several nations across the world have grown their economies through the effective performance management and appropriate governance of SOEs. For South Africa, it was crucial for the PRC to interrogate what the role and contribution of SOEs should be in the new democratic dispensation. The key questions relate to how SOEs should be managed, the objectives they should strive for in order to achieve the State’s economic, developmental and transformational objectives, and whether the existing portfolios of SOEs meet the future long-term needs of South Africa.

Governments the world over are faced by similar questions as those facing South Africa. They constantly have to answer questions around how State-owned enterprises should be harnessed in order to promote economic development; what the relationship between SOEs and the State as owner should be; and what criteria should be used to assess options for establishing, investing in or disposing of SOEs.

In 24 months the PRC undertook a macro review of all entities. The Committee reflected on the past history of SOEs, going back to the 1900s when



the first SOE was established through to the 18 years since 1994 when a democratic South Africa came into being. The review required a forward-looking approach in the context of South Africa’s aspirations as a Developmental State, and the potential for SOEs to contribute to the realisation of such an aspirations. The first phase of the review culminated in the crafting of emerging principles based on observations gleaned in the initial stages of the investigation. The committee’s preliminary findings, contained in the progress report submitted to The President in July 2011, were further researched, tested, and refined to the point where the PRC is now in a position to make final recommendations.

Given the wide scope of the PRC’s brief, it was crucial to determine what and how many entities we were to review. Early observations indicated that there were an estimated 300 SOEs in the country. We observed that the initial estimation did not take into account SOE subsidiaries and other forms of establishment. It also became evident that while good progress has been made in documenting national entities, the same did not hold true for those pertaining to the provinces and municipalities. Having taken some of the omissions mentioned into account, we observed that there are approximately 715 entities serving various social and commercial objectives at different spheres of Government.

As a result of the large number of entities, it was not possible to undertake a micro study of each of the entities. Through the assistance of our primary research advisors, the HSRC, the PRC developed a scientific representative sample of entities to study. The recommendations contained in this report were enhanced by the scientific research, literature review, and various stakeholder engagements undertaken by the PRC during the review. Public submissions, an SOE survey, policy dialogues, provincial dialogues, as well as international benchmarking were some of the initiatives undertaken to gather data.

A database of SOEs was developed by the PRC comprising information on SOEs at all three spheres of Government. The information was largely obtained from publicly available sources as well as through the SOE survey conducted by the HSRC on behalf of the PRC. We hope we have provided a sound basis for the administration of a management information system on SOEs going forward. The database should have a host and should be kept live and be updated regularly.

The PRC calls for continued in-depth micro assessment of SOEs to assist the merging and rationalisation of the many entities, a requirement that is supported by some of our review findings. This will assist in positioning SOEs as efficient vehicles of social and commercial delivery for the State.

FOREWORD BY THE CHAIRPERSON OF THE PRESIDENTIAL REVIEW COMMITTEE ON STATE-OWNED ENTITIES continued

The PRC was also encouraged by an emerging focus by the Auditor General’s office on the evaluation of performance objectives of SOEs which goes beyond the normal performance audit on financial, efficiency and effectiveness. We believe that such a move is essential if the unique performance requirements of SOEs are to be realised. The ability of SOEs to remain viable while delivering on determined socioeconomic imperatives should be transparently measured.

This report highlights the following critical factors that the State should give consideration to in order to reposition SOEs:

- The State should **clearly define and communicate a consistent strategy for SOEs** (including definition, purpose, role, function and objectives). In addition, it is necessary to create and maintain a portfolio of SOEs, which should be periodically reviewed.
- The State should ensure that **governance policies and practices are in place** and that streamlined points of contact between regulators, agencies, Government and SOE are maintained. Appropriate legal frameworks to support and enable SOE performance should also be in place.
- The State, as owner should define the purpose of SOEs. Standardised monitoring and evaluation criteria modelled on best-practice should be adopted to make performance monitoring more effective. Such performance criteria should be supported by **relevant economic and socio-political Key Performance Indicators (KPIs)** that are commonly embraced by SOEs and the State, as owner.
- The State should enable high operational performance of SOEs so that they are able to meet economic and developmental objectives in a cost effective manner. SOEs should have sufficient operational independence, which should be articulated in the shareholder compact. The State, as owner should **ensure**

SOE access to adequate funding. The entities should possess the capacity to attract and retain human resources as well as scarce skills.

In conclusion, we thank all stakeholders including the Government, SOEs, business, civil society, international partners, as well as all our service providers, expert writers and researchers, for having tirelessly assisted us in the review task. Sincere appreciation is also extended to the members that served on the PRC selflessly and the Secretariat that worked far beyond what was asked of them.

Lastly, I thank The President of the Republic of South Africa, His Excellency Mr JG Zuma, for having entrusted the committee with a task of such national importance.



Ms Mangwashi Victoria Phiyega
Chairperson

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The PRC acknowledges all the Presidency officials (including the team that provided all the PRC administration and communication support) who were involved in support of the project, including and in particular the Presidency PRC Steering Committee that comprised of the following members: Honourable Minister Collins Chabane, Minister in the Presidency: for Performance, Monitoring and Evaluation and Administration; Dr Cassius Reginald Lubisi, Director-General in the Presidency and Secretary to Cabinet; and Advocate Bonisiwe Makhene, Legal Advisor to the President.

The PRC also wishes to acknowledge the Office of the Deputy President’s recognition for the work done by it.

The resource and project partnerships as well as support made available by various stakeholders are also recognised. The Presidency, the Organisation for Economic Cooperation and Development (OECD), the Royal Netherlands Embassy, Department of Public Enterprises, Eskom, Transnet, PRASA, PetroSA, the DBSA, SAA as well as the Belgian Study Fund, through the International Donors unit of National Treasury.

Various participants at the PRC seminars, policy dialogues, round-tables, public submissions, as well as direct stakeholder engagements made possible the collation of various literature, perspectives, information, and insights into the SOE landscape of South Africa, which assisted the review process of the PRC. Further, the contribution of the following stakeholders was invaluable to the PRC: the Organisation for Economic Cooperation and Development (OECD); the National Planning Commission (NPC); the SOE Procurement Forum (SOEPF); Parliament Portfolio Committees; all national departments that participated in the consultations of the PRC all Provincial Governments through their Departments of Economic Development; Local Governments through SALGA; business

organisations including BUSA, SACCI, BASA, and the JSE; political parties including the Economic Transformation Committee of the African National Congress (ANC), the Democratic Alliance (DA), as well as the South African Communist Party (SACP); organised labour including NUM, and NACTU; civil society organisations; and the School of Oriental and African Studies (SOAS) at the University of London.

The benchmarking of South Africa’s SOE landscape against global trends and lessons was crucial to ensuring that the PRC makes relevant recommendations sensitive to both local and global dynamics. The PRC recognises the collaboration with OECD, in hosting a delegation from UK, Malaysia, Finland, Namibia, China, and NEPAD for the PRC’s International Benchmarking Seminar. The following countries’ contribution during further international benchmarking by the committee is acknowledged and appreciated: Netherlands (Ministry of Infrastructure and the Environment and Ministry of Finance); Germany (SOE Legal Framework); Norway (Ministry of Trade and Industry); Poland (Treasury Ministry); and France (Agences des participations de l’Etat APE).

Lastly, the PRC acknowledges the work of various research partners and service providers, expert researchers, expert writers, and the quality assurance team for going beyond the call of duty in providing service to it.

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ABBREVIATIONS AND ACRONYMS

ACSA	Airports Company of South Africa	DPME	Department of Performance Monitoring and Evaluation	M&E	Monitoring and evaluation	RDP	Reconstruction and Development Programme
ADB	Asian Development Bank	DPSA	Department of Public Service and Administration	MEC	Member of the Executive Council	RSA	Republic of South Africa
ANAO	Australian National Audit Office	DTI	Department of Trade and Industry	MinMEC	Forum of Minister and Members of the Executive Councils	SAA	South African Airways
APE	Agence des participations de l'Etat	DWA	Department of Water Affairs	MoF	Minister of Finance	SABC	South African Broadcasting Corporation
ARMSCOR	Armaments Corporation of South Africa Ltd	EDD	Economic Development Department	MOE	Municipal-owned entity	SADC	Southern African Development Community
BC	Business case and viability PRC work-stream	ENS	Edward Nathan & Sonnenbergs Incorporated	MPSA	Minister of Public Service and Administration	SALGA	South African Local Government Association
BEE	Black economic empowerment	FDI	Foreign direct investment	MTEF	Medium-term expenditure framework	SANRAL	South African National Roads Agency Limited
B-BBEE	Broad-based black economic empowerment	FOSAD	Forum of South African Directors General	MTSF	Medium-term strategic framework	SASAC	State-owned Assets Supervision and Administration Commission of the State Council
BUSA	Business Unity South Africa	FMA Act	Financial Management and Accountability Act, 1997 (Australia)	MuniMECs	Forum of Municipalities and Members of the Executive Councils	SASRIA	South African Special Risks Insurance Association
BWASA	Businesswomen's Association of South Africa	G&O	Governance and ownership PRC work-stream	NAMB	National Artisan Moderating Body	SCOPA	Standing Committee on Public Accounts
CAC Act	Commonwealth Authorities and Companies Act, 1997 (Australia)	GBE	Government business enterprises	NCoP	National Council of Provinces	SED	Socio-economic development
CAD	Comparative-advantage-defying	GCIS	Government Communications and Information Systems	NDoT	National Department of Transport	SETA	Sector Education and Training Authority
CAF	Comparative-advantage-following	GEP	Gauteng Enterprise Propeller	NECSA	Nuclear Energy Corporation South Africa	SIC	Standard Industrial Classification
CAGR	Compound annual growth rate	GMI	Governance Metrics International	NGP	New Growth Path	SMOE	Strategy, management and operational effectiveness PRC work-stream
CCMAU	Crown Company Management Advisory Unit	GPFIP	Gauteng Province Freeway Improvement Project	NIPF	National Industrial Policy Framework	SOE	State-owned Entity
CSOE	Cabinet Committee on State-owned Entities	HEQF	Higher education qualification framework	NPC	National Planning Commission	SOEGC	State-owned Enterprises Governing Council
CEF	Central Energy Fund	HSRC	Human Sciences Research Council	NSDS	National Skills Development Strategy	SOEPF	State-owned Entity Procurement Forum
CEO	Chief Executive Officer	IDC	Industrial Development Corporation	NSF	National Skills Fund	SOEs	State-owned Entities
CoGTA	Co-operative Governance and Traditional Affairs	IDP	Integrated development plan	NT	National Treasury	SPV	Special purpose vehicle
CRA	Central remuneration authority	IEC	Independent Electoral Commission	NUMSA	National Union of Metalworkers of South Africa	SSMAA	State Shareholder Monitoring and Advisory Agency
CSM	Centralised shareholder management model	IGR	Intergovernmental relations	NURCHA	National Urban and Reconstruction Agency	TIA	Technology Innovation Agency
CV	Curriculum vitae	IGRF	Intergovernmental Relations Forum	OECD	Organisation for Economic Co-operation and Development	ToR	Terms of reference
D&T	Development and transformation PRC work-stream	IPAP 2	Industrial Policy Action Plan 2	PCC	President's Coordinating Council	UN	United Nations
DBSA	Development Bank of Southern Africa	IT	Information technology	PRC	Presidential Review Committee	UNRISD	United Nations Research Institute for Social Development
DFI	Developmental Finance Institution	JSE	Johannesburg Stock Exchange	PFMA	Public Finance Management Act	USAOs	Universal Service and Universal Access Obligations
DG	Director-General	KPI	Key performance indicator	PPP	Public-Private Partnerships		
DMTN	Domestic medium-term note	KPMG	Klynveld, Peat, Marwick and Goerdeler	PwC	PriceWaterhouseCoopers		
DOD	Department of Defence	KSIA	King Shaka International Airport	QCTO	The Quality Council for Trades & Occupations		
DPE	Department of Public Enterprises	KZN	KwaZulu-Natal	R&D	Research and development		
DPL	Department of Local Government						

DEFINITION OF KEY TERMS

BROAD-BASED BLACK ECONOMIC EMPOWERMENT (B-BBEE)

According to the Broad-Based Black Economic Empowerment Act, No. 53 of 2003, B-BBEE is the economic empowerment of all black people, including women, workers, youth, people with disabilities and those living in rural areas. It involves diverse but integrated socio-economic empowerment strategies that include but are not limited to:

- Increasing the number of black people who manage, own and control enterprises and productive assets;
- Facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises;
- Human resource and skills development;
- Achieving equitable representation in all occupational categories and levels in the workforce;
- Preferential procurement; and
- Investment in enterprises that are owned or managed by black people.

CENTRAL SOEs AUTHORITY

A department or agency at the national, provincial or municipal sphere of Government, under which SOEs are owned, controlled or supervised.

CENTRAL SOE AUTHORITY FOR COMMERCIAL ENTITIES

A department or agency at national, provincial or municipal sphere of Government, under which all commercial SOEs are owned, controlled or supervised.

CENTRAL SOE AUTHORITY FOR DEVELOPMENT FINANCE INSTITUTIONS

A department or agency at national, provincial or municipal sphere of Government, under which all development finance entities are owned, controlled or supervised.

COMMERCIAL ENTITY

A SOE that:

- Commands market-related revenues;
- Has a balance sheet capability;
- Has ability to post surplus or profit;
- Maintains and replenishes market capitalisation autonomously from the State; and
- Has State contracts with the entity for non-commercial mandates.

CORPORATE PLAN

A document submitted to the accounting officer of a department designated by the executive authority responsible for that public entity or Government business enterprise, and to the relevant treasury, at least one month (or a period agreed to in consultation with the National Treasury) before the start of its financial year. The document must be in the prescribed format and cover the affairs of that public entity or business enterprise for the following three financial years. If it has subsidiaries the affairs of the subsidiaries (in accordance with section 52 (amended by section 30) of the Public Finance Management Act No. 1 of 1999) must also be submitted).

DEVELOPMENT FINANCE ENTITIES

State-owned development finance institutions.

DEVELOPMENTAL STATE

A State led by a Government that pursues rapid and deliberate economic growth and development. A Developmental State is further characterised by the active intervention of the State in the economy.

ECONOMIC INFRASTRUCTURE

Improvements in land-areas, which are typified by physical forms of capital investment in the usefulness of land for production and habitation.

ECONOMIC REGULATION

A form of Government intervention designed to influence the behaviour of firms and individuals in the private sector.

EXECUTIVE AUTHORITY

According to the Public Finance Management Act, No. 1 of 1999, the term executive authority, depending on the context,

- In relation to a national department, means the Cabinet member who is accountable to Parliament for that department;
- In relation to a provincial department, means the member of the Executive Council of a province who is accountable to the Provincial Legislature for that department;
- In relation to a national public entity, means the Cabinet member who is accountable to Parliament for that public entity or in whose portfolio it falls; and
- In relation to a provincial public entity, means the member of the Provincial Executive Council who is accountable to the Provincial Legislature for that public entity or in whose portfolio it falls.

GOVERNANCE

Governance is concerned with overseeing the responsible, legal, ethical, transparent and effective achievement of national or organisational goals. Governance deals with the formation and stewardship of the formal and informal rules, laws, regulations and policies that regulate delivery of services in the public and private sectors. Boards (e.g. of directors or governors) who have been appointed or elected according to specified conditions usually exercise governance.

GOVERNMENT

The collective of Cabinet and executive structures in the three spheres of national, provincial and local Government.

LINE MINISTRY

The executive authority responsible for a specific SOE as representative shareholder, as denoted in the Public Finance Management Act, No. 1 of 1999.

MANDATES

Primary purpose for the existence of a SOE.

MUNICIPAL ENTITY

Company, co-operative, trust, fund or any other corporate entity established in terms of any applicable national or provincial legislation and which operates under the ownership/control of one or more municipalities. May also refer to any subsidiary of a company that is a municipal entity in terms of Paragraph 5(a); or a service utility established in terms of section 82(1)(c) of the Municipal Systems Act.

NON-COMMERCIAL ENTITY

A SOE, which is predominantly dependent on the State for financial sustainability, through:

- Budget vote transfers;
- Subsidies and grants;
- Special tax arrangements;
- Multilateral institutions and donor funding;
- Fundraising and sponsorships;
- Limited income stream; and
- Constitutional or State policy mandates.

OWNERSHIP POLICY

Government or State ownership or control of any asset, industry, or enterprise at any sphere i.e. national, regional or local (municipal).

POLICY DEPARTMENT

The ministry responsible for enforcing Government's industry or sector policy, such as the Departments of Energy or Communication.

PERFORMANCE MANAGEMENT SYSTEM

A management technique and mechanism intended to consider the performance of SOEs holistically.

DEFINITION OF KEY TERMS continued

REGULATOR

An agency established by Government for the control of, or intervention in, the behaviour of organisations, firms, markets, and individuals.

RESOURCE TAX

A tax payable on profits generated from the exploitation of non-renewable resources.

SERVICE DELIVERY

Those services provided by Governments (national, provincial, or municipal) to the public. The need for services that no individual can or will pay for, but that benefit all by their presence, is one of the justifications for taxation. Examples include sewage, refuse disposal, street cleaning, public education and public health services.

SHAREHOLDER

The Government of South Africa, with the relevant Minister who holds a share in an SOE on behalf of Government, such as the Minister of Public Enterprises.

SHAREHOLDER ACTIVISM

A process of dialogue between the shareholder, in this case the State or Government, and relevant SOE board and executives. Such dialogue may include advocating shareholders’ strategic intent and resolutions through various private and public communication platforms and generating pressure on the executive.

SHAREHOLDER COMPACTS

The agreement between the executive authority and the accounting authority. It is a reflection of the expectations of each party, expressed in terms of outcomes and outputs that need to be achieved. The shareholder’s compact should be reviewed and adjusted on an annual basis in line with the performance of the public entity over the previous financial year.

SOCIAL INFRASTRUCTURE

A group of physical assets and improvements in land areas that accommodate social services; they cannot be readily catered for by markets. Examples of social infrastructure assets include schools, universities, hospitals, prisons and community housing.

STATE

The set of governing and supportive institutions that have sovereignty over a specific territory and population.

STATE-OWNED ENTITY

A public entity as defined in the Public Finance Management Act, No 1. of 1999, including national and provincial public entities; and municipal entities.

STATEMENT OF STRATEGIC INTENT

A statement setting out an entity’s long-term strategic and broad policy directions. It includes the entity’s strategic intent; its purpose and vision; the reason it will continue to exist in the future; its mission statement and a statement of how it best intends to meet and serve the needs of its stakeholders.

STATUTORY CORPORATION

A SOE that:

- Provides basic and essential services;
- Manifests a hybrid of commercial and non-commercial activities;
- Lends itself to a cross-subsidisation mandate; and
- Is wholly State-owned.

TRANSFORMATION

Interventions to address the systematic exclusion of the majority of South Africans from full participation in the different spheres of life in the society. These encompass, inter alia, skills, procurement, social, and economic development.

CHAPTER 1

INTRODUCTION

1.1 Developing a framework for SOE contribution towards growth, development, and transformation

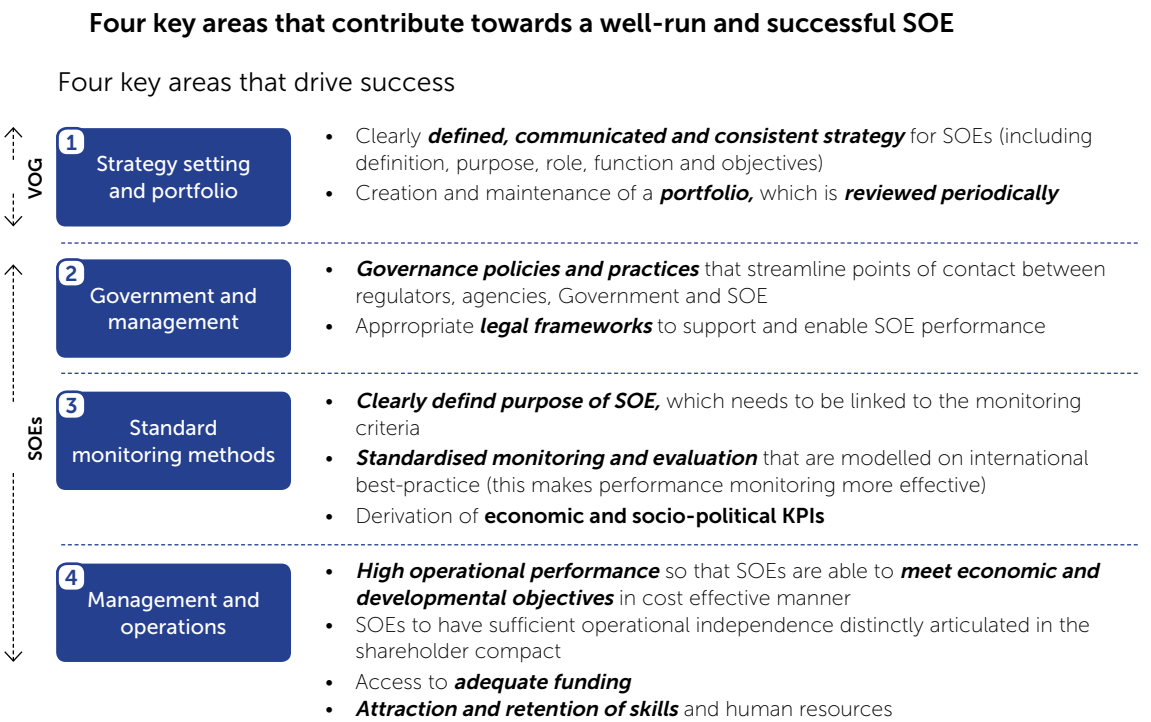
This report contains the main findings and recommendations of the PRC on the optimisation of SOE contribution to growth, development, including creation of decent work opportunities, and social and economic transformation of South Africa. The importance of the review of SOEs, in particular the role of SOEs in the Developmental State agenda, cannot be over-emphasised. A clear policy framework governing and guiding the strategic role of SOEs in propelling the developmental agenda is both desirable and long overdue. SOEs are central to economic growth, job creation, building the capability and technical

capacity of the State, international cooperation, meeting the basic needs of the people; and ultimately building a prosperous non-racial society.

The main question under investigation was whether SOEs are responding to the State’s developmental agenda. This requires that the State be an active and decisive owner and shareholder, meaning that the State should play a leadership role in creating an enabling environment for SOEs to fulfil their mandate and that the State be at the forefront of ensuring that SOEs are performing effectively. The PRC posits that there are core critical success factors for transforming SOEs. Figure 1 outlines these factors.

Successful SOEs should have a business structure with a mix of features from public and private sector institutions.

Figure 1: Key areas that drive success in achieving SOE reforms



CHAPTER 1 continued

SOEs benefit from the financial muscle and support of their State parents; whether directly in terms of budget votes or indirectly in terms of certain guarantees. SOEs also benefit from structured and effective oversight by the executive authority. Clear definition of the roles and functions of the executive authority, the board and operational management is a primary requirement for success. Through continued consultation and refinement, it is imperative that the practical meaning and implications of active shareholder involvement and interference be clearly elucidated and mutually understood. The lack of such insight and understanding will negatively impact upon the success of the SOE.

It is our hope that this report will assist the State in transforming the SOE sector. We also sincerely anticipate that with the President having initiated this macro review, if these recommendations are accepted, the President will appoint officials or an agency to implement them.

1.2 Mandate and terms of reference of the PRC

A need to review SOEs was identified in the medium-term strategic framework (MTSF) (2009–2014) published by Government in July 2009.

The President of the Republic of South Africa, Mr Jacob Zuma, announced the establishment of the PRC on SOEs in Parliament on 12 May 2010 during his budget vote. The PRC was gazetted on 19 May 2010, President’s Act No. 142. Twelve members were subsequently appointed to the PRC on SOEs. The PRC Committee was placed under the chairmanship of Ms Riah Phiyega. The PRC is an independent structure that operates independently of the State organs, and was supported by a limited professional secretariat comprising a good mix of multi-disciplinary expertise.

The following are the 21 terms of reference (ToR), upon which the PRC made recommendations:

1. A common understanding and definition of SOEs;
2. The place of SOEs in a Developmental State;
3. Strategic importance and value creation of SOEs;
4. The viability and funding of SOEs;
5. The existing portfolio of investments by the State in strategic businesses;
6. The efficiency and effectiveness of SOEs with respect to service delivery;
7. Current policy and regulatory framework and the impact thereof on the management of SOEs;
8. The balance of social, political and economic imperatives in delivering objectives for SOEs;
9. Harmonisation of performance measurements among SOEs;
10. Standardisation of accounting and reporting processes for SOEs;
11. Owner/shareholder oversight and governance of SOEs;
12. Recruitment, selection and appointment of boards and executive management of SOEs;
13. Remuneration policies of SOEs taking into account wage differential aspects;
14. Current restructuring initiatives (privatisation, retrenchments, public/private partnerships, etc.) of SOEs, and implications thereof;
15. SOEs as a platform for sustainable human capital development and a catalyst for scarce skills;
16. Establishment of a comprehensive database of SOEs across all spheres of Government;
17. Policy for the establishment and disestablishment of SOEs;
18. Criteria and framework for identifying and establishing priority SOEs, as well as relevant global benchmarking and best-practices;
19. Alignment, collaboration and cooperation among SOEs for the purpose of optimising State resources;
20. Relationship and collaboration between Government Ministries to facilitate achievement of SOE objectives; and

21. Compliance of SOEs with the Government’s development and transformation agenda.

1.3 Background and context

The purpose and the principles behind the PRC terms of reference are derived from the medium-term strategic framework (MTSF) (2009–2014); a briefing meeting the PRC had with the President; as well as the Constitution of the Republic of South Africa (in particular Chapters 1, 2, 3 and 10). Strategic priority 10 in the medium-term strategic framework (2009–2014): ‘Building Developmental State, including improvement of public services and strengthening democratic institutions’, noted that the Government would ‘integrate SOEs into planning processes and improve M&E of their performance’. Also, in announcing the formation of the PRC on SOEs, President Jacob Zuma clearly articulated the intention of Government regarding the review of SOEs when he said: “We have to ensure that while they remain financially viable, the SOEs, development finance institutions as well as companies in which the State has a significant shareholding must respond to a clearly defined public mandate, and help us to build a Developmental State.”

Chapter 10 of the Constitution sets out the following principles of public administration as applicable to all spheres of Government, organs of State, and public enterprises:

- A high standard of professional ethics must be promoted and maintained;
- Efficient, economic and effective use of resources must be promoted;
- Public administration must be development-oriented;
- Services must be provided impartially, fairly, equitably and without bias;
- People’s needs must be responded to, and the public must be encouraged to participate in policy-making;
- Public administration must be accountable;

- Transparency must be fostered by providing the public with timely, accessible and accurate information;
- Good human resource management and career development practices must be cultivated to maximise human potential; and
- Public administration must be broadly representative of the South African people, with employment and personnel management practices based on ability, objectivity, fairness, and the need to redress the imbalances of the past to achieve broad representation.

The PRC’s key role was therefore to assist the State in transforming SOEs from an inherited strategic and operational environment that was chaotic and fragmented. The hope is to move towards a more coordinated and enabling environment that optimises the contribution of SOEs to growth, development, and transformation. This involved, among other things, making recommendations for overcoming many of the serious challenges and constraints facing SOEs that were identified in the early years of democratic South Africa, such as those raised in the Commission of Inquiry Regarding the Transformation and Reform of the Public Service (1998), many of which were inherited from the previous regime. These included:

- The lack of racial, gender and occupational representativeness;
- The lack of clarity and communication in respect of the vision for change;
- Centralised control and top-down management;
- Poor productivity;
- The low level of service delivery, especially to the majority population;
- A disempowering work ethic;
- The absence of clearly defined roles and responsibilities;
- The lack of effective coordination and communication among the key agencies of transformation; and

CHAPTER 1 continued

- The persistence of rule-bound practices and culture.

The PRC undertook its work in an environment that was highly fluid. Over the past eighteen years to date, there have been various initiatives to transform and leverage the full potential of SOEs in different spheres of Government and within SOEs themselves. These initiatives included, among others, restructuring; Government guarantees and 'bail-out' of some SOEs; unbundling and mergers; Public Private Partnerships (PPPs); and the establishment and disestablishment of a number of SOEs. The results and impact of some of these initiatives have raised more questions than answers, particularly in relation to SOEs' contribution to development and transformation; service delivery; perceptions on rampant corruption within the SOEs; and, in some instances, their weak market positioning.

Furthermore, previous reviews have tended to focus on the larger SOEs because of their size, impact and the higher probability that they would be privatised or stripped of assets deemed to be non-core. Inadvertently, this led to the neglect of the majority of national assets in SOEs not so prioritised. There are other SOEs whose value may not necessarily be of a commercial nature but whose services are strategic, critical or equally valuable to South African society and its development process.

The PRC also noted at the outset that although there were numerous efforts to review the SOE environment, there were other active developments around generation of new policies and strategies that had an impact on SOEs. The lack of implementation, follow-through and continuity presents as a major impediment to sustained progress on SOE reform. There appears to be a very strong 'human factor' driven by changes in the executive authority leadership. In most instances, it seems the direction and focus of the SOEs is apt to change every time a new

leader is appointed, and that progress traction is then lost.

It is as a result of some of these factors that the President of the Republic of South Africa, Mr Jacob Zuma, called for a broad review of all SOEs inclusive of all SOEs classified under the PFMA those outside the scope of the PFMA as well as those under local Government. Many countries, including our neighbours have undertaken such reviews. The PRC has observed other countries' initiatives and has learnt from their experience. The PRC has also developed contacts with other countries with similar or related experiences.

This means that for the first time since the democratic dispensation, an all-inclusive and comprehensive review of SOEs both commercial and non-commercial, regardless of their size, has now been undertaken. The review is long overdue and necessary, because SOEs play an important role in promoting economic growth and development, improving service delivery and eradicating poverty. They can be used to transform our society in a meaningful and positive way.

NOTE: The PRC also considered some of the reviews undertaken such as the review of chapter 9 institutions. The PRC considered the challenges facing chapter 9 institutions and engaged Parliament, as well as analysed the findings of the Kader Asmal review. The PRC is, therefore, of the view that in addition to general recommendations contained in this report, the recommendations of the Kader Asmal review should be implemented by Parliament.

1.4 PRC review: Key considerations

In its review process, taking into account the terms of reference and the problem statement, the PRC was guided by the following considerations:

- The focus was on all SOEs: commercial, agencies, regulators and other relevant entities;

- A macro examination was undertaken of Government owned entities instead of a detailed micro audit of individual SOEs and sectors;
- Engagement with the existing knowledge contained in numerous reviews undertaken by various stakeholders;
- An examination was made of existing benchmarks, both domestic and international; and
- Emphasis was placed on leveraging that which existed while also seeking to identify gaps and fresh opportunities.

1.5 Methodology and approach

1.5.1 Problem statement

After observing the social, economic, and political challenges facing South Africa, and gaining insight into the complex nature of the review task, expected outcomes, and principles underpinning the role of SOEs in Developmental States, the PRC concluded that the SOE review

problem can be briefly stated as: "How can SOEs optimally contribute to growth, development and transformation of South Africa, while remaining financially viable and effective?"

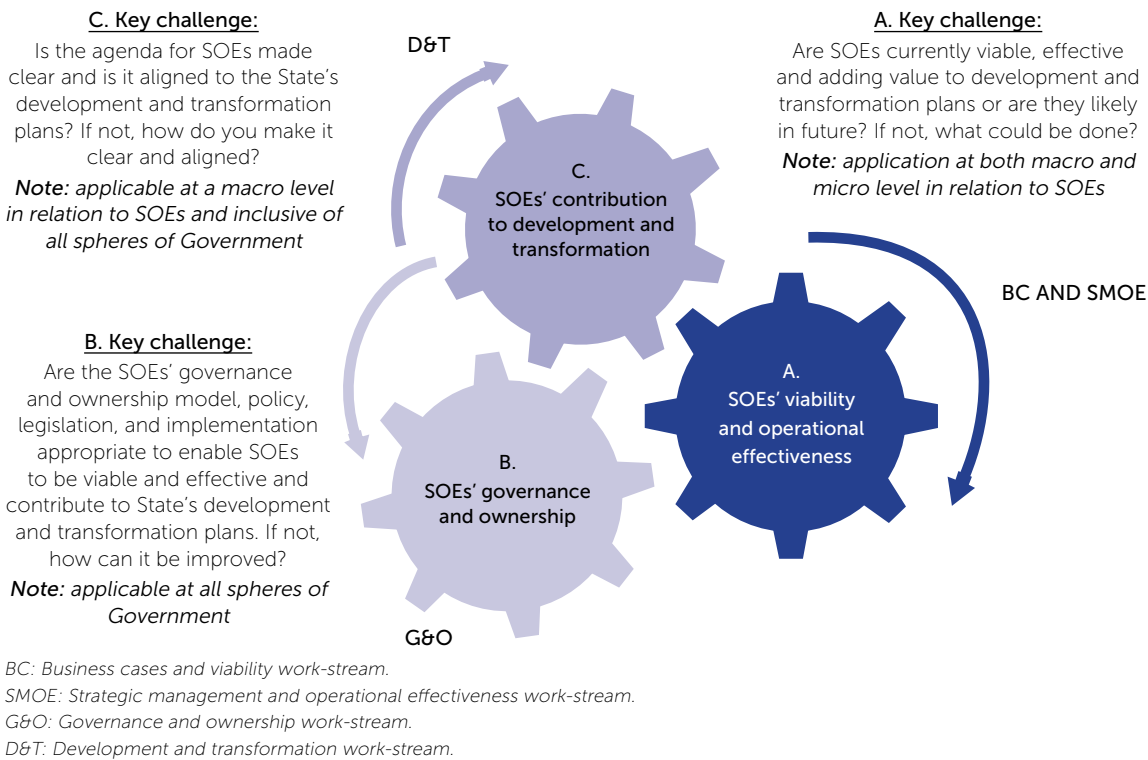
In other words, can SOEs create the maximum balance between supporting South Africa's Developmental State objectives (including, among others, creating jobs and addressing socio-economic inequalities) while remaining viable and competitive?

The observation by the PRC was that there are three pillars to this problem, namely:

- the SOEs' viability and operational effectiveness;
- the SOEs' governance and ownership; and
- the SOEs' contribution to development and transformation.

These three pillars are illustrated graphically in Figure 2.

Figure 2: The three pillars of the SOE review problem statement



CHAPTER 1 continued

Each pillar identified by the PRC is a special component in the macro context of SOEs that contribute to a successful SOE model (symbolically represented by three wheels that must be harmonised in Figure 2 above). The problem is hypothesised as: The identification of distortions and possible solutions within each problem pillar, taking into account various views that exist in the society as well as international benchmarking, will result in the PRC coming-up with appropriate recommendations for an improved South African SOE model that maximises the balance between SOEs’ contribution to growth, development and transformation, and SOEs’ viability and operational effectiveness.

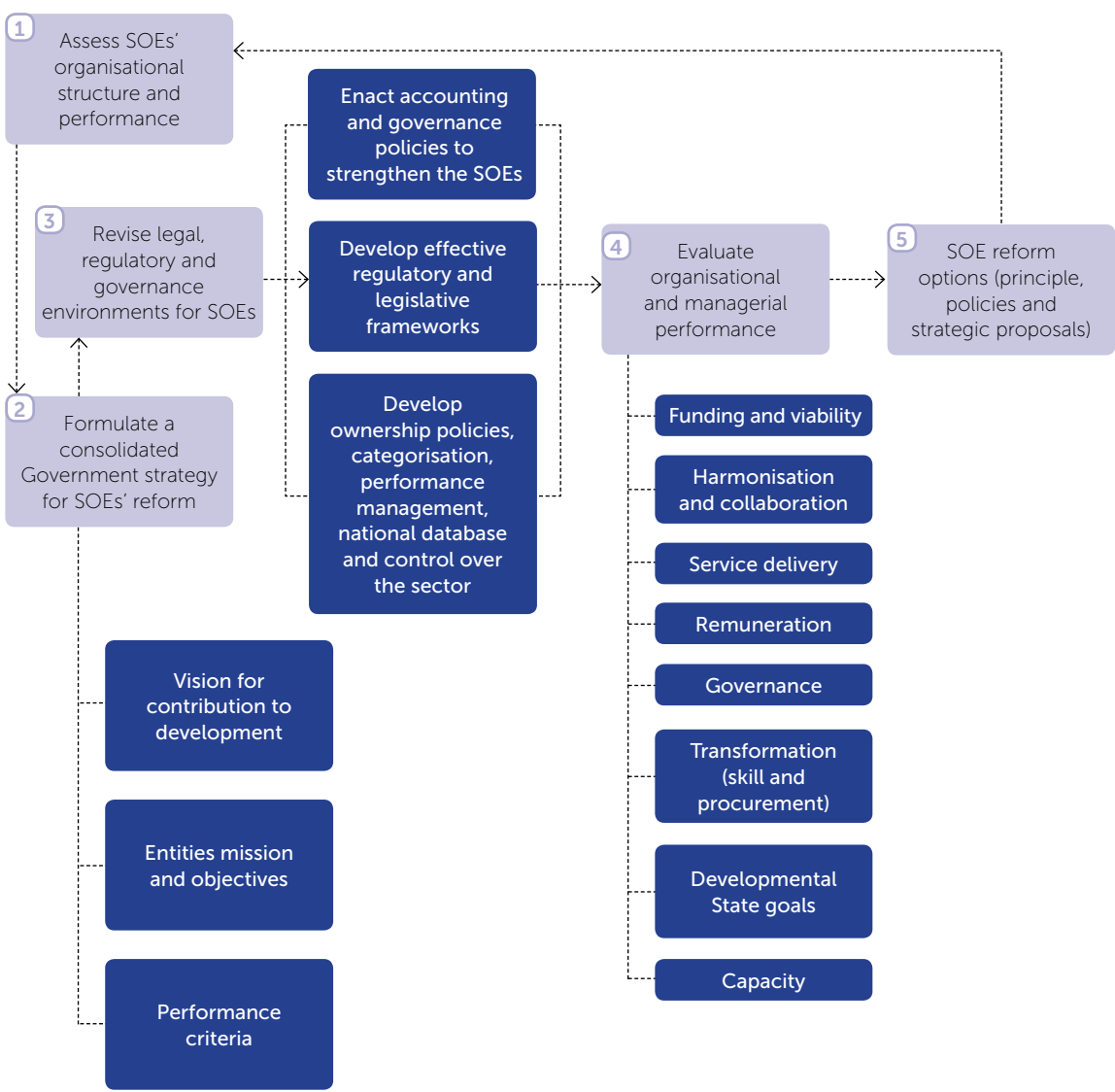
The review of SOEs, represented an opportunity to redefine the role of SOEs in relation to the South African Government’s growth, developmental, and transformation objectives and plans – as would be embodied in the concept of a Developmental State. Our work has been informed by various Government policy and strategic documents notably, the New Growth Path (NGP); Industrial

Policy Action Plan 2 (IPAP 2); and the National Planning Commission (NPC) reports.

An United Nations report (2008, p. 30) suggests that a review of SOEs in any country seeking to reform public enterprises: “...should be preceded by an assessment of the performance of the enterprise sector carried out by a Government commission or agency that can identify SOE objectives, assets, and resources; assess their financial assets and liabilities; evaluate their performance in meeting their objectives; and demonstrate their contribution to economic and social development. Government undertaking public enterprise reform must often revise the legal framework to clarify the ownership relationships between the State and SOEs, impose internationally accepted accounting and financial reporting standards, and outline governance options.”

The following diagram, adapted from the UN report, identifies five stages to any review and transformation of SOEs.

Figure 3: International best-practice for SOE sector review and transformation



Source: Adapted from United Nations, 2008.

CHAPTER 1 continued

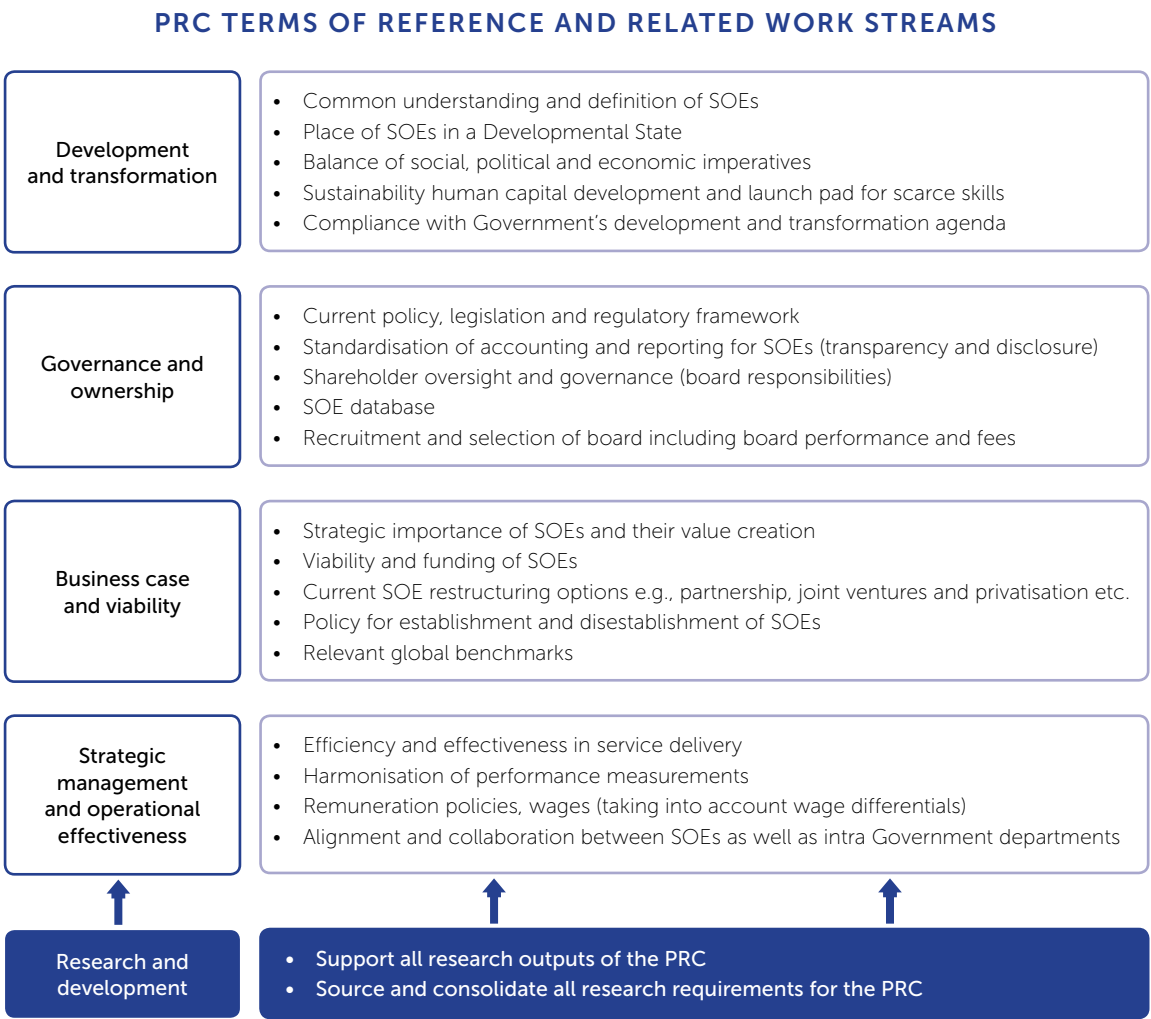
The content and approach in each review stage is dependent on the individual country’s specific needs and requirements. South Africa’s needs and conditions are generally outlined in a number of documents as noted above. In addition, the PRC has formulated its own problem statement, which guided the review process as stated above. Based on the PRC terms of reference, comparative international perspective, and the PRC problem statement, the PRC review assesses SOE performance and provides guidelines for the development of a strategy towards SOEs that

is aligned to South Africa’s Developmental State objectives (following the stages as illustrated in figure 3 above).

In order to facilitate the review, the PRC clustered its 21 terms of reference (as outlined in figure 4) into four thematic areas. These thematic areas are:

- Development and transformation (D&T);
- Governance and ownership (G&O);
- Business case (Viability) (BC); and
- Strategic Management and Operational Effectiveness (SMOE).

Figure 4: PRC work-streams and terms of reference



From the four thematic areas mentioned earlier, the PRC established four work-streams made up of members of the PRC. The 12 members of the PRC were allocated into various work-streams according to their areas of expertise and experience in the SOE environment. The work-streams were assisted by the PRC Secretariat, which consists of full-time project managers.

The PRC formulated a set of key research questions for each term of reference. These guided the

activities of each work-stream. The PRC review entails two main processes, namely research and stakeholder engagements.

1.5.2 Research

The PRC, from its inception, acknowledged that quality research is critical for the review process. A number of primary and secondary research activities aimed at soliciting quality data were executed.

Table 1: Research activities undertaken

Research activity	Aim	Output
Literature review	To obtain a conceptual understanding of the past and current debates, programmes, and positions.	Concept Papers (for each term of reference).
Seminar series	To obtain an understanding of the issues policy makers and practitioners are contending with in the SOE environment under each thematic area.	Seminar reports (an understanding of critical issues in the SOE environment).
Census	To respond to a term of reference: “establishment of a comprehensive database of SOEs across all spheres of Government”.	A comprehensive database and associated issues.
General SOEs survey	To assess the environment and performance of SOEs responding to all terms of reference.	Survey report.
Key interviews with experts and relevant officials	To understand the views and observations by experts and practitioners on SOEs.	Interview transcripts.
Case studies	To further expand on specific issues and test the emerging principles.	Case study reports.
International engagement	To test emerging principles with a selected group of countries.	International engagement report.
Focus groups/ policy dialogues	To test recommendations with a representative sample of stakeholders and experts.	Transcripts.
Special research projects	To explore specific issues critical to the SOE review such as transformation audit, spend analysis, remuneration, and others.	Research reports on specific areas that enhance review output.

CHAPTER 1 continued

The PRC completed the following research activities:

- Work-streams conducted literature reviews.
- Three seminars were convened and attended by stakeholders, SOE practitioners, and academics. The themes of two of the seminars were ‘Development and Transformation’ and ‘Governance and Ownership’, while the third was an international seminar hosted by the PRC in collaboration with the OECD.
- Analysis of SOE annual reports was conducted by the PRC through the services of KPMG. The research covered basic financial and non-financial performance information.
- A general survey of SOEs was conducted (through the services of the HSRC on ‘development and transformation’ and ‘governance and ownership’ related terms of reference; and the services of PwC for ‘business case and viability’ and ‘strategic management and operational effectiveness’ related terms of reference).
- A study tour of Europe included visits to Germany, the Netherlands, France, Norway, Poland, and the OECD.
- Case studies were undertaken, e.g. of the King Shaka International Airport.
- A number of special research projects were conducted, as detailed in volume 4 and 5 of the PRC report.

The advantages of the research-based review adopted by the PRC were that it allowed the PRC to:

- Adopt a holistic, macro review of the role of SOEs across all spheres of Government;
- Ensure the alignment of SOEs with the challenges of the State in an integrative approach;
- Enable reviewers to consider and recommend collaboration and integration of Government and SOEs to maximise output of their efforts at macro level;
- Relate South African experience and aspirations

on the role of SOEs in a Developmental State to international benchmarks;

- Advance an optimal role of SOEs in a Developmental State in South Africa;
- Obtain inputs from Government; SOEs, organised labour and business, customers, funders, and other key stakeholders that ensure the relevance of the review; and
- Identify commonalities and contradictions among stakeholders in terms of their experience and expectations from SOEs at the macro level.

1.5.3 Engagement with stakeholders

The PRC considers views from stakeholders and role-players within the SOE environment as crucial. This allows for an understanding of divergent opinions and for the testing of observations and principles. These engagements included:

- Written public submissions, communicated widely through the media. Input was also solicited directly from key stakeholders including SOEs themselves; organised business; political parties; and organised labour;
- Oral submissions by public interest groups, subject matter experts and members of the public at large;
- SOEs’ engagements on the terms of reference; and
- Engagement with Government departments in national, provincial, and local Government spheres, and Parliamentary structures on the terms of reference.

The PRC managed to meet with a number of stakeholders including major SOEs such as ESKOM; South African Airways; Transnet; the Industrial Development Corporation; the Central Energy Fund; PetroSA; and the Airports Company of South Africa. It also met with trade unions. In addition, the PRC engaged with almost all provinces and metropolitan authorities.

1.5.4 Review process

In compiling the findings and recommendations contained in this report, the PRC made use of the following methodologies and sources of information:

- Original information from the activities of the four PRC work-streams distilled in terms of reference discussion papers (see volume 3);
- Policy dialogues and roundtable discussion with subject matter experts on the relevant fields, executive management, middle management, board members of SOEs, representatives of

Government departments, as well as the private sector (see volume 5);

- Public submissions from a range of stakeholders including those in the private sector, Government departments, civil society, and labour (see volume 5); and
- The reports of the previous reviews were made available by Government departments (see some of the previous initiatives in Table 2 below). The previous reviews included, among others, the commissioned research papers by experts and a survey of SOEs (see volume 4).

Table 2: List of initiatives

Initiative and year	Initiator	Affected SOEs
Policy framework for an accelerated agenda for the restructuring of State-owned enterprises	Department of Public Enterprises	DPE SOEs
Review of chapter 9 and associated institutions	National Assembly of South Africa	Constitutional SOEs (PFMA, schedule 1)
Analysis of SOE performance during the period 2003/04 – 2007/08	Department of Public Enterprises	State-owned enterprises under the Department of Public Enterprises
Remuneration review for State-owned enterprises	Department of Public Enterprises	State-owned enterprises under the Department of Public Enterprises
Board and CEO remuneration review (2010)	National Treasury	PFMA schedule 2, 3A and 3B entities
Governance framework review	National Treasury/ DPSA	National non-business public entities and Government business enterprises
Review of human resources and performance management practices (2004)	National Treasury/ DPSA	Public entities
The role and classification of public entities review	National Treasury/ DPSA	All public entities listed in the PFMA
Development financial institutions (DFIs) review	National Treasury	All major DFIs
DOD review – Defence sector and entities within the sector	Department of Defence	Defence entities
Review of South African innovation policy	OECD	All the research institutions
Provincial SOE reviews e.g. Limpopo, Gauteng	Provincial	

CHAPTER 1 continued

1.5.5 Sampling

As the mandate covered different types of entities owned by the State, given the constraints it would have been impossible to cover all types of SOEs at all spheres of Government. The PRC therefore agreed that a comprehensive sample of the population of SOEs would be necessary. The stratified random sample was developed with the support of the HSRC. This sample was supplemented by engagements with key Government departments that have oversight over SOEs at different levels of Government; as well as public submissions.

The following entities and Government departments were interviewed and requested to make presentations:

Table 3: Entity by PFMA schedule

Entity type	
Schedule 1	3
Schedule 2	25
Schedule 3a	38
Schedule 3b	7
Schedule 3c	16
Schedule 3d	3
Non-PFMA listed municipal entities	10
Total	102

Source: PRC-HSRC Survey, 2011

Table 4: Entity by role in the economy

Role of entity	
Service delivery	36
Commercial enterprise	25
Regulator	15
Development finance institution	9
Research institution	6
SETA	5
Non-commercial enterprise	4
Constitutional body	2
Total	102

Source: PRC-HSRC Survey, 2011

In addition, engagements and submissions were solicited from the following Government departments:

National Government

- The Department of National Treasury
- The Department of Public Enterprises
- The Department of Higher Education
- The Department of Defence
- The Department of Economic Development
- The Department of Water Affairs
- The Department of Trade and Industry
- The Presidency: The National Planning Commission
- The Presidency: Department of Monitoring and Evaluation
- The Department of Transport
- The Department of Women, Children, and People Living with Disabilities
- The Department of Communication

Provincial Government

- North-West
- Limpopo
- KwaZulu-Natal
- Gauteng
- Western Cape
- Eastern Cape

Local Government

- Tshwane
- Johannesburg
- eThekweni
- Cape Town
- Ekurhuleni
- Nelson Mandela Bay

Written public submissions were openly solicited through the main media with the assistance of the Presidency and GCIS. The following written submissions were received:

- Eskom
- Durban Chamber of Commerce and Industry
- SASRIA
- NURCHA

- Denel
- SA Express Airways
- Standard Bank
- City of Johannesburg
- Umhlozinga Development Agency
- City of Cape Town
- NECSA
- DBSA
- Nelson Mandela Bay Metro
- Department of Trade and Industry
- South African Chamber of Commerce and Industry
- Democratic Party
- Western Cape provincial Government
- Central Energy Fund (CEF)
- Technology Innovation Agency (TIA)
- ARMSCOR
- Dirapeng
- Business Unity South Africa (BUSA)
- University of the Witwatersrand
- Department of Water Affairs
- KwaZulu-Natal Department of Economic Development
- Department of Communications

1.5.6 Proposed outcomes

The approach adopted sought to compile a number of recommendations that would contribute positively to:

- The South African Government developing an overarching strategy for its SOEs. The overarching strategy will be derived from the shared Developmental State vision and plan;
- Creating an enabling environment for the performance of SOEs;
- Improving the performance of SOEs and making a measurable contribution to South Africa’s growth, development, and transformation; and
- Improved State and SOEs’ capacity.

The PRC report is divided into the following five volumes:

- Volume 1 – Executive summary: The volume provides a high-level summary of the PRC’s findings and recommendations;
- Volume 2 – PRC main findings and recommendations: This volume is the main part of the PRC report, which presents findings and recommendations in detail;
- Volume 3 – Annexure 1, PRC discussion papers for all terms of reference: This presents the discussion papers produced by the four work-streams of the PRC in response to the terms of reference;
- Volume 4 – Annexure 2, PRC primary research reports: This volume presents the reports on the primary research commissioned by the PRC; and
- Volume 5 – Annexure 3, stakeholder engagement reports: The final volume contains various stakeholder engagement reports.

This current report is volume 2, which contains the PRC main findings and recommendations and is structured as follows:

- Part 1 deals with an overarching strategy for SOEs in South Africa;
- Part 2 addresses issues on an enabling environment for SOEs;
- Part 3 looks at SOEs’ performance and deals with performance related issues;
- Part 4 deals with critical issue of capacity, particularly that of the State with regard to its relationship with its SOEs; and
- Part 5 elaborates on the implementation of the PRC recommendations.

PART 1:
AN OVERARCHING STRATEGY
FOR STATE-OWNED ENTITIES

PART 1: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES

INTRODUCTION

Problem statement

Many countries have embarked on re-evaluating the role and structure of their SOEs. Such re-evaluations are necessary to align State entities to the nation’s growth and development objectives. This type of review is also a response to a number of issues of concern to South Africa. These include:

- The increasing impact of globalisation and international trade and competition;

- High levels of unemployment, poverty, and the increasing gap between the rich and the poor;
- Advancement in knowledge and high technologies; and
- Crises and epochs in the history of nations, such as post-World War II in Germany and Japan, recent financial crises in America and Europe, as well as other disasters.

The table provides some examples of countries throughout the world that have recently conducted review initiatives.

Table 5: SOE reviews in other countries

Country	Initiative
Bhutan	Establishment of the Druk Holding and Investments (DHI) in 2007 as the SOE ownership entity.
Brazil	The establishment of the Inter-ministerial Corporate Governance Commission and Federal Government Management of Participations Commission – CGPAR in charge of matters related to the corporate governance of the Federal SOEs.
China	Developing further the system of State-owned assets supervision and administration which was established in 2003.
Czech	Decree No. 1532 proposing to establish an Interdepartmental Committee for the formation of a General Model for Managerial Remuneration System.
Finland	Re-organisation and centralisation of the ownership function in 2007 leading further to establishment of a holding company in 2008.
Hungary	Establishment of National Asset Management Council (NAMC) and the Hungarian State Holding Company (HSHC), which, with few exceptions, exercises the ownership rights in SOEs.
Malaysia	Government Linked Companies Transformation Programme (linked to Vision 2020).
Mozambique	Publication of the Corporate Governance Best-Practices Guide for SOEs by IGEPE – Institute for the Management of Government Shares.
Namibia	The promulgation of the State-owned Enterprise Governance Act, 2006 (Act No. 2 of 2006). The establishment of State-owned Enterprise Governance Council (SOEGC).
Norway	White paper No. 13 confirming that the Norwegian State shall be an active, long-term and predictable owner of some important Norwegian companies with a follow-up document on the Government’s Ownership Policy highlighting corporate social responsibility.

PART 1: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

Over the years, SOEs have stirred up intense political debates and political struggles throughout the world. In recent decades, public sentiment and academic reasoning on the role of SOEs in the economy have fluctuated sharply. During the 1980s and early 1990s, a major wave of disenchantment with State intervention swept through the industrial nations. In those years, the fortunes of SOEs reached their nadir, and countries that previously resisted privatisation began dismantling public undertakings. The pro-market and anti-State climate of that time was reinforced by the sudden collapse of socialist approaches in a number of Eastern European States. In the late 1990s, a new climate developed. The initial euphoria of liberalisation began to wane and the pace of privatisation and deregulation seemed to slow down. Today, there appears to be more emphasis on economic growth, employment, and human capital formation rather than a monolithic focus on fiscal restraint and restrictive monetary policies. Countries continue to debate and alter the role of the State. In this regard, Albert Hirschman (in Toninelli, 2000) poses an intriguing question, namely: "...whether our societies are in some way predisposed towards oscillations between periods of intense pre-occupation with public issues and almost total concentration on individual improvement and private welfare goals." He suggests that we may thus be living through either a recurrent cycle or permanent circular trend in society's employment of SOEs.

The relevance and importance of SOEs remain crucial to most States. Public investment has to play a key role in any pro-poor national development strategy, including the achievement of the Millennium Development Goals (MDGs). Markets are powerful mechanisms to promote economic development, but they often fail to produce the economic dynamism and the social justice that sustainable economic development requires (Chang, 2007).

To achieve a broad-based and politically sustainable development, we need to find mechanisms that can meet the basic needs of everyone. Moreover, there are 'public goods' that are likely to be under-provided by individuals who act exclusively on market incentives. Law and order, basic infrastructure, primary health, education and scientific research are examples of such public goods.

The classic mechanism to provide such goods is through taxation and public provision. Without appropriate regulation, markets encourage short-term profit-seeking at the cost of the long-term investments that are necessary for sustainable economic development. In correcting for the deficiencies of the market, public investment can, and should, play a key role, especially in relation to long-term development. Long-term development calls for investment in a range of physical and human capabilities.

Public investment programmes can increase physical capabilities by investing in capital equipment and physical infrastructure (e.g., transport and telecommunication). Appropriately targeted public investment programmes may also contribute to alleviating poverty and thus to economic and social development in the long run. A vibrant public investment programme can thus contribute to private sector activity through the 'crowding in' effect. There is an unfounded notion that all public investment 'crowds out' private investment. Public investment programmes and a well-developed SOE sector can deliver significant benefits to the private sector. Public investment can further enhance economic development.

In dealing with domestic and global challenges, most Developmental States have adopted a strategy for their SOEs that apply not only to individual entities, but also to State entities collectively. One of the central questions informing this review is therefore whether South Africa's SOEs are functioning according to a common agenda.

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES

2.1 OVERVIEW OF THE CHAPTER

2.1.1 Purpose of this chapter

The purpose of this chapter is to:

- Provide an overview of the current role of SOEs within context of State service delivery, growth, development, and transformation plans and policies;
- Report on the international comparative experiences of other Developmental States in terms of their strategy for SOEs and especially the role of SOEs in those States; and
- Recommend changes towards a holistic and overarching strategy for SOEs in South Africa.

2.1.2 Process and approach

The material for this chapter is derived from a number of PRC processes, which include the following:

- (a) Six PRC terms of reference discussion papers produced by the PRC's development and transformation, and business case and viability work-streams which deliberated, *inter alia*, on:
- A common understanding and definition for SOEs;
 - The place of SOEs in a Developmental State;
 - Strategic importance and value creation of SOEs;
 - The balance of social, political and economic imperatives in delivering objectives for SOEs;
 - The criteria and framework for identifying and establishing priority SOEs, relevant global benchmarking and best-practices; and
 - The existing portfolio of investments by the State in strategic businesses.

2.1.3 Structure of the chapter

The chapter begins with an overview of SOEs in relation to the Developmental State. This includes determining a common conceptual understanding of a Developmental State, an examination of

South Africa's development imperatives, and determining what needs to be done to align SOEs to the development State vision. By unpacking the understanding and analysis of the State's agenda and role expectations for SOEs, the chapter then probes the following key topics:

- The common understanding of what constitute SOEs;
- Strategic sectors, priority SOEs and value creation; and
- The balance of social, economic and political imperatives for SOEs.

The chapter also reflects on the spread of South Africa's SOEs across the three spheres of Government and debates whether they perform according to a common agenda that reflects the country's delivery of services, growth, development, and transformation objectives and plans. It identifies a critical gap and concludes with an exposition of the indispensable, tangible and pragmatic steps to be taken to establish and implement a strategy for SOEs.

2.2 SOEs IN THE CONTEXT OF THE DEVELOPMENTAL STATE

2.2.1 Introduction

In announcing the formation of the PRC, the President of the Republic of South Africa, Mr Jacob Zuma, clarified the public role the State expected of SOEs when he declared: "We have to ensure that while they remain financially viable, the SOEs, development finance institutions as well as companies in which the State has a significant shareholding, must respond to a clearly defined public mandate and help us to build a Developmental State."

Underpinning this call to be Developmental State oriented is the State's acknowledgement of potentially explosive domestic socio-economic challenges and the global environmental and competitive challenges facing South Africa. Notable among these are:

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

- High levels of poverty and unemployment, especially among the youth and rural population;
- The lack of appropriate skills to drive South Africa's industrial and knowledge economy;
- The skewed distribution and maintenance of infrastructure, favouring the old apartheid footprint mainly in urban areas around major mining and industrial hubs;
- The unequal distribution and ownership of land and capital to ensure effective participation and fair distribution of economic opportunities;
- The poor quality of basic education, particularly in township and rural schools, where the majority of the school-going population resides;
- The growing disparities between rich and poor, propelled by a widening wage and income gap between the employees and management;
- The threat of uncompetitive South African industries and increasing competition to local industries;
- The threat of accumulating a burdensome State debt due to non-performing entities;
- The threat of failing to attract commensurate domestic and direct foreign investment finance for the massive infrastructure development that has been planned to stimulate growth;
- The socio-economic and geopolitical impact of the global financial crisis on the domestic and regional economies; and
- The challenges of climate change.

The PRC's examination of international experience found that many countries have embarked on re-evaluating their SOEs in order to align them to the nation's growth and developmental objectives. In addition, the PRC found that in dealing with domestic and global challenges, most Developmental States have adopted a strategy or agenda for their SOEs that apply not only to individual entities, but to SOEs collectively.

Not having an overarching strategy for SOEs from which all SOEs anchor and the capacity to do so creates chaos in the SOE environment and is

costly to Government as indicated in this report. This is noted in the Asian Development Bank report (2007: 61): "When a Government does not set an overarching strategy, the Government operates similar to a sheep herder with regard to its SOEs, frequently chasing the sheep (individual SOEs) that are wandering too far when implementing their own strategies. In each case, a responsible Government will take steps to review, influence, and redirect the SOE strategies.

The 'strategic fence' approach works best for control and for driving SOEs toward common goals and objectives. Setting strategic boundaries empower Government executives to assess the appropriateness of individual SOE strategies against overall Government objectives and strategies".

These diverse entities are given commercial and non-commercial mandates to serve principally as instruments of the State to deal with specific challenges and opportunities, which include, among others:

- Natural monopolies that are socially unsuitable to be conducted by private enterprises;
- Sectors that have the required investment returns essential to support national budgetary objectives;
- Services deemed to be of strategic importance and sectors that are designated as a national priority;
- New and emerging high-risk industries; the State's role is to incubate these industrial initiatives;
- Services that are providing national security and are protecting national interests;
- Sectors characterised by market failures in provisioning essential public goods and services and that might result in an economic, social or political threat; and
- Sectors characterised by essential social, developmental goals and development failure.

It is in the context of such challenges that a review of the country's SOE's was undertaken. It is also

within the context of South Africa's development aspirations and imperatives that the role, function and performance of SOEs must be understood. These above stated dual factors, without being exhaustive, formulate the bedrock for the rationale that justifies why the Government should maintain and strengthen its SOEs.

2.2.2 The meaning and attributes of a Developmental State

In this section, common characteristics of a Developmental State are defined; this provides a framework for developing an overarching agenda for SOEs. In particular, the PRC's comparative analysis of international experience investigated the following questions about the agenda for SOEs in Developmental States:

- What is the ideological meaning of a Developmental State?
- Who formulates the agenda for SOEs in Developmental States?
- How is the agenda for SOEs formulated?
- What constitutes the agenda for SOEs in Developmental States?

2.2.2.1 Definitions

Literature on the Developmental State provides many definitions, which capture the common understanding by different stakeholders of what constitutes such a State. Salient definitions refer to the Developmental State as:

- A State in which Government is intimately involved in the macro and micro economic planning and implementation in order to grow the economy in a steady but rapid manner (Onis, 1991). It has generally been observed that successful Developmental States are able to advance their economies much faster than regulatory States (States that use regulations to manage the economy) (Marwala, 2006).
- A State in which the political elites aim at rapid economic development and give power and authority to the bureaucracy to plan and implement efficient policies. A high

rate of economic growth legitimises the centralised State apparatus (Abe, 2006), and is generally known as State capitalism. The Developmental State aims at rational and deliberate development and implements State-driven economic and industrial policies, with cooperation between the Government and private enterprise. The Developmental State contrasts with the 'regulatory State's relatively free market economies such as that of the United States (Johnson, 1982, p. 10).

The above definitions are indicative of the common themes and understanding of the characteristics of a Developmental State and show that it is fundamentally based on a mixed economy. Accordingly, a Developmental State is one that 'is led by the State or Government in pursuit of a rapid and deliberate economic growth and development'. A Developmental State is distinctly characterised by the active intervention of the State in the economy. This intervention is contrasted to that of a regulatory State with a relatively free market economy. Such an economy is largely left to the markets with minimal State regulation to facilitate fair transactional activities.

2.2.2.2 Success factors and strategic priorities for South Africa's Developmental State

The PRC, based on a literature review and international benchmarks, has identified the following factors as critical for the evolution of South Africa's Developmental State:

- **A shared, long-term Developmental State vision, which is translated into achievable and implementable components.** This vision is accompanied by clear and inspiring leadership committed to driving the vision.
- **Skills and innovation development promotion. The skills promotion drive** includes major interventions to improve the education system with an emphasis on early childhood development, experiential learning

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for the youth and the unemployed; and comprehensive post-matriculation education and training, including industry and work-based human talent development. Education and skills development must be responsive to the industrialisation and growth objectives of Government. Additionally, this entails the appropriate embracing and developing of innovative technologies

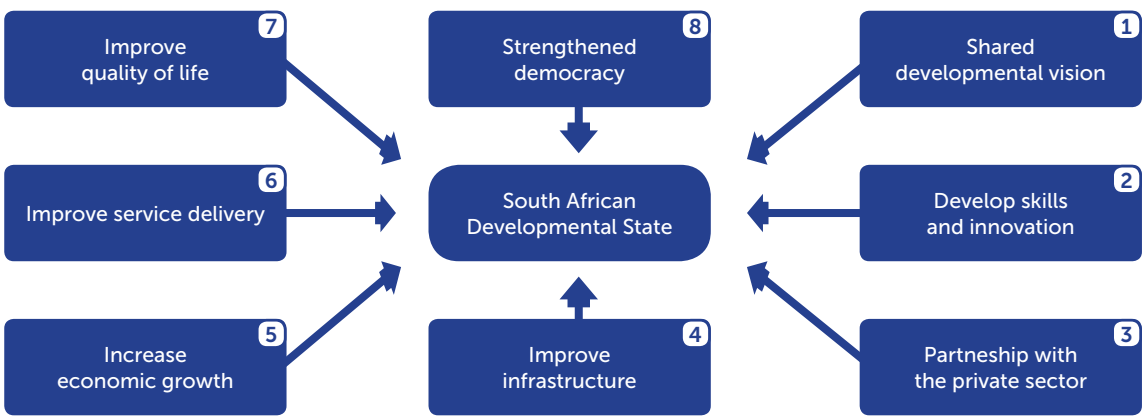
- **A strong partnership, agreement, and common understanding between the Government and its social partners namely, trade unions, the private sector and civil society** over the goals of the Developmental State's vision and its implementation.
- **Improved infrastructure is a precondition for building a viable Developmental State, because it underpins the ability of an economy to be vibrant and successful.** The PRC noted the long-term nature of the President's infrastructure initiative and maintains that it provides an indispensable element in driving Developmental State outcomes for South Africa.
- **Improved service delivery** with respect to the quality, accessibility and geographic spread is essential in all spheres of Government as this affects social cohesion.
- **Economic growth should be promoted** by attracting investment and encouraging

entrepreneurship. National competitiveness is essential to match the dynamics of globalisation as well as promoting the development and sustainability of local industries. This includes creating economic opportunities for emerging and small enterprise development programmes, higher levels of local and foreign investment, and projects, which tap South Africa's extensive mineral deposits.

- **Improved quality of life** must be an ongoing outcome of an evolving and aspiring Developmental State in South Africa. This includes the eradication of economic and social injustices, improvement of wage and income gap, improved workplace conditions, and harmonious industrial relations. Also important are ready access to health facilities, social amenities, quality education, a safe environment etc.
- **Strengthened democracy.** This entails ensuring that constitutional democracy institutions are allowed to carry out their constitutional role without hindrance and are adequately funded to accomplish their mandates without being compromised by resourcing. As a relatively new democracy and an aspiring Developmental State these institutions need to be strengthened if their legitimacy is to be enhanced.

These eight characteristics of a Developmental State are summarised in figure 5.

Figure 5: Characteristics of a Developmental State



Achieving a Developmental State will therefore require that the entire nation is ready, willing and able to change. This will also necessitate a long-term vision, which is shared by all stakeholders who are absolutely committed to implement the steps required to achieve the vision. Furthermore,

the process of achieving the vision should be driven by competent people with adequate financial and other resources; an enabling legal framework; effective performance and evaluation, as well as competence and capacity throughout all spheres of the society as shown in figure 6.

Figure 6: Change management required to effect a Developmental State

VISION AND CONSENSUS	+	ENABLING LEGAL FRAMEWORK	+	PERFORMANCE AND EVALUATION	+	COMPETENCE AND CAPACITY	=	OUTCOME
Missing	+	✓	+	✓	+	✓	=	Fast start, but no direction, "change for change sake" LACK OF LONG-TERM PLANNING
✓	+	Missing	+	✓	+	✓	=	Poor governance, ownership, oversight and controls and implementation is not enforceable
✓	+	✓	+	Missing	+	✓	=	Poor service delivery and mediocre outcomes that will not improve quality of life
✓	+	✓	+	✓	+	Missing	=	Trial and error (ad hoc) approach with negative development impact
✓	+	✓	+	✓	+	✓	=	EFFECTIVE SUSTAINABLE CHANGE

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The change management elements and building blocks towards a Developmental State will result in effective and sustainable change. However, if such change elements are not implemented the likely results will be, for example:

- Where there is no vision, or the vision is unclear, the results are 'change for the sake of change';
- Where the legal and structural environment is not enabling, the outcomes are poor governance, ownership oversight and unenforceable implementation;
- Where performance is not effectively monitored and evaluated, the results are poor service delivery and mediocre outcomes that will not improve quality of life; and
- Where there is no capacity, the State is running on a 'trial and error' approach with negative development impact.

2.2.2.3 The evolution of South Africa's Developmental State

The Reconstruction and Development Programme (RDP) (1995) and the provisions of chapters 3 and 10 of the Constitution (1996) were the first major State initiatives to introduce elements of the democratic Developmental State that South Africa aspires to become. These policy documents argue for an integrated, inter-sectorial, and cooperative approach to governance. The policies also commit Government in all spheres to be transparent in policy making and inclusive in its approach.

The RDP was based on the following important principles:

- **Sustainable and integrated development:** The aim is to achieve economic growth, social development and environmental protection.
- **People-driven:** Development has to be driven by the people and consultation is a key element of any developmental programme. Without consultation, the Government cannot be sure that it is meeting the needs of the public in the best possible way.

- **Peace and security for all:** Development in South Africa has to provide peace and security for all. The development of one community cannot be at the expense of another.
- **Nation building:** Coming from a divided past, South Africa can only meet the challenges if it does so as one nation with a common set of goals and one agenda for action.
- **Reconstruction:** While there are many things that have to be changed, reconstruction should always be linked to development. The intention is not simply to change the faces at the top but also to develop the country to meet the needs of the people who have been most disadvantaged.
- **Democracy:** Reconstruction and development can only take place in a democratic South Africa. Democracy is not only about voting once every five years in an election. It is about building mechanisms, which allow people to participate, to give advice to Government, to be consulted on decisions and to get reports on progress.

To achieve reconstruction and development, the RDP divided the key tasks of Government into four programme areas. They were:

1. Meeting basic needs;
2. Developing human resources;
3. Building the economy; and
4. Democratising the State and society.

The resolutions taken at the ANC's 2007 Polokwane Conference, which became the Government's medium-term strategic framework (MTSF) (2009–2014), reinforce the momentum to build a democratic Developmental State. The strategic priorities set-out in the MTSF are based on South Africa's challenges and strategic planning scenarios. They capture the intent of Government as follows:

- Speeding up growth and transforming the economy to create decent work and sustainable livelihoods;

- Undertaking a massive programme to build economic and social infrastructure;
- Establishing a comprehensive rural development strategy linked to land, agrarian reform and food security;
- Strengthening the skills and human resource base;
- Improving the health profile of all South Africans;
- Intensifying the fight against crime and corruption;
- Building cohesive, caring and sustainable communities;
- Pursuing African advancement and enhanced international cooperation;
- Advancing sustainable resource management and use; and
- Building a Developmental State, including improvement of public services and strengthening democratic institutions.

The above strategic priorities are still premised on the redefined role of the State as developmental, and as originally expressed in the RDP and the Constitution of the Republic of South Africa.

With regard to the current developmental agenda of the South African State and its relevance to SOEs, the PRC investigated the extent to which this agenda is understood. To this end a series of engagements, surveys, public submissions and policy documents were conducted and/or reviewed. The following observations on South Africa's intention to build a democratic Developmental State were made:

- The PRC acknowledges the intent of Government to 'build a democratic Developmental State' and the important role SOEs are envisaged to play. However, what is not clearly articulated in Government publications is meaning of the concept 'Developmental State' for South Africa, and also a common understanding of the role of all SOEs in a long-term vision based on the Developmental State aspirations of Government.

- The intention of the State to build a democratic Developmental State is ambiguously communicated. The public is given mixed messages by the Cabinet and other key State institutions and leaders. For example, the Ministry of Public Enterprises is unambiguous in its SOE reviews about the Government's intention to build a Developmental State, whereas the National Planning Commission in its report does not use the term Developmental State at all, but prefers the term 'capable State'. And the Development Bank of Southern Africa (the State's development finance institution) refers to a 'delivery State'.
- The SOEs are concerned about the lack of continuity and the short-term approach by Government as an owner/shareholder. Each Government administration or Minister tends to pursue short-term goals at the expense of what should be standing long-term plans. This has a negative impact on the ability of SOEs both to plan and perform in the longer term. A key argument raised by SOEs is that it takes time to steer an entity in a certain direction.

2.2.3 The role of SOEs in a Developmental State

2.2.3.1 International benchmarking

A comparative analysis of various countries indicates that each country has a unique experience of the Developmental State. The PRC reviewed particularly the experiences of Namibia, South Korea, Taiwan, Japan, Singapore, China, France, the Scandinavian countries and the United States of America. These were closely examined in order to determine how SOEs are utilised and whether or not development objectives were achieved.

The key finding was that most countries that were reviewed tended to establish some form of an overarching plan for their SOEs. The literature and observation findings point to the critical elements of such overarching agendas as implemented in these countries. These are as follows:

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

Who formulates the agenda for SOEs?

- Developmental States have strong and empowered ‘pilot agencies’ and central planning authorities.
- Most Developmental States move towards strengthened and capacitated central SOE ownership and oversight agencies or departments, in particular for their ‘strategic SOEs’.

How is the agenda for SOEs formulated?

- Developmental States are aggressive in their interventions, but these are comprehensively planned and well-targeted, with clarity on strategic intent and priority sectors.
- SOEs are aggressively utilised, participate in planning, and their mandates are periodically reviewed to ensure alignment to the Developmental State vision and plan.

What constitutes the agenda for SOEs?

- Developmental States spell-out strategic and priority sectors, as well as the catalytic and strategic roles SOEs play in those sectors. These strategic sectors, priorities, and envisaged roles of SOEs are well-founded on research and reviewed periodically.
- The Developmental State’s priorities are specifically and generally targeted to deal with a nation’s unique challenges, e.g., service delivery, skills development, infrastructure, etc.
- The agenda for SOEs takes into account the unique role of SOEs and the balance they are required to achieve between economic, social, and political imperatives. The balance is between driving competitiveness, profitability, and sustainability of SOEs on the one hand, and fulfilling their strategic socio-economic objectives on the other. In this regard the balanced-scorecard approach is often used to manage the State’s portfolio of SOEs.
- Developmental States have gradually adopted the portfolio approach in categorising and managing their SOEs. The portfolio is carefully

planned and managed to align to the State’s strategy for its SOEs and the dynamics of domestic and international markets.

- Most Developmental States strongly promote research and development (R&D) and innovation to drive their economic growth ‘catch-up’ and development programmes.
- Welfare policies are intertwined with the Developmental State’s plans (especially in Scandinavian Developmental States) in order to drive structural changes towards full-employment and high productivity.

2.2.3.2 South Africa’s SOEs in the context of its development objectives

Before 1994, the South African Government’s approach to SOEs was to employ some of them as instruments to help the apartheid State survive sanctions and blockades. They were also useful institutions to grow the economy, even though it was for the benefit of the white minority to the general exclusion of the black majority. Table 6 provides a snapshot of the history of SOEs in South Africa from as early as 1880:

Table 6: History of SOEs in South Africa

Political environment	Rationale	Examples
1880 – 1910 Period of economic self sufficiency. Monopoly concessions were granted to private citizens.	Sovereignty and economic self-sufficiency of the Afrikaner	South African Railways
1910 – 1940s Period of high unemployment. Saw the establishment of a number of key State-owned corporations.	Strategic industries Job creation	Eskom, Iscor and IDC (also SAR, Post Office)
1948 – 1970s The Government used State instruments to improve the living standards of a few in the economy and society. After 1960, with growing isolation, there was an emphasis on self-sufficiency.	Upliftment Strategic industries Self-sufficiency	Aventura, SABC, Sasol Science Council, Land Bank
1976 – mid-1980s The Soweto Uprising and conflict in Angola gave impetus to the development of the State security establishment. Also the Government created entities to circumvent sanctions. In the mid-1980s the Government followed a trend of fostering the private sector and privatising some key State industries.	Avoid Parliamentary scrutiny Busting sanctions Privatisation	Central Energy Fund, Denel, Armscor, Mossgas, SBDC (Iscor and Sasol)
Late 1980s – early 1990s Political change become inevitable. Government sought to use the instruments of State to “win the hearts and minds” of the new voters.	Working around the existing structure of Government	IDT (also used Eskom and Telkom)
1994 – the present New Government focused on poverty alleviation, developing a competitive economy, and improving the functioning of Government. Strong emphasis on creating independent bodies to carry out new functions. Also a tendency to move functions out of Government so as to “create something new” or effect “transformation”.	Regulatory functions autonomous of Government Running away from Government Continued privatisation	NER, Nuclear Regulator, Competition Commission, SA National Parks, Museums, Water boards, Theatres, etc.

Sources:

1. Clarke, N.L. (1994): Manufacturing Apartheid: State Corporations in South Africa Yale University Press, New Haven and London.
2. Fine, B and Rustomjee, Z. (1996): The Political Economy of South Africa: From Minerals-Energy Complex to Industrialisation Witwatersrand University Press, Johannesburg.

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In 1994, the democratic Government was presented with the colossal challenge of dealing with extreme inequalities, poverty, unemployment, illiteracy, and many other colonial and apartheid legacies. The democratic Government inherited a public service structured along a mechanical, closed model of public and development administration. And the features of the apartheid bureaucracy and SOEs included:

- Fragmentation, duplication and waste;
- Poor and outdated management practices;
- Lack of a delineation of State assets and financially credible balance sheets;
- Ageing infrastructure;
- Lack of accountability, controls systems and transparency;
- Demotivated staff; and
- A conflict in labour relations.

To address these challenges, the Government had to decide how institutions and organisations inherited from the past (including SOEs, their subsidiaries and their leadership) were to be transformed and aligned to the new Constitution. The pressure to effect structural change, which by its nature is a long-term project, and in some instances this conflicted with the short-term service delivery expectations held by the majority of South Africans.

Transforming Government and SOEs was further complicated by the fact that not all the information about the strategies and operations of the pre-1994 Government was readily available. Volumes of data on apartheid corruption were destroyed and many of the SOEs and their subsidiaries' funding and activities, for example, could not be accounted for (Institute for Security Studies, 2006). The National Treasury had to virtually begin with a clean slate, collecting information on entities and creating legislation and accompanying regulations. Moreover, many white civil servants left Government and State entities, taking with them a formidable institutional memory- and skills-set.

At the time of democratisation in 1994, there were more than 300 SOEs, and these employed about 300 000 people. The 'big four' – Transnet, Denel, Telkom and Eskom – accounted for 91% of the assets of the top 30 SOEs and employed 77% of their employees (Southall, 2007).

A central question was what to do with these entities. When the ANC took office in 1994, its official policy, as set out in its 1992 policy document *Ready to Govern* was initially to look at the issue of nationalisation versus privatisation on a case-by-case basis. In practice this meant pursuing privatisation in a limited number of targeted areas. Soon, however, the ANC began to consider the sale of State assets to fund the RDP, which envisaged massive State expenditure to meet the basic needs of the historically disadvantaged population, and to reduce the substantial State debt inherited from the apartheid past. For the next five years a debate raged between the Government and sectors of civil society, in particular the trade unions, over the State's strategy of restructuring State assets.

During this period, the ANC Government proceeded to commercialise some of the State's assets and to sell significant portions of its equity in some SOEs. For instance, a 30% stake in Telkom was sold to SBC (18%) and Telkom Malaysia (12%). Another 3% of Telkom stock was purchased by black empowerment groups.

By 2010, SOEs had increased in number, had created jobs to reach an estimated total employment of about 150 000 people, and had combined assets of R175 billion (PRC-KPMG, 2010).

For all their imperfections, there was increased recognition of the role these entities might play. This shift was reinforced by greater international recognition that privatisation might be problematic or inappropriate where SOEs are involved in the provision of essential services (Gómez-Ibáñez et al., 2004).

In response to the implementation of the National Industrial Policy Framework (NIPF) of 2007,

SOEs today face a wide range of objectives. They must serve the needs of capital-intensive industry; provide secure employment; boost black participation in the economy; help Government to implement and learn from implementing industrial policy; and narrow inequalities in access to water, sanitation and electricity. The emphasis placed on these agencies makes it particularly important to ensure that they operate effectively and in the public interest over the long term.

The industrial strategy adopted in 2007 sought to consolidate the competitiveness of existing industries and foster the emergence of new, technology-intensive industries. The objectives of the NIPF include not only diversification and greater value addition, but also employment and the inclusion of marginalised segments of the population. The NIPF sought to promote 'a more labour-absorbing industrialisation path with a particular emphasis on tradable labour-absorbing goods and services and economic linkages that catalyse employment creation'.

SOEs therefore continue to be regarded as important vehicles and contributors to infrastructure development and gross fixed capital formation in South Africa. The strength of fixed capital formation by SOEs was brought about by major projects that include, amongst others:

- Capital spending by the country's electricity utility, Eskom, to increase capacity;
- Construction activities by Transnet to upgrade port facilities and railway lines and to expand a petroleum pipeline;
- The building and upgrading of airports by the Airport Company of South Africa (ACSA); and
- The Gauteng Freeway Improvement Project by the South African National Road Agency Limited (SANRAL).

The State expansionary economic policies through investment in infrastructure and fixed capital formation is seen by the Government as crucial, especially considering the medium- to long-term

multiplier effect that fixed capital formation has in the economic growth and development of a country. SOEs therefore continue to be regarded as important vehicles and contributors to the envisaged infrastructure development and gross fixed capital formation plans of the South African Government. The impact on short- to medium-term employment was evident in the rise of employment in line with these investments in the same period between 2007 and late 2009 to early 2010. The New Growth Path introduced in 2010 also reinforced the role of SOEs in infrastructure development and maintenance. This trend is evident in the proposed R300 billion infrastructure roll-out plan announced by the State President of the Republic of South Africa in his 'State of the Nation' address in February 2012.

Observations on the role of SOEs in infrastructure development and the potential they have to stimulate economic growth and development, particularly during recessionary periods, has re-stimulated interest in their role in the economy both locally and internationally. However, concerns have been raised about whether existing governance structures are adequate to develop long-term strategies for meeting SOEs' multiple obligations. The challenge is to identify better ways of working so that the multiple and competing priorities that are recognised in formal documents can be balanced against each other more effectively in practice.

2.2.3.3 Clarity on macro policies and the role of SOEs

In order to address contemporary challenges and a better way to utilise the country's SOEs, a number of policies have been developed since 1994 that address development and economic growth objectives and strategies in general, and have implications for SOEs in particular.

Central to the review of SOEs is the fundamental issue of clarity of South Africa's long-term macro-policy and the defined role for SOEs. In

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particular, what is necessary is an understanding and interpretation of South African economic and development policies in the short-, medium-, and long-term and their implications for SOEs. This is pointed out by the National Planning Commission (2009, p. 2), which acknowledged: "...to date, the lack of a coherent long-term plan has weakened the [South African Government's] ability to provide

clear and consistent policies, to mobilise all of society in the pursuit of our developmental objectives, to prioritise resource allocations and to drive the implementation of Government's objectives and priorities."

Table 7 presents a general overview of the range of macro-policies that are relevant and applicable to SOEs.

Table 7: Summary of post-1994 policies impacting on SOEs

Policy environment	Rationale
1994: RDP The Government committed itself to reforming the country. The ANC-led Government focused on social issues that were neglected during the apartheid era such as unemployment, housing and crime.	The establishment of SOEs in apartheid South Africa created the conditions for skewed development aims, irregular infrastructure and service delivery, and a host of structural problems. Since 1994, these have limited the ability of SOEs to adjust to new requirements and new policies.
1995: GEAR The Mandela administration began to re-introduce South Africa into the global economy by implementing a market oriented economic plan.	Speeding up the restructuring of State assets to optimise investment resources. The implementation of the public sector asset restructuring programme, including guidelines for the governance, regulation and financing of public corporations, and leading off with the sale of non-strategic assets and the creation of Public-Private Partnerships in transport and telecommunications.
2004: AsgISA AsgISA originated from a commitment made by the ANC in its 2004 election manifesto to halve unemployment and poverty by 2014. To this end and with other stakeholder inputs, Government developed a focused set of initiatives to accelerate shared growth.	The policy was meant primarily to address the scourge of poverty. The policy intended to mandate the Government to halve poverty and unemployment by 2014. Steady improvement in the economy's performance and job creation capacity at the time convinced SA policy makers that these objectives were feasible and achievable.
2010: ANC National General Council Re-affirmed the commitment of the ANC to the Developmental State.	The ANC defined its understanding and vision of the key attributes of the South African Developmental State for the first time in 2007.
2010: New Growth Path (NGP) Re-affirmed the commitment of the ANC to a Developmental State.	The policy is meant to create decent work, reduce inequality and defeat poverty. The realisation is that this can only happen through a new growth path founded on a restructuring of the South African economy to improve its performance in terms of labour absorption as well as the composition and rate of growth.
2011: IPAP2 A plan to guide trade and industry in the country.	To enable the Department of Trade to continue with its efforts to build on its industrial development which, <i>inter alia</i> , will align to the NGP.
2011: NPC Located in the National Planning Department in the Presidency.	The purpose of the NPC is to develop the country's long term vision and national strategic plan as well as producing a development plan of how this vision will be achieved.

The PRC found that SOEs experience a lack of clarity with regard to the State's macro-policies and their specific roles within that policy, primarily due to the perceived proliferation of fragmented policy documents some of which are characterised by limited timeframes.

Thus the PRC is of the view that this critical policy and management practice gap constitutes a legitimate case for a coherent national plan on SOEs. Such an overarching SOE strategy should take into account the clearly articulated and communicated vision and plan for South Africa's Developmental State, as well as sector specific strategies aligned to the Developmental State.

The SOEs' overarching strategy should also entail a clear national framework, established at the national Government strategy and policy level, and should therein set out the following critical elements:

- A clear vision and strategic objectives for SOEs;
- A schedule of strategic sectors and priorities for the State with common national criteria for establishing priority SOEs;
- An outline of the role of Government as an owner, executive authority, policy maker, regulator and an operator;
- An SOE performance scorecard for SOEs that balances the tension between commercial objectives on one hand, and non-commercial objectives on the other hand;
- A consistent and clear naming, definition, and strategic categorisation of SOEs;
- A comprehensive strategic portfolio approach in line with the Developmental State objectives; and
- An international and regional SOE strategy and engagement.

The overarching strategy should be based on a vision of SOE contribution to the Developmental State mission and objectives and have clearly specified and tangible performance criteria.

2.3 KEY ELEMENTS OF AN OVERARCHING STRATEGY FOR SOEs IN SOUTH AFRICA

2.3.1 Introduction

Within the context of the need for an overarching strategy for SOEs, it is imperative to examine the present nature of SOEs and the SOE environment. This includes an exploration of the following:

- The definitions, nature, and character of SOEs in South Africa, as well as their location in the broader structure and scheme of the public and private sectors and of all spheres of Government;
- The extent to which SOEs respond to the long-term plan and the balancing of commercial, socio-economic and political objectives, especially as a key distinguishing feature of SOEs compared to the private sector; and
- The understanding of South Africa's strategic sectors and assets as crucial leverage to achieve the agenda for SOEs.

2.3.2 Common understanding of SOEs

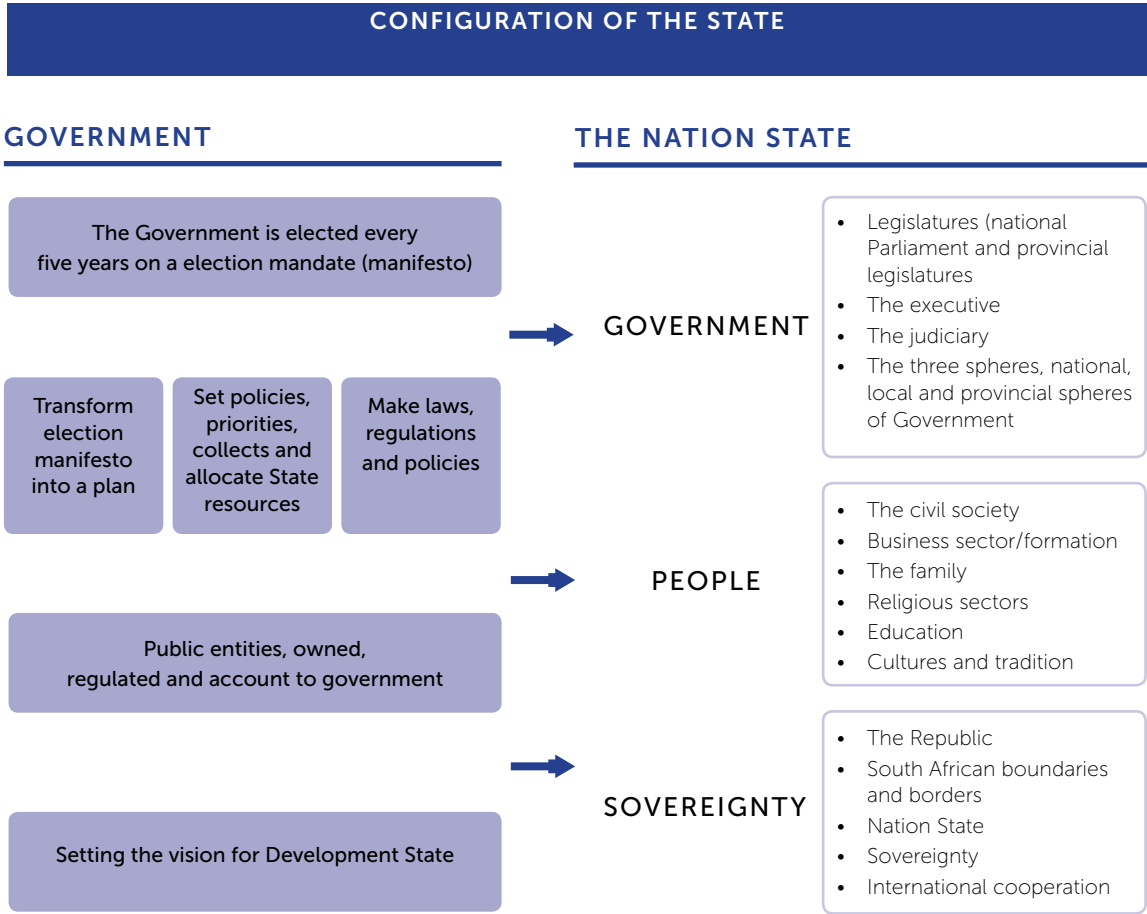
2.3.2.1 Background

A common understanding of the definition and meaning of SOEs by all stakeholders (customers, investors, and citizens or taxpayers; owners/ shareholders or Government departments in particular) is crucial and is the basis for planning by the State.

The understanding of SOEs should be based on a common understanding of the concept and configuration of the "State" as illustrated in figure 7 to follow. Confusion often arises if the Government and the State are treated as one and same. It is important to spell out the difference between the State and the Government; this will provide a clear conceptualisation and will help to locate the ownership of SOEs by the State. The State is an inclusive term that encompasses all societal formations such as Government, people, and the issue of sovereignty. Such shared understanding will better enable the State to communicate a clear strategy for SOEs to all stakeholders.

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Figure 7: Configuration of the State



The policies, legislation and the key terminology of Government are summarised in figure 8 to used to denote SOEs in the three spheres follow:

Figure 8: Terminology used across the three spheres of Government

	Public entities	Policies and laws	Key terms used
National public entities	Economic development Infrastructure development Education and training	<ul style="list-style-type: none">RSA constitutionPFMACompanies ActEstablishment actsDepartment protocolsExecutive authority regulations	<ul style="list-style-type: none">State-owned entitiesState-owned enterprisesParastatalsGovernment-owned business enterprises
Provincial entities	Supporting democracy Service delivery Regulatory services Research and development	<ul style="list-style-type: none">RSA ConstitutionPFMACompanies ActEstablishment actsProvincial department policies, regulations and protocolsProvincial legislations	<ul style="list-style-type: none">Public corporationsPublic entitiesPublic enterprisesMunicipal entities/ Enterprises
Municipal entities	Statutory advisory Agencies Financial intermediaries	<ul style="list-style-type: none">RSA ConstitutionPFMAMFMAMSACompanies ActCouncil policies and by-laws	<ul style="list-style-type: none">State-owned companiesCommercial SOENon-commercial SOEGovernment-owned corporationGovernment entities

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

2.3.2.2 Observations on common understanding of SOEs

The PRC review of terminology used to denote SOEs has given rise to a number of observations:

- While the Constitution of the Republic of South Africa refers to ‘public enterprises’, the main sources of terminology for State entities do not use the term. In South Africa there are three main sources that provide a definition of State entities and yet these do not converge. They are the Public Finance Management Act No 1, 1999 (PFMA), the Companies Act No. 71 of 2008 (these cover entities owned by the national and provincial spheres of Government); and the Municipal Systems and Structures Act No.32 of 2000, which defines entities, owned by the local Government sphere.
- Much confusion arises from the fact that what would be called State-owned ‘enterprise’ or ‘business’ or ‘commercial’ or ‘company’ is signified differently by the PFMA and the Companies Act (e.g., reference to ‘State-owned enterprises’ and ‘State-owned companies’ in the Companies Act does not appear in the PFMA). The PFMA categorises public entities as major public entities; national public entities; provincial public entities; provincial Government business enterprises; or national Government business enterprises. The Companies Act makes provision for some form of categorisation and definition of various SOEs. It regulates matters such as private ownership and public ownership, and makes provision for distinctions in terms of commercial entities and entities for surplus. Recently, the Companies Act has also been amended to provide for what it refers to as ‘State Owned Company Ltd’ (SOC Ltd).
- Assuming the PFMA is currently the main legislation governing State entities, the manner in which the definition and classification of all State entities is treated in the PFMA is not sufficiently comprehensive to deal with terminology confusion and the implications thereof (refer to chapter 3).

The PRC is concerned that South Africa is flooded with terminologies that refer to State entities and the lack of a coherent and common understanding of such entities by Government, as well by SOEs in particular.

Interviews conducted with different Government departments, as well as with SOEs themselves, confirm that there are vast differences of interpretation of what constitutes an SOE. In the survey conducted by the HSRC, for example, the findings indicate that:

- Most State entities identify or define themselves as simply ‘Government- or State-owned’ (88%), with a few perceiving themselves as ‘strategic’ (6%);
- Only 64% of SOEs believe they fulfil the characteristics of a State-owned entity, with the rest hesitant to make such a claim. Reasons for this uncertainty include:
 - Being established by the State but operating ‘independently’;
 - Not being registered or listed in an act, such as the Companies Act or the PFMA;
 - Being ‘partly not owned by the State’, that is, not established by any act, but listed in the PFMA;
 - Being listed in the PFMA, therefore partly an SOE; and
 - Being a public company listed on the JSE where ‘the State is a major shareholder’.

Others perceive the difference because ‘SOEs’ are supposed to be ‘commercial’ and independent whereas ‘State entities’ are more ‘social welfare’ and ‘Government-owned’.

International experience

The PRC review of different jurisdictions indicated the following:

- Various states in the world have different naming conventions for their entities and use them consistently. For example, India uses the name ‘Government companies’ to denote commercial entities or companies in which the State has a majority shareholding.

- In many countries the extent of ownership by the State (although no common formula has been developed based on the size of shareholding) based on classification, as well as the function and criticality of the entity to

the State’s objectives and strategic priorities are key considerations. For example, in China the State-owned enterprises are categorised according to strategic industries as shown in table 8.

Table 8: Categorisation of State-owned enterprises in China

Category/class	Industry included	Ownership objective	Number of SOEs
Strategic and key industries	Defence, power generation and distribution, telecom, oil and petrochemical, coal, civil aviation, shipping.	Maintaining 100 percent State ownership or absolute control; Increasing State-owned assets in these industries.	40
Basic and pillar industries	Machinery, auto, IT, construction, steel, base metals, chemicals, land surveying, R&D.	Absolute or conditional relative controlling stake; enhancing the influence of State ownership even as the ownership share is reduced where appropriate.	60
Other industries	Trading, investment, medicine, construction materials, agriculture, geological exploration.	Maintaining necessary influence by controlling stakes in key companies; In non-key companies State ownership will be clearly reduced.	40

Source: OECD, 2009b.

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

- Countries also sometimes categorise their entities differently depending on their developmental objectives, thus including ‘economic or commercial’ and ‘strategic’ entities, as well as ‘service rendering’ and ‘welfare’ or ‘public benefit’ entities. China, for instance, also categorises enterprises according to economic attributes. Chinese State-owned enterprises are therefore grouped into three types:
 - Natural monopoly or oligopoly**
 - Capability of production control or market pricing by itself or in concert with others;
 - Main measures by Government should be market actions and price control;
 - For those with high profit, Government should control employee income.
 - Companies with special objectives or public interest**
 - Clearly state the relationship between commercial objectives and non-commercial ones; and
 - Clearly calculate the cost of realisation of non-commercial objectives, disclose this, and disclose how the cost will be covered.
 - Competitive companies**
 - The main objective is capital returns.
- Categorising entities according to developmental objectives is further qualified by the type of ownership or ownership objectives of the State in each class of entities. For example, in what is called ‘strategic and key industries’ in China, the State owns a full 100%.

2.3.2.3 Categorisation of SOEs in South Africa

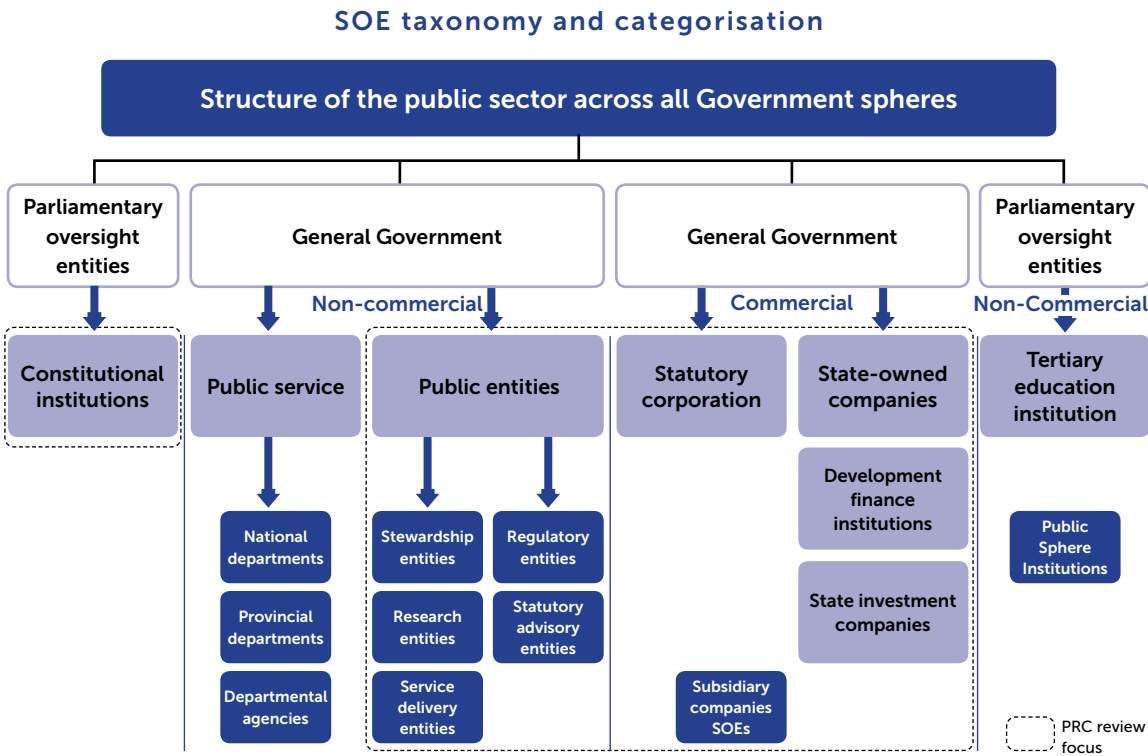
The National Departments of Treasury and Public Service and Administration developed a

- categorisation framework that seeks to facilitate standardisation and transparency, and to improve the review and oversight of existing and future entities. The categorisation framework was developed with the following underpinning principles:
- The framework must promote the basic values and principles governing public administration as set out in chapter 10 of the Constitution;
 - It must clearly define an exclusive list of allowed corporate forms;
 - It must provide the possibility of a growth path towards greater autonomy;
 - It must facilitate standardisation and transparency, and the improvement of the review and oversight of existing and future entities; and
 - It must identify and provide a set of definitions and standard attributes for each of the corporate forms.

The National Treasury/DPSA categorisation framework was reviewed by the PRC in conjunction with the current classification of municipal entities in the MFMA. The conclusion reached by the PRC review was that the categorisation of municipal entities could be expressed and adapted to the categorisation framework developed by National Treasury and the DPSA.

See figure 9 for the PRC categorisation considered in its review. All current and future legislation should conform to the single naming and definition standard.

Figure 9: SOE taxonomy and categorisation



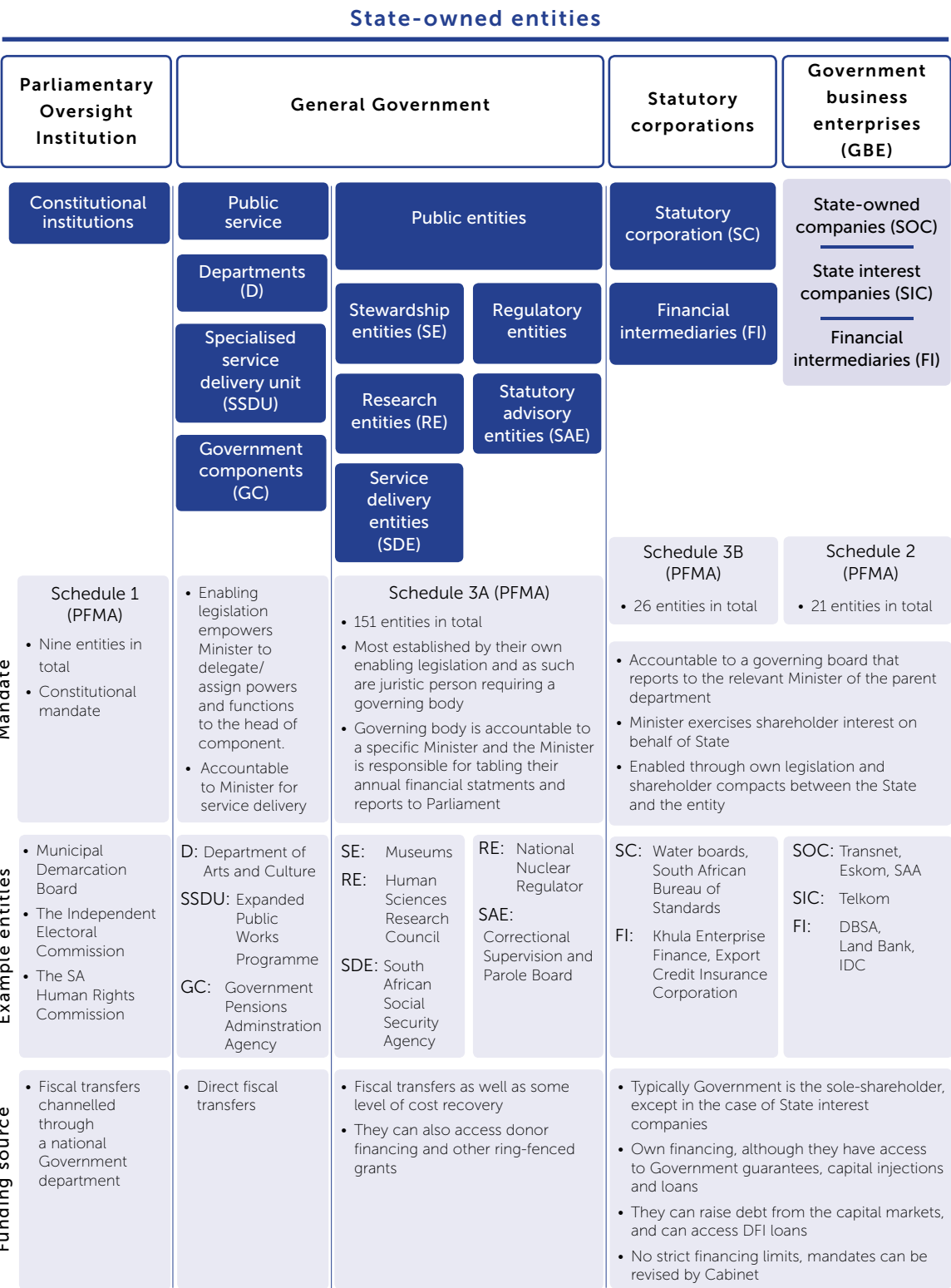
Note: The highlighted black-dotted circles illustrate the SOEs that were included in the PRC review.

For the review, the PRC focused on public entities as well as Government enterprises, including the constitutional entities.

Figure 10 captures a good application of the above proposed categorisation of SOEs. The application was made by Business Unity South Africa in its submission made to the PRC.

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

Figure 10: SOE categorisation framework



Source – Adapted from National Treasury/DPSA categorisation framework.

The definition of the SOE categories in the categorisation framework above is drawn from the National Treasury. Table 9 describes each entity class:

Table 9: Description of the taxonomy categories

Categories	Classes	Description
General Government – public entities	Stewardship	Acts as steward of natural, cultural or other national assets on behalf of citizens.
	Research	Undertakes primarily public interest or merit research.
	Service delivery	A public entity tasked with the delivery of well-defined goods or services that are not regulatory or advisory service.
	Regulatory	A public entity established to perform regulatory or quasi-judicial functions in a manner that enhance public confidence in the level of independence and expertise underpinning its rulings and decisions.
	Statutory advisory	A statutory advisory entity renders independent, expert advisory services to a specific Minister or to Government as a whole. Experts serving on advisory entities are not public servants.
Government enterprises	State-owned companies	All Government enterprises are “private” companies registered in terms of section 32 of the Companies Act, 1973 over which the State exercises ownership control, or in which the State has a material interest.
	Financial intermediaries	A statutory corporation involved in financial intermediation or with banking or quasi-banking objectives.
	State investment companies	A private business enterprise with commercial objectives in which the State, a statutory corporation, a State-owned company or a subsidiary of a State-owned company does not have “ownership control”, but still retains a material interest.
	Statutory corporations	A Government enterprise that the Government has established to supply on commercial basis specific goods or services that are of a strategic nature – in the sense that they address specific market inefficiencies and development objectives.

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These SOEs are defined as follows:

- The name ‘**State-owned enterprises**’ must be used to refer to incorporated and non-incorporated commercial entities, and the name ‘public entities’ must be used to refer to all non-commercial entities.
- A State-owned enterprise is a legal entity created by Government to undertake commercial activities on behalf of the owner, Government. Their legal status would vary, from being a part of Government to being public companies with the State as a shareholder. State-owned enterprises should refer to business entities established by national, provincial or local Governments, whose supervisory officials are from the Government. This definition should include, *inter alia*:
 - Wholly (100%) State-funded entities;
 - Partially State-funded entities, including:
 - 50+1% single-majority holding by the State;
 - 50+1% majority shareholding together with the DFIs and/or PIC; and
 - where the State owns significant share equity in the entity or company.
- A ‘**public entity**’ is an entity that is created and owned by Government to undertake certain functions of Government with the purpose of improving service delivery and other forms of public benefits to citizens.
- On the other hand, a ‘**State-owned entity**’ is a generic term used inclusively to denote all types of entities, commercial and non-commercial, as applied in this review.

2.3.3 Strategic sectors, priority SOEs and value creation

2.3.3.1 Introduction

A precise demarcation is needed to indicate which industries and companies the South African Government considers strategically important. Such understanding will establish whether the State’s participation through SOEs

in various sectors of the economy is necessary in all instances, and whether these organisations create value for the economy and the country’s citizens. It is also necessary for developing clearer guidelines on how tightly these companies ought to be controlled, i.e., the extent of Government control in terms of sole ownership of an entity, regulation of an industry, etc.

International benchmarking confirms the need for establishing strategically important sectors and prioritising SOEs accordingly. It is also crucial that strategic sectors be gazetted (as is the case in Russia and China) to ensure policy alignment, consistency in implementation, and institutional focus, all of which contribute to creating business and public confidence and maximising the impact of SOEs.

There are five common reasons for the State to maintain involvement in the economy, namely natural monopolies; investment returns used to support budgetary objectives; national economic security; capital market failure; and social and development goals. One of the biggest challenges post-1994 was the question of a clearly articulated purpose for existing SOEs and the strategic rationale for creating new SOEs. In the South African context in particular, if developmental objectives such as rural development, youth development, skills development and the creation of a more inclusive society are to be achieved, then the role of SOEs in stimulating economic activity, creating jobs and infrastructure rollout in marginalised communities needs careful examination.

The following headline statistics confirm the strategic role that SOEs presently occupy in the South African economy (see the figure 11):

- The share in the economy occupied by the major SOEs (total revenue expressed as a percentage of GDP) is estimated to be 8.7%;
- On a sectorial basis, transport (28.8%), followed by energy (27.3%), communications (16.2%),

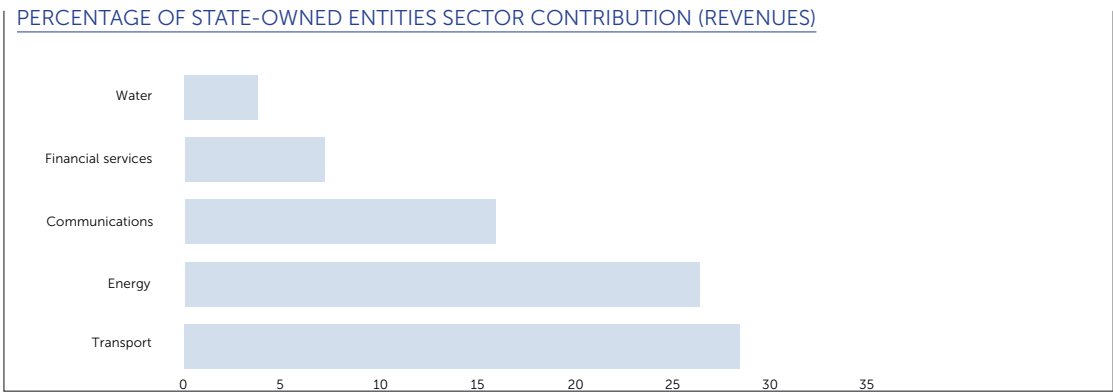
financial services (8.03%), and water (3.61%) account for a significant percentage of revenue generated by SOEs in the sector; and

- The PFMA’s schedule 2 SOEs’ share of total revenue (revenue percentage contribution to all SOEs by sector) currently stands at 71.6%.

In mapping the role that SOEs fulfil in the economy (see Table 10), it becomes clear that in the large majority of cases there are distinct

reasons for the existence of most schedule 2 and some schedule 3 entities. Revenue generation is not the only significant contribution of SOEs. They also contribute to socio-economic development such as rural electrification, telecommunications penetration, security of supply of fuel etc., as all of these remedy market failure and highlight the strategic importance of well-run SOEs.

Figure 11: Percentage of SOEs sector contribution (revenues)



Source: PRC-KPMG, 2010.

Table 10: Roles of large commercial SOEs in the economy

Reason for State involvement	SOE
Natural monopolies	Eskom, Transnet, water boards, SANRAL, ACSA
Investment returns	IDC, DBSA, Land Bank
State and economic security	Denel, CEF, PetroSA, Armscor, TCTA, Water Boards
Social or developmental goals	Post Office, Post Bank, SABC, SETA’s, SAFCOL
Market failures	IDC, DBSA, Land Bank, NEF
Unknown	Sentech, Broadband Infraco, Investment in Telkom, SAA

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

2.3.3.2 International benchmarks for identifying strategic sectors

In 2008, **Russia** identified and gazetted (Rossiiskaya Gazetta, 7 May 2008) 15 broad sectors or industries of strategic importance. This law also seeks to clarify the rules for foreign investors interested in acquiring control over strategic entities or access to strategic natural resource deposits. In addition, the Russian experience shows that the list of strategic entities tends to be modified over time, adding or dropping companies and industries from the list. The Russian strategic sectors include:

- Defence;
- Cryptography;
- Security activities;
- Aerospace and aviation;
- Nuclear;
- Production of goods and services related to natural monopolies;
- Geological research and/or exploration and extraction of natural resources;
- Fishing;
- Production and sale of metals and alloys having special properties and used in the production of arms and military machinery;
- Television broadcasting, radio broadcasting, telecommunication services (excluding the Internet); and
- Publishing and printing.

The Government of **China** has also in recent years identified industries and companies that are strategically important enough for the State to maintain control over them. Seven sectors are considered strategically important because they relate to national or economic security. These are:

- Defence;
- Power generation and distribution;
- Oil and petrochemicals;
- Telecoms;
- Coal;
- Civil aviation; and
- Shipping.

The Government thus maintains absolute control in these sectors, either through sole ownership or an absolute controlling stake. The role of foreign and private investors is restricted to participating in developing downstream petrochemical products and value-added telecommunication products. In addition, the State also maintains significant absolute or relative controlling stakes in another group of industries described as pillar and basic industries. These include the following industries:

- Machinery;
- Auto;
- IT;
- Construction;
- Steel;
- Base metals;
- Chemicals;
- Land surveying; and
- R&D.

Finally, **Singapore** has one of the largest SOE sectors in the world, with entities in the usual sectors including:

- Telecommunications;
- Power (electricity and gas);
- Transport (rail, bus, and even taxi); and
- Airlines and Ports.

Singapore also has entities in sectors related to:

- Semi-conductors manufacturing;
- Shipbuilding;
- Engineering;
- Shipping, and
- Banking.

2.3.3.3 Observations and recommendations on the criteria for establishing strategic sectors and priority SOEs

The following observations have been made on the criteria for establishing strategic sectors and/or priority SOEs:

- The PRC could not trace any existing standard criteria and framework, at policy level across Government spheres, for the identification and

establishment of priority and/or strategic SOEs in South Africa.

- The current South African SOEs portfolio has evolved by default and historic coincidences such as sanctions rather than through a carefully planned, long-term vision and strategy.
- SOEs in South Africa straddle sectors that could be considered strategic, namely power generation and distribution; transport; mineral resources; telecommunications; oil and petrochemicals; water; and defence.

In examining which sectors are strategically important, it is necessary to assess the country's competitive advantage, degree of private sector participation and the potential impact on economic growth. For South Africa, the PRC examined key policy papers such as the National Planning Commission (NPC) report; the New Growth Path; and the IPAP2. It also conducted global research and examined international benchmarks to determine South Africa's current strategic sectors.

The New Growth Path in particular prioritises the following sectors as important based on the potential for job creation:

- Infrastructure;
- Agricultural value chain;
- Mining value chain;
- Green economy;
- Manufacturing sectors, which are included in IPAP2; and
- Tourism.

Also from a job creation perspective, the NPC lists the following sectors/industries as important:

- Agri/agro processing;
- Minerals/metals cluster;
- Manufacturing;
- Construction/infrastructure;
- Green economy;
- Finance;
- Retail/business services;
- Tourism; and
- Public sector.

The strategic importance and value creation of the key commercial entities was mapped in order to assess whether inferences can be drawn on the strategic importance of sectors. In this process, the value dimension was derived from the profit generated over a five-year period; the quality of services delivered; social transformational elements; and alignment to the developmental agenda. The strategic importance dimension was derived from interviews conducted by the PRC through PwC; PRC Seminar Series; international benchmarking; and an analysis of the extent of private sector participation. On the basis of these analyses, recommendations are made on potential strategic sectors.

In examining and identifying strategic sectors for South Africa's Developmental State, the following sectors should be considered:

- Agricultural development, *inter alia* food security;
- Defence;
- Construction;
- Energy;
- Finance and development finance;
- Green economies;
- Manufacturing;
- Mining;
- Telecommunications;
- Tourism;
- Transport, especially rail, ports and roads; and
- Water

The above process may also include a conclusive determination of areas where the private sector can make a valuable contribution.

The processes of identifying strategic sectors and determining priority SOEs should consider, among others, the following universal criteria:

- **Natural monopoly:** In industries where technological conditions dictate that there can be only one supplier, the monopoly supplier may produce at a less than socially optimal level and appropriate monopoly rents (e.g., electricity, water).

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- **Market failure:** The private sector may refuse to invest in industries that have high risk and/or long gestation period for example capital intensive, high-technology industries in developing countries (e.g., steel industry).
- **Externalities:** Private sector investors do not have the incentive to invest in industries that benefit other sectors/industries without being paid for the services (e.g., infrastructure such as broadcasting signals and broadband).
- **Equity:** Profit-seeking firms in industries that provide basic goods and services may refuse to serve less profitable customers, such as poor people or people living in remote areas (e.g., water, postal services).
- **Security of supply:** Pertains to nationally determined availability and supply of scarce and/or essential commodities.
- **Competitive advantage:** Leveraging the country's resources (e.g., natural resources, geographical positioning, strong financial sector and knowledge-based sector).
- **Constitutional imperatives:** Enhancing democracy and social cohesiveness as per the prescripts of the Constitution.
- **Development failure:** This occurs when for example organisations fail to implement their mandates, or where there is capacity failure due to lack of skills to manage development in public institutions. It may also occur where there is information failure and where the public and markets fail to alleviate recurrent developmental challenges.

2.3.3.4 Strategic utilisation of SOEs in regional development

Strategic SOEs are candidates for more active roles in the African and Southern African region. Engagements with SOEs, however, indicate that there is no clear strategy or policy on the role of SOEs in SADC or Africa. The current approach seems to be a failed opportunistic approach, as in the case Eskom Enterprise in Nigeria; Transnet in Zambia; and Telkom in Nigeria.

Regional development is an imperative for sustainable growth. This, however, cannot be done by the public sector alone and it requires close collaboration with the private sector. The New Growth Path estimates that approximately 150 000 jobs can be created by 2020 through increased exports to SADC and with additional employment growth arising from South Africa's position as a financial, logistics and services hub, as well as from collaboration around regional infrastructure and investment. The International Monetary Fund Direction of Trade statistics lists Africa's intra-regional trade at 12% (SADC is at 15%), while Western Europe is at 61% and Asia-Pacific is at 39%. Expanding trade in the region could provide significant lift to future growth. The role of SOEs in regional development must therefore be made explicit within national policy.

2.3.3.5 Strategic consolidation, rationalisation and investment

Over the years, there has been a proliferation of SOEs at national, provincial and local levels. The PRC identified sectors or industries where this proliferation is especially concerning, and therefore require strategic consolidation or rationalisation. These were primarily commercial SOEs, SETAs, water boards and DFIs. The PRC also identified sectors that require greater investment by the State to support these key economic sectors, namely mining, tourism, agriculture and agro-processing, and SMMEs.

2.3.3.6 Management for value and the portfolio approach

Value creation through State entities cannot be limited to economic value. The developmental role of SOEs is not unique to South Africa and in most other countries SOEs have distinct profit and non-profit objectives, such as provision of basic services, industrialisation, employment generation and social transformation. In the survey of SOEs conducted, every entity highlighted the tension between profit and non-profit objectives,

indicating that there is ambiguity regarding the expectations from the owner/shareholder.

It is imperative that the tension between profit and developmental objectives be managed. This must be done by being explicit on economic returns on invested capital and by clearly identifying non-profit objectives. In the case of the large schedule 2 entities, economic return will often be measured through the return on the market value of the equity. For companies in which the State has a shareholding for commercial reasons, such a return is the key performance indicator. For companies with sectorial policy objectives that do not operate in a market or administer a monopoly, e.g. water boards, return requirements should be balanced with other targets related to service delivery and efficiency. Thus, a long-term perspective on investments and expected return on investments must take into account developmental objectives and targets. And further, such objectives must be defined and the opportunity costs clarified.

Adopting a portfolio approach for managing State entities will enable the State to assess the economic value contribution of commercial SOEs. According to KPMG data, in 2010 schedule 2 entities contributed in excess of 8% of GDP. However, despite increasing revenue growth of these entities, there is a decline in their contribution to GDP since 2006, indicating the diminishing contribution of SOEs in stimulating economic growth. However, with the proposed massive multi-billion rand infrastructure investment envisaged in the next five MTEF years, the SOEs GDP contribution is going to increase significantly. This further underpins the important role that the SOEs are expected to play.

Appropriately, categorising State entities will create focus on managing the portfolio of SOEs better, thereby enhancing capacity to ensure sustainable financial performance and delivery financial returns, quality services and development objectives.

2.3.4 Balance of social, economic and political imperatives for SOEs

2.3.4.1 Background

The performance of SOEs in Developmental States is measured differently from those of private companies. SOEs are created by Government to support strategies for economic development and to promote public interests. However, such entities are often challenged with trying to strike a balance between the interests of the public and the revenue and profitability targets. There is a natural conflict between the commercial interests of SOEs and the State's developmental interests. In addition, at any given time there are multiple stakeholders' expectations of SOEs. Many countries are therefore searching for ways to strike the correct balance between economic imperatives and socio-political objectives.

Several Governments have successfully implemented performance management models to support the drive towards a balance of these two key objectives. In these instances, there is greater focus on defining an SOE and its core mandate. Enhanced clarity on definitions and purposes of an SOE will allow for a more accurate balance of performance objectives and management strategies. With this clarity, the owner/shareholder will be able to support the funding needs of the entity to deliver on determined objectives, and real and tangible results can be realised.

For example, Telkom, in a submission made to the telecommunications regulator, ICASA, acknowledged that Governments across the globe advocate universal service and universal access policies and programmes so as to attain their strategic goals, in particular to 'bridge the digital divide'. This is achieved by:

- Driving physical proximity/ownership to electronic communication services in areas where it may be uneconomic for licensees to provide services; and
- Facilitating affordable electronic communication services where residents

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cannot afford access to the services available at their locations.

In South Africa, the inequalities in telecommunication resources exist not only along national lines (urban and rural), but also along race and class lines. To this extent, policy directives and legislation, from the 1996 white paper, the Telecommunications Act of 1996, through to the Electronic Communications Act of 2005, have over the years been geared to articulate a vision that balances the provision of basic universal service to disadvantaged rural and urban communities with the delivery of high level services capable of meeting the needs of a developing South African economy. This reflects the challenge of balancing socio-political imperatives with economic or financial objectives.

It is noted that despite all of the above legislative amendments, changes in the licensing regime, as well as other significant market forces, the regulatory framework on universal service and universal access has not been reviewed since the initial set of Universal Service and Universal Access Obligations (USAOs) that were imposed on the licensed operators as far back as 1997 when Telkom was first issued with its PSTS licence. However, it is noted that the implementation and maintenance of existing USAOs has left the country with valuable experience that cannot be overlooked going forward. Among others lessons that can be cited include:

- The disconnect between roll-out targets and issues of affordability, culminating in mass disconnections and wasteful investment;
- The failure to achieve a 'techno-centric' obligation e.g., Public payphones;
- The uncoordinated and selective rollout of CSTs, mainly in commercially viable areas, that has left most of the contemplated needy areas un-served; and
- The unfortunate setback arising from the lack of proper mechanisms to facilitate and monitor the implementation of obligations.

2.3.4.2 Observations and recommendations on the balance of social, political and economic imperatives for SOEs

On the whole, South Africa's SOEs would seem to have mixed results when assessed against the competing but equally prioritised economic and socio-political objectives. South Africa is not immune to the challenge of using its SOEs to extend their service and product offerings for socio-economic purposes.

The existing oversight matrix seems to be convoluted and overbearing. Management of the SOEs is through a mix of ministerial guidance as well as internal and external stakeholders (e.g., owners/shareholders and credit providers). Entities are managed through diverse methods ranging from direct ownership relations with specific ministries (e.g., Ministry of Public Enterprise) to dotted line relationships with policy ministries (e.g., Eskom's relationship with the Ministry of Energy). The oversight model results in non-standardised requirements and approaches in many areas. Approaches to the interpretation and treatment of social, political and economic objectives reflect a similar lack of uniformity across various ownership/shareholder ministries. Equally, performance assessment of such indicators, where applicable, is not standardised. Other existing governance processes outside of the organisation, such as regulators and Parliamentary Oversight Committees, are also a consideration in the mixed oversight model.

South Africa's SOE oversight model is not transparent in articulating output indicators for the entities, particularly those of a socio-political nature. There are multiple stakeholders demanding attention. Performance measurement by the various demanding stakeholders on socio-economic objectives is inadequate and disjointed. Collaboration between ministries and between SOEs is ad hoc.

The natural focus for most SOEs has been to manage narrow, short-term commercial objectives in line with capital markets return-requirements, while ignoring more pressing, wider and longer-term viability and sustainability related challenges and objectives.

To achieve that balance, the Government should adhere to a clear set of principles:

- Recognition of the unique nature of SOEs for balancing service delivery, viability and delivery on socio-economic imperatives;
- Identification and articulation of socio-economic and political objectives;
- SOEs must deliver on their core objectives in a viable/sustainable manner;
- Identified objectives should be included in the shareholder compacts;
- Objectives should align with the developmental goals of the State;
- Recognition of costs associated with delivery of essential but non-commercially viable mandates and the State must enter into funding arrangements with each SOE;
- There should be structured M&E of performance against identified objectives; and
- The application of these principles should take into account the proposed categorisation framework for SOEs.

The South African economy has evolved since the establishment of many of the SOEs. Furthermore, the rationale for the establishment of SOEs during the apartheid era and those established in the post-1994 dispensation require reconsideration and alignment to contemporary Government priorities. This, coupled with a changing economic context, necessitates a review of the mission and goals of SOEs. In the absence of regular, managed reviews of a country's portfolio of SOEs it is possible that SOEs could end up being misaligned with their founding goals or could be totally misaligned with the existing economic and socio-political needs of the country.

The PRC would like to emphasise that community service obligations need to be directly related to the Government's developmental outcomes; be specified in explicit contractual or performance arrangements with entities; and administered with a high degree of transparency and accountability, as well as subsidisation where it pertains to commercial enterprises ('Community Service Obligations: A Policy Framework', Queensland Treasury, March 1999).

In requiring SOEs to lower their charges for products and services to certain groups of consumers as a community-service obligation, for instance, the SOE would no longer operate with a truly commercial focus. This could undermine the incentives for the entity to improve its efficiency and operate to the best of its ability. Whilst it is by and large the Government's responsibility to provide such services, it is equally essential to understand that Government uses the length and breadth of its organisation and structures to ensure that the services are delivered.

SOEs are not ordinary commercial enterprises. They have a mandate to achieve longer-term strategic economic, social and political objectives. This obviates the need for the argued delicate balance. If the strategic objective subverts commercial and economic discipline, the enterprise might fail to achieve viability. If the commercial considerations override strategic social purposes, Government objectives will be compromised. The owner/shareholder should acknowledge and recognise that the extended social and political imperatives required of the commercial entities are additional tasks and are not funded. Further, these put pressure on the otherwise expected viability and sustainability of these entities. However, with the appropriate capacity, reach and skills of the entity, the owner/shareholder, through alternative support measures, may ensure that the balanced objectives are deliverable.

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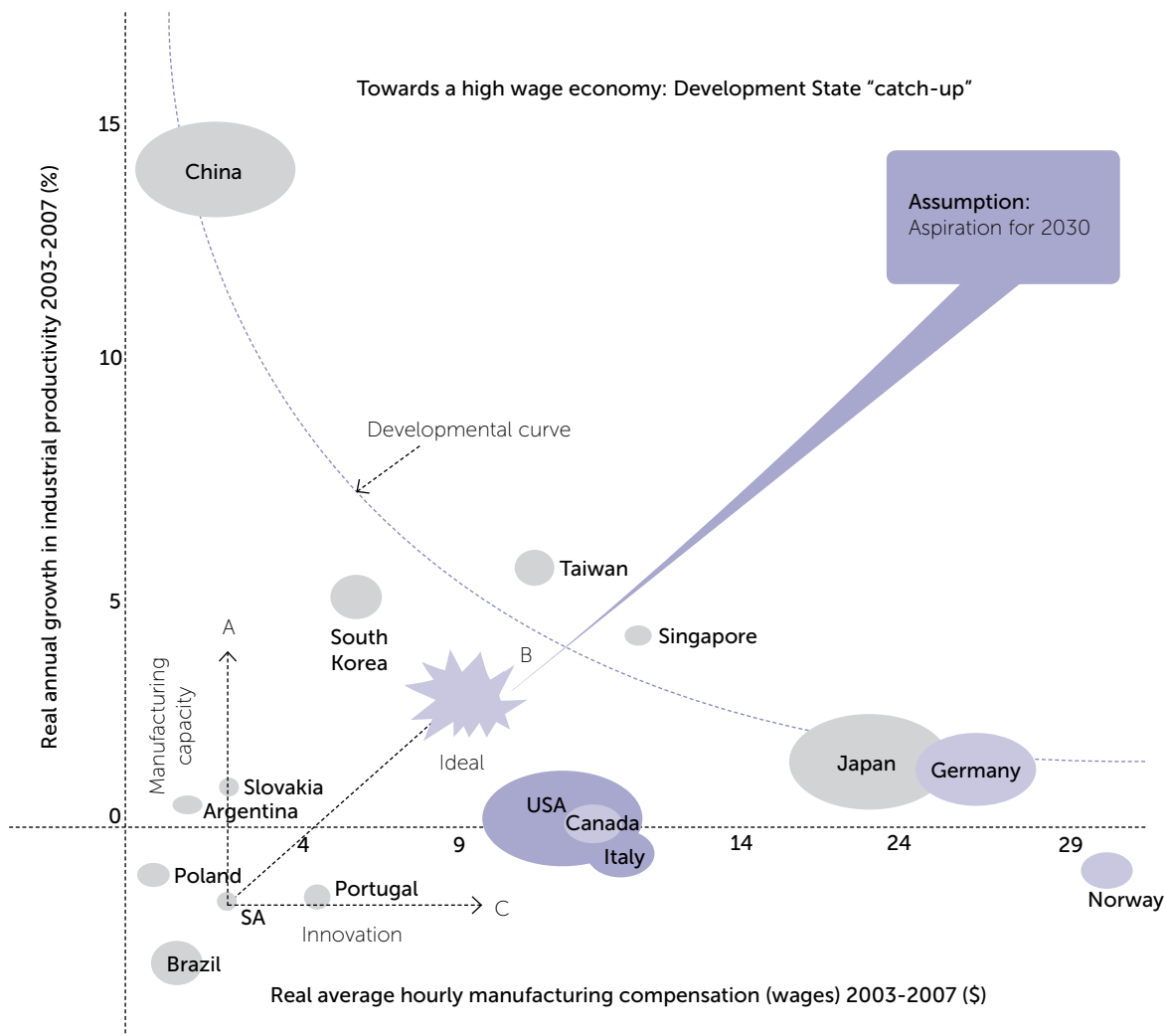
2.4 TOWARDS AN OVERARCHING STRATEGY FOR SOES IN SOUTH AFRICA

2.4.1 Initial elements of a vision for State entities

The above contextualisation of the Developmental State for South Africa has shown what a Developmental State orientation would involve and the incremental steps needed to bring it in line with the most successful developmental countries. Figure 12 depicts the developmental nature of South Africa relative to a number of

other countries. It compares real annual growth in industrial productivity against real average hourly manufacturing compensation for the period 2003 to 2007. It also reflects the fact that South Africa is a relatively low wage economy with a relatively low level of industrial productivity. It is therefore imperative to ask what steps South Africa must take to bring it closer to the developmental curve. The figure above illustrates the growth trajectory needed for South Africa to move it closer to the developmental curve. Broadly, South Africa will have to invest in industrial production capacity

Figure 12: Towards a high-wage economy: Developmental State ‘catch-up’



Source: Economist Intelligence Unit (EIU), US Bureau of Labor Statistics, Quantec, World Development Indicators.

- and in creating a knowledge-based economy and society (move towards B path indicated by a red arrow). This will require a number of bold initiatives that include:
- A cohesive Government-led developmental vision with clear objectives;
 - A development-oriented leadership to drive the developmental vision;
 - A partnership between Government, the private sector, labour and civil society to build coherent momentum;
 - The maintenance and expansion of local manufacturing capacity in key industrial sectors;

- The creation of an environment conducive to inflows of foreign direct investment (FDI); and
- A strategic and focused use of State-owned enterprises.

To this end, all State entities would play an important role in achieving the vision of the State in line with the eight characteristics of South Africa’s Developmental State. Table 11 indicates the roles that both commercial and non-commercial entities could play.

Characteristic	SOE role	Commercial SOEs	Non-commercial SOEs
Shared developmental vision	• Align SOE strategy with developmental mandate and country’s long-term vision as espoused by the National Development Plan.	✓	✓
Developed skills and innovation	• Develop SOE specific skills; • Use existing and new training infrastructure to develop technical and scarce skills like artisans, engineers, accountants, etc.; • Integrate to the National Plan for High Education strategy e.g., provide work place experience for students; • Increase research and development spend for further innovation; and • Intellectual property retention.	✓	✓
Partnership with private sector	• Partner with private sector in PPPs that work and have mutual benefits e.g., build healthcare centres, provide additional capital for infrastructure development. Partner to give effect to the long-term country vision.	✓	✓
Improved infrastructure	• Use capital spend to drive infrastructure and equipment procurement projects; • Leverage balance sheet to raise capital on the capital market; • Identify opportunity and grow the SME sector thereby creating and enabling entrepreneurs to flourish. Promotes transformation; and • Integrate to IPAP2 to promote strategic sectors and create opportunity to increase local manufacturing capability.	✓	✗

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

Characteristic	SOE role	Commercial SOEs	Non-commercial SOEs
Increased economic growth	<ul style="list-style-type: none">• Partner with companies that can:<ul style="list-style-type: none">◦ provide additional capital; and◦ introduce new technologies, processes and markets;• Integrate to the New Growth Path e.g., use DFIs to fund new strategic economic areas where there is no private sector appetite;• Integrate to IPAP2; and• Increase effectiveness and efficiencies of the operations.	✓	✗
Improve service delivery	<ul style="list-style-type: none">• Access to basic services; and• Provide service delivery effectively and efficiently.	✓	✓
Improve quality of life	<ul style="list-style-type: none">• Job creation, poverty relief, improve health; and• Deal with corruption decisively.	✓	✓
Strengthen democracy	<ul style="list-style-type: none">• Practise good governance.	✓	✓

Source: Adapted from Chang, 2010(b).

Furthermore, the PRC concurs with the strategic sectors identified in the New Growth Path, the National Industrial Policy Framework, and the strategic role of the National Planning Commission, in further consolidating all strategic frameworks into a single long-term plan. In

that context, the role of SOEs could be clearly articulated. An example of the envisaged strategic sectors and the role of SOEs are depicted in the table 12. These could be further specified and be implemented by the central SOE authority (as proposed in chapter 3).

Table 12: Strategic sectors and the role of SOEs

Strategic sector (NDP)	NGP	IPAP 2	SOEs and capacity
Manufacturing		<ul style="list-style-type: none">• Automotives components, medium and heavy commercial vehicles;• Plastics and chemicals;• Advanced manufacturing;• Forestry, paper and pulp, furniture;• Pharmaceuticals;• Clothing, textiles and footwear, leather; and• Metals fabrication, capital and transport equipment.	<ul style="list-style-type: none">• DFIs e.g., IDC and NEF;• Research entities e.g., CSIR;• National and provincial trade and investment companies; and• <i>DTI, NPC, DME, Treasury, private sector.</i>
Agriculture value chain		<ul style="list-style-type: none">• Agro – processing.	<ul style="list-style-type: none">• DFIs e.g., Landbank;• Research entities e.g., Agricultural Research Council;• SOC e.g., Mpendle-Ntambana Agric. Co; and• <i>DAFF, DTI, Treasury, private sector.</i>
The green economy		<ul style="list-style-type: none">• Green and energy saving industry; and• Bio fuels.	<ul style="list-style-type: none">• Research Entities e.g., CSIR;• Tertiary education institutions e.g., universities; and• <i>DEAT, DTI, EDD, DST, NPC, DME, Treasury, private sector.</i>
Infrastructure	<ul style="list-style-type: none">• Logistics;• Infrastructure:<ul style="list-style-type: none">◦ Industrial;◦ Energy (power);◦ Telecommunication;◦ Transport; and◦ Water.		<ul style="list-style-type: none">• State-owned companies e.g., Transnet, Eskom, Telkom, Sentech, PRASA, national and provincial trade and investments companies;• DFIs e.g., DBSA, PIC; and• <i>PIIC, NPC, DPE, DME, DOT, DWAF, EDD, Treasury, private sector.</i>
Knowledge economy	<ul style="list-style-type: none">• Healthcare;• ICT;• Mining related technologies; and• Bio technology.		<ul style="list-style-type: none">• Research entities e.g., CSIR;• Tertiary education institutions;• State-owned companies e.g., Transnet, Eskom;• Private sector; and• <i>DST, DTI, EDD, DME, Treasury, private sector.</i>
Tourism and culture industries	<ul style="list-style-type: none">• High-level services.	<ul style="list-style-type: none">• Craft and film; and• Business process services.	<ul style="list-style-type: none">• Stewardship entities e.g., arts and culture councils, KZN Film Company; and• <i>DAC, DEAT, EDD, DME, Treasury, private sector.</i>
Mining value chain	<ul style="list-style-type: none">• Mining.	<ul style="list-style-type: none">• Downstream mineral beneficiation.	<ul style="list-style-type: none">• Research entities e.g., CSIR;• State-owned companies e.g., Alexkor; and• <i>DME, DTI, Treasury, private sector.</i>

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

2.4.2 Implementation of an overarching strategy for SOEs

The PRC recommends that the Government develops and implements an overarching strategy for SOEs. To do so, the approach to be adopted must be clearly and unambiguously framed for path A (Figure 12).

SOE reform initiatives are largely characterised by steady, consistent incremental processes with clearly articulated milestones. To be effective, SOE reforms must be accompanied by administrative reforms. It is necessary for the Government as an active shareholder to improve its capacity in order to manage the SOE reform process effectively. Unless the bureaucrats monitoring the SOEs are competent in doing their job, creating the political space for them is not going to produce results.

Administrative reform requires a number of different elements. It is necessary to recruit better people, invest in a strong performance management and monitoring system, align rewards to performance, and to reduce corruption. Training needs to be improved and accelerated to inculcate a strong service delivery ethos. Administrative reforms should also be geared towards driving the Government’s transformation agenda.

A high-quality economic establishment is necessary for the success of SOE reforms. Such an establishment cannot be built overnight, but it is possible to build one within a relatively short span of time if there is the political will to implement the recommendations proposed in this report and a commitment to make sound economic investment.

Part 5 of the review report will address some of the implementation milestones and processes proposed by the PRC.

Taking into account the recommendations made by the PRC in this report, milestones towards an overarching strategy (path A) include the following:

- Developing a long-term Developmental State-oriented national plan and vision that clearly outlines the strategic and priority sectors and the role of all stakeholders in working towards this national plan (acknowledging the draft national development plan and the processes leading to the finalisation of the plan);
- Setting up an SOE Reform Task Team, which will manage the entire move towards the best case scenario (path A);
- Constructing a long-term overarching strategy for SOEs in consultation with stakeholders, including a proposal for a reconfigured SOE portfolio;
- Producing an SOE performance scorecard for SOEs;
- Reviewing the legislative framework to align with the overarching strategy, including strategic classification of SOEs;
- Simultaneous implementation of the legislative framework and rationalising and consolidating of SOE structures (oversight, mergers, new entities in priority sectors);
- Ensuring that improved and standardised performance management systems are in place and functioning; and
- Ensuring that minimum capacity requirements are in place.

Figure 13: Towards an overarching strategy for SOEs in South Africa

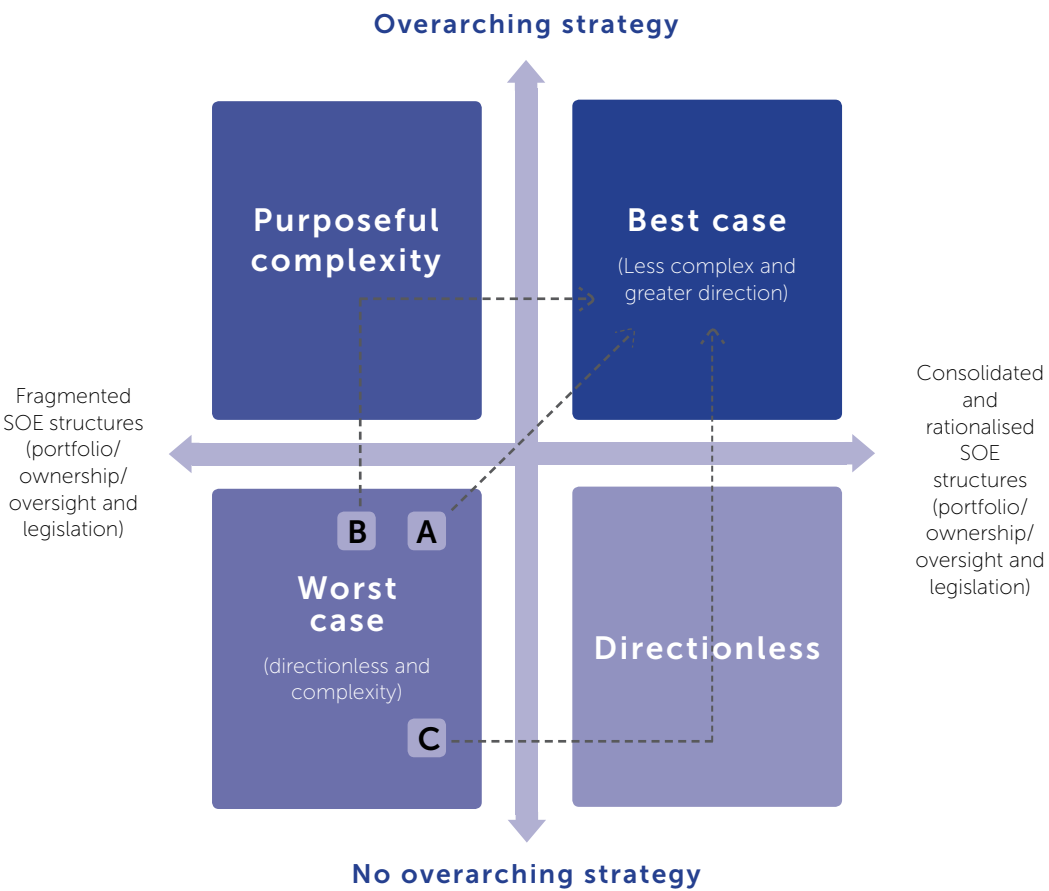


Figure 13 shows four possible states or scenarios describing the SOE environment. It comprises two axes: a vertical axis reflecting an overarching strategy, and a horizontal axis reflecting the degree of consolidation and rationalisation of SOEs (whether in numbers, oversight, ownership, policy ministries, etc.). This results in four quadrants:

- **Worst case:** This is both complex and directionless. SOEs are established and function without the guidance of national strategy and SOE structures, portfolios, etc. and are fragmented, proliferating, etc.
- **Directionless:** There is an improvement in the consolidation and rationalisation of SOEs, but not in respect of a national strategy.

- **Purposeful complexity:** There is a move towards a national strategy but with no consolidation.
- **The best case** scenario reflects both consolidation and an over-arching strategy.

Based on the review conducted by the PRC, we believe that South Africa inhabits the bottom left quadrant, exemplified by an oversight matrix that seems to be convoluted and overbearing, with a continuing proliferation of SOEs across all levels of Government. Furthermore there is a clear lack of an encompassing strategy for SOEs and a national policy framework covering all major facets of SOE governance, oversight, ownership expectations, etc.

CHAPTER 2: AN OVERARCHING STRATEGY FOR STATE-OWNED ENTITIES continued

Ideally, South Africa must move along path A. Doing so requires a commitment by the Government to move simultaneously on two fronts: developing and implementing a national strategy while also undertaking a consolidation of SOE structures. A move towards consolidation will be difficult. Firm leadership is required because many captured interests will be offended.

If this action is not undertaken more or less simultaneously (or phased in over a longer rather than a shorter period), the danger lies in drifting along either Path B or Path C. This will reflect an improvement in one respect (axis), but the move from top left to top right or from bottom right to top left will still need to be made. However, it will be a much longer process characterised by ‘trial and error’ or possible ‘policy drift’.

Implications:

- **Path A:** Somewhat paradoxically, this path, even though pursued on both axes, cannot necessarily be implemented in the shortest period, compared to path B or path C. This is due to constitutional, bureaucratic and financial issues and the need for a sustained policy focus and implementation challenges.

However, international experience suggests that comprehensive SOE reform is a long-term process.

- **Path B:** The Government accepts the need to move towards an over-arching strategy while, delaying any progress in consolidation and rationalisation of SOE structures, etc.
- **Path C:** The Government consolidates SOE structures, while delaying a move towards a national strategy.

Cautions:

We suggest that the country is currently moving along path C. This is reflected by some mergers at the national and provincial spheres of Government (e.g. the merging of Khula and Apex Fund with the Industrial Development Corporation (IDC), as well as the consolidation of SOEs in the North West, Limpopo, and Western Cape provinces, for example). These confirm and recognise that rationalisation needs to be pursued.

However, the PRC warns against a path C scenario. Path C might constitute change for the sake of change or for reasons that are not steeped in the national plan and strategy. These efforts may prove to be wasteful and are unlikely to result in any positive measurable change if a clear overarching strategy for SOEs is not in place.

Recommendation 1:

The Government should develop an overarching, long-term strategy for SOEs.

The strategy must:

- be aligned to the objectives of the Developmental State that South Africa aspires to become;
- find articulation in a white paper on SOEs based on further recommendations herein contained, which white paper should aim to inform a comprehensive SOE Act that we propose (see recommendation 2);
- be periodically reviewed and evaluated, at least every five years to ensure long-term alignment with the objectives and circumstances of South Africa’s Developmental State.

The SOE strategy and a white paper will contain the following elements:

- (a) **A categorisation framework for SOEs, which must be applicable to all three spheres of Government.**
 - A naming and terminology standard for SOEs must be developed and adopted, in accordance with the recommended categorisation.
 - All current and future legislation should conform to the single naming and definition standard.
- (b) **A thorough examination and identification of strategic sectors for South Africa’s Developmental State, and the role of SOEs therein.**
 - The identified strategic sectors should be either legislated or policy-led.
 - The sectors should be subjected to a periodic review process by some designated authority (e.g., the executive authority and Parliament).
- (c) **A framework should be developed for identifying priority and strategic SOEs with a potential for increased impact on economic growth, development and employment creation.**
- (d) **A comprehensive SOE approach on regional and international trade and development should be incorporated into the overarching strategy for SOEs.**
- (e) **SOEs should be consolidated and rationalised as and where needed.**
 - Consolidate SOEs that operate in similar sectors and industries, e.g., SETAs, water boards and DFIs.
 - Rationalise the number of SOEs so that focus can be placed on the most strategic sectors and industries.
 - Re-incorporate those functions that can be optimally performed by Government departments.
- (f) **Adopt a portfolio management approach to SOEs, particularly in commercial entities and DFIs.**
- (g) **Develop a structured framework for balancing commercial and socio-economic priorities.**
 - Periodically review and balance the social, political and economic priorities of SOEs.
 - Ensure commensurate resourcing and funding for additional socio-economic priorities.

PART 2: AN ENABLING ENVIRONMENT FOR STATE-OWNED ENTITIES

PART 2: AN ENABLING ENVIRONMENT FOR STATE-OWNED ENTITIES

INTRODUCTION

The PRC has established that there are currently at least 715 State-owned enterprises/entities (SOEs) (including their subsidiaries) in South Africa. As indicated in chapter 2 of this report, the Government has identified SOEs as key agencies in advancing the developmental mandate of the State. This requires that SOEs are run efficiently and, at the same time, meet certain developmental and social objectives. The purpose of this section of the report is to review the existing environment within which SOEs operate in South Africa, and to come up with recommendations to create an enabling environment for these SOEs to perform better.

SOEs operate within an environment that could either enable them to perform better or undermine their ability to perform. The objective of this chapter is to review a number of different features of the environment SOEs operate in to determine its impact on SOEs and to make suggestions on possible improvements.

The SOE environment is shaped by a number of elements. This review focuses on only a few of these. Perhaps the most significant element of the SOE environment is the legislative framework under which SOEs operate. This legislative framework is critical because it deals with the structures, systems, processes, procedures and/or controls related to:

- Corporate governance;
- Reporting and accountability;
- The oversight role of Government and other agencies;
- The selection and appointment of boards and executive management of SOEs;
- Performance management and monitoring; and
- The establishment and disestablishment of SOEs.

All these functions have an impact on the performance of SOEs and Government's ability to influence their performance.

This report proceeds from the premise that in as much as the ease of doing business is important for private sector companies to thrive, the enabling regulatory environment in the public sector is of pivotal importance if State resources are to be optimally utilised. Sentiments expressed by a previous British President of the Board of Trade, Margaret Beckett, in relation to the company law reform, process in that country are as relevant today as they were when expressed in 1998 when she authoritatively commented that the costs of creating a patchwork of regulation that is immensely complex and seriously out of date over a long period of time "may not be obvious to all, but they are real and substantial nonetheless" (Beckett, 1998).

The above comments are certainly relevant in relation to the SOE legislative environment in South Africa, which is generally accepted to be characterised by a myriad of legislation that is overlapping, conflicting, and fraught with duplicated provisions that lead to confusion in interpretation and application. This report examines whether the 'patchwork' of the regulatory environment affecting SOEs in South Africa is, indeed, overlapping, conflicting and burdened with duplicated provisions, which lead to confusion in interpretation and application. A related question addressed in this report is whether this legislative framework, under which SOEs function, is adequate to enable SOEs to contribute meaningfully to the State's development objectives. Based on the challenges and opportunities identified in the position papers, the report considers recommendations on whether there is a need to amend any of the existing statutes reviewed or, alternatively, to develop a new overarching SOE Act.

PART 2: AN ENABLING ENVIRONMENT FOR STATE-OWNED ENTITIES continued

The review of the current legislative framework also takes into account its treatment of subsidiaries of SOEs. SOEs in South Africa have the power to establish subsidiaries, and many have done so. A core issue that arises is whether or not the current legislation applicable to SOEs applies to their subsidiaries as well.

This review of legislation is followed by a review of some of the key components of legislation impacting on SOEs, with a focus on the treatment of SOEs in the legislation and the consequent effect on SOEs, as well as some of the practical issues and challenges arising from the application of these aspects of the legislation. The crucial issues dealt with include:

- Corporate governance;
- Ownership and oversight;
- The recruitment, selection and appointment of boards and executive management of SOEs;
- Remuneration;
- Performance management;
- Collaboration, coordination and cooperation among SOEs, and between SOEs and Government departments; and
- The establishment and disestablishment of SOEs.

The PRC has also included a number of legislative changes such as the development of an ownership database of all SOEs.

The performance of SOEs and Government's ability to influence this performance is also affected by a number of other factors. Two such factors are:

- The remuneration of chief executive officers and senior management of SOEs; and
- The impact of economic regulation of SOEs on management and performance.

This section (part two) of the report is divided into three chapters:

- **Chapter 3: SOE legislation, corporate governance, ownership, oversight and establishment and disestablishment of SOEs**

The chapter deals with the broad SOE legislative framework in South Africa, before proceeding to examine the core issues in this framework that deal with corporate governance, ownership and oversight, and the establishment and disestablishment of SOEs. The emphasis is on the features of these aspects of the SOE environment that impact on the performance of SOEs.

- **Chapter 4: Board and executive management appointments and collaboration among SOEs**

The chapter focuses on the key administrative elements of legislation, including the exercising of some of the ownership rights of Government as an owner/shareholder.

- **Chapter 5: SOE remuneration and economic regulation**

This chapter focuses on some of the key features of the SOE financial environment, including one of the ways SOEs' utilise their resources, i.e., remuneration of executive management. It also looks at how economic regulation affects the performance of SOEs.

CHAPTER 3: STATE-OWNED ENTITY LEGISLATION, CORPORATE GOVERNANCE, OWNERSHIP, OVERSIGHT AND ESTABLISHMENT AND DISESTABLISHMENT OF STATE-OWNED ENTITIES

3.1 OVERVIEW OF CHAPTER

3.1.1 Background and problem statement

3.1.1.1 Global context

Legislation underpins the relationship between the State and its SOEs in countries throughout the world, and defines the rights and responsibilities of these two key stakeholders. Many States subject such legislation to periodic review in order to align their SOE legislative frameworks to international, regional and local developments. Refinement of legislation is also aimed at resolving challenges that arise from the practical impact of legislative frameworks on SOEs as well as their relationship with Government.

In their reviews of legislative frameworks, most States review the impact of these frameworks on the performance of SOEs, and refine their legislation in ways that can contribute to enhancing performance. In particular, States refine their legislative frameworks to enhance, among other things:

- Corporate governance of SOEs;
- Their rights and role as owner of SOEs; and
- The oversight functions over SOEs.

The review of legislative frameworks in many countries has given rise to coherent legislative frameworks for SOEs that contribute to efficient and effective performance while enhancing the respective Governments' ability to monitor their performance. Some of the key features of these legislative tools other countries have adopted are:

- An overarching SOE Act, regulating all SOEs;
- Clarity and separation of roles of Government as owner, policy maker and regulator;
- Corporate governance guidelines defining roles and responsibilities of key stakeholders;
- Ownership frameworks that define the rights of Government as owner of SOEs; and
- Oversight frameworks that define the responsibilities and roles of key stakeholders.

An international comparative review of the SOE legislation in three countries (among other

countries studied by the PRC) was conducted, and principles of best-practice abroad were looked at in examining the impact of the current SOE legislative frameworks in South Africa.

These countries were: Australia, New Zealand and Namibia. The choice of these particular countries was primarily predicated on the strong similarities in SOE governance (from a legislative point of view) between the selected countries and South Africa, as well as other relevant areas in the sense that in all these countries:

- The supremacy of the Constitution is affirmed.
- SOEs are established by founding statute.
- There is a multiplicity of legislation impacting on SOEs.
- The SOE Act is the supreme Act governing SOEs, and specifically states that it replaces any Act that was previously in existence. Furthermore, it is stipulated that should any previous Act be inconsistent with the SOE Act, then the SOE Acts, and no other Act, prevails.
- In the SOE legislation, reserved ownership/ shareholder rights and powers are codified.
- Their SOE legislation covers all forms of SOEs – commercial, non-commercial, and incorporated and unincorporated.
- The SOE legislation aims at the standardisation of SOE terminology.
- Government plays an active role in the SOEs of these countries.
- There is a lack of uniformity in the governance role by the particular Ministries that exercise ownership of different SOEs. Furthermore, there is varied Government involvement in the management of SOEs.
- There is a mixed bag of different types of SOEs.

3.1.1.2 Domestic context

A carefully developed and well-designed SOE legal framework is essential to ensure the viability and efficiency of the SOE sector. The SOE legislative environment in South Africa is characterised by a myriad of legislation that is overlapping, conflicting,

CHAPTER 3: STATE-OWNED ENTITY LEGISLATION, CORPORATE GOVERNANCE, OWNERSHIP, OVERSIGHT AND ESTABLISHMENT AND DISESTABLISHMENT OF STATE-OWNED ENTITIES continued

and fraught with duplicated provisions that lead to confusion in interpretation and application. The laws and other instruments arising from the legislation that apply across all SOEs include:

- The Companies Act 2008 (Companies Act 2008 repealed the Companies Act of 1973);
- The Public Finance Management Act (PFMA);
- The Municipal Finance Management Act (MFMA);
- Memoranda of Incorporation;
- Shareholder’s compacts;
- The Preferential Procurement Policy Framework Act;
- Treasury regulations, practice notes, guidelines and circulars;
- Sector specific legislation;
- Individual SOE founding legislation;
- The Public Audit Act;
- The Employment Equity Act;
- The Skills Development Act;
- Constitutional legislation;
- Other ‘public law’ statutes (Electronic Communications Security Act; the National Environmental Management, Government Immovable Asset Management Act, etc.);
- General legislation (employment laws, tax laws, etc.);
- Various regulatory acts; and
- Provincial legislation.

Different SOEs are affected in different ways by the above laws. Accordingly, a review of the legislative framework directly impinging on SOEs is critical for developing an understanding of how specific SOE legislation affects the performance of SOEs, and to suggest reforms to this legislative framework to make it more effective.

The aspects of the SOE legislative framework that are the most significant relate to corporate governance, ownership rights and responsibilities, and oversight. This review of the SOE legislative framework considers the impact of the current arrangements for these three elements on the enabling environment for SOEs.

3.1.2 Purpose of this chapter

The purpose of this chapter of the PRC report is:

- To investigate whether the legislative framework(s) under which SOEs currently function is adequate to enable SOEs to perform efficiently and effectively;
- To benchmark South Africa’s current legislative framework with international best-practice with a view to recommending effective reforms; and
- To recommend changes to the legislative framework that would contribute to enhancing the performance of SOEs in South Africa.

Thus, the primary aim is to establish whether or not the current legislative framework for SOEs is characterised by a myriad of legislation that has overlapping, conflicting, and duplicated provisions that lead to confusion in interpretation and application, which negatively affect the efficient formation, governance and ownership of SOEs. A secondary purpose is to review the current corporate governance, ownership and oversight frameworks and the framework for the establishment and disestablishment of SOEs to assess their impact on SOEs with a view to recommending changes to these frameworks.

3.1.3 Process and approach

The material for this chapter is derived from a number of PRC processes, which include the following:

Four PRC terms of reference position papers produced by the PRC’s governance and ownership (G&O) and business case and viability work-streams:

- The current SOE legislative framework and the impact it has on the management of SOEs/enterprises;
- SOE database;
- SOE corporate governance, ownership and oversight; and
- Policy for the establishment and disestablishment of SOEs.

3.1.4 Structure of the chapter

The chapter is divided into five sections. The first looks at the overall legislative framework in South Africa. This is followed by a review of the SOE corporate governance environment; the SOE ownership framework; the SOE oversight framework, and establishment and disestablishment of SOEs. Each section of this chapter provides an overview, assessment, international experience, and recommendations on the various areas reviewed, which are:

- SOE legislation;
- Corporate governance;
- Ownership;
- Oversight; and
- Establishment and disestablishment of SOEs.

3.2 SOE LEGISLATION

3.2.1 Background

Regulatory instruments are applicable depending on the sphere of Government in which the entity is established and operates. The focus of this review is on legislation that has specific reference to SOEs that apply to: (i) national and provincial entities and (ii) local municipal entities. (These entities are governed by *inter alia*, the Public Finance Management Act, SOE founding legislation), the Municipal Finance Management Act, No. 56 of 2003; the Municipal Systems Act, No. 32 of 2000; the Municipal Structures Act, No. 117 of 1998; and the Companies Act, No. 71 of 2008. The SOEs are further governed by non-legislative governance instruments such as the King III Report on Corporate Governance in South Africa and the Department of Public Enterprises’ (DPE) Protocol on Corporate Governance in the Public Sector.

South Africa has three spheres of Government: national, provincial and local. All Government spheres (with the exception of local Government) have the power to create statutes, and it is through these statutes that most of these institutions have established SOEs, through which some of the programmes of these Government institutions

are driven. These statutes are referred to as the ‘founding acts’ of these SOEs. Almost all significant SOEs (with a few exceptions) were established either by way of SOE founding legislation (e.g., South African Maritime Safety Act), or by sector-based legislation (e.g. Water Services Act). Consequently, there are a large number of founding acts currently governing SOEs.

The introduction of the Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA) brought about uniformity in financial reporting and accountability across all SOEs at the national and provincial levels (PFMA) and at the local Government level (MFMA). SOEs that are incorporated also have the Companies Act to grapple with. The Companies Act contains some provisions, which are contained in the SOE Founding Acts, or the PFMA/MFMA.

This review of existing legislation has given rise to a number of observations and challenges. It must be noted that these relate to issues that are currently included in the existing legislative frameworks, or include areas proposed in National Treasury’s Public Finance Management Bill and the Department of Public Enterprises’ Government Shareholding Management Bill. Consequently, any proposed changes arising from the review give rise to amendments to existing legislation or have to be included in any proposed new legislation.

3.2.2 Issues and challenges

The review has identified the following core issues and challenges with existing legislations and regulations:

- The absence of a single, overarching SOE law;
- The adverse effect of the multiplicity of laws governing SOEs;
- The burden of compliance with existing sometimes conflicting SOE legislation (whether perceived or real); and
- The arbitrary legislative treatment of subsidiaries of SOEs.

CHAPTER 3: STATE-OWNED ENTITY LEGISLATION, CORPORATE GOVERNANCE, OWNERSHIP, OVERSIGHT AND ESTABLISHMENT AND DISESTABLISHMENT OF STATE-OWNED ENTITIES continued

3.2.2.1 The absence of a dedicated SOE law

The review notes that there is no dedicated overarching SOE legislative framework in South Africa. The PFMA is a financial tool for management and promotes the objective of good financial management in order to maximise service delivery through the effective and efficient use of limited resources at national and provincial level. The MFMA fulfils this responsibility in the local Government sphere. An argument may be made that the seemingly overarching statutes consisting of the PFMA and the MFMA introduce legislative uniformity because in the event of inconsistency between their provisions and the provisions of any other existing or future legislation, the provisions of the PFMA or MFMA take precedence.

This apparent introduction of uniform regulation of SOEs by the overriding provisions of both the PFMA and the MFMA would be sufficient if these two statutes regulated all aspects of SOE operation. On the contrary, the introduction of these Acts brought about commendable uniformity only in financial reporting and accountability across all SOEs at national and provincial levels (PFMA) and local Government level (MFMA). In particular, the PFMA and the MFMA do not foster uniformity in the following areas:

- Establishment of SOEs;
- Appointment of the board of an SOE, its committees and the chief executive officer (CEO);
- Determination of Government officials to sit on the boards; and
- Developmental matters.

Nevertheless, these two acts 'continue to register enormous successes in improving SOE financial governance, accountability and reporting'.

Regardless of the above core functions of the PFMA and the MFMA in bolstering fiscal accountability and reporting, these acts also include non-financial and governance provisions.

The treatment of non-financial and governance provisions under the PFMA and the MFMA is, admittedly, in addition to an already existing plethora of such provisions sitting in SOE founding acts and, in the Companies Act. This therefore makes the impact of the PFMA and the MFMA on the SOEs highly untenable, particularly as certain non-financial matters are addressed in those acts while others of similarly common application are left to be disparately addressed by a bouquet of SOE founding legislation. The question that then arises is whether these financial governance legislative instruments should include non-financial provisions and, more importantly, what impact the current inclusion of these is for SOEs.

The new Companies Act contains provisions applicable to incorporated SOEs, some of which are also found either in SOE founding acts or in the PFMA/MFMA. A study commissioned by the Department of Public Enterprises (DPE) that was conducted by the law firm Edward Nathan & Sonnenbergs in 2010, found that the main differences between 'corporatised' SOEs and their private sector counterparts are:

- The higher degree of accountability expected of SOEs;
- The role of the owner/shareholder (Government) and not the board (as is the case in the private sector) in informing and directing the strategies of SOEs, because SOEs carry out Government policy;
- That 'voting with their feet' by divesting or disposing of shareholding is not as practical an option for Government as it is to a shareholder in the private sector; and
- That there may be some aspects of SOE activity, structure or governance that are dictated by constitutional principles (unlike in the private sector).

In addition, the study concluded that although the new Companies Act addresses the shortfalls identified with regard to the PFMA and the

MFMA in relation to the regulation of SOEs, it does not cover issues such as procurement of goods and services; budgeting and financial planning; borrowings, guarantees and securities; and delegation of powers and responsibilities of officials other than directors. All these are dealt with by the PFMA. In private companies these are matters left to the discretion of the company. The PRC notes that while the Companies Act is, admittedly, an enabling legislation regulating the formation, financial administration, governance, consolidations, rescue and dissolution of corporate entities in South Africa, the overwhelming majority of SOEs are not corporatised. Those SOEs that are not companies are therefore not subject to the Companies Act, but remain bound by the PFMA and their founding legislation. Furthermore, private companies are driven by the profit motive, and the Companies Act is aimed mainly at regulating the relationship of the managers who generate profit for the owners. In SOEs, that relationship is different as the SOE is not only required to generate profit, but in many instances has a dual mandate, which include delivery on social mandates, which may not necessarily generate any profit. Quite the converse, such mandates may lead to massive losses to the SOE, yet they require to be performed.

Various processes undertaken by Government departments in the last few years indicate that a number of other issues and challenges are to be found in the existing legislation. For instance, National Treasury proposed the introduction of a new Public Finance Management Bill (PFM Bill) instead of amending the PFMA because any amendments would be too extensive. While the PFMA was seen as a purely financial oversight instrument, the proposed PFM Bill would be a dual financial oversight and governance legislative instrument. The new bill would have provided for establishment and disestablishment processes and procedures for public entities and Government

enterprises, Government oversight of public entities and Government enterprises, and the responsibilities of executive authorities, parent and ownership/shareholder departments, as well as the relationship of SOEs to their governing authorities.

Included in the new bill were the following issues:

- Performance plans, corporate plans, and compacts of SOEs;
- Financial and other inter-Governmental relations;
- Executive authorities of State-controlled institutions;
- Accounting officers of State-controlled institutions;
- The listing and delisting of State-controlled institutions;
- The establishment of State-controlled institutions;
- State-controlled institutions that are companies;
- Governance issues of State-controlled institutions; and
- Reporting of these State-controlled institutions.

Similarly, the DPE developed a Government Shareholder Management Bill (GSM Bill) to complement the PFMA (Department of Public Enterprises). It stipulated that in the event that any provisions of other legislation conflicted with the GSM Bill (except the PFMA) then the GSM Bill would prevail. The GSM Bill included provisions for the classification of SOEs; establishment of SOEs; the duties and responsibilities of executive authorities that play an ownership/shareholder role; and the appointment of boards, CEOs and other senior management, among other things. The proposed new legislation was intended to have the effect of enhancing clarity on the mandate and strategic intent of the State's investment in SOEs, aligning SOE planning, corporate governance and performance with such mandate and strategic intent, and improving the line of sight and accountability of the performance of SOEs and executive authorities.

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The GSM Bill was to provide for the establishment of a Cabinet Committee on SOEs (CSOE), which would have the role of considering Cabinet recommendations on portfolio structuring or establishment of a new SOE, capitalisation and shareholder loans. The proposed new GSM Bill would also have provided for the establishment of a new Ministry of SOEs, which was intended to be the custodian of the GSM Act (new SOE Act), as well as ownership/shareholder management practices across the State's shareholding portfolio. The GSM Bill also suggests that the Minister of SOEs be supported by a State Shareholder Monitoring and Advisory Agency (SSMAA). The new SOE Act would also have detailed the duties and responsibilities of executive authorities that play a Shareholder Ministry role.

The proposed new SOE Act included provisions for the standardisation of accounting and reporting practices and measures to reinforce the existing legislative and constitutional injunction on State organs (including SOEs) to cooperate with one another. All provisions in the PFMA related to boards, i.e., fiduciary duties, appointment, delegation of powers, etc. in a distinct framework developed for schedule 2 SOEs, would be transferred to the new act. In addition, the new act included provisions for the formulation of a strategic intent statement for each SOE by the relevant executive authority, which would then guide the conclusion of binding shareholder compacts. The proposed new act had provisions for delivery of a corporate plan by boards of SOEs.

The GSM Bill was not introduced to Parliament. The PFMA remains as it has always been, and no amendments thereto have been effected. However, the ENS study stresses that Government will have to determine exactly what aspects of the existing laws should be rigidly applied by SOEs in pursuance of consistency, and where flexibility can be allowed to apply those legislative provisions suited to individual SOE circumstances. This view is supported by the PRC.

The legislative framework under which SOEs operate in certain countries, indicates that like South Africa, there is a multiplicity of laws impacting on SOEs. However, a number of countries have a dedicated overarching SOE Act. Examples are the Australian Government-owned Corporation Act, 1993 (GOC Act); New Zealand's State-owned Enterprises Act, 1986; and Namibia's State-owned Enterprises Governance Act (SOEG Act), 2006 – all which position themselves as the supreme act governing SOEs and replace any act previously in existence. In addition, should any of the previous acts established before the SOE Act be inconsistent with them, the SOE Act prevails.

In terms of the international experience referred to above, it is critical that an SOE Act be supreme and over-ride any others in the event of inconsistencies. SOE-related governance, financial management, remuneration and ownership/shareholder management provisions should be part of a single piece of legislation to ensure uniformity in application, implementation and monitoring. In addition, there would be no need to amend all the existing acts on governance, remuneration and any other provisions that the new SOE Act would cover. Such provisions would simply be meaningless and no longer have any effect in as much as they were inconsistent with a new SOE Act.

3.2.2.2 Effects of the existence of a multiplicity of laws impacting on SOEs

Another reason for the development of an overarching SOE Act is found in the negative consequences arising from the existence of a large number of laws impacting on SOEs. Virtually all major SOEs were established through founding legislation or sector legislation, which contained provisions dealing with their constitutional or establishment powers, the objectives of the particular SOE, and issues of governance, reporting and accountability.

The problem here is that these provisions are not uniform across the various founding statutes, and the existence of a number of Founding SOE legislative instruments is problematic in that it leads to the different treatment of similar issues affecting SOEs. In addition, the treatment of non-financial and governance provisions under the PFMA and the MFMA, and the plethora of such provisions sitting in a bouquet of SOE founding Acts and the Companies Act, is untenable. For instance, each SOE has some form of provision in its founding act dealing with its reporting obligations, reporting officer and frequency of reporting. Over and above such provisions in the individual founding acts, the PFMA then again regulates all the reporting obligations of SOEs. Furthermore, the Companies Act also includes reporting obligations, which apply to every company, including the SOEs that are corporatised.

Another challenge arising from the multiplicity of laws impacting on SOEs is the wide variety of different definitions of SOEs. Section (1) of the PFMA refers to a State-owned enterprise either as a 'national Government business enterprise' or a 'provincial Government business enterprise'. On the other hand, the Companies Act lists State-owned companies under the 'for-profit companies' in its classification of companies. Each of these companies must include the abbreviation 'SoC Ltd' at the end of its name. Included in the PFMA's definitions of national and provincial entities, is the qualification that these national or provincial Government business enterprises; boards; commissions; companies; corporations; funds; or other any other entity (other than a national or provincial Government business enterprise) are 'fully or substantially funded either from the National Revenue Fund, or by way of a tax, levy, or other money imposed in terms of national legislation'. In addition, it is unclear what is meant by an entity being 'substantively' financed by Government.

This raises serious questions about which entities can be classified as 'State-owned', particularly with regard to corporatised entities in which the State holds equity, and in entities that are funded through a grant from the State and other sources of income.

There is therefore a need to establish common terminology that will be used consistently throughout Government, including all Government documents. This absence of a widely accepted term denoting what constitutes an SOE has serious implications for an entity's application or resistance to applying SOE legislation. The PRC review has found that many SOEs do not classify themselves as SOEs.

By contrast, the Australian GOC Act standardises SOE terminology by referring to all SOEs as 'Government-owned corporations', and then sets out to define these corporations (Uhrig, 2003).

When one looks at the content of the multiplicity of laws under which SOEs operate, what becomes apparent is that there are duplications, repetitive provisions and/or contradictory provisions dealing with the same issues. What this effectively means is that SOEs are obliged to compare different pieces of legislation in an effort to harmonise application of, and compliance with these laws, while also focusing on entity performance.

The ENS study found that there is considerable duplication between some provisions of the PFMA and the Companies Act, such as: financial record-keeping; annual financial statements; annual returns/reports; directors' duties; personal financial interests and liabilities; audit committees, etc. Although these matters are duplicated in both acts, they do not deal with them in an identical way. The study suggests that the appropriateness of any SOE seeking exemptions from either one of the acts where there are duplications would require some consideration. However, very few conflicting provisions were found in the two acts.

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The PRC is of the view that the issue is not how many conflicting provisions sit between the two acts, but the operational impact thereof. In addition, there may be few conflicts, but the inconsistencies in wording (of provisions dealing with similar matters, e.g., fiduciary duties) are many.

SOE boards then have to engage in the process of determining whether certain actions are consistent with one act or the other. Therefore inconsistencies and conflicts, irrespective of extent or prevalence, have to be removed and harmonisation achieved in the best interests of the SOEs and the State's ability to exercise ownership effectively.

The ENS study also points out that SOE founding legislation normally contains provisions that are already in the Companies Act, resulting in regulatory duplication. In addition, most of the founding statutes include restrictions on SOEs' powers and responsibilities or additional procedural requirements for transacting; these would not have been necessary had the SOE been regulated by general legislation such as the Companies Act or PFMA (Edward Nathan & Sonnenbergs, 2010).

The founding legislation provides each SOE with its own constitutional or establishment powers, governance and other processes. While these are directed to assisting them to resolve similar governance and process-related issues and problems, they are not uniform across the various founding statutes. These inconsistencies are partly the product of successive Governments' ad hoc and reactive approach to the development of the SOE legislative framework. An example here is the inconsistent provisions on the appointment of CEOs, ranging from appointment by various Ministers, to appointment by the boards of directors. There are also instances where there are no clear provisions at all for such appointments, notwithstanding that such entities would nevertheless have CEOs.

Further, as problems with a particular SOE's powers or governance and other processes are identified, usually as the result of costly litigation, they are rectified by legislative amendments. As an example, the Companies Act was amended before it became effective. Despite its amendment, the Companies Act still contains many provisions that do not make sense and in some instances, makes incorrect referencing. But such amendments are not applied uniformly or consistently across all SOE founding legislation, even though the problems may be universal. In many other cases, founding legislation is left unrevised for unacceptably long periods of time. In other instances, the problems are not rectified by express provisions and the matter is governed by common law or equitable principles. Nor do those general law principles always provide a clear resolution to the problem. These inconsistencies and ambiguities impact adversely on the effectiveness and the efficiency of the South African SOE legislative framework taken as a whole, and have a negative impact on the effectiveness and efficiency with which Government, SOEs and individuals in the public sector can operate.

3.2.2.3 Burden of compliance in existing SOE legislation

Another argument in favour of the development of an overarching SOE Act is the burdensome nature of current SOE legislation. In particular, many SOEs find the legislative environment bureaucratic and time-consuming. Staff responsible for compliance matters in SOEs asserts that merely complying with the legislative environment is overwhelmingly time consuming, leaving reduced capacity to actually execute the principal objective of the SOE. This situation is made even more complex by the multiplicity of institutions SOEs have to report to, including ownership Ministries, provincial Government structures, Parliamentary Portfolio Committees, and other related Ministries, and the requirement to make statutory monthly

and quarterly reports, as well as to provide the same reports on an ad hoc basis in different formats to other institutions, often requiring extensive adjustment of templates and countless hours of work.

In addition, some SOEs have to comply with numerous sector-specific laws. For instance, South African Airways (SAA) has to comply with the Airports Company Act, No. 44 of 1993; the Air Services and Licensing Act, No. 115 of 1990; the Air Traffic and Navigation Services Company Act, No. 45 of 1993; the Carriage by Air Act, No. 17 of 1946; the Civil Aviation Act, No. 13 of 2007; the Convention on International Interests in Mobile Equipment Act, No. 4 of 2007; the International Air Services Act, No. 60 of 1993; the Shipping and Civil Aviation Laws Rationalisation Act, No. 28 of 1994; the South African Airways Act, No. 5 of 2007; the South African Civil Aviation Authority Act, No. 41 of 1998; the South African Maritime and Aeronautical Search and Rescue Act, No. 44 of 2002; and the Transport Advisory Council Abolition Act, No. 9 of 1996. Accordingly, in our view, any proposed solutions to the challenges of SOEs needs to take cognisance of this fact and must contribute to streamlining the process and simplifying the complex legislative framework. If the legislative framework is to be changed, it is necessary to decrease the onerous environment under which SOEs already operate.

The Companies Act was crafted in such a manner that it reduces the cost of compliance. However, this means very little for SOEs since the PFMA and MFMA have a myriad of compliance requirements. There is a widely held view that the PFMA inhibits the performance of SOEs, including constraining the ability of SOEs to undertake certain investments, and the time and resources wasted on complying with the requirements of sections of the act.

Accordingly, the PRC submits that there is sufficient basis to conclude that the current SOE legislative framework poses challenges to SOEs.

3.2.2.4 The legislative treatment of subsidiaries of SOEs

The legislative framework for the operation of SOEs in South Africa does not address the need for sufficient rules for the establishment, governance and operation of SOE subsidiaries. What appears to be the only reference to subsidiaries in the PFMA is the provision that subsidiaries of regulated SOEs are also subject to the stipulations of the act, because subsidiaries are also deemed to be listed in the same schedules of the PFMA in which their parent SOEs are listed (PRC-Bronstein and Olivier, 2011). This is done without the creation of a framework for the regulation of SOE subsidiaries. The only other relevant law that provides a legislative framework for the creation of subsidiaries is that which is laid out under the 2008 Companies Act, however, this is primarily suitable for corporate subsidiaries.

The PFMA does not explicitly require SOEs having subsidiaries to include information on those subsidiaries in their corporate plans. In practice, reference to subsidiaries, if declared, is contained in annual reports and is limited to information on what the subsidiaries are and the extent of the SOE's shareholding in the subsidiaries. Other information on these subsidiaries is never declared.

The PFMA allows any SOE (except schedule 1 institutions) to form subsidiaries. This has led to the emergence of a multiplicity of different subsidiary formations and numerous modes of operation. Thus, SOEs that are not incorporated have established subsidiaries that are incorporated, i.e., defined as companies in terms of the Companies Act. In addition, certain SOEs have subsidiaries that although defined as such in the Companies Act, are not subsidiaries in the sense of having been established through founding legislation or in terms of the PFMA. For instance, some of the State-owned development finance institutions (DFIs) take majority equity of companies that they finance to safeguard their investment (Industrial

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Development Corporation, 2011). And yet the PFMA States that any subsidiary of an SOE is also an SOE subject to the provisions of the act. The implication is that they should, as SOEs, submit reports like their parent companies and, in effect, operate as if they were SOEs themselves. However, not all SOEs submit reports to the executive authorities.

Another concern is that there is no legislative account of the number of subsidiaries established by South African SOEs. The PFMA does not list subsidiaries of SOEs listed in its Schedules, and there is thus no record of how many subsidiaries exist under the listed SOEs. There is no evidence of any record-keeping or database (legislated or otherwise) of how many approvals have been granted for the establishment/disestablishment of subsidiaries, or the taking of significant interests or shareholding in entities, which renders such entities subsidiaries of SOEs. Many subsidiaries of SOEs have established their own subsidiaries that fall outside the ambit of the PFMA regime. Nothing precludes the subsidiaries of SOE subsidiaries from establishing, in turn, their own subsidiaries. Thus, an endless number of subsidiaries can be established that are neither listed in the PFMA schedules, nor are bound to comply with the PFMA. In addition, there is no limit set in existing legislation on the number of subsidiaries SOEs can set up (refer also to the section on the establishment and disestablishment of SOEs in chapter 3, section 3.6).

Subsidiaries are tightly and clearly managed in other countries through legislation. The Australian GOC Act, the Namibian State-owned Enterprises Governance Act, and New Zealand’s State-owned Enterprises Act deal explicitly with SOE subsidiaries. The GOC Act, for example requires SOEs that have subsidiaries to include such information in their corporate plans, imposing obligations on these subsidiaries in relation to any matter with a view to achieving its efficient governance and the

monitoring not only of its performance but that of its board and senior management. Alternatively, SOEs are obliged to include a report on subsidiary affairs in their corporate intent statement submitted to the shareholder Minister.

3.3 CORPORATE GOVERNANCE

3.3.1 Background

The Government is the majority or sole owner of almost all SOEs, and as such is responsible for ensuring that frameworks exist that set out the corporate governance of these entities. The State’s ownership interest in SOEs is represented by Government through different institutions: Shareholder Ministers/members of Executive Committees and municipalities. Within the national and provincial Government spheres the Government is, in most cases, represented by policy Ministers that also double up as shareholder Ministers. The questions that have to be resolved in this section of the report are the following:

- Is there an overarching framework relating to corporate governance arrangements in the South African SOE sector?
- What are the commonly encountered corporate governance problems in South Africa?
- Which structures and processes best support good SOE corporate governance?

The method and the effectiveness with which SOEs are directed, controlled and held to account are of particular importance to all stakeholders. SOEs operate under a governance structure that is quite complex, involving relationships between Parliament, Ministers, boards and CEOs. This complexity of relationships and interdependence invariably results in confusion over the allocation of responsibilities and the accountability for results. Under these circumstances, effective corporate governance is vital for ensuring stakeholder confidence in the management of SOEs. In addition, the importance of corporate governance generally for companies, whether private or State-owned has been underscored by

the global financial crises, corruption scandals, waste and bankruptcy of companies. Despite the noble reasons for the creation of SOEs, they are in many cases in many countries often less productive than private companies.

SOEs in South Africa are often in the news for poor performance in delivering on Government guarantees; corporate governance breaches; routine unqualified audited financial statements; and ineffective boards and CEOs. Among the key factors that undermine the effectiveness of SOEs is the way they are governed – the legislation and frameworks governing them, oversight institutions, shareholder and stakeholder responsibilities, boards of directors, and management. “Transparency of SOE operations, planning and reporting, and a clear accountability framework, which also sets out the roles of Government (as owner), Ministers, boards, and senior management of SOEs, are fundamental principles that underlie good governance” (OECD, 2005a, p. 1). In South Africa most SOEs operate without clearly defined legislation or frameworks that set out how they should be governed, organised, managed and what their purposes should be (Ramano, 2010).

There are more than 715 SOEs in South Africa, which straddle different departments and tiers of Government. Only nine (excluding subsidiaries) fall within ambit of the Department of Public Enterprises. Because there is no common shareholder governance model across departments and spheres of Government, the State is forced to rely on ‘ad hoc instruments’, which are unsuitable to hold SOEs accountable (Gigaba, 2010).

It must be noted, from the outset, that South Africa has no consolidated framework for SOE corporate governance.

Corporate governance is defined here as all those structures, systems, processes, procedures and controls within an organisation, at both oversight

and monitoring level, and within the management structures of the organisation, that are designed to ensure that it achieves its objectives, that it does so within sensible risk management parameters, and that it does so efficiently, ethically and equitably.

In South Africa, structures, systems, processes, procedures and controls for corporate governance of SOEs are set out in a variety of different laws. These include the founding legislation of specific SOEs; the PFMA; MFMA; the Municipal Systems Act; the Companies Act; the Protocol on Corporate Governance in the Public Sector that is directly applicable to SOEs under the control of the Department of Public Enterprises; and the King III Report on Corporate Governance. In addition to the legislation protocol and codes referred herein, the Auditor General’s Act and the Accounting Standards Board apply.

The frameworks are very similar to those of other countries such as Australia and New Zealand. However, other countries have, in addition to similar frameworks, an SOE ownership policy as well as an SOE Act. The ownership policy, for instance, defines ‘the overall objectives of State ownership, the State’s role in the corporate governance of SOEs, and how it will implement its ownership policy’ (OECD, 2005b). Such a framework combines all the elements that are essential for the successful implementation of corporate governance processes and practices.

Like their counterparts in many countries, the South African public sector and SOEs operate in a challenging and changing environment. SOEs have to navigate a cumbersome legal and regulation framework to conduct their businesses. They also have to contend with enormous amounts of contradictory policy papers. Nevertheless, the South African framework provides SOEs with a solid foundation from which they can develop and implement governance structures such as boards, committees and risk management processes. However, implementation of the framework is not without its challenges.

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SOEs are controlled, directed or advised using mainly three broad governance models:

- Boards (schedule 2, 3A, 3B, 3C, 3D entities of the PFMA);
- Governing bodies (schedule 4 and 5); and
- Councils and commissions (schedule 1).

The controlling boards are in the main created by law through founding legislation, or, for corporatised SOEs, through their articles of association and the Companies Act as well. Their role is to provide governance (direction and control), policy and management advice, or the achievement of various stakeholder objectives.

Corporate governance in South Africa was institutionalised by the publication of the King I Report on Corporate Governance in November 1994. The King Committee on Corporate Governance issued a detailed report on corporate governance, a series of recommendations and a Code of Corporate Practices and Conduct. The report went beyond the financial regulatory aspects of corporate governance by advocating an integrated approach to good governance in the interests of a wide range of stakeholders and showing regard for the fundamental principles of good financial, social, ethical and environmental practice. The King Report considered financial reporting and accountability; good practice on the responsibility of directors; the case for audit committees; the principal responsibility of auditors; and the links between shareholders, boards and auditors. In addition, the King Committee's terms of reference included a Code of Ethical Practice for South African enterprises and took account of special circumstances and of disadvantaged communities in South Africa.

The King Committee subsequently reviewed corporate governance standards and practices in South Africa against developments that took place after the publication of King I. The Code of Corporate Practices and Conduct in King II replaced the Code of Good Corporate Practices

and Conduct in King I, with effect from 1 March 2002. Subsequently, King III was, among other things, necessitated by the simultaneous development of the New Companies Act, which became effective in 2010. The King III Report places more emphasis on leadership, sustainability and corporate citizenship. Emphasis is also placed on integrated reporting, which provides a holistic evaluation of a company's impact on the economic life of the stakeholders in the environment in which it operates.

The King III guidelines apply to all SOEs, whether the entities are commercial or not. As a result there is an expectation that all these entities will implement corporate governance measures recommended by the report on a 'comply or explain' basis. King III sets out the roles and responsibilities of boards, which it envisages as having a central role in providing ethical leadership and ensuring that their companies are responsible corporate citizens whose ethics are managed effectively.

The PFMA also sets out the powers and duties of the boards of SOEs, as prescribed by King II. The PFMA stipulates that an SOE board is appointed by and accountable to the shareholder for its stewardship of the company and the company's assets and resources. The board has a collective responsibility to provide effective corporate governance that involves a relationship between the management of the company, its board, its shareowners and other stakeholders, to determine the company's purpose and values.

The Companies Act contains provisions on directors' duties and liability; meetings; appointment and removal of directors; and other matters concerning the board and its committees, directors and shareholders. In particular, focus is placed on directors' fiduciary duties. Generally, fiduciary duties require directors to act in good faith, for a proper purpose and in the best interests of the company.

Although the Code of Corporate Governance Practices and Conduct contained in the King I Report applied to SOEs and agencies that fall under the PFMA, there was a need to develop a public sector-focused code to address governance issues that are pertinent to the public sector. The Protocol on Corporate Governance in the Public Sector was first published in 1997 with a view to inculcating the principles of good governance in the SOEs under the control of the DPE. The second protocol constituted a substantial revision of the first in the light of King II and international developments, and is a combination of the principles of King II and the PFMA. The principles enunciated in the second protocol were specifically intended to apply to all SOEs listed in schedules 2 and 3 (b) and (d) of the PFMA; and any unlisted SOEs that are subsidiaries of an SOE, whether listed in the PFMA or not.

The governance principles for SOE boards are set out by the PFMA and the 2002 Protocol on Corporate Governance. The PFMA also governs the standards for financial management of SOEs' managers. The PFMA puts the responsibility of implementation of mandates of SOEs on managers. Furthermore, the responsibility of the executive (line Ministers of SOEs and/or provincial MECs) is to resolve management failures in SOEs. In the protocol the boards of SOEs are fundamental in corporate governance. It sets similar responsibilities for boards of SOEs as those in the private sector. Adopting principles emanating from the PMFA, the protocol states that the relationship between the executive authority and SOE boards should be governed by a shareholder's compact. Furthermore, it says that the majority of the board should be non-executive, to increase their objectivity and independence. Crucially, it states that the executive authority should effect remedial action, when SOE boards fail to meet their objectives and performance targets. The boards of SOEs, like in the King Code,

have a charter outlining their responsibilities. The protocol recommends the establishment in every SOE board of audit, remuneration, nomination and risk management committees.

There is a need to review the SOE Protocol on Corporate Governance to give effect to unique and nuanced principles governing SOEs, because King III does not do so adequately. It is also necessary to ensure that such a protocol applies to all SOEs.

Without detracting from all the other principles contained in King III, a few of the most pertinent principles are highlighted here.

- Boards should be at the centre of corporate governance (principle 1.1).
- The board should appoint the CEO (principle 1.6) and should elect the chairman, who should be an independent non-executive director.
- Boards should ensure SOEs have effective risk-based internal audit (principle 1.10) and internal financial controls (principle 1. 11).
- Owners/shareholders (or in the context of most SOEs, the owner/shareholder) are responsible for the composition of the board. However, a nomination committee should assist proactively in the process.
- The board should comprise a balance of executive and non-executive directors, with a majority of non-executive directors (principle 1.17). Rotation of non-executive directors is recommended to ensure that one third of the non-executive directors retire each year, by rotation.
- The board should be led by a non-executive chairman who should not be the CEO of the company (principle 1.18). The chairman should be re-appointed on an annual basis (principle 1.18).
- The performance of the board, its committees, individual directors and CEO should be evaluated annually (principle 1. 23). An independent non-executive director should lead the processes

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for the assessment of the performance of the chairman of the board. The evaluation of the CEO's performance should concentrate on his/her performance as a director and as CEO. It leaves open who should conduct the assessment of the CEO. However, the board and the owner/shareholder (Government) could do this, based on transparent criteria. The results and action plans from these evaluations should be disclosed in an integrated report, which will assist the executive authority to monitor performance of the SOE.

Some of the new requirements from King III that are particularly useful for SOEs include:

- The need for an annual integrated report that focuses on the impact of the organization in the economic, environmental and social spheres.
- A statement by the audit committee to the board and owners/shareholders on the effectiveness of internal financial controls to be included in the integrated report.
- The consideration of the strategic role of IT and its importance from a governance perspective.
- The positioning of internal audit as a strategic function that conducts a risk-based internal audit and provides a written assessment of the organisation's system of internal control, including internal financial controls.
- The governance of risk must be handled through formal risk management processes.
- There is a need to follow the business rescue procedures, when it becomes evident that the entity is distressed.

King III has wider reporting requirements in that it encompasses the principles of 'sustainability' and 'corporate citizenship' as part of a greater emphasis on more integrated reporting. Therefore, in King III the emphasis is not only placed on the interests of the shareholders, but on a more inclusive (or enlightened) stakeholder approach. In the public sector this means that SOEs cannot only focus

on pleasing the owner (the Government), but must report much more widely on whether the interests of the broader public, consumers and the environment have been served.

3.3.2 Issues and challenges

Despite these provisions, this review of corporate governance in South Africa, as well as a number of other previous reviews, identified a number of issues and challenges.

3.3.2.1 Legislation of corporate governance for SOEs

As indicated earlier in this chapter, SOE officials find the numerous laws applicable to SOEs very onerous, particularly so for smaller SOEs in the provincial and municipal spheres, which do not have the legal support or the means to pay for legal advice. Interpretation becomes subjective, and it leads to lack of compliance, leading to poor governance.

For the most part, founding legislation for SOEs that are incorporated makes provision for governance matters that duplicate the provisions contained in the Companies Act. It is often onerous and therefore undesirable for SOEs to rely on the conflicting provisions in the Companies Act and the PFMA when complying with governance expectations. In addition, there is persistent duplication where separate legislation applicable to one SOE contains provisions regulating the same subject matter. The duplication of provisions in different legislation on one subject may lead to unintended consequences and is a potential source of confusion. By way of example in this regard, in most instances the founding legislation of the SOE attempts to provide for issues such as the reporting obligations of the SOE. However, this would also be dealt with in other legislation such as the PFMA, meaning that in order to comply, the accounting officers of these SOEs must observe provisions appearing in two or more pieces of legislation to ensure compliance.

Blurred purpose, unclear legal statutes, 'ambiguity regarding policy objectives, or legislative shortcomings' makes it difficult for SOE board members to exercise their duties (World Bank, 2006, p. 23). SOEs are regulated by multiple laws and measures that often conflict. In cases where founding legislation exists, which set out the mandate of the SOEs, they are also regulated by the Public Finance Management Act (PFMA) as well as the Companies Act of 2008 (and now the New Companies Act of 2009). The PMFA and Companies Act conflict in a number of areas (Lund, 2010).

The PRC review of international approaches to policies regarding corporate governance of SOEs indicated that careful consideration is given to the development of clearly defined corporate governance principles. The Australian Government established a policy document entitled "The Governance Arrangement for Commonwealth Business Enterprises" (the GBE Guidelines). This document is similar to South Africa's Protocol on Corporate Governance in the Public Sector. However, the Australian document has undergone several iterations matching the changes and developments of the country's corporate governance practices. The GBE Guidelines provides a framework for defining the Australian Government's working relationship with its Government business enterprises (this document is widely used by other SOEs that are not enterprises). To entrench provisions of the document, as well as the framework of corporate governance, which exists in Australia, the Australian National Audit Office (ANAO) developed and published a series of guideline documents entitled *Better Practice Guide on Public Sector Governance* (Uhrig, 2003).

For Australia's CAC bodies, key elements of corporate governance include the transparency of corporate structures and operations; the

implementation of effective risk management and internal control systems; the accountability of the board to stakeholders through, for example, clear and timely disclosure; and responsibility to society. The board is responsible for ensuring good corporate governance, determining and approving corporate strategy, and providing guidance and oversight to senior management. It is also responsible for approving and reviewing the overall business strategies, significant policies and structure of the organisation; has the absolute responsibility for the performance of a CAC body in meeting its stated objectives and obligations as a public body; and is fully accountable for this outcome to the responsible Minister(s). The board must also ensure that an effective system of controls is in place to manage, among other things, the major risks faced by the organisation; reporting performance to stakeholders; and complying with applicable laws and regulations (Uhrig, 2003).

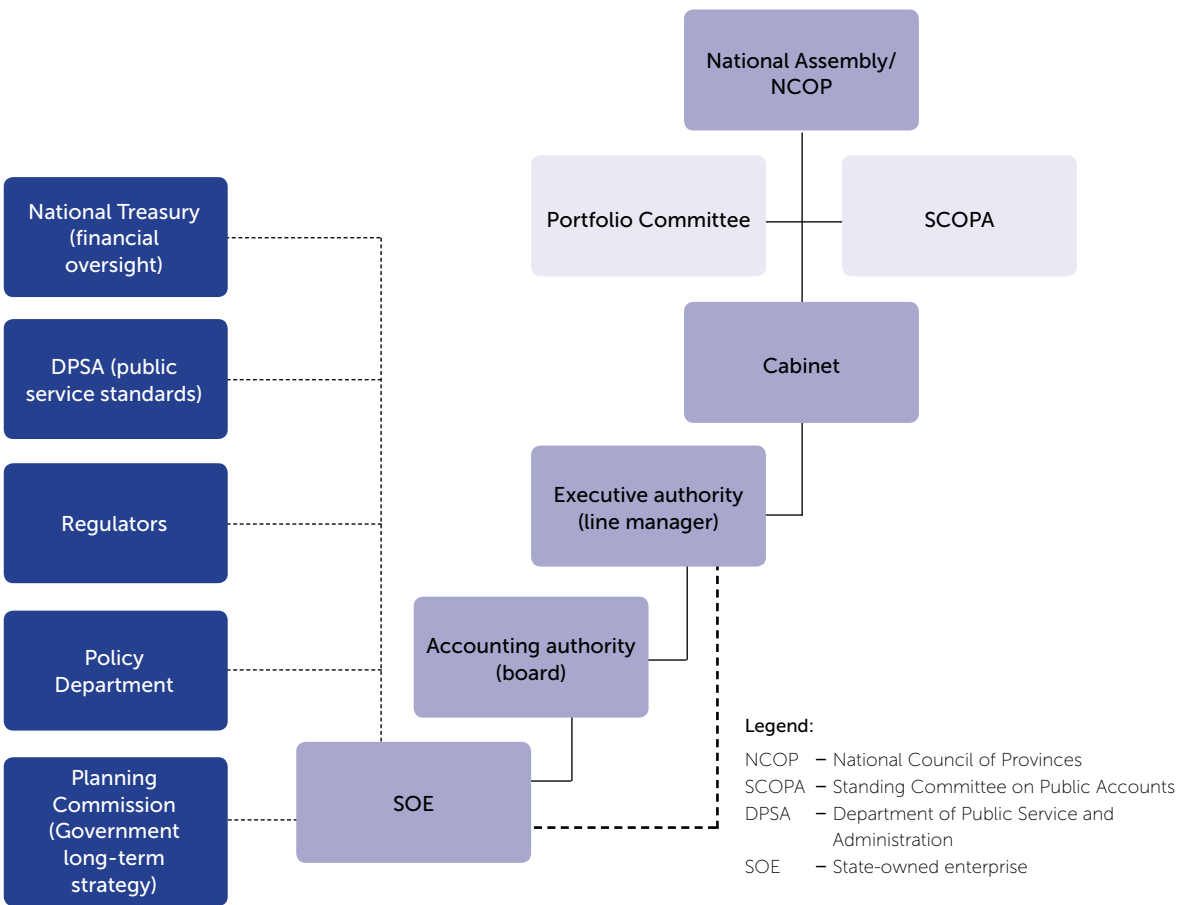
It is clear that an effective governance framework must start with the powers, roles and responsibilities of the board being clearly defined. Without such definition, clear accountability for the achievement of objectives cannot be achieved.

In a white paper on Norwegian State-ownership a number of key elements of 'generally accepted principles of corporate governance' are outlined. These include the notion of social responsibility, which is the recognition that Norwegian SOEs are expected 'to integrate social and environmental consideration in their daily operations'. The State also has high expectations with respect to labour rights, human rights, anti-corruption and transparency pertaining to 'monetary flows'.

Levels of responsibility and accountability should be clarified by the proposed protocol to reduce role confusion and overlaps that invariably affect good governance.

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Figure 14: Typical governance structure of SOEs in South Africa



Source: Adapted from National Treasury (2005).
— Represents the current practice
- - - Represents the current indirect practice
..... Represents a frail relationship

Constitutional oversight of the performance of SOEs rests with Parliament (being the National Assembly and the National Council of Provinces and its portfolio committees, public accounts committees and joint committees). The Standing Committee on Public Accounts (SCOPA) interrogates the annual financial statements of SOEs. Portfolio committees review the non-financial information on SOEs, such as their service delivery performance. The challenge facing members of Parliament is to improve the capacity of the policy/Parliamentary committees to hold departments and SOEs to account for their performance, using their strategic plans, budget

documents and annual reports as the basis for comparison to their mandates, which are set by Parliament.

The Auditor General

Accountable to Parliament, the Auditor General provides audit reports on SOEs. According to the Constitution (section 188) the Auditor General audits the accounts, financial statements and management of all departments or entities required by legislation, except those he has opted not to audit as referred to in section 4(3) of the Public Audit Act, 2004. This audit includes the audit of reporting on performance against predetermined objectives, otherwise known as

performance information. SCOPA interrogates the audit reports of the Auditor General.

Cabinet and policy departments

The ultimate authority to direct policy is vested in the Cabinet. Cabinet, comprising the various Ministers, decides on the appropriate and desired policy to meet the mission and mandate of the country. Through their departments, Ministers give policy directives and ensure that the necessary structures, processes and activities are in place to implement policy in the SOEs.

National Treasury, the Department of Public Service and Administration (DPSA) and various regulators provide support in the monitoring of policy implementation through respective financial, public service and regulatory mandates.

The executive authority

As representative shareholder, the line Minister as executive authority is concerned with a suitable return on investments, and ensuring the financial viability of the SOE. The executive authority is responsible for the effective and efficient provision of the service delivery requirements.

The board as accounting authority

The board of an SOE is responsible for the performance of the SOE. Its duty is to ensure that the SOE meets the strategic objectives as agreed with the line Minister, while at the same time reaching its commercial goals. The board is also responsible to other stakeholders, *inter alia*, consumers of the SOE's goods and services, lenders, employees and the general public. The board of an SOE also carries certain fiduciary responsibilities in terms of the Companies Act and the PFMA.

Through legislation, various ministries, the Auditor General and boards of SOEs are mandated to monitor performance. However, various pieces of legislation create confusion on where these levels of monitoring begin and end.

The development of a consolidated and effective corporate governance framework that applies to SOEs at all three levels of Government requires the formation of a task team comprising Government officials, relevant experts on corporate governance, and other stakeholders such as SOEs and labour. Unlike the protocols, which were developed by the Department of Public Enterprises (essentially for large commercial SOEs) the new framework, which ideally should be an updated protocol, will apply to all SOEs. In addition, it should be required that the protocol be reviewed periodically, at least every three years, by a standing committee established in the process of developing the new framework.

3.4 OWNERSHIP

3.4.1 Background

The State's ownership interest in SOEs is represented for Government through different institutions: ownership Ministers, members of Provincial Executive Councils, and municipalities. Within the national and provincial Government spheres, this is in most cases represented by policy ministries that also double up as ownership ministries. Each of these Government institutions may, and most have, established SOEs. As a result, there are multiple Government institutions playing an ownership role on behalf of the South African Government. In examining the SOE legislative framework, another set of questions arise relating to the ownership role of the Government. These include:

- How is the issue of Government ownership dealt with in the current legislation that impacts on SOEs?
- What is South Africa's current shareholder/ownership management model and how does it affect SOEs?
- What instrument should the Government use to exercise ownership: a Government department or an institution detached from Government structures?

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In addition, the PRC was charged with determining, among other things, how many SOEs there are in South Africa; where these SOEs are located; the corporate type; asset base; the revenue of these SOEs; and the number of staff employed. This exercise was fraught with challenges, among the most important being the inaccuracies of, and limited public and accessible information in relation to existing data on SOEs that were sitting with a wide variety of Government institutions. It became clear to the PRC that there is a need to develop a centralised SOE database.

Section 63 (2) of the PFMA states: "...the executive authority responsible for the public entity under the ownership control of the national or provincial executive must exercise that executive's ownership control powers to ensure that that public entity complies with this act and the financial policies of the executive."

Founding legislation of State entities also grants the ownership rights to the relevant Ownership Ministry. The PRC concludes that whilst no evidence was produced on request of the existence of an 'ownership policy', the provisions of the PFMA, as well as the establishing legislation of various entities, provide a legal framework regarding ownership of the entities and their responsibilities and the benefits that flow from such ownership. Despite this, the PRC notes a number of issues and challenges.

3.4.2 Issues and challenges

3.4.2.1 Lack of an overarching SOE ownership policy or framework

There is currently no overarching SOE ownership framework that forms the basis for any Government institution playing an ownership role over SOEs, and doing so in a manner that is uniform across the different Government institutions playing an ownership role.

The consequences of there being no overarching ownership policy and/or framework are numerous. For instance, as indicated in the

section on SOE legislation above, ownership is defined and treated differently in the existing SOE legislation. In addition, in the PFMA the term 'executive authority' means a number of things, including what may be interpreted to mean ownership of (i.e., shareholding in) SOEs, although the relevant legislative provisions do not expressly state this. In defining what an executive authority is in relation to SOEs, there is no reference to the word 'ownership'. All that the legislative provision states is that the role played by Government ministries of SOEs falling under them is that of being accountable to Parliament (nationally or provincially), thereby imputing the necessary role of SOE ownership (and in some instances, oversight). Therefore, ownership/ shareholding is inferred (in the absence of express reference thereto).

At local Government level there is no definition of ownership or shareholding. The MFMA, however, makes reference to 'sole control', which it defines, in relation to a municipal entity, to mean 'the rights and powers a municipality has over a municipal entity'. The Municipal Systems Act does not make any reference to the concept of ownership or shareholding either. This act, however, makes reference to 'effective control', which it defines similar to a private company as being: "...the power which a shareholder in the private company may have to appoint or remove at least the majority of the board of directors of the private company; or to control at least the majority of the voting rights at a general meeting of the private company."

There is no indication of the applicability of this term to non-corporatised entities.

The absence of a uniform way through which Government legislatively defines what its ownership of SOEs entails, undermines the Government's ownership role and oversight framework.

The SOE ownership framework should include the following principles:

- It should clearly delineate who the owner is;
- It should clearly delineate the rights and responsibilities of the owner (including culpability for liabilities of SOEs);
- It should clearly delineate extent of ownership; and
- It should be included in the SOE Act.

3.4.2.2 Ownership model

Numerous Government institutions in all three spheres of Government have the right to establish SOEs. This multiple shareholder/ ownership management approach has given rise to a number of challenges. Most importantly, it impacts on other aspects of SOE governance such as legislation; oversight; board and CEO appointments; board remuneration, accounting and reporting; and overall management practices by the different Government institutions over SOEs. These challenges are chiefly in relation to the lack of uniformity in ownership practice, which results in a lack of uniformity in the monitoring and evaluation of SOE performance. Further, this makes it difficult for Government to report effectively, comprehensively and accurately on the impact of SOEs in the South African economy.

The Department of Public Enterprises (DPE) embarked on a preliminary process to develop a model of ownership of SOEs, the centralised shareholder management model (CSM), which is a centralised shareholder management approach to ownership of SOEs specifically for the large commercial SOEs. The DPE maintains further that the decision on what shareholder/ownership model to adopt is ultimately a legislative issue. The current decentralised model (in terms of which different ownership/shareholder departments perform an ownership/shareholder role) is based on SOE founding legislation. Should this current model change, then this would result in a significant legislative shift for SOEs.

It must be noted that the DPE proposed model is biased in its focus on the major commercial SOEs, which are largely (if not all) incorporated. Accordingly, it does not necessarily arise from a balanced assessment of the broad spectrum of SOEs across all three spheres of Government. Its scope excludes many national, provincial and municipal entities that do not operate on a commercial basis, and which are not incorporated. However, to the extent that principles advocated by the DPE's proposals on SOE ownership can be generalised to the entire SOE landscape, this should be done. This includes its recommendations on a future shareholder/ownership management approach.

There are different ownership models in different countries. Some have adopted the decentralised model; others a dual model; still others use a centralised model; and in some instances, a hybrid one.

In the **decentralised model**, SOEs are under the responsibility of branch or sector ministries. This is the case in South Africa, where a multitude of Government institutions from all spheres exercise the ownership function.

The **dual model** differs from the decentralised model in that there are two ministries – sector ministries and a 'common ministry', usually the Ministry of Finance – responsible for exercising the ownership function. There may be a dual responsibility about certain specific aspects of the ownership role, for example, where both ministries have the right to nominate representatives to the board of directors. This is the case in Mexico, where representatives from the Ministry of Finance and Public Credit and the sector ministries sit on the board of State-owned companies. These State representatives must represent at least 50% of the board, and the chair of the board is from the sector ministry. In New Zealand, the sector ministry and the common ministry each own half of the State's shares in SOEs. The common or central Minister

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may be in charge of the nomination of board members, or aggregate reporting (i.e., reporting about the overall State-owned sector). In Korea, at least three ministries exercise the Government’s ownership rights in SOEs.

The **centralised model**, which has emerged more recently, is characterised by a strong centralisation of the ownership function. In this model most commercial SOEs are put under the responsibility of one ministry or agency. In most cases this is the Ministry of Finance (Denmark, the Netherlands, and Spain), or the Ministry of Industry (Norway and Sweden), which used to have the most important SOEs under its responsibility in the previous model of sector ministry organisation. In a few cases, a specific agency has been established, and this agency is more or less autonomous, usually reporting to the Ministry of Finance (as in the case of France). In some instances, the ownership of most or a specific list of SOEs has been transferred to one or several holdings which are in turn owned by the State and under the responsibility of one ministry. The centralised unit is in charge of establishing common standards or guidelines that have to be followed by other ministries regarding the enterprises under their responsibility. It is also in charge of global reporting. A significant number of SOEs remain under the responsibility of other ministries, but their ownership responsibilities are increasingly transferred in the short or medium term to the ‘centralising’ ministry.

The following are the main advantages and rationale for a centralised model of ownership:

- It makes possible the separation of the ownership function from the policy function;
- It facilitates a greater unity and consistency of the ownership policy, such as in implementing unified guidelines regarding disclosure, board nomination or executive remuneration;
- It has been a major force toward the elaboration of centralised or aggregate financial reporting on SOEs; and

- It allows for centralising competencies and organising ‘pools’ of experts in relevant matters, such as financial reporting or board nomination.

Very few advantages were identified in international experience that had the other ownership models.

The main disadvantage of a decentralised ownership model is the greater difficulty in making a clear separation of the ownership functions from other State functions, particularly its regulatory and policy roles. No advantages were identified in having a decentralised model.

Internationally, the decentralised (multiple) ownership model is the most traditional one, and the dual model is the least prevalent. The centralised model has been on the increase more recently, while a slight majority of countries use the multiple-ownership model. A few countries use a combination of more than one model. Accordingly, there is no global ‘one size fits all’ when it comes to the appropriate ownership/ shareholder management model. Whilst some of the international benchmarks are persuasive, the determining factor regarding the South African SOE ownership model should be the circumstances that are relevant to South Africa.

SOE legislative reform in a number of countries has resulted in effective SOE ownership and oversight including Namibia. SOE legislative frameworks that clearly outline the different roles of Government institutions playing an ownership and oversight role over SOEs could go a long to improving the current situation in South Africa. The strengthening of the SOE legislative framework, including an SOE Act, could bring about improvements in SOE management and oversight as well as ownership within the existing shareholder management/ ownership model. However, there is a widespread trend internationally towards clearly distinguishing and separating Government’s different roles and interests as owner, fiscal manager, policy-maker and regulator, such as in China, New Zealand, Australia, the UK and France.

There is a need to reduce the number of Government institutions playing an ownership/ shareholder role, as well as to separate the ownership/ shareholder role from the policy-making and regulatory role currently residing in the same department, particularly for the large commercial entities. This should be given legislative treatment in line with the Namibian, New Zealand and Australian models, where a portfolio ministry plays the policy role, and the ownership/ shareholder role is played by another Government institution. This will bring about focused execution of each of the Government roles by the respective Government institutions in the three spheres of Government. The ownership/ shareholder model should take a specific dual form, in which the ownership of the large commercial entities are centralised at all spheres of Government, while the ownership of non-commercial entities remain with line ministries.

The Government institutions that should play distinct roles within the existing ownership model are as follows:

- At the national level: the fiscal oversight role should remain with National Treasury as per the constitutional mandate. The shareholding role for commercial entities should be the responsibility of the central oversight authority for commercial entities (currently the Department of Public Enterprises). The shareholding role for DFIs should be the responsibility of the central oversight authority for DFIs and the separation of DFIs from other commercial entities is informed by the PRC’s observations regarding current challenges relating to capacity for oversight. The proposed phased centralisation will allow for better synergies among like entities. The shareholding role for statutory corporations and all non-commercial entities would be the line ministries; and the policy role should reside with line ministries.

- At the provincial level: the fiscal oversight role should remain with the Provincial Treasuries. The shareholding role for commercial entities should be the responsibility of the provincial central oversight authority for Commercial Entities and DFI’s. The PRCs experience is that in most provinces, commercial and DFI roles are housed in departments for economic development. The shareholding role for statutory corporations and all non-commercial entities would be the line provincial ministries; and the policy role should reside with line provincial ministries.
- At the local level: the fiscal oversight role should remain with the municipal treasuries, the shareholding role for commercial entities should be the responsibility of the municipal central oversight authority for commercial entities and DFIs. The shareholding role for statutory corporations and all non-commercial entities would be the line departments, and the policy role should reside with line departments.

3.4.2.3 Role of the Government as owner representative

The current SOE legislative framework does not recognise the distinct role of Government as an owner/ shareholder representative.

The decision made by two key Government departments – DPE and National Treasury – to conduct extensive reviews and propose SOE legislative reforms so as to strengthen the role of Government as an owner/ shareholder is evidence that the distinct role of the Government as owner/ shareholder is currently truncated. The result is that Government’s ability to assert its role as owner and in overseeing SOE performance is negatively affected by the absence of legislation giving full effect to that power.

The ENS study recommended that the Government should exercise the ownership role in line with company laws and that provisions in

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any other statutes (PFMA, GSM Bill, etc.) should be substituted by what is contained in company law. This would result in a less active ownership role for the Government. The PRC rejects this view. One reason for this rejection is the fact that the ENS position is informed by an exclusive focus on incorporated SOEs in the ENS study, and no evaluation of the applicability of company law to the wide variety of different SOEs of all three spheres of Government. The Companies Act is only limited to SOEs that are incorporated, which are far less in number than the SOEs that are not incorporated. Therefore, the Companies Act is inadequate in this regard. The PRC identified a number of other challenges in the current relationship between SOEs and Government ministries.

- Ministries perform multiple roles such as owner, fiscal manager, policy maker and regulator, and these often compete. As the owner of SOEs, Government is an owner/ shareholder concerned with returns on investments and other imperatives that are in the interests of the economy at large, such as infrastructure development. It is also a policy maker overseeing the implementation of policies and delivery of services, including social contributions such as skills development, transformation and job creation. Government is also the regulator supervising industry practices and safeguarding the interests of consumers. These multiple roles confuse SOEs, which are often unable to determine what is expected from them by Government as owner, policy-maker, or regulator. When SOEs receive directives from their ownership/shareholder institution it is unclear whether they are in pursuance of ownership interests, in pursuance of Government policy, or regulatory interests.
- The role and responsibilities of different Government departments/institutions (in relation to SOEs) are not clearly delineated with the resultant confusion of the rights

of the departments and the reporting and accountability lines for SOEs.

3.4.2.4 Balance between political interference and exercising ownership functions

The necessity for a clear delineation of the State's rights and role as an owner is demonstrated further by charges that the Government interferes unduly in the activities of SOEs. The distinction between the role of the ownership/ shareholder representative (i.e., Government) and the role of the board needs to be defined clearly. This can only be achieved through the creation of a clear governance framework that stipulates comprehensive and clear principles for the exercise of the ownership function. The word 'interference' is often used loosely, even in situations where Government justifiably exercises its role to be 'involved' as an owner of public assets, or 'intervening' where boards of SOEs do not act in the interest of the SOE or in accordance with the SOE mandate. It is probably correct that at times the Government acts in a manner that points to interference. Clear rules of engagement, and rights and responsibilities, will ensure that there is no violation of good corporate governance principles that negatively affect the effective delivery of the SOEs' mandates and the achievement of the State's developmental objectives.

Government must institute a task team with representation from all key stakeholders, notably Government departments playing an ownership role; SOEs; and other relevant stakeholders to develop a SOE ownership policy.

3.4.2.5 Ownership database

Exercising an ownership role requires knowing what is owned. The State does not know exactly what it owns. This is in part because there is no single repository or centralised source of all SOE information through which Government can access information about how many SOEs exist, what its level of ownership is in specific SOEs,

their funding history and data, and their board status. Nor is there access to the performance and operational data on each of these institutions. Whatever is available and accessible as SOE information is found in many different locations. The absence of a central database poses a challenge and constrains Government's ability to exercise ownership and oversight responsibilities.

In addition, National Treasury scheduling through the PFMA, whilst currently serving this purpose, has limitations in that it depends on ministries to inform the Treasury on new listing of SOEs and delisting those that no longer exist. The system is at times unreliable because the Treasury is not fully advised of the listing and delisting by the ministries. In some instances, existing SOEs are not listed; particularly in the provinces. Other entities operate outside the public sector and yet receive full or partial funding from (and in most instances having been established by) the State. Many of these entities are not included in the PFMA schedules. A centralised national SOE database is a key instrument through which the State as an owner can be informed on what it owns and the extent of ownership of such entities.

France maintains a very effective system of SOE data supported by a comprehensive reporting system on French SOEs. The Agence des participations de l'Etat (APE) reports on all SOEs in meticulous detail. It lists all its SOEs and it does so per sector and per extent of shareholding. It also details the total asset base, equity and liabilities, and income of its entire SOE portfolio on a common platform. APE can also report on the total return on capital (RoC), return on equity (RoE); operating margin, and the net debt/EBIDTA or net debt/equity attributable to each SOE. The APE reports on the total profit made by the SOEs, the dividend paid to it by each SOE, and the total number of employees employed by all these entities (including subsidiaries), as well as detailing their gender equity statistics. This is

partially the result of a centralised reporting and data collection system maintained by a single Government institution.

The proposed database for South African SOEs must include data on all SOEs as well as any other institution in which the Government, either directly or through SOEs, holds interest or shareholding (big or small), and/or provides full or partial funding for purposes of the continued existence of that institution. Annual reports of all Government institutions at all spheres that play an ownership role must include comprehensive reporting on SOEs under their control, as well as their subsidiaries to facilitate the development of a SOE database. The database should be updated quarterly. A summarised total SOE landscape with key attributes must be published quarterly and be accessible in public places such as libraries in Government departments playing an ownership role.

As part of its review, the PRC assisted by the HSRC, undertook a pilot initiative to develop an SOE database prototype. The pilot database will be submitted as part of the report to the President. It is necessary to keep the database up to date, and to this end, the PRC proposes that the HSRC continue to host the database independently on behalf of the State until such time that permanent arrangements are made to host the database.

3.5 OVERSIGHT

3.5.1 Background

According to the National Treasury, oversight is concerned with reviewing and monitoring the affairs, practices, activities, behaviour and conduct of SOEs in order to determine whether or not their affairs and business practices are conducted in the manner expected of them and in accordance with all normal commercial, legislative and other prescribed or agreed norms. This includes the review, monitoring and oversight of the management of SOEs; their strategic and business

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planning; their conduct of business operations; and their reporting thereon and accounting thereof. In addition, oversight includes reviewing and monitoring whether SOEs are effectively managed by their executive management and staff and that the assets and goodwill are properly protected and preserved. The PRC’s review of the oversight exercised over SOEs in South Africa is imperative so as to determine:

- How the issue of oversight is dealt with in the current legislation that impacts on SOEs;
- The nature of the current oversight framework and how it affects SOEs; and
- The instruments the Government should use to exercise effective oversight.

3.5.2 Issues and challenges

3.5.2.1 Lack of a coordinated and unitary oversight framework

As a consequence of the decentralised ownership model, many policy and shareholding Government institutions conduct their oversight role on a decentralised basis. Thus, in addition to National and Provincial Treasuries, many policy institutions have an oversight function and, as a result, duplicate other oversight structures. In the case of SOE’s, oversight is vested in Parliament, the executive authorities of numerous Government institutions, and the boards of SOEs.

Parliament exercises its role through evaluating the performance of SOEs by interrogating their annual financial statements. In addition, the relevant Parliamentary Portfolio Committee exercises oversight over SOEs and reviews the non-financial information contained in the annual reports of SOEs to monitor issues that relate to service delivery and enhancing economic growth. Oversight by the executive authority is based on the prescripts of the PFMA, which gives authority to the executive authority to exercise oversight powers with particular reference to corporate plans, shareholders’ compacts and quarterly reports. The Minister of Finance and the National

Treasury are responsible for financial oversight.

However, the oversight function is just as adversely affected as corporate governance and ownership are by the lack of a coordinated and unitary oversight framework. As correctly noted by the ENS study, SOE founding legislation contains additional SOE-specific procedural requirements for transacting that would not exist were SOEs regulated only by general legislation such as companies’ statutes or the PFMA. Moreover, certain founding statutes regulate matters that are already regulated by company law, resulting in regulatory duplication. This is in addition to reporting requirements contained in the PFMA. The list of such legislative provisions in SOE founding acts given here is not exhaustive. Therefore, oversight measures should be excised from SOE founding acts so that there is uniformity in content and application. SOE founding acts should focus on policy and mandate-related issues, while a single legislative source should be developed to deal with the oversight function.

3.5.2.2 Multiplicity of reporting institutions

Another argument in favour of developing an overarching oversight framework arises from the effects of a multiplicity of reporting institutions. SOEs find themselves accountable to the Shareholder Ministries; provincial Government structures; Parliamentary Portfolio Committees; and other related ministries. In the case of a municipal-owned entity (MOE), this reporting is compounded by similar requests from the provincial department responsible for local Government and occasionally a request from the Premier’s Office. Provincial legislatures are also entitled to request any information from provincial SOEs as and when they deem necessary, as part of their oversight responsibility.

This provides numerous inefficiencies for SOEs because they have to meet the different requirements of each of these authorities on demand. In addition to the statutory monthly and

quarterly reports, entities are frequently requested to provide the same reports on an ad hoc basis in different formats, often requiring extensive adjustments of templates, which involves countless hours of work. One example is the employment equity report, which forms part of a quarterly report to the owner/shareholder and to the Department of Labour, which has to be presented in many different formats to a number of institutions, such as the Gender Commission which tracks progress on gender transformation.

The manner in which SOEs are held to account and required to be transparent can deviate from the ownership model. Two examples from international experience are of relevance here. In Finland, the Prime Minister’s Office took ownership of the majority of SOEs. Only SOEs with special tasks were left with line ministries. An Ownership Steering Department was established in the Prime Minister’s Office to develop SOE strategies. This steering committee is responsible for commercial/business entities. The relocation of the ownership of the major SOEs was intended to separate ownership and regulation.

In New Zealand, the oversight function is centralised in the Crown Company Management Advisory Unit (CCMAU, now COMU) within the Prime Minister’s Office. The Minister of Finance focuses on financial reporting and the ‘sector ministries’ (through COMU) adopts a commercially-oriented perspective with a primary emphasis on ensuring that SOEs are successful companies. In addition, sector ministries, through the COMU, take the lead in monitoring performance and have sole responsibility for board composition.

International experience supports the view that there can be many shareholder institutions co-playing the role of ownership and yet managing SOEs effectively. The important element is legislative management of relations and roles of SOE and owner/shareholder (the Government).

3.5.2.3 Absence of a uniform approach to implementing oversight

There is no uniform approach in exercising oversight of SOEs in South Africa. As noted above, many institutions play this role. Inevitably, each institution does so in a manner that it deems prudent, and this leads to a multiplicity of different, fragmented oversight practices by Government institutions. In addition, what constitutes oversight and intervention is interpreted and understood differently by institutions of the different sectors of the Government. ‘Ownership’ and ‘oversight’ are often interpreted to mean the same thing. This is not the case. Even where there are uniform frameworks, application by different institutions exercising oversight is not uniform. (This feature of oversight is dealt with in more detail in the section of the report dealing with SOE performance.)

3.5.2.4 Lack of capacity to perform the oversight task

The survey of chief executives of SOEs conducted on behalf of the PRC reveals that most SOEs complain that they submit reports but receive no, or extremely belated, feedback from the relevant department or ministry. There is a huge disparity in oversight skill levels in various ownership units. This means that the capacity to conduct oversight is uneven across Government institutions. In addition, Government institutions overseeing SOEs play a number of roles simultaneously, such as policy-making, oversight, regulation, etc. The capacity of these institutions to do so is limited because the resources are stretched and straddle these many roles. This gives credence to the separation of these different Government roles in order to ensure that the oversight function receives focused, well-resourced and capacitated attention.

3.5.2.5 Lack of oversight over subsidiaries

There is a dearth of literature on how best to exercise oversight over SOE subsidiaries. It is also true that there is very little reporting by SOEs on

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the affairs of the subsidiaries they own. It is the PRC's submission that the development of a future oversight framework should take into account the oversight of SOE subsidiaries. In addition, there is a lack of oversight over unlisted Government institutions that do not fall within the purview of SOE legislative frameworks (e.g., universities, sports bodies, etc.). There are also institutions that are either partially or fully-owned by Government, and/or partially or fully funded by Government that are not under the remit of SOE legislative frameworks, as well as oversight by Government. It is our submission that a future SOE oversight framework must also extend to these entities.

3.5.2.6 Lack of inter-Governmental cooperation and collaboration

Effective oversight is dependent upon, among other things, closer collaboration between shareholder ministries, policy ministries and regulators. SOE oversight is a collective responsibility. There is a legislative and constitutional injunction on State organs to cooperate with one another. However, there are inconsistencies with respect to the extent of such cooperation in State organs, as we note in another part of the report, which deals with collaboration. Currently, collaboration and cooperation within the context of oversight is very weak or non-existent. Oversight institutions should be measured on the extent to which they engage other stakeholders in exercising oversight over SOEs.

There is often no coordination between the Minister/department responsible for policy making and the shareholding Minister/department, when these two are different. This undermines effective oversight, performance and even the financial sustainability and viability of SOEs. Government institutions playing a leading oversight role must be required to have structured, documented collaboration, cooperation and consultative arrangements with other Government institutions

that have an interest in SOEs. The strategic plans of Government institutions (irrespective of role) should, in relation to SOE plans, contain key performance indicators on collaboration and cooperation between Government institutions. Those that play an oversight role over SOEs must be measured thereon on an annual basis by Parliament. (The relevant recommendation on this issue is in the section on SOE performance.)

The Government must institute a task team with representation from all key stakeholders, notably Government departments playing an oversight role; SOEs; and other relevant stakeholders, to develop a Government SOE oversight framework. The future SOE oversight framework should be underpinned and/or given effect by legislation.

3.6 THE ESTABLISHMENT AND DISESTABLISHMENT OF SOES

3.6.1 Legislative framework for establishment and disestablishment of SOEs

The policy framework for the establishment and disestablishment of SOEs is regulated by various pieces of legislation. Amongst others, these include the PFMA, MFMA, Municipal Systems Act, etc. In terms of Chapter 6 of the PFMA, an accounting authority for a public entity should promptly inform the National Treasury of any new entity it intends to establish, or in the establishment of which it takes the initiative. It is also stipulated that the National Treasury be allowed a reasonable time to submit its decision prior to formal establishment. Despite limitations, a policy framework for the establishment and disestablishment of SOEs exists at local Government level, while there are legislative provisions for the establishment of SOEs at the provincial and national levels. However, there is no policy for the disestablishment of SOEs at the national and provincial spheres.

The PFMA stipulates that before a public entity concludes any of the following transactions, the accounting authority for that public entity must promptly and in writing inform the relevant Treasury of the transaction and submit the particulars of the transaction to its executive authority for approval. This process must be followed prior to:

- The establishment or participation in the establishment of a company;
- Participation in a significant partnership, trust, unincorporated joint venture or similar arrangement;
- Acquisition or disposal of a significant shareholding in a company;
- Acquisition or disposal of a significant asset;
- Commencement or cessation of a significant business activity; and
- A significant change in the nature or extent of its interest in a significant partnership, trust, unincorporated joint venture or similar arrangement.

In terms of clause 82(1) of the Municipal Systems Act (No. 32 of 2000), '... if a municipality intends to provide a municipal service in the municipality through a service delivery agreement with a municipal entity, it may:

- Alone or together with another municipality, establish in terms of applicable national or provincial legislation a company, a cooperative, trust, fund or other corporate entity to provide that municipal service as a municipal entity under the ownership control of that municipality or those municipalities;
- Alone or together with another municipality, acquire ownership control in any existing company, cooperative, trust, fund or other corporate entity which as its main business intends to provide that municipal service in terms of a service delivery agreement with the municipality; or
- Establish in terms of subsection (2) a service utility to provide that municipal service.

The MFMA also provides for the disestablishment of SOEs in the following terms:

If a municipal entity experiences serious or persistent financial problems and the board of directors of the entity fails to act effectively, the parent municipality must either:

- Take appropriate steps in terms of its rights and powers over that entity, including its rights and powers in terms of any relevant service delivery or other agreement;
- Impose a financial recovery plan, which must meet the same criteria set out in section 142 for a municipal recovery plan; or
- Liquidate and disestablish the entity.

3.6.2 Broad processes for the creation of national public entities

The national executive authority exercises ownership/shareholder management over SOEs, using the applicable legal and regulatory instruments, including the PFMA and SOE founding legislation. The national executive authority is both the founder and the administrative custodian of all legislation relating to the establishment of national SOEs. Except for Denel, all SOEs that fall under the Department of Public Enterprises are established in terms of their own founding legislation, which sets out the purpose, mandate and objectives for which they are founded. In the case of Eskom, for example, the relevant founding legislation is the Eskom Act, No. 40 of 1987. Under the Act, Eskom shall, among others, have power:

- To investigate, establish, acquire, maintain, coordinate, amalgamate and carry on undertakings to provide an efficient and cost-effective supply of electricity to any person in the Republic;
- To purchase or acquire in any way stock-in-trade, plant, machinery, land, buildings, agencies, shares, debentures, mineral rights and every other kind or description of movable and immovable property including electricity;

CHAPTER 3: STATE-OWNED ENTITY LEGISLATION, CORPORATE GOVERNANCE, OWNERSHIP, OVERSIGHT AND ESTABLISHMENT AND DISESTABLISHMENT OF STATE-OWNED ENTITIES continued

- To manage, insure, sell, lease, mortgage, dispose of, give in exchange, work, develop, build on, improve, turn to account or in any way otherwise deal with all or part of its property and assets, etc.;
- To form and have an interest in any company or companies for purposes of acquiring the business or all or any of the assets or liabilities of any company or for any other purpose which may seem, directly or indirectly, calculated to benefit Eskom; and
- To enter into any contract or perform any act, whether within the Republic or outside, which, in the opinion of the Electricity Council, contributes towards the attainment of Eskom's objectives.

Over and above the existing legislation, a policy framework for the establishment of SOEs at the national level has been introduced. On 4 April 2004, Cabinet approved, as an interim measure, the Interim Guide for Creating Public Entities at the National Sphere of Government. It was anticipated that the broad process would remain in operation until it was replaced and/or updated by an appropriate institutional framework for public entities. The Ministers of Public Service and Administration (MPSA) and Finance (MoF) were given a key role in the determination of the mandates for the creation, listing and classification of national public enterprises. In terms of the broad interim process, there are four critical steps that should be followed in order to create a national public entity.

- In **step 1**, an executive authority is required to prepare a business case for the intended national public entity. It should take into account the following: situation analysis and strategic plans, and identifying and assessing service delivery options, governance issues and recommending the appropriate service delivery option.

Once an executive authority has recommended the appropriate service delivery option and submitted the business case, an MPSA and MoF joint evaluation panel will assess the business case for the intended national public entity, i.e., **step 2**. If the application meets the minimum requirements of both the MPSA and MoF, consent will be granted for the establishment of the national public entity.

- Thereafter, as **step 3**, the relevant department must:
 - Submit the necessary motivation and consent of the MPSA and the MoF to the relevant portfolio committee for discussion before it is submitted to Cabinet;
 - Inform Cabinet of the consent of the MPSA and MoF and request Cabinet approval to introduce a bill in Parliament for establishing the national public entity; and
 - Table a bill in Parliament for establishing the public entity.
- To effect the establishment of a national public entity, as **step 4**, the executive must:
 - Approve the initial organisation and post-establishment structure for the public entity;
 - Appoint the members of the controlling body/board for the public entity in terms of its establishing act;
 - In the case where a public entity is established for a new function, allocate/transfer resources to the public entity where appropriate;
 - Effect the transfer of the function and concomitant resources to the public entity based on a number of set principles;
 - Request in writing the listing and classification of the public entity in terms of the PFMA; and
 - Ensure that the public enterprise complies and submits a borrowing programme and budget projection.

3.6.3 Issues and challenges

The Department of Public Enterprises found a number of challenges in the provisions of the PFMA that relate to the establishment of SOEs. In a paper referred to as the centralised shareholder management model (CSM), it is argued that, while chapter 6, part 1 of the PFMA confers power on the Minister of Finance to list schedule 3 entities (as defined in the PFMA), it does not confer any such power on the Minister to do the same for schedule 2 entities. In addition, the document argues, the PFMA does not include a mechanism for the executive authority to establish SOEs (other than subsidiaries of a holding company SOE) as and when strategic demand for such an entity arises. This has been partially resolved by developing the broad process for the creation of national SOEs. In addition, it can be argued,

executive authorities are able to establish SOEs through founding legislation. The main issue here, however, is the absence of a framework for the disestablishment of national and provincial SOEs. No such legislative or policy framework exists in South Africa.

The codification of the disestablishment of SOEs at the national and provincial levels should include the reasons for disestablishment and the processes underlying disestablishment. International experience confirms that a policy for establishment and disestablishment of SOEs should be derived from the basis or reasons for the State's ownership in the various sectors/companies, e.g., Norway. In addition, a framework should be in place for the State to reconfigure the SOE landscape when necessary through the disestablishment of SOEs.

RECOMMENDATION 2:

The Government should enact a single overarching law ('State-owned Entities Act') governing all SOEs

The State-owned Entities Act must:

- Supersede all current legislation governing SOEs;
- Reduce the current burden of compliance with multiple laws and regulations; and
- Include all subsidiaries of SOEs.

The proposed legislation will aim to address the duplication, conflicting provisions, different founding legislation, and sometimes serious omissions. The legislation should provide for:

- (a) The mandatory requirement to undertake a critical review of the overarching strategy and mandates of SOEs every five years;
- (b) An SOE Council of Ministers (comprising DPE, Treasury, DTI, EDD, the National Planning Ministry and other relevant Government stakeholders) whose functions shall entail oversight over the implementation of the act in relation to strategic joint planning as well as collaboration between SOEs and Government departments at all spheres of Government;
- (c) The establishment of a central remuneration authority, which will set guidelines and standards for remuneration of boards and executives in SOEs;
- (d) The extent and nature of ownership, corporate type as well as categorisation;

CHAPTER 3: STATE-OWNED ENTITY LEGISLATION, CORPORATE GOVERNANCE, OWNERSHIP, OVERSIGHT AND ESTABLISHMENT AND DISESTABLISHMENT OF STATE-OWNED ENTITIES continued

- (e) The mandatory registration of all SOEs and subsidiaries in every sphere of Government;
- (f) The protocols and processes for establishment and disestablishment of SOEs in all spheres of Government;
- (g) The establishment of two central SOE authorities, one for commercial entities, and the other for development finance institutions;
- (h) A determination of the role and responsibility of the owner/executive authority;
- (i) Prohibition of the creation and proliferation of non-compliant structures e.g., section 21 companies and other prohibited forms:
 - The Municipal Finance Management Act (MFMA), Municipal Systems Act and any other overlapping legislation should be aligned with this principle; and
 - Sanctions should be introduced in the proposed new SOE Act in order to address issues of non-compliance. (See recommendation 16.);
- (j) Outline principles of an SOE performance framework to measure and evaluate the performance of an SOE;
- (k) Develop a corporate governance framework for all SOEs, which should:
 - Embrace the Developmental State agenda and the unique positioning of SOEs;
 - Encompass principles of ethical leadership, transformative corporate citizenship, service delivery, viability and sustainability; and
 - Outline principles of collaboration among SOEs;
- (l) Development of an SOE ownership framework;
- (m) A centralised ownership model for commercial entities and development finance institutions (DFIs) and a decentralised ownership/shareholder model for statutory and non-commercial entities. The ownership model should:
 - Apply to all spheres of Government, taking into account constitutional requirements;
 - Be included in the SOE Act; and
 - Clearly delineate the separate roles of Government as owner, policy-maker, regulator and implementer;
- (n) The establishment of a consolidated SOE database for all SOEs and their subsidiaries (as defined in the PFMA) of all three spheres of Government, controlled by the central authority responsible for commercial entities; The HSRC is recommended by the PRC to host the pilot database as well as to handle the transition for permanent hosting of the database;
- (o) An SOE oversight framework should be developed by the central authority responsible for commercial entities; and
- (p) Mandatory collaboration among SOEs.

Other areas that may be covered by the SOE Act should include:

- Governance and ownership-related issues;
- The role of Government in SOEs (whether activist or otherwise);
- Uniformity in the exercise of the governance role by different ministries;
- Ownership rights and powers; and
- Powers of SOEs.

The single act is necessary in the light of prevailing confusion in legislation governing SOEs, characterised by the duplication, conflicting provisions, different founding legislations, and sometimes serious omissions.

A task team should be established consisting of representatives of relevant stakeholders, external experts (eminent jurists and business professionals with SOE experience in the SOE legislative environment) and Government, including the South African Law Reform Commission, so as to ensure that an effective, balanced and representative team is in place that will produce a quality piece of legislation. Provisions sitting in the draft GSM Bill (DPE) and the draft PFM Bill should be considered in drafting the new SOE Act. The key attribute of the SOE Act should include provisions that apply to specific SOE circumstances. The Australian, New Zealand and Namibia legislative models could be used as points of reference in drafting future SOE legislation. These countries, just like South Africa, operate with a decentralised ownership/shareholder management model and their SOE Acts cover all forms of SOEs.

The Namibian model would provide useful reference. The legal context within which SOEs operate include the State-owned Enterprises Governance Act, No. 2 of 2006 (SOE Act) and other legislation in terms of which SOEs were established. The SOE Act provides for the efficient governance of SOEs, and the establishment of the State-owned Enterprises

Governing Council (SOEGC), which exercises oversight responsibilities with due regard to the legal status of individual SOEs, the functions of their respective boards of directors and the responsibilities of shareholder or portfolio Ministers. The SOEGC is chaired by the Prime Minister and supported by a Secretariat. The SOE Act specifically makes provision for the SOEGC to lay down directives in relation to:

- Establish generally accepted common principles of corporate governance and good practice governing SOEs; to develop common policy frameworks for the operations of SOEs, including policy on issues relating to human resources, assets and finance;
- Determine criteria for the performance measurement and evaluation of SOEs, and develop appropriate means for monitoring their performance;
- Make determinations in relation to the number of members to be appointed to the boards of SOEs and advise the portfolio Ministers on the appointment of such members in accordance with sections to facilitate the provision of programmes for the training and development of members of the boards and management staff of SOEs on corporate governance and efficient management practices; and
- Receive and consider for approval submissions made by SOEs on the annual distribution of profits and the declaration of dividends (Murangi, 2010).

CHAPTER 4: BOARD AND EXECUTIVE MANAGEMENT APPOINTMENTS, AND COLLABORATION AMONG STATE-OWNED ENTITIES

4.1 INTRODUCTION

4.1.1 Background and problem statements

The performance of SOEs depends to a large extent on the capabilities and performance of its board. In turn, the skills, experience and qualifications of individual directors influence the overall ability and performance of the board. Therefore, selection processes are important in ensuring that boards have high performing directors with appropriate skills. Internationally there is no one common approach for SOE board recruitment. Most genuine SOE reforms in developed and developing countries acknowledge the necessity of strengthening the role of boards. Countries like Poland, Australia, the United Kingdom and New Zealand have gone a long way towards establishing brief guidelines in terms of processes and procedures. In South Africa there is a need to review the framework for recruitment, selection, appointment, and induction of SOE boards. Current approaches are observed by the PRC as disparate and inconsistent.

The efficient and effective performance of SOEs is affected by the ways in which they execute their mandates. Among the important influences on performance is the way in which SOEs align their activities to achieve common objectives of the State. The Auditor General’s Review of 247 infrastructure projects found that the communication and coordination between Government, management, local authorities and/or communities were insufficient to ensure comprehensive delivery of infrastructure. It was found that on one activity in which cooperation is crucial, there was a lack of collaboration, coordination and cooperation in implementation of infrastructure projects. The impact this has on the critical delivery of services to the people is highly negative. The key question here is: To what extent does a framework exist for SOEs to align their activities such that there is effective collaboration to achieve common objectives?

4.1.2 Purpose of this chapter

The purpose of this chapter of the PRC report is to:

- Understand which recruitment framework within the SOE sector gives guidance to the recruitment, selection, appointment and induction of boards of SOEs;
- Ascertain whether there is compliance with such a framework;
- Establish the key challenges currently being faced by SOEs in relation to the recruitment, selection, appointment and induction framework under which SOE’s operate;
- Identify the weaknesses of the recruitment, selection, appointment and induction framework that lead to the identified challenges;
- Benchmark South Africa’s current recruitment, selection, appointment and induction framework and compare it with international best-practice, with a view to recommending effective reform; and
- Based on the findings of the review, recommend what action should be taken to remedy the prevailing weaknesses.

Finally, this review explores the frameworks for collaboration between SOEs to determine:

- Whether or not there is an effective framework for collaboration among SOEs;
- The key challenges currently being faced by SOEs as far as alignment, collaboration and coordination with each other and with Government institutions are concerned; and
- The most appropriate mechanisms to encourage collaboration among SOEs and between SOEs and Government institutions.

4.1.3 Process and approach

The material for this chapter is derived from a number of PRC processes, which include the two PRC terms of reference position papers produced by two different work-streams of the PRC – the business case and viability (BCV) work-stream and the strategic management and operational

effectiveness (SMOE) work-stream. These investigated:

- The recruitment, selection and appointment of boards and executive management of SOEs; and
- The alignment, collaboration and cooperation among SOEs and between SOEs and all spheres of Government.

4.1.4 Structure of the chapter

Chapter 4 comprises two sections. They are divided as follows:

- Recruitment, selection and appointment of boards and executive management of SOEs; and
- Collaboration, coordination and cooperation among SOEs.

Each section of this chapter provides an overview, assessment, international experience, and recommendations on the various areas reviewed.

4.2 RECRUITMENT, SELECTION AND APPOINTMENT OF BOARDS AND EXECUTIVE MANAGEMENT OF SOES

4.2.1 Background

The focus of this section of the chapter is to gain a broad understanding of the current recruitment, selection, appointment and induction framework for SOEs, and to assess weaknesses and strengths of this framework with a view to recommending reforms that will bring about transparency and accountability in these processes. The boards of SOEs should collectively have a mix of skills that are both technical and have operational expertise relevant to the operations of the SOE. They should also have a mix of financial and legal expertise and knowledge of how Government works as well as the Government’s regulatory environment. In South Africa, an attempt to harmonise and formalise recruitment practices by SOEs in all three spheres of Government was undertaken through the publication of the *Handbook for the Appointment of Persons to Boards of State and*

State-Controlled Institutions, which was approved by Parliament on 17 September 2008.

The PRC review has revealed that the use of the Handbook is sporadic in all spheres of Government. In particular, there is minimal knowledge of the existence of the handbook at the local and provincial level. Its sporadic use is due to the fact that:

- Most of the laws that provide for the appointment of persons to boards of SOEs are not aligned to the handbook and there is no mention of it in the PFMA or SOE founding legislation;
- It is unclear whether provincial premiers have adopted the handbook formally and whether an implementation programme was developed to institutionalise it;
- There is no monitoring mechanism in place to ensure compliance with the handbook; and
- Some of the critical elements needed for the success of the handbook, such as the creation of databases, have not been established in all departments.

The PRC has identified a number of issues and challenges with the current framework for recruitment, selection, appointment and induction of boards of SOEs. These include:

- The absence of a clear legislative framework for recruitment, selection, appointment and induction of boards of SOEs; and
- The lack of uniformity in the application of appointment procedures, not least in respect of to each category of SOEs.

4.2.2 Issues and challenges

4.2.2.1 The absence of a clear legislative framework for recruitment, selection, appointment and induction of boards of SOEs

The legislative framework for recruitment of SOE boards predominantly derives from SOE founding legislation; the Protocol on Corporate Governance in the Public Sector; and articles of

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association for those SOEs that are incorporated. There is no single generic legislation that governs the recruitment and appointment procedures and processes. In many cases, for example, specific founding legislation of an SOE gives the executive authority and/or owner/shareholder the power to appoint and dismiss the board, board chairperson and chief executive officer (CEO) of an SOE, whereas the Protocol on Corporate Governance in the Public Sector states that the board should appoint one of its members, preferably an independent non-executive director (unless otherwise agreed by the owner/shareholder), as the chairperson. This is in conflict with many of the provisions of the founding legislation of SOEs.

Where there is no founding legislation, an SOE's articles of association, or even the shareholder compact signed annually between the policy Minister/executive authority and the SOE board, may codify the recruitment and appointment of boards. Where the policy department and the executive authority/line ministry are two different ministries, conflict could arise between the two over who should recruit and appoint the board of the SOE, or over the specific candidates for chairpersons, CEOs and board appointments, unless the recruitment and appointment process is clearly codified in the articles of association or the shareholder compact between the line ministry/executive authority and the SOE board.

For SOEs that are listed and have shareholders other than Government, Johannesburg Stock Exchange (JSE) Listings Requirements also codify the board recruitment and appointments of the SOE. The requirements of the King III Code on Corporate Governance have much more currency for listed SOEs than for SOEs that are unlisted. In such cases, the SOE's articles of association, shareholder compact and JSE Listings Requirements codify recruitment and appointment of the board. In these cases a certain number of independent non-executive

directors are appointed at the company's annual general meeting or by the board as set out in the prescripts of the JSE Listings Requirements and the King III Code. Government, as a shareholder, is also entitled to appoint a specified number of non-executive directors, and may also have the right to appoint the chairperson.

The roles, rules and responsibilities between owner/shareholder (policy ministry/executive authority) and the SOE boards on who is responsible for board and executive recruitment and appointments is not explicitly codified and legislated in some cases. This undermines the operational effectiveness of SOEs because in such instances there is no formal framework that holds SOEs accountable. This opens the space for political and self-interested meddling in the appointment and recruitment of boards and executives. In other instances, it often appears to be a case of rules and legislative dictates in place, but little monitoring by the executive authority/policy Minister, or other oversight bodies and stakeholders. And if discrepancies are found, there appears to be little accountability.

The Handbook for the Appointment of Persons to Boards of State and State-Controlled Institutions outlines the roles and responsibilities of all role players involved in the recruitment of boards for all types of entities across all spheres of Government. The handbook shows that there are nine role-players involved in the recruitment of boards, which is far more complex and different from the private sector, where only shareholders and the board are involved. The participation of too many role players in the appointment of boards of SOE's creates opportunism, conflicts and leads to great confusion.

There are rare occasions where Parliament is involved in the appointment of SOE boards. A typical case is the SABC, in terms of the Broadcasting Act, No. 4 of 1999, with the Communications Portfolio Committee of Parliament involved

in the appointment of the board. In practice, the President's approval is sought by Cabinet in the appointment of most schedule 2 SOE boards as well as for the appointment of the Governor and Deputy Governors of the Reserve Bank. Approval is also sought for the appointment of the Commissioner of the South African Revenue Services.

Cabinet approval of the appointment of boards is also necessary in a number of instances where it is recognised that the collective interests of Government are best served if the whole Cabinet participates in the making of key appointments of a significant nature. The following criteria specify significant appointments:

- Institutions for which the Constitution expressly requires the approval of or consultation with Cabinet when board members are appointed;
- Large institutions with more than 500 employees and/or operational budgets of more than R200 million;
- Institutions with responsibilities of a transversal nature in which several departments, ministries or Cabinet clusters may have an interest (e.g., the State Information Technology Agency);
- Government enterprises with an asset base of more than R1 billion (e.g., Airports Company);
- Institutions that predominantly perform functions of a regulatory or tribunal nature; and
- Institutions that, at the discretion of the executive authority responsible for the institution, perform functions of a strategic nature.

In advertising applications for such appointments, the Cabinet memoranda must outline the required competencies (skills, expertise, experience, and knowledge); nature of the appointment; and the benefits and risks of making such an appointment. The practice of notifying and seeking Cabinet's approval of significant appointments has been institutionalised. Subsequent to Cabinet's approval of the appointments they are gazetted.

The executive authority responsible for an SOE may, on recommendation of the head of the department, approve the appointment of:

- A public service official (who is not the head of a department or a Deputy Director-General) to a board, except a Government enterprise, provided that special circumstances are fully substantiated and demonstrate that the appointment is justified;
- Private persons if the appointment is not of a significant nature; and
- Persons whom the enabling act of the institution requires the executive authority to appoint.

The executive authority responsible for State or State-controlled institutions may approve a deviation to exceed the limit for multiple memberships of boards on the recommendation of the Selection Committee if there are justifiable reasons for doing so. The executive authority formally appoints board members.

When new board members are appointed, one of the matters they are supposed to receive information on is conflicts of interest and how they should be managed (this does not consistently happen). Some founding legislation, as well as King III and the Companies Act, emphasise the importance of dealing properly with conflicts of interest. Potentially, these may become an issue in two quite different ways:

- A conflict may be such that it precludes a person being appointed; or
- A conflict will not prevent a person being appointed, but will need to be appropriately managed by the board member, i.e., by declaring the conflict; excluding themselves from a particular discussion; and/or not voting on a particular issue (Gill, 1999, p. 15).

The statutory provisions on conflict of interest in founding legislation vary; some founding statutes are silent on this issue.

The PRC has established that the absence of a clear legislative framework for recruitment, selection, appointment and induction of boards of SOEs gives rise to a number of other challenges.

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- **Security clearance prior to being appointed to a board:** There is no standardised policy to do so – it all depends on the individual SOE or ownership/shareholder department.
- **Appointment of departmental/municipal officials to SOE boards:** This is also dependent on the type of SOE. In some instances, there are provisions for representation from the line ministry/executive authority or even other departments.
- **Terms of office of boards and board members:** The PFMA does not explicitly stipulate an SOE board's terms of office. The line Minister/executive authority can exempt SOEs from sections of the Companies Act, which sets out terms of office for boards of private companies. The founding legislation establishing an SOE can also exempt an SOE from sections of the Companies Act. The founding legislation governs how long board members can serve on an SOE. In cases where the terms of office for SOE boards are not codified clearly in their founding legislation, board terms can vary depending on the executive authority/line ministry. The 2002 Protocol on Corporate Governance for the Public Sector stipulates that each SOE director should be appointed to serve a maximum period of three years. However, this code is rarely implemented.
- **Number of board members:** The PFMA does not stipulate how many board members should be appointed to an SOE board. There appears to be no convention that says the larger the balance sheet, assets, and the more complex the SOE's mandate, the larger the board should be in number. It appears that relatively small SOEs often have the same number of members on their boards as much larger ones. The protocol stipulates that an SOE board should have a majority of non-executive directors, but does not specify how many there should be in total. In some cases, the founding legislation of an SOE states the number of members that the

board should have. The articles of association of some SOEs also stipulate the number of board members.

- **Representation in terms of race, gender, skills, experience, industry background, and political and ideological affiliation:** The protocol stipulates that the "board should also, on an annual basis, review and evaluate its required mix of skills and experience and other qualities in order to assess the effectiveness of the entire board, its committees and the contribution of each individual director during the entire term of office."

The PFMA does not say anything about the representation or gender parity. The founding legislation and articles of association of some SOEs emphasise that boards should be balanced in terms of representivity and have a mix of relevant skills.

- **Clarity on the limit for multiple board membership:** To promote efficiency and effectiveness of SOE board members, it is necessary to give attention to the number of boards that members should serve on. The limit takes into consideration the fact that board members have to participate in board sub-committees.

4.2.2.2 The lack of uniformity in the application of appointment procedures

The PRC review of appointment processes has found that whilst the founding legislation grants ultimate responsibility for SOE appointments to Ministers/MECs, actual responsibility for running the appointment process varies considerably in practice, with the Minister/MEC (and the oversight units) having the dominant role in some provincial SOEs. Some SOEs surveyed were found to have established a Board Nomination Committee; a Directors' Affairs Committee or a Human Resources Committee to assist in the selection and appointment processes and the Minister has the final say on who should be appointed. In most

cases the Minister's particular department has some role, although the nature of that role seems to vary significantly. There were some examples where the department had no role, while in others it was not entirely clear who was responsible for which aspect of the appointment process. This is an issue of role clarity in terms of the extent of department's responsibilities, and the role played by the Minister and the Minister's office.

The procedure followed by most SOEs is that they inform the shareholder Minister of a vacancy or an imminent vacancy and then either the SOE or a shareholder Minister advertises the post. Respondents are short listed and considered by the shareholder Minister for approval or disapproval. According to the handbook, State or State-controlled institutions with parent departments that fall under the portfolio of an executive authority are required to:

- Maintain a consolidated succession management plan for board members;
- Ensure that the chairperson of the board implements a succession management plan for board members;
- Ensure that the chairperson of the board implements an approved induction and training programme for board members;
- Maintain a database of board member information;
- Provide the Department of Public Service and Administration with updated board Member information on an annual basis by 1 April of each year;
- Implement the framework for disclosing interests for existing and newly appointed board and council members of State and State-controlled institutions;
- Subject all short-listed candidates to pre-appointment suitability checks and/or security clearance, as the case may be;
- Report on the appointment of officials to the boards of State or State-controlled

institutions in the annual report of the parent department; and

- Manage the appointment process.

An executive authority or the parent department may consult the chairperson of a board on the nomination and selection of board members. However, the PRC found that the process followed by various departments in the recruitment of new board members varies from one department to another. The quality and the professionalism with which the process is undertaken in departments depend on the extent to which the recruitment processes are institutionalised, the preference of the Director-General and the capacity and skill of the oversight unit. There are also considerable variations in terms of whether departments use dedicated resources internally, or whether ad hoc allocation of responsibility is assigned to a senior official when the recruitment is 'sensitive'. At times the responsibility is assigned to an outside head-hunter but the exact circumstances of taking such action are unclear. The instances in which departments consult with the board are also inconsistent. Nor is it clear when and how the consultation occurs and under what circumstances. Also vague is the matter of which person from the department has the authority to consult with the chairman of the board. It is debatable whether this should be the Minister, Director General or members of the oversight unit. Other issues that arise are:

- Different processes are usually followed for re-appointments. This process often involves consultation with the chairman of the board. It is unclear what type of assessments is made to ensure the suitability of a board member for re-appointment. The process does not appear to be formal or particularly robust. It seems to involve a negative assessment such as: Was there an obviously bad report about someone? (For example, did they frequently fail to attend board meetings?) In general terms, re-

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appointment is likely in the absence of negative reports. Political changes also have an influence on whether directors are re-appointed or not.

- At times, appointments have not been timely. This has occurred either because of poor record keeping (no one has realised there was about to be a vacancy), or a lack of clarity on the respective roles of Ministers and their departments. The obvious consequence of poor planning is that the board has fewer members than would be desirable for its effective performance. A more pressing problem arises where the failure to initiate an appointment process in a timely manner means that a board fails to have a quorum or other legal authority to act. Poor planning by departments around an appointment also makes it difficult for Ministers to carry out succession planning. This is a significant issue given Cabinet’s expectation that board members should normally serve only two terms, and this is particularly important in terms of chairpersons of the boards.

The handbook sets out a pre-appointment system.

- **Guidelines for phase 1 of this system include practices such as advertising for candidates, interviewing and consultations.** The PRC found that there are no guidelines to assist SOEs, especially at a subsidiary level as well as smaller SOEs, to manage the pre-appointment system in a manner that will institutionalise the practice. Larger SOEs, however, are able to institute sophisticated and stable practices. In some cases there is no clarity in terms of the preferred process. As a result there is no consistency in determining the advertising process, where the advertisement should appear and what time-frames should be allowed. There is no clarity on who needs to be consulted and which legislation provides guidance. Sometimes Government departments do not allow enough time for pre-appointment processes to take place and the process is sometimes initiated

too late. The evidence suggests that the initial phase of the appointment process is not as effective as it could be.

- **Steps that need to be undertaken in phase 2 of the pre-appointment process, include the establishment and maintenance of a database of board-member information; the compilation of a succession management plan; and a generic role description and board profile for board members.** The Department of Public Service and Administration was supposed to maintain a comprehensive database of all SOE directors who fall outside the Department of Public Enterprises, however, there are inconsistencies in the creation and maintenance of databases. Indeed, most departments do not have a database.

The way requirements are managed during the pre-appointment phase differs considerably. There are times when no distinction is drawn between the requirements for a position and the choice of a particular person to fill that position. Often there is no general sense of placing an appointment in the context of the entity’s and Government’s interests (or of making a clear assessment of the composition of the board and the needs of the SOE) to use these as the basis for drawing up a job specification. This largely depended on the sophistication of the process used and the capacity of the SOEs to recruit professionals.

At times the Minister may not be asked to sign off on the role description, although the Minister has a significant influence on that position. The extent of Ministerial involvement in this part of the process appeared to vary enormously, from a dominant role to limited involvement. Again, the balance of responsibilities between Minister and department was not always clear.

Generally, when deciding upon the requirements of a position, or the type of person required, reliance was placed on:

- The appropriate legislation;

- The department’s institutional/sectorial knowledge;
- Sectorial nominees (nominations are commonly sought from sector groups – in some cases there is a legal requirement to do so);
- An awareness of the need for balance in terms of gender, ethnicity, demographic or geographic considerations (in some cases);
- General business/governance and specialist skills; and
- Community representativeness (in some cases).

The actual emphasis given to some of these issues varied a great deal. The chair and (less frequently) the board were sometimes consulted on the desired skills for a new board member. The formality of this consultation varied. Some legislation contained limited specifications on the required qualifications of board members.

- **The handbook includes a set of appointment principles, which stipulates that the following must be taken into account:**
 - Appointments must be merit-based;
 - The process must be transparent, representative and consistent; and
 - It must be conducted with due regard for probity.

However, most of the SOEs that the PRC interviewed have never heard of these principles. It is unclear how the SOEs were informed about the principles and whether there were guidelines to assist SOE’s to integrate them into their recruitment processes. In consequence, these appointment principles are not entrenched in their recruitment processes.

- **The next step is the short-listing of candidates, which is normally done by the Nomination Committee.** Candidates are then subjected to suitability checks. However, the PRC found that quite often there is no short-listing, and the process of arriving at the preferred candidate is not transparent. Suitability checks are not

consistently conducted and some committees do a credit check as well as criminal checks.

- **The next phase is for the department concerned to select and invite candidates, and acquire relevant information from the candidates, including their interests.** The PRC found that there are inconsistencies in the practices of identifying and finding candidates. The role played by the Minister in locating and selecting candidates varied enormously, from dominant to more limited (agreeing to names at the end of the process). There is a strong correlation between the significance of the entity and the level of ministerial involvement.

The PRC found that it is not standard practice for candidates to be interviewed, except for a few SOEs such as the SABC board. Nor are referees generally used, again with exceptions. The implication of this is that selection is made on the basis of the Curriculum Vitae (CV) submitted and any other knowledge of the candidate the department or Minister happens to have. In most cases candidates are recommended to Cabinet for approval without being interviewed.

Most departments interviewed for the PRC review were aware of conflicts of interest, and took them into account when considering candidates. However, there were a number of problems with the way conflicts were dealt with. With some exceptions, candidates were not generally asked about conflict of interest. Instead, departments relied on the CV and their knowledge of the sector to assess potential conflicts. This is clearly a problem.

- In some cases the issue of conflicts of interest was not considered until the appointment stage (i.e. not at selection).
- Some departments felt it would be desirable to have a clearer statement of what constituted a conflict of interest – a view that the existing material was not as useful as it might be.

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- In some cases there was a lack of available advice on how to manage conflict.

As a general comment, the PRC found that although the handbook attempted to clarify such roles, it has not succeeded. These are blurred. There is no standardisation of how roles are performed to ensure that there be effective and well performing boards. There is unfortunately still no clarity in terms of who does what and when.

Even in the international SOE recruitment arena, complexity is brought about by the large number of role players involved in the appointment processes of the board. However, most countries have focused their reforms on clarifying, simplifying and streamlining the roles of Government as owner and policy maker by centralising ownership. The centralisation of the ownership function has the advantage of developing and institutionalising recruitment processes. The centralised unit can act as an advisor to the ministries and departments and develop guidelines that have the capacity to harmonise recruitment practices. The unit can also train the role-players.

Ensuring that SOEs have qualified boards is a critical task and a priority for ownership entities in many OECD countries. In practice, the nomination of SOE boards is sometimes complex and may also lack transparency. The ownership entities are not always the main decision-making bodies on the nomination of SOE board members, and, more particularly, the nomination of State representatives to SOE boards. Many different ministries or other Government organs may be involved, especially where the dual model of ownership is used, and strong political influence is frequent. Very few countries have set up clearly defined processes for the nomination of SOE boards.

The main characteristics of the nomination process, according to the different models of organisation of the ownership function, are the following:

- In the centralised model of State ownership, the ownership entity is often fully in charge of the nomination of SOE boards, both of State representatives, if any, and of other 'independent' members.
- In other models, dual or decentralised, State representatives are often nominated by the sector Ministers concerned. But they usually have to be cleared by the Cabinet before a final decision is taken and are in most cases nominated by decree, at the Prime Minister or Ministerial level.
- In the dual model, the centralising entity is often in charge of nominating non-State representatives. Political influence in the nomination process is strong in a number of OECD countries, but the process may (and often does) degenerate into a situation characterised as 'political interference'.
- In a number of cases there is a direct political dimension to the nomination with the direct involvement of the Council of Ministries or even the President (such as in France) for chairpersons and CEOs of some large SOEs.
- Sometimes SOE boards will even be overstaffed with political appointees. In Finland, for example, the 'relative support of Parliamentary parties has become the core criteria for the composition of supervisory boards' of SOEs.
- In the most extreme cases, even the nomination of non-State representatives will be the outcome of bargaining among the ministries concerned, possibly involving specific committees or organs.
- Some countries, such as Norway, have explicitly excluded the participation of members of the Parliament, Ministers, or State secretaries on the boards of SOEs.

A number of countries have a formal policy of nominating relevant and independent private sector experts based on their business experience (Witherell, 2005, p. 91). In some instances, these requirements are even articulated in relevant laws.

However, in practice the nomination of board members rarely derives from a global strategy based on an evaluation of needed competencies. It is more often a succession of individual decisions, which do not take into consideration the overall balance of skills and experiences at the board level. The result is that some critical skills are often missing.

The main way of restricting Governmental or political interference in the nomination of SOE boards and to increase their independence and professionalism is to put in place a structured nomination process, making sure that the ultimate selection criteria is competency. Moreover, focusing upon setting up structured nomination processes allows ownership entities to perform their nomination role with a limited administrative capacity.

Very few countries, notably Australia, New Zealand and Sweden, have set up such structured and clearly skill-based nomination systems. Structured systems are based on a systematic evaluation of existing boards. In view of the corporate strategy and the existing mix of competences and skills, candidates are systematically identified, interviewed and assessed, based on appropriate profiles drawn up for each position on the board.

In the Namibian model, the State-owned Governance Council makes determinations on the number of members to be appointed to the boards of SOEs, and advises the portfolio Ministers on the appointment of such members. International experience leans in favour of the involvement of a Governance Council or a Minister in the appointment of boards (Murangi, 2010).

4.2.2.3 Inadequate induction processes for board members

King III recommends that induction, and the ongoing training and development of directors should be through a formal process. All SOEs interviewed for the PRC review indicated that they

conduct induction and training of new directors, especially when a number of members join as a result of a rotation. However, the challenge often arises when only one new director joins the board and the induction process is delayed. The review found that although there is, to a large extent, compliance with the King III requirements on board induction, there are significant differences between SOEs in terms of the content of the induction programmes utilised. There are also marked differences in terms of the role the board and chair play in the induction programme for new members.

In practice, the quality of the induction programmes varied between SOEs, and at times induction proved to be a challenging process within the same ministry. Often, insufficient information is provided for new board members. For entities that do not conduct induction, new board members only receive an appointment letter. The involvement of Ministers and their oversight units is limited and at times non-existent so there is often little or no strategic input from Government in the induction process. Nor is there standardised orientation material that can be used across the three spheres of Government to create consistency. SOEs are expected to produce their own induction material; there is, however, information that can be commonly shared amongst all SOEs. For instance, the roles of all the players in the governance process, information on the PFMA or MFMA, etc.

Internationally there is recognition of the importance of the induction process of SOE directors as well as the need for board directors to have a combination of skills, experience and knowledge to perform effectively. There is also a focus on continuous improvement of the board in general, and of individual directors. In most countries there is a standard template for induction of SOE boards that is used in most of the spheres of Government. In addition to an

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effective induction programme for directors, there is also the recognition of the need for continuous education. Beyond induction there also appear to be inconsistencies as far as ongoing and further training for board members is concerned.

4.2.2.4 Inconsistencies in the process for appointment of CEOs

In South Africa, the appointment of CEOs of almost all SOEs has to be approved by the executive authority. This is entrenched in founding legislation as well as the PFMA (Uhrig report 2003, chapters 3 and 4).

However, the practice and process associated with the recruitment and selection of CEOs is applied inconsistently within the SOE arena. The process depends on the preference of the Minister, who can choose to manage the recruitment process internally or delegate the nominations process to the board of an SOE. Most Ministers choose to delegate that authority to the chairperson who is then able to delegate the management of the process to the Human Resources and Nominations Committee. Depending on the size of the SOE, the common practice would be for the SOE to run the process internally. In the case of significant SOEs, the process is outsourced to a recruitment agent. The recruitment agent will then keep the board informed of the process.

A shortlist of three to five candidates is then prepared and forwarded to the Human Resources and Nominations Committee of the board. The committee selects the preferred candidate, whose name gets forwarded to the Minister. The Minister may accept or reject the selected candidate. However, it is rare for the Minister to reject the preferred candidate because it is common practice for the chairperson to keep the Minister informed during the recruitment process. Depending on the significance of the SOE, the name of the selected candidate will then be forwarded to Cabinet for approval. Once Cabinet has approved

it and the nominee has accepted the position, the appointment is gazetted. A contract with the CEO will then be drafted and signed by the Minister.

Most (if not all) SOEs' founding acts deal with the issue of CEO appointment, which is a power mainly accorded to the policy Minister rather than the board. The PFMA is silent on the issue, and the Municipal Systems Act contradicts most SOE founding acts and accords the power to appoint CEOs to the board of a municipal entity. This is also in line with private sector practice, notably arising from King III. However, there are strong views in Government that the shareholder Minister should appoint the CEO. The survey of chief executives of SOEs conducted on behalf of the PRC also indicates that the latter practice is prevalent. However, the Government's role in the appointment of CEO is fraught with difficulties.

The ENS study concluded that CEO appointments should be left to the boards of SOEs. However, in recognition of the Government's ownership/ shareholder role, it may be appropriate to require shareholder approval of the CEO. It was further argued that the CEO should not have direct access to the shareholder (Edward Nathan & Sonnenbergs, 2010).

Everingham argues that the board should appoint the CEO, but notes that at present the Government appoints the CEO. One of the arguments in support of this is that boards require the services of competent executives to carry out their strategic objectives and that it is likely that boards are best placed (perhaps with the assistance of services such as 'head-hunting' companies) to identify persons with the requisite skills. In addition, if the board appoints the CEO it is likely that it will be far more invested in ensuring the CEO acquits him/ herself successfully than if an appointee has been imposed on them.

The OECD's Comparative Report on Corporate Governance of State Owned Enterprises indicates

that in a number of countries, SOE boards do not nominate and remove CEOs. SOE boards are in charge of nominating the CEO only in a few countries such as Australia, Denmark, Finland, Germany, New Zealand, and Norway. In France, the CEOs of the largest SOEs are nominated by Presidential decrees, usually in accordance with the ownership entity, which proposes candidates based on their competencies. In the Mexican case, even senior executives two levels below the CEO are appointed and/or removed by the ownership entity (Witherell, 2005).

RECOMMENDATION 3(a): BOARD APPOINTMENTS

The Government should develop a framework for the appointment of SOE boards.

The framework should be set out in a Handbook on Board Appointments, which should define the rules for the selection of candidates. The rules should cover the following:

- Clarification of roles for the executive authority, the entity board and the CEO.
- The role of the Minister in relation to Cabinet and to Parliament should be clarified.
- Clarification of the board appointment process. The PRC recommends the guidelines for board appointments outlined by the DPE. See table 13.
- The appointment of an independent board should be made in writing by the executive authority, and should be duly gazetted.
- Provisions for board appointment should take into account the following:
 - Ensuring a transparent and merit-based recruitment and appointment process;
 - Transparent determination of board fees/remuneration in accordance with recommendations of the central remuneration authority as recommended by the PRC;

- Board composition and representivity, taking into account race, disability and gender. The targets endorsed by the B-BBEE and the Department of Women, Children and People with Disabilities should be duly considered;
- Confirmation of the term of office for board members;
- Stipulation of the number of boards on which a member should serve;
- Clear articulation of performance indicators in writing, for which there should be mandatory annual evaluations;
- Board training and development programmes (both induction and further ongoing development); and
- Building succession planning for new directors and preparing next generation directors.
- Recruitment, selection and appointment processes should be subjected to auditing as part of the pre-determined objectives of entities.

The handbook for the appointment of board members should include the following:

- The nominations and selection process;
- Composition of the Nominations Committee;
- The specification of requirements of the board;
- The development of a database of candidates for board membership;
- The specifications limiting the number of boards a board member can participate in;
- Criteria relating to the performance of board members;
- Consequence management for non-compliance and poor performance of boards;
- The size of the board;
- Gender and other areas of representivity; and
- Issues relating to conflict of interest.

The proposed handbook should be appropriate for all entities and be mindful of the categorisation of SOEs.

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The Department of Public Enterprises has an institutionalised recruitment process for SOEs under its oversight. The department also has an established database that is well-maintained. The DPE’s recruitment process entails eight elements undertaken as follows:

Table 13: DPE process for appointment of board members

Process	Practice
Skills review and identification	<ul style="list-style-type: none">• The board members should have the combination of skills necessary to carry out their work.• DPE sector teams identify the skills required for each SOE board following a skill review and performance assessment for the previous year alongside an assessment for future skills requirement.• The skills based process reinforces the role of shareholders in identifying the requirement for a particular position on an SOE board. Every vacancy creates an opportunity to reassess the needs of a board, and the skills and experience that will best complement the talents of the other board members.
Identifying suitable candidates	<ul style="list-style-type: none">• SOE committees identify suitable well qualified candidates who reflect the demographic diversity of South Africa from the board database.• The board performance assessment and skills review provides criteria for each sector team to determine the suitability of candidates.
Candidate screening and vetting	<ul style="list-style-type: none">• Candidates are screened through the CIPC or other database to determine the number of board seats the candidates holds as well as other reference, credit and background checks.
Selection and short-listing	<ul style="list-style-type: none">• From the identified candidates, the SOE teams select and shortlist proposed suitable candidates by matching such candidate’s competencies and skills with the relevant SOE board’s skills requirements and other relevant shareholder requirements.
Interviews	<ul style="list-style-type: none">• SOE teams (with support from ministry and legal and governance) may interview shortlisted candidates to confirm their suitability for the specifically identified board seat.
Obtain Minister’s approval	<ul style="list-style-type: none">• SOE teams submit their shortlisted candidates as well as the recommended candidates for the relevant board to Minister for his/her approval.
Cabinet approval	<ul style="list-style-type: none">• Once the Minister approves the recommended candidates, the submission is prepared for Cabinet endorsement.
Appointment	<ul style="list-style-type: none">• Following the Cabinet approval, the candidate is formally notified of his/her appointment, including the terms and conditions of the appointment. A board member may be appointed for a second term to ensure stability in board dynamics and to recognise the significant intellectual investment in being a good director. Such reappointment should be subject to the director’s performance and his/her skills continuing to be relevant to the business.

RECOMMENDATION 3(b): CEO APPOINTMENTS

The appointment of the CEO will be done by the Minister in concurrence with Cabinet, at the recommendation of the board.

The following is the recommended process:

- The board is responsible for the process of recruitment and assessment of the nominated candidates.
- The board recommends to the executive authority two or three ‘appointable’ candidates for approval.
- The executive authority confirms the appointment in writing.

To manage sustainable development and retention of skills, the PRC recommends longer-term employment contracts.

The board should adopt a structured and intensive performance management system for SOE executive management.

Incentives should be strictly aligned to performance.

4.3 COLLABORATION,
COORDINATION AND COOPERATION
AMONG SOEs

4.3.1. Background

Government and all its entities need to ensure that they achieve national objectives in an efficient and cost effective manner. There should be strategic alignment, collaboration and cooperation in Government and SOEs. This will help to achieve the following:

- Improved deployment of State assets and resources across SOEs;
- Optimal utilisation of State assets and resources across SOEs;
- Improved sharing of information between Government (at all spheres) and SOEs to facilitate effective planning and delivery of services by SOEs; and
- Effective monitoring and evaluation of SOEs by Government.

The lack of collaboration negatively affects the delivery of services and can also lead to the duplication of the efforts of different SOEs. This occurs, for instance, in situations arising from the concurrent functions of different spheres of Government, which often leads to overlapping and/or duplicate mandates given to SOEs in the different spheres.

4.3.2 Issues and challenges

In South Africa there are a number of inter-Governmental structures that are designed to promote cooperative governance amongst the three spheres of Government. These include: the President’s Co-ordinating Council (PCC); the National Council of Provinces (NCOP); the Ministerial Forum of National Ministers and Provincial MECs (MINMECS); Cabinet clusters; the Forum of South African Director Generals (FOSAD); and MUNIMECS. These structures are mainly pitched at the highest level in Government involving Ministers, Directors General, chairpersons and CEOs. Their terms of reference largely recognise the importance to align, collaborate, coordinate and cooperate across all spheres of Government and SOEs. These form a leadership coalition to achieve cooperative governance in South Africa.

The inter-Governmental relations (IGR) system allows for cooperative Government in policy and planning; budgeting; implementation; and monitoring and evaluation (M&E) processes across and within the three spheres of Government. An example of this is found in the Cabinet committees and clusters. The review of the terms of reference of some of the Cabinet clusters demonstrates that most recognise the importance of collaboration, coordination and alignment.

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- **Infrastructure Development Cluster:** The cluster has four main objectives, including promoting active collaboration between ministries, departments, SOEs, and the three spheres of Government to ensure the implementation of the Government’s programme of action.
- **Social Protection and Community Development Cluster:** The cluster’s objective is to ensure coordination and alignment of Government-wide priorities in the programme of action.
- **Economic Sector and Employment Cluster:** This cluster aims to strengthen coordination and policy coherence across Government, between departments and with State institutions and SOEs by identifying and leveraging synergies.

The composition of Cabinet and clusters also indicates the extent of collaboration within the national Government and across the different spheres of Government. For instance, the Infrastructure Development Cluster is co-chaired by the Ministers of Transport and Public Enterprises, and its core members are the Ministers of Communication; Cooperative Governance and Traditional Affairs; Economic Development; Energy; Human Settlements; Water and Environmental Affairs; National Treasury; Public Works; Rural Development and Land Affairs; and the Ministries of Planning Commission; and Performance Monitoring and Evaluation in the Presidency. The Director-Generals from national and provincial departments are also represented as may be required, as are chairpersons or CEOs of relevant SOEs, representatives from metros and strategic district municipalities, and invited stakeholders. The various clusters also collaborate to achieve certain national outcomes, such as the Infrastructure Development Cluster and the Economic Sectors and Employment Cluster to create jobs through infrastructure development.

The existence of such inter-Governmental relations (IGR) Forums provides an excellent

basis to encourage collaboration between SOEs. However, elements of collaboration exist at the level of Cabinet committees, clusters and between the different spheres of Government do not seem to have cascaded down to SOEs. Collaboration takes place at Government level through IGR Forums and not among SOEs. This is due to a number of factors. The most important is that there is no specific framework that imposes an obligation on SOEs to collaborate and cooperate with other SOEs, and to coordinate their activities.

4.3.2.1 The absence of a specific framework obliging SOEs to collaborate, cooperate and to coordinate their activities

Section 40 of the Constitution defines the principles of cooperative Government and inter-Governmental relations amongst the spheres of Government. Section 41 of the Constitution provides for a legislative framework to be passed through an Act of Parliament to establish structures that promote inter-Governmental relations (IGR). From the Constitution’s description of Government, it is apparent that cooperation and collaboration between and/or amongst the three spheres of Government is required for optimum and seamless delivery of services. It furthermore holds that there should be no duplication of effort amongst these spheres, particularly on concurrent functions. To that end, the Government has put in place various IGR structures mentioned above to enable some level of collaboration and cooperation. In addition, the Inter-Governmental Relations Act was promulgated in 2005 in line with section 41 of the Constitution. No such constitutional requirement is placed on, or institutional structures established for SOE collaboration.

For instance, whereas Ministers and Government departments work together in Government clusters to achieve certain goals such as the Infrastructure Development Cluster, SOE involvement is ad hoc. There is no formal involvement of SOEs in

the cluster work-streams. The arrangement is that each work-stream does its own assessment of the need and level of involvement of SOEs. However, no evidence could be found of attendance of cluster meetings by SOEs and the Infrastructure Development Cluster leaves the involvement of SOEs to its work-streams. Nor was evidence found of involvement of SOEs in work-streams of the cluster. National outcomes are assigned to Ministerial clusters. For example, the Infrastructure Development Cluster reports quarterly on the achievement of its assigned outcomes, but does not seem to coordinate SOEs in this cluster towards meeting the assigned national outcome. No level of cooperation by SOEs within this cluster was detected, even though delivery plans for the outcomes indicate that SOEs play a crucial role in the delivery of some of the national outcomes.

The ad hoc and apparently undefined participation of SOEs in these forums indicates that there is no framework for collaboration, coordination and cooperation for SOEs. Nor are Government departments required to include collaboration with Government structures or other SOEs in their quarterly and annual reports.

Collaboration could be promoted by amending the Inter-Governmental Relations Act to enforce collaboration by providing protocols and resources to affect collaborative mechanisms and spell out consequences for failing to collaborate between spheres of Government and among SOEs.

4.3.2.2. The failure to encourage collaboration by including collaboration in the mandates of SOEs

Mandates that are given to SOEs do not require them to collaborate, even though some of their mandates overlap or are duplicated. For instance, the development funding institutions (DFIs) of the different spheres of Government often have similar mandates. For example, both the Land Bank and Ithala Bank in KwaZulu-Natal provide, among other services, loans to farmers to acquire

farmland. If there is effective collaboration, there can be uniform project identification standards and procedures across the DFIs of all three spheres of Government. Thus, national DFIs can utilise the provincial and local DFIs to carry out the initial project identification as well as dissemination of information.

It is clear that lack of cooperation and collaboration between SOEs leads to ineffective use of resources, disjointed processes and wastage. Some SOEs, like the Land Bank, have taken it upon themselves to facilitate more collaboration with different political stakeholders. The Land Bank has tried to be the central point of coordination between different related ministries. However, it must also be acknowledged that it is very difficult for SOEs to cooperate with other entities, spheres and Government departments in areas like investment and trade promotion. There is, however, no policy directive or legislation in place to encourage collaboration in these areas and there are numerous examples of duplication and conflicts that arise when individual departments and/or SOEs carry out their mandates without any consideration of the bigger collaborative picture – serving the best interests of the country and its determined national outcomes. Any alignment, collaboration and cooperation of SOEs that takes place are ad hoc occurrences rather than the result of an established mechanism driven and monitored by Government.

4.3.2.3 The inadequate treatment of collaboration in the evaluation of SOE performance

In addition, the monitoring of alignment, collaboration and cooperation of SOEs is weak. Institutional oversight structures that oversee SOEs operate in silos without any ability to oversee collaboration and cooperation. In addition, there are no standing forums for institutions exercising oversight over SOEs to collaborate in their oversight of institutions in similar value chains, for

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example the Department of Public Enterprises and the Department of Transport for rail and aviation. Furthermore, there are no standing integrative forums between the oversight structures of Government departments that monitor collaboration of SOEs. Institutional oversight structures in these departments do not meet or liaise regularly to direct, monitor and encourage collaboration among their SOEs. Finally, standards and mechanisms to monitor collaboration and cooperation of SOEs have not been developed.

A consolidated monitoring of collaboration and its oversight among SOEs by any empowered ministry like the Department of Public Enterprises or an agency created for this purpose is critical (similar to National Treasury’s mandate to oversee financial management of SOEs). Such consolidated monitoring of cooperation and collaboration should be enabled through appropriate legislation and should form part of the performance management framework of SOEs.

A central body/ministry like the Department of Performance, Monitoring and Evaluation or the Department of Public Enterprises should set standards and legal/policy frameworks; be responsible for institutional oversight over collaboration and cooperation among SOEs; and oversee compliance to these standards. Such consolidated monitoring of cooperation and collaboration should be enabled through appropriate legislation and should form part of the performance management framework of SOEs.

4.3.3 Experience of collaboration in South Africa: King Shaka International Airport and Dube Trade Port case study

A study was conducted of collaboration during the development of the King Shaka International Airport and Dube Trade Port in Durban. The provincial Government of KwaZulu-Natal initially developed the project as a Public Private Partnership (PPP), which is the model on which the feasibility study was based. A number of

issues were identified in the case study that led to misalignment between the parties that were involved at a strategic level. Among these issues was the fact that certain airports are a concurrent function of national and provincial Governments in terms of the Constitution of South Africa. There is, however, no clarity on the roles of the two spheres of Government as far as these are concerned. The Airports Company of South Africa (ACSA) was not given any assurance about the extent to which the provinces could advocate for airports to be built. There is no clear relationship between the mandate of ACSA and that of the concurrent function of provinces on airports. In other words, there is no indication of who should champion the development of airports. ACSA and Ethekewini Metro appear to have leaned towards the King Shaka International Airport being built in about 2017 to 2020, based on projected passenger numbers and the capacity of Durban International Airport.

ACSA had a hub (OR Tambo International Airport) and spoke model (with other regional airports in South Africa forming the spokes). The FIFA 2010 bid for South Africa presented three ports of entry based on OR Tambo International Airport for visitors coming from Europe; Cape Town International Airport for visitors coming from America; and Durban International Airport for visitors coming from Asia and other countries located in the East. This contrasted with ACSA’s hub and spoke model. The provincial Government only had R1,370 billion budgeted for the project, requiring ACSA to fund the remaining R6,7 billion. Key stakeholders that were necessary to collaborate for the success of this project were therefore misaligned at a strategic level.

It was clear that the commercial viability of ACSA was negatively affected by the pursuit of a national interest. ACSA carried the lion’s share of the funding that was required, and the regulator forced ACSA to rely on borrowed funds. In the

course of the feasibility study the benefits of the project for the eThekwini Metro were not clarified, leading to costly ‘resistance’ from its officials. Political support for the project was good, but stakeholder engagement and buy-in, especially from ACSA and eThekwini Metro, was poor.

In this case study, collaboration between the different spheres of Government and between these organs of Government and an SOE, ACSA, was fraught with difficulty and uncertainty.

RECOMMENDATION 4:

The Government should develop a mandatory framework for effective collaboration among SOEs.

The collaboration framework should:

- Be in line with the constitutional requirements for collaboration;
- Consist of a common plan, derived from the overarching Developmental State strategy;
- Strengthen partnerships between SOEs to drive Government priorities; and
- Establish and strengthen partnership between Government and the private sector to drive the Developmental State agenda and priority projects.

CHAPTER 5: STATE-OWNED ENTITY REMUNERATION AND ECONOMIC REGULATION

5.1 OVERVIEW OF CHAPTER

5.1.1 Background and problem statements

One component of the utilisation of resources is an assessment of how effective SOEs are in controlling remuneration practices. On the other hand, regulatory mechanisms impact on the way in which SOEs utilise scarce resources to maintain and expand their activities.

The remuneration policies and practices of private and SOEs remain emotive issues in many countries throughout the world. The debate on remuneration often hinges on the perceived value added by the incumbent executives, managers or professionals. The perceived value is to a large degree influenced by the vantage point from which it is viewed. As the world economy currently struggles to come to terms with the credit crises and meltdown witnessed in 2008, the issue of executive remuneration has been placed even more in the spotlight. This has been especially true as far as private entities in Europe and the United States are concerned; they had to be bailed out by their respective Governments, effectively placing them under curatorship, if not ownership, of the State – and there still seems to be no end to excessive executive pay and bonus measures.

Although economic regulation of public utilities has been exercised in South Africa for a number of years (usually by the relevant line Government department) the establishment of independent economic regulation only emerged a little more than 10 years ago. Economic regulation was directed at, or in response to the following:

- The establishment of a common framework governing the functions, responsibilities and operations of regulatory authorities;
- To promote competition;
- To stimulate investments;
- The introduction of new technologies;
- To counteract market failures, such as externalities, monopoly power, the need to

incorporate public good and information asymmetries; and

- The need to maximise social welfare by way of affordable prices, quality improvement and choice for the consumer.

The core question is: How effective has economic regulation been in achieving or responding to these imperatives?

5.1.2 Purpose of this chapter

The purpose of this chapter of the PRC report is, firstly, to determine:

- Whether or not the approach to remuneration in SOEs was based to some degree on standardisation and whether it follows the guidelines provided by State departments;
- Whether or not the levels of remuneration of senior management of SOEs are consistent with the value offered to the owner/shareholder and ultimately the taxpayer;
- Whether or not SOEs are contributing to a widening wage gap or attempting to reverse the trend; and
- Whether the performance of SOEs serves as a key driver for remuneration.

A second purpose of this chapter is to:

- Establish the impact of regulatory actions and decisions on the performance of SOEs and sector outcomes;
- Determine the key challenges that are currently faced by SOEs in relation to the regulatory and policy environment under which they operate;
- Identify weaknesses in the regulatory system that lead to the above challenges;
- Benchmark South Africa's current policy and regulatory framework with international best-practice, with a view to recommending effective reforms; and
- Recommend what actions should be taken to remedy the prevailing weaknesses.

5.1.3 Process and approach

The material for this chapter is derived from a number of PRC processes, which include two PRC

terms of reference discussion papers produced by two different work-streams of the PRC:

- SOE remuneration and wage gap; and
- Impact of economic regulation on the management and performance of Government-owned enterprises.

5.1.4 Structure of the chapter

The chapter is divided into two sections. They are divided as follows:

- SOE remuneration; and
- Economic regulation.

Each section of this chapter provides an overview, assessment, consideration of international experience, and recommendations on the various areas reviewed.

5.2 SOE REMUNERATION

5.2.1 Background

The performance of SOEs is constantly under public scrutiny, in part because much of the funding and equity in them flows directly from the tax base of the country. SOEs are therefore accountable to the taxpayer through the taxpayer representative, i.e., the executive authority providing oversight. Governments establish SOEs to use as instruments for addressing the developmental needs of their countries. Proper functioning SOEs with sound management (and remuneration) practices are critical to encouraging the perception that the Government is serving its citizens.

5.2.2 Issues and challenges

5.2.2.1 Inconsistencies of remuneration in SOEs

In most cases, the boards of SOEs set the level of remuneration of executives and senior staff. However, the remuneration of the executives and senior staff of SOEs is highly inconsistent, with no clear reason why in some SOEs they are remunerated at significantly higher levels than those of others. For instance, a National Treasury review of board and executive remuneration of schedule 1, 2, 3A and 3B entities (as per the PFMA)

released in September 2010, found substantial differences in the salary increases given to the chief executive officers (CEOs) of different SOEs. It is very difficult to explain varying degrees of increase in remuneration when there are no apparent reasons for such extraordinary movements. The annual remuneration of the CEOs of some entities has risen substantially at some stage, only to fall to initial levels later. In addition, the CEOs of entities of similar size have vastly different basic salaries. On the other hand, some smaller and less complex SOEs pay their executives and staff relatively high salaries.

The main reason for these anomalies appears to be the absence of clear guidelines for setting the remuneration of the executives and senior staff of SOEs. In addition, where guidelines for remuneration of CEOs and senior management do exist for certain categories of SOEs – such as the 2007 Department of Public Enterprise guidelines for SOE remuneration, which is based on the size of the SOE as determined by assets and revenue generated applicable to those SOEs that report to the department – most SOEs in the category do not follow the guidelines. In a review of compliance with its guidelines conducted in 2010, the Department of Public Enterprises found that the SOE remuneration practices in SOEs that reported to the department were aligned to what happened in the general market, and that there was a significant lack of standardisation in the way remuneration was determined. Some SOEs followed the guidelines, while others did not.

The DPE review engaged a broad base of specialist stakeholders, and it was noted that the following are significant:

- Remuneration should be calculated in a formal, transparent and coherent manner to ensure the owner's interests (and those of the taxpayers) are protected;
- Remuneration packages should not create perverse incentives, i.e., huge short-term

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- driven pay-outs where performance and achievements do not align with monies paid;
- The private sector, whilst considered a relevant benchmark, cannot be used as the sole source for an appropriate benchmarking model for SOE remuneration because it is stated that this is where the skills are to be sourced; and
 - The boards and remuneration committees must ensure a proper risk sensitive approach in setting remuneration, and should also ensure that claw-back mechanisms are in place to recoup monies paid to executives based on unsubstantiated performance which later proves not to be a fair reflection.

The remainder of SOEs appear not be governed by any guidelines other than that of the Department of Public Service and Administration for the public sector. National Treasury has suggested that the remuneration of CEOs of SOEs should:

- Be based on the public service salary structure;
- Have a 5% of package short-term incentive;
- Have a maximum 50% of package long-term incentive (once in three years and twice in five years); and
- Allow for cost of living adjustments.

Most of the countries visited by the PRC in the international benchmarking exercise emphasised the need to align remuneration to the market but added that pegging should be slightly below the market. The problem here is that this might lead to difficulties in attracting suitable professionals for the large commercial entities. The PRC supports the approach of pegging SOE salaries to the market.

5.2.2.2 The income disparity between management and workers

The income disparity between management and workers is another reason that a review of the remuneration of CEOs and the senior management of SOEs is necessary. PriceWaterhouseCooper (PwC) issued the results of a study of executive remuneration commissioned by the PRC in

2010 from which it became apparent that the remuneration levels of executives throughout the market was moving further and further away from the lowest level workers, creating an ever widening wage gap. It is in this environment that SOE remuneration frameworks, policies and practices are established.

According to a study by 21st Century, commissioned by the PRC, the current Gini-Coefficient for SOEs is 34.8. This is significantly lower than the rest of the country – which is 65.0 – and would immediately give the observer a sense of comfort that SOEs are doing their bit to reduce the wage gap. However, the median level pay of SOEs is anywhere between 102% and 140% of private sector salaries at all levels of employment. This means that as executive level salaries of SOEs leap forward so too do those at lower levels. Eventually this becomes unaffordable to the owner or shareholder.

5.2.2.3 Absence of a centralised authority to manage SOE remuneration

One of the main problems with the existing remuneration frameworks is the absence of a centralised authority to manage SOE remuneration. The result is that the boards of SOEs and CEOs define their salaries themselves, and these differ significantly from the equality and/or market line. In some instances, the executive authority, or Minister, is required to approve the board's recommendations. For instance, the remuneration policy framework for Water Board chief executives issued by the Department of Water Affairs in 2010 provides for ministerial approval of the remuneration of the CEOs of water boards. This approval is also guided by a set of principles including a common set of standards and a centralised set of available remuneration data (through ongoing market surveys). These enable the Minister to give appropriate approvals; take a sound organisation and job sizing approach using recognised grading systems to back up decision-making; and to make ongoing benchmarking

and comparisons to relevant market or industry grouping – currently a mixture of companies including State-owned enterprises, tribunals, Government-linked entities, and provincial and municipal-linked entities.

The essence of this remuneration policy is that there is a central authority – in this case the Minister of Water Affairs – that applies a proper process of evaluation based on set principles and standards on which to base remuneration. The private sector is not used as a benchmark for setting remuneration – a practice different to other commercially-orientated SOEs. This remuneration practice calls for a strong ownership/shareholder oversight role to ensure appropriate and acceptable remuneration of the CEOs for these particular SOEs.

5.2.3 Development of a guide for the determination of remuneration levels

During a round-table exercise conducted by the PRC with board, executive and middle management representatives during November 2011, the board representatives made strong calls for an independent review of remuneration and guiding principles to assist boards in making the correct decisions. Executives, on the other hand, felt that remuneration guidelines such as those issued by the DPE in 2007 were not appropriate for the market in which they were operating and in which SOEs have to procure relevant skills.

A sub-group of the PRC undertook a benchmarking tour of Europe where various countries were visited. Here are some of the key findings:

- In the Netherlands, the shareholder has the right to define the remuneration policies of SOEs. The Ministry of Finance also produced a policy on remuneration, which identified three categories of SOEs and capped upper pay ranges for each category.
- In Germany, the intention of Government is to keep the salaries of SOEs below the market average.

- In Norway, the Government's Ownership Department developed guidelines on remuneration that aimed at inducing moderation in executive pay, reducing severance packages and ensuring that variable pay did not exceed 50% of overall remuneration. SOEs are also required to develop a remuneration policy and submit this to the shareholder(s), including Government, and present it in annual reports.
- In Poland a draft bill was introduced to abolish capped pay for CEOs.
- In France, the remuneration of executive staff is in the ambit of board responsibilities. However, the Agencies des participations de l'Etat (APE) has representation on the boards of SOEs. In addition, remuneration levels have to be approved by the shareholder Minister.

Based on the information gained from this exercise, it appears that some effort has been made by various European Governments to intervene in SOE remuneration policies.

The need for a taxonomy or categorisation model of SOEs is central to this process. Based on the SOE taxonomy recommended by the PRC in chapter 2 of this report, the following 10 elements should be considered to guide the determination of remuneration levels and ranges for individual entities:

- **Budget/revenue of the SOE.** The budget of some SOEs would be an appropriate measure. If one considered the revenue of SARS they would be the biggest corporation in the country. In other cases the revenue generated from operations would be more important than the budget, e.g., Denel.
- **Operating costs.** This should be indicative of the relative financial space in which the SOE operates.
- **Number of employees.** This dimension would not just be about absolute numbers but also about the type of employees employed by the SOE.

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- **Structure or autonomy of the organisation.** Does the organisation have relative autonomy in the direction and strategic objectives that are set, or are these dimensions mandated?
- **Strategic importance of the organisation.** Two SOEs with the same ranking based on the dimensions listed above would be compared on the basis of their strategic importance.
- **Number of operations/branches.** This adds to the complexity of management.
- **Number of core businesses.** The complexity of running an organisation can be reliably anchored to the number of core businesses managed.
- **Nature or complexity of the organisation.** The nature of the organisation is a sound measure to determine the level of skills of the CEO or executives employed. Diversity of appropriate experience and ability would clearly be a determinant of remuneration.
- **Number of countries in which the SOE operates.** Understanding multiple legislatures, tax regimes, company laws, etc. no doubt add complexity to the role of CEOs. At another level, executives exposed to international markets operate within an international remuneration space.
- **Qualifications and experience required for performing the role.** Certain roles would have a combination of qualifications and experience.

While all the PRC members supported recommendation 6, a minority felt that the above guidelines for remuneration were unacceptable because various other guidelines have been developed and the abovementioned considerations do not adequately deal with the remuneration of SOE employees who operate in countries abroad.

Another relevant issue is the level of effort that needs to be managed to add value or to bring beneficiation to resources. It is an area that requires further investigation to ascertain whether this influences the positioning points for setting remuneration levels.

5.2.4 Other observations and recommendations

There are clear suggestions by the remuneration specialists engaged by the PRC that the awareness levels about remuneration points and ranges in SOEs themselves are low. It is thus proposed that SOEs (with the support of the central remuneration authority) undertake an extensive education and awareness project, carried to all staff, within the short to medium term. This project will have the objective not only of educating staff where their positions resort on the pay scales and benchmarks relative to the broader market, but also allow for some preliminary communication on the process of recalibration that is to be undertaken.

RECOMMENDATION 5:

The Government should establish a central remuneration authority (CRA).

The CRA should:

- Be allocated a strong degree of independence as well as the necessary authority to develop an overarching framework for remuneration in SOEs;
- Provide guidelines and parameters within which the board may apply its discretion on remuneration;
- Provide direction on remuneration of SOEs’ boards and executives;
- Advise Government on the appropriateness of the remuneration policies, practices and both short and long-term incentive approaches developed by the SOEs;
- Periodically review the relevance and appropriateness of executive perks or benefits paid outside the executive’s total package;
- Conduct benchmarking and set standards for annual remuneration; and
- Produce an annual SOE remuneration update for Government to encourage transparency processes.

This CRA – albeit established by the State – must be allocated a strong degree of independence as well as the necessary authority to direct SOE practices and act punitively when directives are not followed. The CRA will not assume board responsibilities and will still recognise the discretion of the board to do what is in the best interest of the company. The CRA will, however, provide strong guidelines and parameters within which the board may apply its discretion on remuneration. Any deviation from these would need to be approved by the CRA.

Two options have been given consideration for the composition of the CRA. In the first, it is proposed that National Treasury chairs the CRA. The other proposal is that the CRA be a small (three to seven) independent body of subject matter experts chaired by a judge. Both these options would be handles with a commensurate technical specialist secretariat. The PRC is leading towards a small decision-making body with a high degree of independence in order to avoid conflict of interest. CRA-like structures such as the Independent Commission for the Remuneration of Public Office-Bearers should acknowledge and recognise the need for ongoing impartial harmonisation and adjudication of appropriate and competitive levels of remuneration for SOEs after taking formal

submission from key stakeholders such as the National Treasury, executive authorities, boards and employees representatives. Such an approach will enhance elements of objectivity, transparency, confidence and public trust.

5.3 ECONOMIC REGULATION

5.3.1 Background

The focus for the review was on economic regulation, in particular the manner in which regulation affects the efficient and effective performance of SOEs. Although economic regulation of public utilities has been exercised in South Africa for a number of years, the establishment of independent economic regulation only emerged a little more than 10 years ago. Prior to 1994, all public utilities in the energy, telecommunications, water and transport sectors were mainly dominated by powerful monopolies owned by the Government with very little oversight or regulation. From 1994, independent regulators were proposed in various policy papers. Consequently, independent economic regulators have been established for a number of sectors, such as electricity, transport, and telecommunications.

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Economic regulation has an impact on the performance and management of SOEs in a number of key areas.

- Tariffs and charges: Regulators are required to set tariffs to cover costs and allow a return on assets commensurate with the risk associated with investing in the assets.
- Market entry: Regulators are often empowered to regulate 'market entry' through the mechanism of licensing new projects.
- Investment and maintenance of infrastructure/ financial viability: The decisions regulators take about market entry and tariffs and charges directly affect the ability of regulated SOEs to invest and maintain their infrastructure and to retain financial viability.
- The achievement of individual SOE and broad developmental objectives: All three elements above have a direct influence on the achievement of individual SOE mandates and the broad developmental goals of the Government.

There is a role for economic regulators to play from an economic growth and development point of view to facilitate access to certain essential services to all consumers, regardless of their income status. This requires regulatory intervention to promote equitable outcomes.

5.3.2 Economic regulation policy in South Africa

It was during the process of the development of the Policy Framework towards the restructuring of the Government-owned enterprises in early 2000 that the Ministry of Public Enterprises noted that the establishment of a regulatory regime prior to the restructuring of a monopoly had become standard practice in South Africa. The ministry recognised the need to establish a common framework governing the functions, responsibilities and operations of regulatory authorities, and possibly for consolidating regulators in certain sectors. The option of using the Competitions

Commission as a multi-sectorial regulator that would take over the functions of the individual sector-specific regulators was considered. The decision was taken not to pursue the multi-sectorial regulator option. Amongst various reasons, the differences in methodology used by regulatory agencies and those used by competition authorities were an important consideration, particularly when it comes to the issue of the timing of their intervention. The ministry determined that regulation is usually prospective and consists of legislation, regulations, rules, directives and the terms and conditions of licences, all of which are aimed at preventing harmful business practices. These rules are determined in advance and will pertain to situations that may arise in the future. By contrast, competition law, with the exception of merger control, is applied retrospectively by the competition authorities only once a concern in this respect is raised or identified.

5.3.3 Benefits of the regulatory framework

Among the key benefits of a regulatory framework is that all South Africans should benefit from improvement in the regulatory environment in the key sectors. On the one hand, South Africa's globalising economy will benefit from lower prices and/or improved service outputs, which will enable it to become more competitive, thus creating more employment and investment opportunities. On the other hand, the unemployed and poor, in particular, will benefit from increased job opportunities and more affordable and available services. More certainty in the sectors involving SOEs will stimulate investment and enhance customer satisfaction, thereby ensuring an improved quality of life for all South Africans.

It has been recognised in various reviews of the existing regulatory framework that it has led to much greater transparency and more informed public debate about infrastructure economic issues. To the extent that regulators have contained tariff increases they have also contributed to a

more pointed debate on the trade-offs to be made in large infrastructure investment decisions. At times, regulators have also acted as an important check on the more excessive aspects of behaviour by senior Government officials and even Ministers.

5.3.4 Issues and challenges

However, the reviews of the economic regulatory frameworks in South Africa, as well as comparison with those in other countries reveal the following issues and challenges with regard to their impact on SOE management and performance.

5.3.4.1 Inadequacy of tariffs

Tariff increases are often unavoidably high, but still insufficient. If SOEs invest in new infrastructure projects that effectively double or triple their total balance sheet values, regulators will not be able to contain tariff increases at a level below the general inflation rate. Under these circumstances, high double-digit tariff increases for multiple years will be unavoidable if the regulator is to ensure a modicum of financial viability for the SOEs. The tariff increases awarded by regulators in recent years are nevertheless often not high enough to ensure the financial viability of the SOEs during the peak of the investment cycle. Therefore, if infrastructure capital costs should become unaffordable and threaten to damage the economy, the focus should shift from concern about tariff increases to an earlier stage when the nature of the capital projects that SOEs invest in is determined.

5.3.4.2 Inability of regulators to review market entry and new capital projects

Regulators are unable to review new market entry and new capital projects effectively. At times capital projects are not selected as part of their commercial mandate, but are imposed on SOEs by Government for political, 'strategic' or social reasons. Such projects are typically not financially viable, whilst they may paradoxically derive socio-economic benefits. Research has also shown that

SOE managers are often biased towards larger and technologically more complex projects. By the time the SOE approaches the regulator with the licence application the decision to undertake the project is often a fait accompli, or regulators are simply not adequately resourced or interested in taking on the large vested interests behind such projects. These problems of inefficient and inappropriate capital investment decision-making, and unfunded mandates, appear to be among the main causes of poor SOE performance and soaring infrastructure prices.

5.3.4.3 Unpredictable, arbitrary and poor quality of regulatory decisions

Regulatory decisions are sometimes unpredictable, arbitrary or of poor quality. The predictability and standard of regulatory decisions is a key factor behind the performance of regulated entities. It affects their general financial planning, and their ability to raise finance efficiently. Both the amount of debt that can be raised and the cost of debt (the interest rate) are substantially affected by the view taken by rating agencies and lenders of the amount and nature of 'regulatory risk'. When the legal regulatory framework is ambiguous or incomplete, or when the regulatory tariff methodology is not properly applied, SOEs are unable to convince rating agencies that they would be able to maintain sufficient cash flows to cover their debt service obligations with certainty. This state of affairs could lead to a downgrade in the SOE's credit rating.

This situation has arisen in South African due to a number of factors arising from the ineffectiveness and inefficiencies in the regulatory system. One significant issue is the lack of clarity on the principles governing the regulatory system in South Africa. A regulatory system can be effective only if it is:

- Credible, i.e., investors must have confidence that the regulatory system will honour its commitments;

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- Legitimate, i.e., consumers must be convinced that the regulatory system will protect them from the exercise of monopoly power, whether through high prices, poor service, or both;
- Transparent, i.e., the regulatory system must operate so that investors and consumers ‘know the terms of the deal’; and
- Efficient, i.e., the regulatory system should promote pricing and production efficiency.

In terms of international best-practice, regulators are underpinned by comprehensive legislation, which provides for their creation, members, appointment, qualification, terms and vacancies. A clear regulatory framework for tariff setting for all the regulated entities is also in place. The regulators are for the most part autonomous and independent entities, and their roles and duties are clearly defined. Regulators are vested with complete power and jurisdiction to regulate all rates, fares, fees, charges, services, rules, conditions of service and all other matters pertaining to the formation, operation, or direction of regulated SOEs. They are also granted the power and jurisdiction to hear and decide on all matters pertaining to the regulation of those regulated SOEs. Regulators are normally funded by fees charged to the various sector participants for the range of services they provide.

A review was made of a number of previous studies of the South African regulatory system. These studies have stressed that limits to regulatory independence, lack of technical and specialist regulatory capacities, as well as political interference are the most pressing challenges facing the regulatory system in South Africa. In addition, the following weaknesses were also identified:

- Inconsistencies and ad hoc tendencies in the development of regulatory frameworks for economic regulation;
- Inconsistencies in the institutional design of the regulator;

- Regulatory uncertainty;
- Lack of clear appeals process against the decision of a regulator;
- Political interference, the perceived absence of regulatory commitment from Government;
- Institutional fragility and capacity;
- Lack of role clarity for all participants within the regulatory system;
- Policy formulation delays/contradictions/capacity;
- Information asymmetry;
- Lack of clear regulatory objectives/objective trade-offs/regulatory instruments; and
- The absence of a performance evaluation regulatory system.

Just a few of these will be elaborated upon here.

The Steyn report, which arose from a study commissioned by the PRC, found that regulatory frameworks are developed on an ad hoc basis and are often inconsistent. While there are similarities in the regulatory frameworks developed within the energy sector (compare petroleum pipelines and storage, with gas pipelines and electricity), the regulatory frameworks across the sectors reviewed is inconsistent and appears almost ad hoc in nature. The differences between the sectors cannot readily be explained by the characteristics of each sector, but are more likely to reflect the views of the specific sector officials responsible for the legislative frameworks and the (often foreign) consultants who advised them. One consequence is that only a small number of experts in each sector have a good understanding of the regulatory issues in the sector. The Steyn report also noted that a number of unresolved policy contradictions create perverse incentives for SOEs and set regulators up for failure. Often, problems that appear to be regulatory failure are in fact the symptoms of an underlying policy failure.

In addition to the review of prior studies of the regulatory system, the PRC engaged with a number of other inputs during consultation and

public submissions processes. Together with the findings from prior studies, the PRC noted that the greatest challenge facing South Africa’s regulatory framework is regulatory uncertainty emanating from the lack of comprehensive legislation. Other challenges include the issue of multiple regulators with varying degrees of discretionary power and limited independence; inappropriate institutional structures; limited funding; and a lack of technically experienced human capital. Regulatory risk is heightened in South Africa by delays in finalising policy; the lack of common regulatory frameworks; and poor regulatory decisions that cannot be taken on appeal with a quick turn-around time. Regulatory credibility is impacted by inconsistent regulatory methodologies that are subject to frequent changes, perceived political opportunism, and lack of transparency in decision-making.

The policy ministry focuses on creating policy frameworks that facilitate adequate decision-making processes that include what factors to consider in regulatory decision frameworks as well as specific mechanical approaches. The regulators are then responsible for the decision itself within the framework provided by the sector policy ministry.

5.3.4.4 Inconsistent regulatory methodologies

Regulatory methodologies are inconsistent and subject to frequent change. While some regulators have gone to considerable effort to develop and clarify their regulatory methodologies, they face many challenges during this process. Firstly, the issues involved are often exceedingly complex, and given the challenge they face with acquiring skilled personnel, and the inexperience of the regulator members themselves, they often have to go through a long learning curve before the regulatory methodology is sufficiently stable. Secondly, unresolved fundamental policy

questions and, in some cases, ambiguity in the legislative frameworks on key questions have made it difficult for regulators to finalise tariff methodology frameworks. These problems have also had the result that key aspects of regulatory methodologies, such as the approach to asset valuation; the treatment of capital works under construction; the calculation of the cost of capital, etc. differ across the different sectors reviewed, for no apparent reason.

There is a need to consider alternative regulatory methodologies. Internationally, economic regulation has been relatively uncontroversial and has facilitated businesses growing their asset bases at relatively low cost to the tax payer and consumer. However, in South Africa it is argued that the way in which regulatory methodologies have been implemented has rarely been ‘smooth’. In order to reduce the complexity faced by sector regulators; reduce long learning curves; improve the quality of regulatory decisions; and reduce regulatory uncertainty, the Minister of Finance should specify, by regulation, binding cross-sectorial tariff-setting and capital project evaluation methodology principles.

5.3.4.5 The need for a legislative framework for economic regulation of SOEs

Most of the proposals set out above will mostly have to be implemented by passing new legislation. It is recommended that the Presidency request the Minister of Finance to prepare an Infrastructure Economic Regulation Bill that will accomplish the changes proposed in this report. The bill will replace the relevant sections in the legislation that governs economic regulation in the transport (airports and ports); energy (electricity, gas, and petroleum pipelines and storage); and telecommunication sectors, and should thus be applicable across the key SOE infrastructure sectors.

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RECOMMENDATION 6(A):

- Government should develop a uniform framework for economic regulation.**
- An executive authority should be appointed to establish a framework for economic regulation and to oversee the implementation of core regulatory principles. This framework for economic regulation should immediately tackle the following:
 - Develop a regulatory strategy that will create credibility, bring stability and attract investors to the utility sectors;
 - As an intermediate phase, develop a blueprint that will act as a guide to all the sectors on how to improve the existing regulatory designs;
 - Start a process of overhauling the current array of sector-specific statutory provision for economic regulation in order to create an economic regulator that will immediately regulate all of South Africa’s network industries; and
 - Develop action plans that will reinforce regulators’ independence, accountability, and transparency by building the professional and technical capabilities of regulators.
 - A uniform regulatory framework must:
 - Promote the independence of regulators – to have independent autonomy;
 - Be competent – have the means to acquire the resources necessary to do the job properly;
 - Adopt principles to guide their independence taking into account the Developmental State objectives. The principles should be based on the following:
 - Autonomy to make regulatory decisions;
 - Powers to appoint and dismiss the regulatory staff to reside with Parliament;
 - Funding must be independent of the relevant line or shareholding ministry and raised either through industry levies (or licensing fees) or an independent budget vote;
 - Reporting line and performance oversight should reside with Parliament;
 - The regulator should be granted organisational autonomy in terms of its legal identity, physical location, and staffing pool;
 - The decision-making process of the regulator should be transparent to demonstrate that there is no manipulation by any external forces; and
 - A focus on competitive neutrality.

RECOMMENDATION 6(B):

Government should undertake a process of identifying policy inconsistencies and policy conflicts; clarify the role of economic regulators; and develop a blueprint to guide regulatory designs.

PART 3:
PERFORMANCE OF
STATE-OWNED ENTITIES

PART 3: PERFORMANCE OF STATE-OWNED ENTITIES

INTRODUCTION

Having established that there is no overarching strategy for SOEs in South Africa (part 1), and that there is room for making the legal environment and owner’s governance model more conducive or enabling to the smooth operation of SOEs (part 2), this section of the report focuses on the actual current performance of SOEs in respect of the services which they are mandated to deliver. In responding to the findings of this section, we build on the foundations laid by the recommendations made in sections 1 and 2. Thus, the Government should:

- Design an overarching strategy that is aligned with Developmental State imperatives and national development goals;
- Create and nurture an enabling legal framework;
- Craft a framework for effective collaboration, coordination and cooperation for Government and SOEs;
- Create and maintain a single SOE database;
- Forge a harmonised performance management system; and
- Utilise SOEs effectively to enhance Government service delivery.

Within the context of an overarching strategy and an enabling legal environment, the *raison d’être* and primary mandate of SOEs is the efficient and effective delivery of the services for which they were established. This section thus interrogates the extent to which there might be:

- Inefficiency and/or ineffectiveness in responding to the primary mandate; or
- Excessive focus on secondary objectives at the expense of the primary mandate of an SOE.

The assumption is that SOEs are operating optimally and that they are achieving the goals of efficiency and effectiveness. Deviations from these goals will thus be highlighted.

The specific aspects covered in this section of the report on SOE performance relate to:

- The efficiency and effectiveness of SOE service delivery;
- The extent to which SOEs are operating in compliance with the development and transformation agenda of the Government;
- The role of SOEs in human capital development and the sustainability thereof; and
- The funding and financial viability of SOEs.

This section of the report is divided into two chapters:

• **Chapter 6: State-owned entity efficiency and effectiveness in service delivery**

The chapter evaluates the efficiency and effectiveness of SOEs in achieving the purposes for which they were established. The chapter also focuses on the extent to which SOEs are meeting the development agenda of the State.

• **Chapter 7: State-owned entity funding and financial viability**

Finally, the funding environment of SOEs is investigated to determine its impact on the viability of SOEs.

CHAPTER 6: STATE-OWNED ENTITY EFFICIENCY AND EFFECTIVENESS IN SERVICE DELIVERY

6.1 OVERVIEW OF THE CHAPTER

6.1.1 Background and problem statements

Universally, SOE effectiveness and efficiency stem from intelligibly defined mandates, a robust strategic planning process and implementable plans. These clarify to governing boards, executive management and all stakeholders the purpose and performance expectations placed on each SOE by its owner(s) or shareholder(s). These measures in turn give impetus to the improvement of the level and quality of services delivered by the SOEs. Further, the PRC draws a distinction between what constitutes a primary mandate (i.e., the purpose for which an SOE was established, such as to provide water); and a secondary mandate (i.e., the contribution to the State’s developmental and transformation agenda, such as to create jobs).

SOEs are established for various reasons that can be logically grouped as commercial and non-commercial. In respect of commercial SOEs, it lies within the ownership ambit of the State to:

- Ensure appropriate pricing of a service or product, which is critical for the country to function and for the economy to work;
- Secure a dividend pay-out which will serve to, firstly, ensure that the invested capital value is maintained and improved; secondly allow for re-investment in the SOEs to enhance growth; and thirdly, boost the State’s revenues and allow for increased cross-subsidised spending in critical transformation and development areas; and
- Ensure the offering of a service that balances commercial interests and objectives with developmental interests and objectives (the latter often being difficult to fund and sustain where the profit margin is dominant).

In respect of non-commercial SOEs, the State establishes and structures entities that are either being funded through levies or taxes, or have managed through proper processes and systems to secure sufficient revenue to sustain themselves. These entities would generally be established to

ensure the execution of Government policies or see to the execution of specific services, which fall within the ambit of the State’s responsibility to the taxpayer or as prescribed by the South African Constitution. These SOEs are normally instrumental in assisting the Government to deliver on its strategic objectives.

In those countries, which have adopted a Developmental State agenda, Government departments have limitations, such as their form, legal construct and arduous bureaucracy, which inhibit the State’s ability to undertake certain mandates. SOEs thus become an alternate and essential tool in delivering on the State’s developmental agenda – as it is often only through them that the State can give direct impetus to the realisation of the pressing developmental needs of the country. It is therefore of critical importance that these entities should be effective and efficient.

In commercial terms, ‘effectiveness’ is defined as ‘the degree to which objectives are achieved and the extent to which targeted problems are solved – in other words, doing the right things’, while efficiency, on the other hand, is referred to as the ‘ability to accomplish the job with minimum inputs (time, cost and effort) to create the greatest outputs – that is doing things right’.

The effectiveness of an SOE entails the proper execution of its mandate. A clearly defined mandate is important in ensuring that the SOE takes full accountability for its execution, thereby providing a basis for setting specific targets for the SOE’s operations. Best-practice established by the PRC is such that:

- Mandates are politically approved and are contained in a legal document, the shareholder’s compact, which is supposed to be used consistently as the reference point to determine the appropriateness of objectives and activities of the SOE;
- It is the oversight ministry’s responsibility to establish whether the relevant SOE mandate is

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in line with the country’s overall objectives such as national outcomes; Developmental State objectives; millennium development goals; national growth path; IPAP 1 and 2, etc.; and

- According to the guidelines provided by OECD guide for State ownership, SOE mandates should ‘give some clear indication of how to articulate the trade-offs between commercial and policy objectives’ (OECD, 2010).

In line with the National Treasury guidelines, SOEs are required to have performance agreements, which are contained in a shareholder compact, or performance agreement. To ensure effectiveness and efficiency in commercial entities, the terms should be in respect of a clearly defined and appropriate mandate (effectiveness) and within the parameters of cost-effectiveness and maximum return for resources expended, i.e. with clearly defined cost and return parameters (efficiency), but not at the expense of service quality. Non-commercial entities enter into measurable key performance indicator (KPI) performance agreements with their line function and oversight owners/shareholders.

SOEs’ performance agreements in the form of shareholder compacts or corporate plans outline strategic objectives, key performance indicators and targets pertaining to delivery of the mandate. In line with the Treasury regulations, corporate plans are submitted to the executive authorities together with the shareholder compact to give further details on how the SOE intends to address the mandate and execute its strategy with its available resources.

According to the National Treasury guidelines, only schedule 2; 3b and 3d entities are required to submit shareholder compacts and corporate plans which are accompanied by other supporting documents such as a risk management plan; fraud prevention plan; corporate balanced scorecard; and financial plan (National Treasury 2002, Guideline Framework for Corporate Planning and Shareholder’s Compact 2002). Although they may

not be subject to the provisions of the PFMA, other entities submit business plans to their executive authorities, outlining their strategy and plans for a five-year period or more. It is these mandates and strategic objectives, as set out in the shareholder compacts and performance agreements, that provide the basis for monitoring and evaluating the performance of SOEs. SOEs are also evaluated in terms of their contribution to achieving certain national developmental and transformation goals.

6.1.2 Purpose of this chapter

The purpose of the chapter is, firstly, too:

- Assess whether SOEs are delivering services as per the primary purpose for which they were established and whether the service delivered is relevant and adequate;
- Assess whether SOE performance and service delivery is aligned to their mandate, strategy and the Developmental State agenda; and
- Recommend corrective measures going forward.

The second objective of the chapter is to understand whether or not SOEs are achieving the transformation objectives of Government. In order to get a better understanding, the paper asks the following questions:

- What is Government’s development and transformation agenda (the ‘agenda’)?
- Is there a common understanding of the agenda?
- What is the mandate of the SOE vs. the agenda?
- Are SOEs achieving the transformation agenda?
- What factors are negatively affecting SOEs from achieving their agendas?
- What should the SOEs do to enable them to achieve their respective agendas?

6.1.3 Process and approach

The material for this chapter is derived from a number of PRC processes, which include the following:

Two PRC terms of reference discussion papers produced by the PRC’s Strategic Management

and Operational effectiveness (SMOE) and development and transformation (D&T) work-streams:

- The efficiency and effectiveness of State-owned enterprises with respect to service delivery; and
- Compliance of SOEs to the Government’s development and transformation agenda.

6.1.4 Structure of the chapter

The chapter is divided into four sections. Each section provides an overview, assessment, discussion on international experience, and recommendations on the various areas reviewed, namely:

- Issues and challenges in performance assessment;
- Performance of SOEs;
- Performance of SOEs in addressing the State’s developmental and transformation agendas; and
- Skills development, sustainable human capital development and job creation.

6.2 PERFORMANCE MANAGEMENT

6.2.1 Background

It is important that there is oversight over the collective performance of SOEs. A performance management system for SOEs should be two-dimensional: at an **enterprise assessment level** (internal systems and management performance to produce outputs efficiently) and at a **service delivery value chain assessment level** (an external perspective on how the SOEs have played their part in a collective delivery of expected outcomes). Government spends considerable financial resources from the fiscus on SOEs. The question is often raised whether or not the performance of SOEs warrants this investment. The State relies on SOEs to execute their mandates with effectiveness and efficiency, so it is therefore important to maintain strong performance management and monitoring of the SOEs. As the Asian Development Bank notes: “The ultimate aim of implementing a performance measurement system is to improve

the performance of an organisation so that it may better serve its customers, employees, owners, and stakeholders.” (Asian Development Bank, 2007, p. 1).

6.2.2 Issues and challenges

The responsibility of the oversight authorities in performance monitoring is established in the PFMA regulations. Performance in terms of the PFMA is managed by ensuring that SOEs have **strategic objectives** reflective of their mandate; the **business strategy objectives** of the authority they report to; and **national objectives**. SOE mandates and/or founding acts do not contain a measurable statement of objectives but state the role of the SOE. The measurability of the mandates is usually clarified by the objectives stated by SOEs in their strategic documents.

Treasury regulation 29.1 provides that the accounting authority of a public entity listed in schedule 2 and 3B must:

- Submit a corporate plan annually to their executive authority and the relevant Treasury.
- The corporate plan must cover a period of three years and should include:
 - Strategic objectives, identified outcomes;
 - Strategic and business initiatives;
 - Key performance measures and indicators for assessing the entity’s performance in delivering the desired outcomes and objectives;
 - A risk management plan;
 - A fraud prevention plan; and
 - A financial plan addressing projections of revenue, expenditure, borrowings, asset and liability management, cash flow projections, capital expenditure programmes, and dividend policies. The plan should be agreed upon by the executive authority.

Annually, once objectives, goals and KPIs are determined, the executive authority or ownership entity signs a shareholder compact with the respective SOE. Systems are put in place to

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analyse the performance of entities in relation to agreed-upon outcomes on a quarterly and annual basis. The oversight authority provides feedback and recommendations to SOEs on assessed performance. National Treasury regulations require regular reviews of the implementation of the recommendations of the oversight authority, and ministries are required to offer support where needed by SOEs. All quarterly performance results and remedial actions are included in the annual report at the end of each financial year. Annual reports present an opportunity for executive authorities to assess the extent to which goals have been met for the full financial year.

The discussion that follows highlights some of the readily observable challenges relating to current performance management of SOEs.

6.2.2.1 Inconsistency in the measurement of performance by SOEs and the oversight authorities

There appears to be failure in some SOEs to develop a clear criterion to measure key KPIs. Reports by the Auditor-General and independent auditors indicate that some SOEs have poorly defined KPIs and targets. Such instances make it difficult for SOEs to assess their own performance, while undermining the ability of oversight structures to do the same.

6.2.2.2 Inadequacy of State-owned Entity mandates

Although all SOEs have enabling legislation and articles of association that set out their mandates, the mandates of many SOEs are not aligned with the current Government's Developmental State priorities. There is a pronounced need for enhanced alignment between the specific national development priorities and that of the priorities of many of the SOEs. This is necessitated by the fact that in some instances, most of the mandates have not been consciously refreshed since the end of the post-apartheid dispensation. Changes have largely been ad-hoc and reactive.

Furthermore, there has not been a clear national Government policy on just how SOEs fit into national development strategies and priorities. There appears to be a widespread 'lack of clarity of purpose' for many SOEs. In some cases SOEs' boards and management do not know what they are supposed to do. In this policy and leadership vacuum, many SOEs tend to pursue their mandates on a stand-alone basis, rather than interlinking with national development strategies.

In some cases, mandates are fluid, allowing an executive authority to change or expand the tasks of an SOE without formalising such changes or expanding the resources. Evidence gained from engagements with various stakeholders, including SOE board members, executives, managers and customers of various SOEs, indicates that there is general concern about SOE mandates that change constantly. The problem arises from the broad nature of mandates. The mandates of the commercial SOEs, for example, generally cover broad Government objectives, and they include phrases such as 'assist in lowering the cost of doing business in South Africa and enabling economic growth'; 'rural development and economic transformation'; 'provision, maintenance and management of infrastructure/ Government assets'; and 'provision of transport services'. Mandates are so broad that the executive authority often shifts the mandates by including other responsibilities that are outside the SOE's core mandate without formalising such changes. One of the areas in which this comes to the fore is when developmental imperatives are prioritised over commercial imperatives. Of the commercial entities surveyed by the HSRC, 65% indicated that their mandate has changed significantly over the past five years due to factors such as political, social and economic circumstances; changes in Government policy; and directives that resulted in issuing of ministerial directives. Mandates that are fluid and constantly changing without being

formalised, result in difficulties in assessing the performance of SOEs in achieving these mandates.

Internationally, reforms of the SOE environment have included a focus on developing less opaque mandates, and boosting monitoring and evaluation mechanisms. Generally, the idea is to set clearer 'objectives and targets which can be monitored and reported on over time' (Forfas, 2010, p. 4).

6.2.2.3 Difficulties associated with shareholder compacts

Limited technical competence and capacity in executive oversight departments often result in failures of executive authorities to review and sign off shareholder compacts, as observed during the review of actual shareholder compacts of various SOEs. This limits their optimum usage as a performance assessment tool. For example, oversight of water boards lies with the Ministry of Water Affairs. However, a survey conducted by PwC on behalf of the PRC found that: 10% of shareholder compacts were not signed off by the board and the Minister; 65% were signed off by the board, but not by the Minister; and only 25% were signed off by both the board and the Minister.

In some cases, where the performance agreements are signed by the executive authorities, it appears that the focus is more on compliance and not actually focused on an in-depth analysis of the SOEs' strategic focus and performance. For instance, although the Department of Transport's SOEs have signed shareholder compacts, which are reviewed annually, and an internal performance monitoring unit has been set up for this purpose, the department has serious capacity constraints, particularly in its entity oversight portfolio, which curtails in-depth analysis of objectives, targets and the assessment of performance. The performance monitoring division is thus reduced to administrative oversight and is not able to make substantial input into the plans of SOEs.

Some national SOEs indicated during the roundtable engagement sessions that one of the reasons they do not submit shareholder compacts is to accommodate the preference of their relevant oversight ministries for fluid deliverables, changeable whenever required by the executive authority/Minister concerned.

The Government invests heavily in constructing a developmental framework, which is often not adopted by SOEs as expected in their role as major delivery arms of the State. In the survey commissioned by the PRC and conducted by PwC (2011), SOEs indicated they are committed to supporting the principles of the Developmental State, but indicated varying degrees of alignment of these principles to their existing mandates and strategic plans. This situation may derive from the relationship between the oversight authorities or shareholder ministries and the SOEs themselves, which appear not to be conducive to robust debate and formal agreement on those aspects of the developmental agenda for which SOEs would be held accountable. Since some SOE objectives are not aligned to Developmental State objectives, it becomes difficult to assess their contribution to Developmental State goals.

6.2.2.4 Lack of a standard reporting template

SOEs report to different ministries, and do not have standard reporting templates that reflect the national objectives, business objectives, objective measures, annual performance indicators, targets, and performance. In addition, while most SOEs tend to report on both the operational aspects and financial aspects of performance, a significant number only report on the operational aspects. Only 78% of SOEs have balanced reports that emphasise both operational and financial performance.

Some departments have adopted guidelines, which include a template for reporting performance. For instance, the Department of Water Affairs

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has set out a template in its guideline for drafting quarterly reports. Quarterly performance targets are compared to what entities actually achieve for the period under review. Also reflected are annual targets; the extent to which these have been achieved in the year to date; and comments on deviations from the targets. The oversight authority then sends out the performance assessment reports and highlights areas of concern where these exist.

6.2.2.5 The absence of horizontal performance assessment

The current performance management processes only look at the performance of the entities against their own individual pre-determined objectives. They disregard the fundamental aspect of harmonisation of performance management to achieve national outcomes, which evaluates the combined performance of entities in the same value chain in terms of impact on service delivery. The review indicated that there is no current process or system in the oversight structures of SOEs where such harmonised views of performance are developed, directed, reported on and overseen. Oversight structures of different departments in Government do not currently have integrative platforms to do this.

In a harmonised horizontal performance management system, SOEs and other organisations that serve in a similar value chain ought to cooperate with each other to achieve their goals. Investments, funding and delivery of projects and processes should be harmonised to achieve the desired levels of performance in quantity, quality, price and other performance attributes of such a value chain. These value chains are defined by service delivered. They may involve entities in different industry sectors whose performance contributes to a delivery of services towards achieving a national outcome, such as access to decent housing.

The assessment of value chain performance does not look at the internal performance processes. Instead it looks at how the results of internal operational and strategic decisions of SOEs influence the ability of the value chain to, for example, address housing needs and targets set by the national Government for low and middle income households. Government should be able to have a harmonised view of the performance of the different entities towards achievement of the objectives of this value chain to ensure that the efforts of the different entities yield the desired output for the country.

6.2.2.6 The absence of a central authority to set performance targets and monitor and evaluate the performance of SOEs

South Africa lacks a central authority to set performance targets and to monitor and evaluate the performance of SOEs. The centralised setting of performance targets and evaluation and monitoring of SOE performance enables the Governments of countries like India, Korea and Namibia to consolidate their strategic leadership of SOEs – a step towards horizontal harmonisation of performance management.

Some departments have introduced systems to facilitate reporting that can enable evaluation of the performance of SOEs, such as the Department of Public Enterprises, which has a semi-automated web-based system on which SOEs can place their performance results every quarter. This allows the executive authority to analyse and monitor performance on a comparative basis. The department also developed the Isibuko Dashboard system to allow on-time reporting by SOEs, thus enhancing detection, mitigation and monitoring of enterprise and cross-cutting shareholder risks on an ongoing basis. The system also assists the oversight authority to monitor trends in the following areas: financial and operational performance; capital investment programmes; environmental impact assessments; socio-economic issues; governance; skills

development; competitive supplier development programmes; and property disposals. Once reviewed, the SOE performance monitoring team analyses the reports, submits memoranda and updates the system with the quarterly report analysis results within two weeks of receipt of the quarterly reports from the SOEs.

International benchmarking indicates that there is a need for a standardised performance management system.

RECOMMENDATION 7:

The Government should develop a common performance management system.

The common performance management system should:

- Be based on an SOE performance scorecard which should be developed by the central authority responsible for commercial entities;
- Be aligned to the Developmental State principles;
- Be linked to the performance reporting systems of the oversight authority;
- Have standardised reporting guidelines for SOEs;
- Be based on the mandates and strategic objectives of SOEs;
- Include monitoring and evaluation of collaboration amongst SOEs;
- Include customer (user) satisfaction indices customised for each SOE, measured regularly (annually) through independent surveys conducted by independent auditing or research entities; and
- Assess SOEs on the basis of outputs of the value chain that the particular SOE contributes to through its activities (total impact assessment).

RECOMMENDATION 8:

The mandates of SOEs should be subject to critical strategic review every five years, and the requirement thereof should be factored into the SOE Act.

Changes to mandates should be:

- Aligned with the SOEs’ overarching strategy;
- Approved in concurrence with the SOE Council of Ministers (this council is discussed further in section 9.4. of this report);
- Subjected to Parliamentary oversight; and
- Formulated to include a strong element of measurability.

RECOMMENDATION 9:

The agreement and sign-off of statements of strategic intent and corporate performance plans should be:

- Made mandatory for every executive oversight authority; and
- Developed within a specified time-line.

There should be a focus on a dedicated, deliberate training and development programme for oversight functionaries.

In addition, strong sanctions and accountability measures should be in place to deal with non-compliance and ensure accountability and productivity.

In summary, in order to improve the oversight and developmental performance of SOEs, the following should be strongly considered by the Government:

- The agreement and sign-off of statements of strategic intent and shareholder compacts and corporate performance plans must be made mandatory for every executive oversight authority and strong punitive and accountability measures should be in place to deal with non-compliance.
- Strategic objectives should be carefully considered and evaluated and should be the

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- product of robust debate and formal agreement between SOEs and their executive authorities/ shareholder ministries on those aspects of the Developmental State agenda for which SOEs would be held accountable.
- Oversight ministries and oversight authorities need to undertake much more direct and regular (quarterly) reviews of SOE performance and to communicate expectations for year-end outcomes, to the Cabinet and Parliament.

Oversight authorities need to pursue an immediate and significant upgrade in technical competencies and capacity to provide effective oversight of SOEs, failing which there must be consequences including relieving the ultimate party responsible of those duties. The SOEs in question need to be under the oversight of departments, which have the requisite skills and capabilities to perform this task.

6.3 PERFORMANCE OF SOES

- The evaluation of performance of SOEs is done on two levels:
- The achievement of their strategic objectives; and
 - The contribution of SOEs to the State’s developmental and transformation agendas.

6.3.1 Achievement of strategic objectives

The mandates of SOEs are diverse, and are the purpose or reason for the existence of an SOE, i.e. what it is called upon to execute. However, SOEs have both primary and secondary mandates, and in both of these there may be a wide range of objectives. Effectiveness measures must be linked back to delivery on key objectives. Part of the investigation done by KPMG on available SOE annual reports and schedules was to provide some idea on the performance of SOEs against set strategic objectives. ‘Performance bands’ are listed in the table 14.

Table 14: SOE performance bands

Status	Degree of achievement of target
Not achieved/under-achieved	0-49%
Achieved	50-79%
Substantially achieved	80-99%
Fully achieved	100-109%
Over achieved	>109%

In terms of the achievement of the stated objectives as per the commissioned study and database, the following results were concluded for the SOEs per the two categories covered in the KPMG report.

Table 15: Achievement of strategic objectives by schedule 2 and schedule 3B entities

Schedule 2 – achievement of strategic objectives

	Not/under achieved	Achieved	Substantially achieved	Fully achieved	Over achieved	No information
Total	29	19	47	51	49	5
%	24%		73%			3%

Schedule 3B – Achievement of strategic objectives

	Not/under achieved	Achieved	Substantially achieved	Fully achieved	Over achieved	No information
Total	29	31	28	56	27	32
%	29%		54%			15%

What the above seems to represent is that with the schedule 2 entities that are more exposed to commercial discipline and stakeholder oversight, the achievement of objectives was significantly better than in the case of schedule 3B SOEs. The performance in meeting objectives in general does indicate that SOEs need to become more effective. Linked to the issue of strategic objective proliferation mentioned above, it calls for a more stringent and robust process in setting strategic direction and defining objectives.

If an SOE performs well on the majority of strategic objectives it has set as part of its strategy, but fails in one or two primary mandate-critical objectives, that particular SOE has failed its owner/ shareholder and its stakeholders.

Direct engagement with customers and the private sector indicated a disturbing groundswell of dissatisfaction with SOEs’ worsening track record on delivery, while levies and fees kept growing. One may be tempted to discount this general gripe against anything that belongs to or is managed by the State, but the intensity of dissatisfaction in the private sector points towards a much more serious problem as far as primary service delivery is concerned. Noticeably, most SOEs do not conduct independent customer satisfaction and service delivery assurance surveys to determine how well are they performing and if this is to their customers’ satisfaction.

- Nevertheless, SOEs mention a number of reasons that hinder the delivery of their strategic objectives. These include, among other issues:
- The lack of required technical skills;
 - The inability to sustain operations;
 - Poor corporate governance and non-accountability;
 - Inadequate infrastructure;
 - The lack of enabling legislation and insufficient funding;
 - Poor and conflicting political oversight as evident in the whole issue of mandates; and
 - Lack of long-term planning.

The PRC also noted another serious challenge faced by SOEs, which affects their performance – the wide range of objectives that are found in the mandates of some SOEs. Governments face many and diverse political and policy pressures. In their attempts to address this complexity it is often tempting to expect SOEs, who typically control vast resources, to assist with achieving many of these objectives. Not only do SOEs have to deliver on their core functions, but they now also have to assist with executing a myriad of economic policy and other social objectives.

The wider the set of objectives for an SOE the more managerial time and resources are stretched, and the more an SOE will have to make trade-offs in the achievement of its objectives – which may to some extent entail political judgements. With the trend of more policy trade-offs being made inside SOEs, the executive authorities and their departmental officials will be more inclined (legitimately) to intervene by exercising influence over the prioritisation of objectives and resource allocation, while inadvertently taking the risk of compromising the separation of roles between the oversight authority and executive authority.

6.3.2 Performance of SOEs in addressing the State’s developmental and transformation agendas

The debate about the nature of the State invariably informs the nature and role of State institutions such as SOEs. For this reason, the broader role of SOEs, and specifically their economic role, cannot be divorced from the discourse of a Developmental State. This section reviews the broader context within which the SOEs play a role in the Developmental State. The emphasis is on the developmental agenda for SOEs and how they facilitate transformation.

While Government is currently pursuing policies that can be deemed to be laying the basis for a Developmental State, SOEs too have undergone a series of restructuring and transformation over

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the past 18 years. The rate, pace, degree and level of transformation within SOEs have been uneven and to a large extent uncoordinated. In the process of transforming the SOEs, there has been consideration of policies such as privatisation, Public Private Partnerships, the sale of certain SOEs and even consideration for the buying back of what was previously sold. SOEs have witnessed an uneven level of development and as a result, their strengths and capacities differ.

In the recent past some of the major SOEs in the economic infrastructure sector have received massive investment and capitalisation from Government and international borrowing. This has strengthened the capacity of those SOEs and led to massive infrastructure investment in various areas, such as transport (rail and roads), electricity and telecoms. The turn of events regarding infrastructure investments through major SOEs has resulted in better appreciation of the significant role SOEs can play in the broader developmental agenda of the State.

Government has also adjusted its expenditure priorities in order to put the economy on a new course in line with Government's New Growth Path – an economic strategy in which employment creation is paramount and which has set the bold target of creating five million additional jobs by 2020. Government's New Growth Path specifically calls on SOEs to play a key developmental role. "The New Growth Path will require some re orientation from all State agencies, not just the national departments. Critical players include the Development finance institutions, Government Employee Pension Fund and Public Investment Commission as crucial investors of savings" (Economic Development Department, 2010).

Current Government policies, such as the industrial policy action plan (IPAP2), the new growth plan (NGP) and the medium-term strategic framework (MTSF), are increasingly reliant on the

SOEs to achieve their stated objectives. SOEs are thus enjoying renewed focus and attention on their strategic role.

The PRC review also demonstrates the level of significance that the current administration is placing on SOEs. The alignment of key Government objectives and the mandate and functions of SOEs has also come to the forefront. With the increasing realisation that SOEs are significant players in the Developmental State agenda, Government, through various mechanisms and instruments is ensuring that mandates and functions are aligned to the broader objectives of the country.

Regarding transformation per se, since 1994 Government has embarked upon a comprehensive programme to provide a legislative framework for the transformation of our economy. New laws have restored rights to land and tenure; have prescribed unfair discrimination; and introduced specific active measures to overcome the distortions in the labour market as well as provide new economic opportunities to historically disadvantaged persons.

In addition, Government has implemented various policies, strategies and programmes aimed at overcoming economic inequalities and underdevelopment, including the integrated human resources development strategy; urban renewal programme; integrated sustainable rural development programme; the tourism transformation strategy; the strategic sector plan for agriculture; and the national small business development promotion programme.

One of the Government's new policies, black economic empowerment (BEE) is derived from the reconstruction and development programme (RDP), a Government blueprint for transformation in 1996. The RDP articulated the vision and values of BEE in stating: "The domination of business activities by white business and the exclusion of

black people and women from the mainstream of economic activity are causes for great concern for the reconstruction and development process... It is envisaged that State and parastatal institutions will also provide capital for the attainment of BEE objectives. The democratic Government must also introduce tendering out procedures, which facilitate BEE. Special emphasis is also placed on training, upgrading and real participation in ownership (RSA, 1995)."

Some of the studies conducted before 2001 on BEE progress suggest there has been very little change in overall inequality and wealth. The result is that black people remain in poverty and marginalised from ownership, control and management of economic activities. Lack of satisfactory progress in BEE transformation initiatives hindered the growth prospects and competitiveness of the nation and led to the formation of a BEE Commission, which was tasked to deal with the following challenges:

- The lack of a national vision for BEE;
- The failure by Government and black business to provide leadership and a vision for BEE;
- Empowerment versus enrichment;
- The empowerment process being driven by white institutions; and
- The lack of a coherent definition for BEE.

It is now widely agreed that 'black economic empowerment' (BEE) and affirmative-action laws introduced for transformation, have not fared optimally. The country's economic 'transformation', meaning the redistribution of power and wealth to the majority of citizens, has been slow.

The failure of BEE led to the enactment of the B-BBEE Act and the establishment of the B-BEE Advisory Council whose responsibility is to provide leadership and direction in implementation of B-BBEE in the country. The function of the Council is to:

- Advise Government on B-BBEE;
- Review progress in achieving B-BBEE;

- If requested to do so, advise on the draft transformation charters;
- Facilitate partnership between organs of State and the private sector that will advance the objectives of the B-BBEE Act.

It is within this context that this section of the chapter seeks to evaluate the performance of SOEs in relation to their delivery on the codified policy for transformation of the Government. The objective is to understand whether SOEs are achieving the transformation objectives of Government and to establish what should be done to improve achievement of the agenda by SOEs.

6.3.2.1 Nature of the Developmental State agenda

The importance of the review of SOEs, in particular the subject matter on the role of SOEs in the Developmental State agenda, cannot be over emphasised. A clear policy framework governing and guiding the strategic role of SOEs in propelling the developmental agenda as well as delivering on the transformation imperatives is desirable and long overdue. The role of SOEs is central to economic growth, job creation, building the capability and technical capacity of the State, international cooperation, meeting the basic needs of the people and ultimately building a non-racial prosperous society. SOEs are powerful instruments for achieving developmental goals.

The earlier chapters of this report emphasise the PRC's position that the specific role of SOEs in the developmental agenda needs to be spelt out and aligned with other Government initiatives. In terms of various Government policies, SOEs are envisaged to play a role as key drivers and implementing agents of a developmental mandate as well as leaders of the State's transformation agenda. SOEs are expected to take the lead in the provision of the modern infrastructure that will serve the economic growth of the country as well as as facilitating benefits for the citizens.

CHAPTER 6: STATE-OWNED ENTITY EFFICIENCY AND EFFECTIVENESS IN SERVICE DELIVERY continued

The PRC survey highlighted a high level of awareness on the expected role of SOEs in supporting the Developmental State objectives. The survey, among others, noted the following:

- Most (92%) perceive that there is a relationship between the activities of their SOEs and the Developmental State.
- SOEs identify Government's social priorities most frequently as education (38%); health (36%); employment creation (26%); safety and security (23%); and poverty alleviation (16%).
- Economic priorities are seen to be employment creation (50%); and economic growth and/or development (37%); infrastructure development (12%); skills development (11%); promotion of SMMEs (7%); industrial beneficiation (6%); land reform (4%); financial stability (4%); and promotion of competitiveness (4%).
- Most SOEs (79%) perceive that they are achieving the optimal balance between the social, economic and political imperatives of Government. Where this is not happening, the hindrances are seen to be financial or resource constraints.
- Of the three imperatives, 58% of SOEs say their most significant area of contribution is economic, while 40% are of the opinion that it is in respect of social imperatives and 9% say it is political. Of SOEs surveyed, 15 % mention more than one area as being significant.

Misalignment of Developmental State objectives with the SOEs' mandates and functions, could potentially lead to misdirected initiatives by SOEs.

6.3.2.2 Nature of the State's transformation agenda

The discussion of South Africa as a Developmental State cannot be optimally argued without making reference to the discussion of economic transformation and the codified policy for broad-based black economic empowerment (B-BBEE) that has been adopted.

B-BBEE is an evolving policy; it is an integrated and socio-economic process that directly contributes to the economic transformation of South Africa. If implemented well, B-BBEE may result in some profound and significant benefits beyond the obvious targeted redress of imbalances. SOEs have a significant role to play in driving the codified economic transformation policy for Government. SOEs should set the pace in achieving statutory requirements in support of Government and national priorities.

As one of Government's codified policies, B-BBEE requires companies to increase access to ownership; management positions; employment equity; skills development; supply chain opportunities; services; enterprise development; and socio-economic development benefits for historically disadvantaged South Africans. B-BBEE should be viewed within the broad scope of empowerment processes including job creation; rural development; urban renewal; poverty alleviation; specific measures to empower black women; skills and management development; education; meaningful ownership; and access to finance for households and for the purpose of conducting business.

The broad-based black economic empowerment strategy is a necessary Government intervention to address the systematic exclusion of the majority of South Africans from full participation in the economy. According to the DTI the B-BBEE strategy is underpinned by four principles:

1. Black economic empowerment is broad-based:

The process of B-BBEE seeks to accelerate the deracialisation of the South African economy and fast track the re-entry of historically marginalised communities, in particular the African majority as the previously most oppressed, into the mainstream of the economy.

2. Black economic empowerment is an inclusive process:

A more equitable economy will benefit all South Africans, individuals and enterprises. The process of B-BBEE is an inclusive one, and all enterprises operating within South Africa can, and indeed should, participate in this process.

3. Black economic empowerment is associated with good governance:

A fundamental part of our economic reform and transformation is improving the quality and transparency of all economic activity. Accordingly, B-BBEE must be associated with and ensure the highest standards of corporate governance.

4. Black economic empowerment is part of our growth strategy:

Economic growth, development and B-BBEE are complementary and related processes. No economy can grow by excluding any part of its people and an economy that is not growing cannot integrate all of its citizens in a meaningful way. This strategy stresses a B-BBEE process that is associated with growth, development and enterprise development, and not merely the redistribution of existing wealth.

6.3.2.3 Codes of Good Practice

These codes are issued in terms of section 9 the B-BBEE Act and they function to promote the objectives of the Act, which are to:

- Transform South Africa's economy to allow meaningful participation by black people;

- Substantially change the racial profile of companies' owners, managers and skilled professionals;
- Increase the ownership and management of companies by black women, communities, workers, cooperatives and others, and help them access greater economic opportunities;
- Promote investment that leads to broad-based and meaningful participation in the economy by black people;
- Help rural and local communities access economic opportunities; and
- Promote access to finance for black economic empowerment.

The codes should be aligned with key pieces of legislation including:

- The Employment Equity Act;
- The Skills Development Act;
- The Preferential Procurement Act; and
- The Small Business Act.

The codes are used to 'guide and direct' the B-BBEE process within the South African economy. They 'encourage all entities, both public and private, through the issuing of licenses, concessions, sale of assets and preferential procurement to implement proper B-BBEE initiatives'.

State-owned enterprises are measured in terms of the adjusted generic scorecard within the ambit of the Broad Based Black Economic Empowerment Generic Codes of Good Practice as shown in the table 16.

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Table 16: B-BBEE adjusted generic scorecard

Description	Description	Weighting
Overall BEE score		100%
Direct empowerment		15%
Equity ownership	Ownership means thee will be an increase in the number of black people who own, manage and control business	n/a
Management and control	Management control means there will be an increase in black management appointed by the board	15%
Human resource development		35%
Employment equity	To ensure employment equity there will be a spread of black managers from junior level to senior level	15%
Skills development	Skills development involves business spending on training in the form of courses and on-the-job training	20%
Indirect empowerment		35%
Preferential procurement	Business will buy goods and services from BEE compliant and black owned business	20%
Enterprise development	Organised business will find initiatives to develop small black owned business	15%
Residual		15%
Socio-economic development	Business will give free advice or time to help black people develop the skills to move into organised business	15%

The adjusted generic scorecard for SOEs is characterised by the exclusion of the equity ownership considerations, and the increased emphasis on the socio-economic development element.

6.3.2.4 SOE perceptions of the transformation and Developmental State agenda

Almost all SOEs (92%) perceive that there is a relationship between the activities of their SOE and the Developmental State (HSRC Survey, 2011). However, interpretations of a Developmental State and the nature of the development and transformation agenda do vary between SOEs.

- SOEs were asked more specifically what they thought were the Government's social priorities. The most frequent responses were education (38%); health (36%); employment creation (26%); safety and security (23%); and poverty alleviation (16%).
- In respect of the Government's economic priorities, SOEs most commonly perceive them to be employment creation (50%); economic growth and/or development (37%); infrastructure development (12%); skills development (11%); the promotion of SMMEs (7%); industrial beneficiation (6%); land reform (4%); financial stability (4%); and the promotion of competitiveness (4%).

- Thirdly, political priorities are identified by SOEs as the protection or strengthening of our democracy (27%); political stability (10%); black economic empowerment (6%); and poverty reduction (5%).

The areas identified and outlined by the SOEs, are positively aligned to Government's articulated pillars for transformation.

The PRC, as part of its review, organised a transformation consultative workshop for SOEs (2012). The participating SOEs reflected on the various highlights of their unique journey of transformation. The common highlights noted by most participants were as follows:

- Increased BEE awareness within SOEs, especially around procurement. Some noted that this awareness was partly stimulated by the Preferential Procurement Policy Framework Act. (PPPFA);
- More strides have been made in employment equity within SOEs, especially at the top management levels. There is a much greater representation of the demographics in SOEs than in the private sector; and
- Contribution to skills development initiatives is considered one of the main achievements by SOEs.

Other notable highlights mentioned included the following:

- Implementation of supplier performance management programmes, which has resulted in improved value and the supplier's ability to develop;
- More focus on black women-owned businesses, even though this is still in the initial stages in most SOEs and public entities;
- Positioning of the entity to pull through the transformation agenda in an untransformed sector;
- Clear mandate from the shareholder which filters down to the board and executive committee;

- Establishment of a board sub-committee to deal with transformation broadly;
- Documented transformation policies. This is significant because it formalises B-BBEE throughout the entity; and
- The willingness, ability and dedicated resources to execute B-BBEE goals.

Key lowlights

There were numerous lowlights highlighted by the participants. While strides have been made by SOEs and public entities in driving transformation, there were challenges affecting their sustainable contribution by SOEs to B-BBEE. The lowlights fall into three broad categories:

1. Psychological:

Where the level of buy-in across the entire organisation is limited. In some cases there might be a buy-in at the top but that does not translate to performance at the lower levels within the organisation. The compliance mode rather than proper contribution to transformation is the driver for most entities. For example 'the toning down of efforts to transform our economy, almost being 'shy' of the transformation pursuit' is symptomatic of the psychological barrier towards transformation.

2. Financial:

The public entities rely on appropriations from National Treasury, which makes the budgeting of contributions towards enterprise development and socio-economic development initiatives very difficult because these are not necessarily part of the entity's core mandate. The impact of the global financial crisis has had a negative impact on enterprise development and socio-economic development for SOEs. Public entities, which rely on budget allocations from National Treasury, do not have clarity on the base they need to use to calculate their scores on the B-BBEE scorecard on the enterprise development and socio-economic development components.

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3. Legislative:

There is no harmonisation between the different laws that govern BEE in the different sectors. For example the Preferential Procurement Policy Framework Act (PPPFA) was at odds with the B-BBEE Act and Codes of Good Practice until recently. However, there are some laws that are still not harmonised, which creates legal uncertainty about which act ranks higher when there is conflict.

Other notable lowlights mentioned

- Procurement spend on black women-owned businesses is poor.
- There is focus on the economic sectors that are mainstream to the exclusion of others which are less visible but might well be relevant to today's youth.
- Demand management in the public sector is not consistently applied.
- Black people are occupying insignificant positions that have no influence on business.
- There is an extremely low number (or no blacks) in the technical and core functions of the organisations.
- The socio-economic development initiatives undertaken can be patronising in their implementation.
- The red tape of large organisations, which results in most transformation initiatives, takes time to filter through the organisation.

- SOEs have, to date, had limited impact to encouraging and leading industrialization, more so in a manner that spurs creation of businesses that can contribute to meaningful B-BBEE.
- There is a major challenge in integrating people with disabilities within the organisation.
- There is greater realisation that sustainable development takes time. Capacity building is only showing an impact after 12 to 24 months.
- Projects are frequently incomplete due to the inability of Government to pay contractors on time.
- In the sectors that are very high-tech in nature, such as the petroleum and airline industries, there is slow progress in bringing black people through.

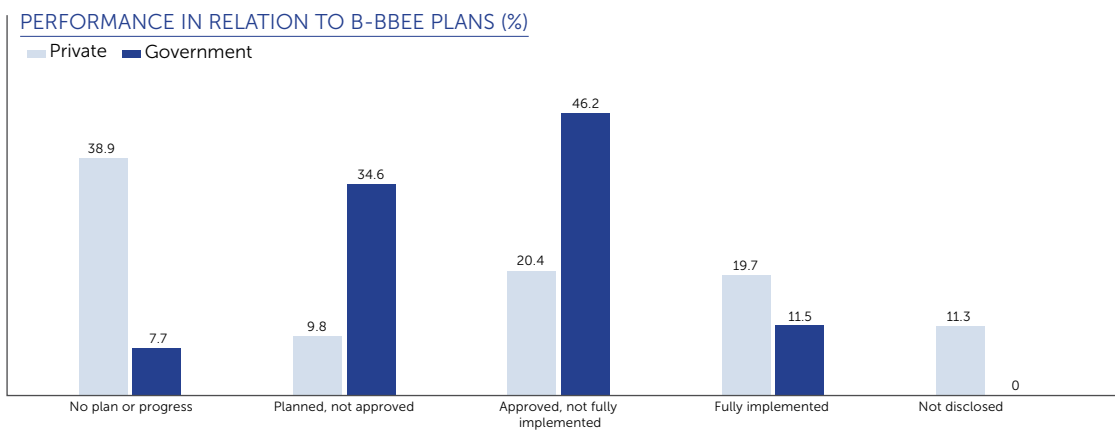
In the section that follows, focus is on the performance of SOEs and their compliance with Government's transformation requirements. The analysis on compliance is largely based on the study that was undertaken by Consulta who were commissioned by the B-BBEE Advisory Council to conduct research in this regard. The research focused in general on Government and its entities.

6.3.2.5 Transformation pillars

6.3.2.5.1 Current B-BBEE progress

A focused and planned approach to delivery of B-BBEE by business is considered one of

Figure 15: Performance in relation to B-BBEE plans



the important elements for achieving success. Figure 15 illustrates how the private sector as well as Government fared in terms of developing organisational plans for facilitating delivery of B-BBEE.

- Government, including SOEs, fared better compared to the private sector with regard to the development of plans for transformation delivery. A substantial number of Government respondents are indicated to have developed plans even though they were not approved. The findings further highlight the fact that even in instances where there are plans, there seem to be weaknesses in their implementation in the 'approved plans' category. Government fared significantly better than the private sector with 46.2% compared with 20.4% from the private sector.
- The lack of focused and deliberate planning is a reflection of poor commitment by organisations to achieve the specified transformation imperatives.
- Overall implementation of B-BBEE appears to be slow.

Transformation planning should be prioritised in SOEs. It is necessary to increase B-BBEE awareness to the leadership and staff employed in SOEs and public entities. SOEs' executive authorities

and boards should ensure that B-BBEE as a KPI is entrenched in the performance management contracts of SOE executives and management.

6.3.2.5.2 Management control

In respect of management control, overall, the Government performed better than the private sector. For example, on 'exercisable voting rights of black board members' Government exceeded the compliance target of 50%. Government also came close to the target of 40% on black managers. The research findings support the fact that the boards of Government entities are more diverse and representative. (See figure 16)

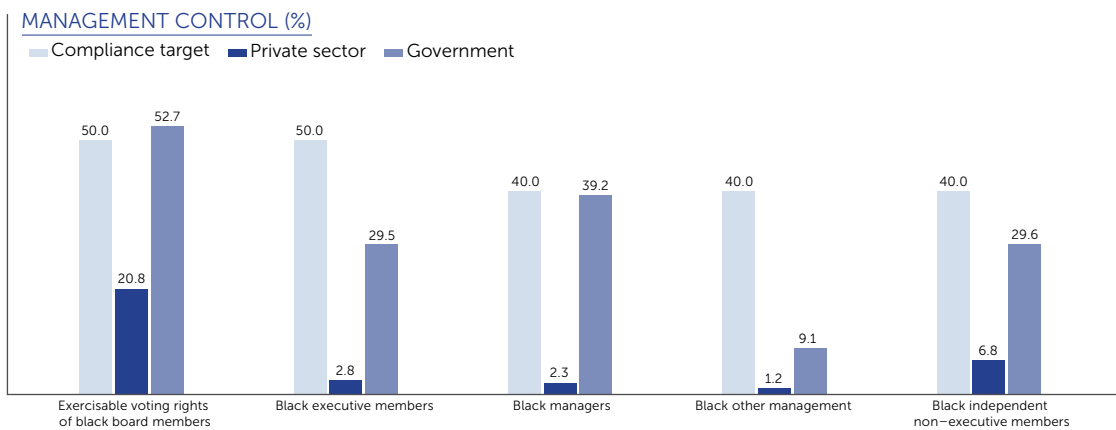
6.3.2.5.3 Employment equity

a) Employment equity compliance of private sector and Government (See figure 17)

b) Employment equity in Government

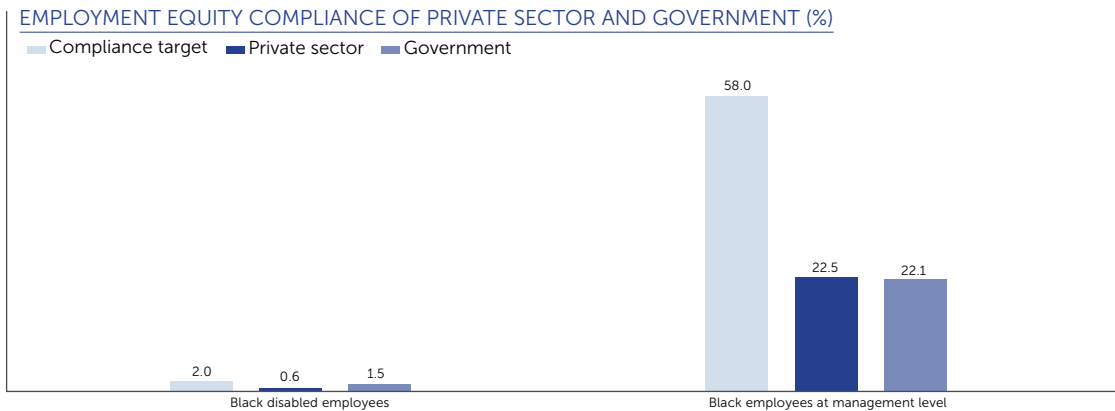
- Government performed slightly better than the private sector on disability and is close to the target of 2% (as a percentage of all employees) at 1.5%.
- Although the private sector fairs slightly better than the Government on "black employees in senior and middle management", both the private sector and Government are significantly off the target of 58% with scores of 22.5% and 22.1% respectively.

Figure 16: Management control



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Figure 17: Employment equity compliance of private sector and government



- Government is progressing in as far as representation of black employees at junior levels of management. Both the senior and middle management levels, while admittedly progressing, are not doing so at the same pace as the junior levels.
- All the management levels are significantly off target.

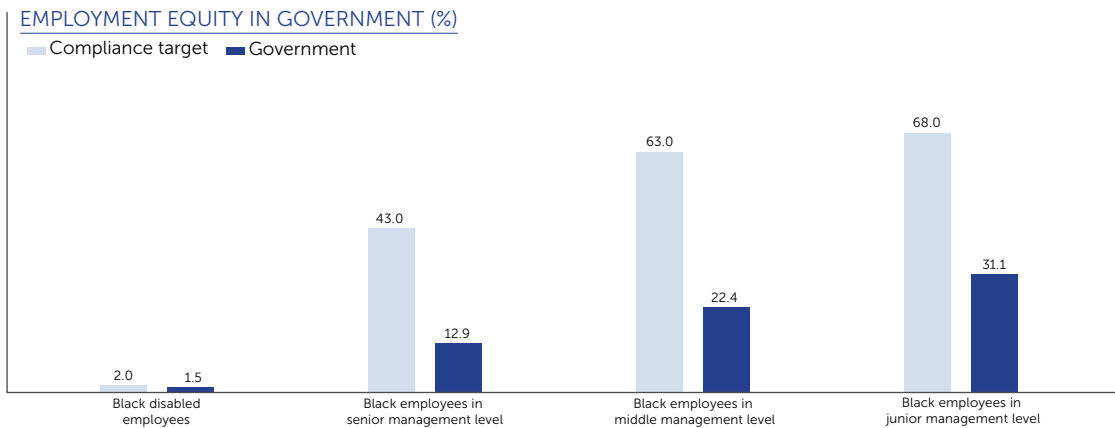
The implications of the off target performance under employment equity imply that the intended objectives of employment equity in transforming the work place are not optimally delivered. The policy of employment equity seeks the elimination of unfair discrimination and the achievement of a

diverse workforce. It aims to facilitate economic development and achieve equality.

While SOEs have made greater strides in employment equity compared to the private sector, there are still challenges that need to be overcome. Gender equity and representation remains an area of concern particularly within the SOE sector.

The 2011 Women in Leadership Census, conducted by the Businesswomen’s Association of South Africa (BWASA), measured 319 companies listed on the Johannesburg Stock Exchange and found women hold only 4.4% of CEO/managing director positions; 5.3% of chairperson positions; and

Figure 18: Employment equity in government



15.8% of all directorships. Each year, the census reveals a minimal increase of top-level female employment (0.1%) and there are still companies that have no female representation at all at senior level (Businesswomen’s Association of South Africa, 2011).

The need for SOEs to lead in gender parity was emphasised during a dialogue session for women hosted by the PRC. The Minister of Women, Children, and Disabilities, Lulama Xingwana, who addressed the dialogue session, highlighted the fact that Parliament continues to perform better in delivering gender parity. She indicated that her department will in the near future be tabling a Gender Bill, in which they intend proposing a common target of 50/50, as in Parliament.

Globally in countries such as Norway, structured efforts to promote the representation of women in boardrooms have been undertaken. In 2005, a full 50% of publicly-held companies had no women on their boards.

“More than half of the people who have a business education today are women. It is wrong for companies not to use them”, says the Minister for Equality, Karita Bekkemellem. In January 2006, not content to wait for companies to come to their senses and employ more women, the Norwegian

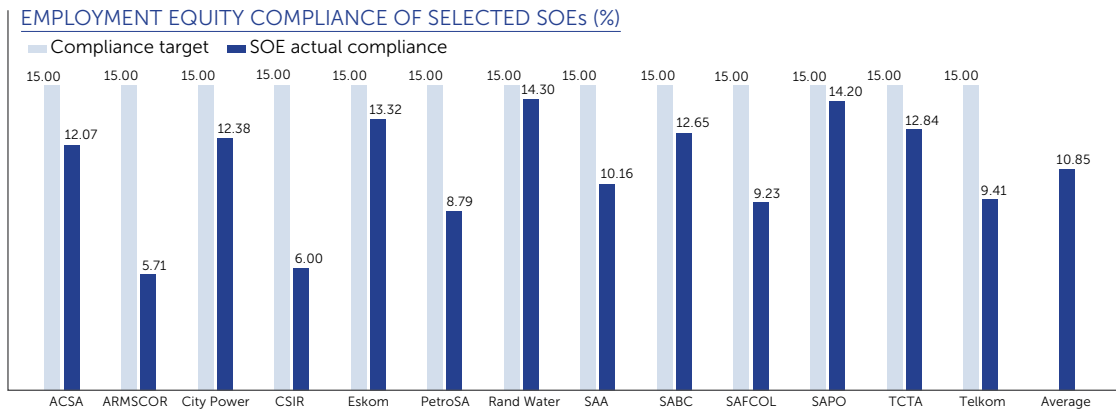
Government put a law into effect requiring that by 2008 there should be a minimum of 40% of both men and women in the boardroom of any publicly-held company.

France’s National Assembly has recently passed a law imposing gender diversity quotas. Legislation will impose a 20% quota within three years and 40% within six years. Other countries such as the Netherlands, Spain are also following the trend of institutionalising the issue of gender quotas. In the US, on the other hand, SEC governance disclosure rules now require a description of the skills and experience needed for board membership, including ‘disclosure of whether, and if so how, a nominating committee considers diversity in identifying nominees for directorship’.

c) Employment equity compliance of selected SOEs (compliance target for this element is 15%)

To summarise the findings, it emerges that while SOEs have made strides in employment equity when compared to the private sector, there are still challenges that need to be overcome. In the occupations that are very technical in nature, the SOEs struggle to achieve the representivity required by the B-BBEE codes and the Employment Equity Act. The representation of black women and disabled people is a further area of concern. SOEs should proactively consider playing a direct role in facilitating development of scarce skills for their

Figure 19: Employment equity compliance of selected SOEs



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own consumption as well as for the economy at large.

GMI for 2011 again looked at the differences amongst various countries – specifically that market where it had coverage of at least 20 companies. The three countries with the highest aggregate percentage of female directors were Norway (35.6%); Sweden (27.3%); and Finland (24.5%).

It is no coincidence that the countries with the highest percentage of companies that had at least one female director were Finland (100%); Sweden (100%); and Norway (96%). South Africa is notable amongst emerging market economies because it recorded a high percentage in this category as well. By a wide margin, the worst

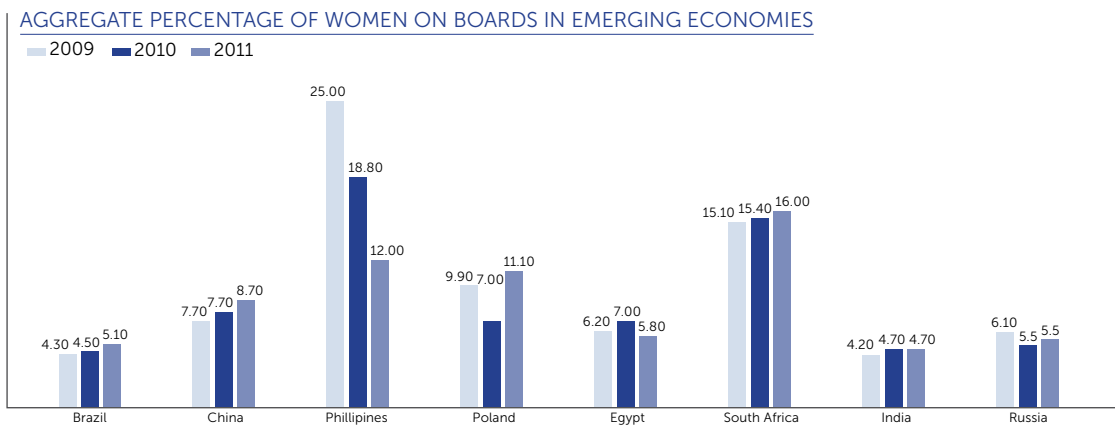
markets were perennial under-performers Japan (9.9%) and South Korea (15.4%). The above global comparisons of emerging economies suggest that South Africa is reflecting an upward positive trend worth nurturing and growing.

Countries with the largest percentage of companies with boards comprising at least three women directors were Sweden (55.0%); Norway (52.0%); and South Africa (33.3%). These countries are supported by the fact that performance targets in terms of gender equity are institutionalised.

6.3.2.5.4 Skills development

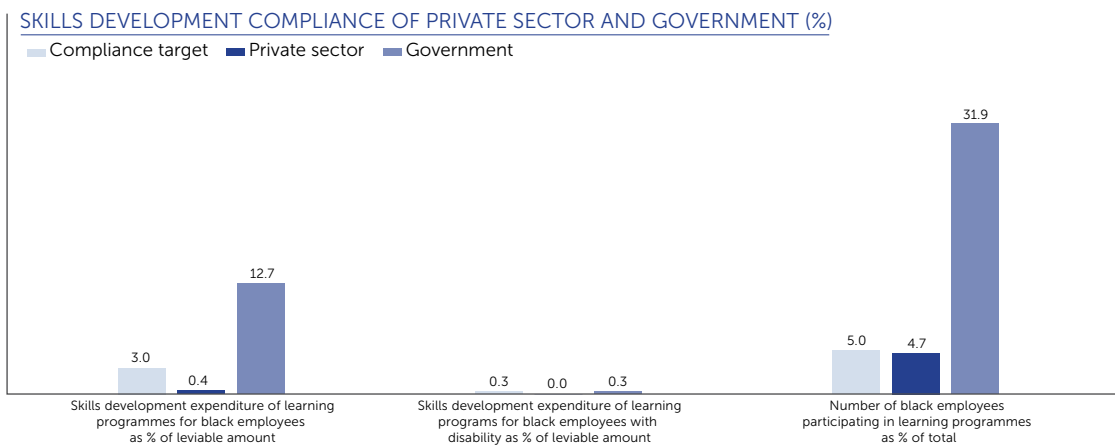
Figure 21 assesses skills development in organisations operating in the private sector and Government.

Figure 20: Aggregate percentage of women on boards in emerging economies



Adapted from 2011 Governance Metrics International (GMI) Inc.

Figure 21: Skills development compliance of private sector and Government



Compliance with skills development requirements focuses largely on the extent to which entities spent resources on learning programmes as a proportion of their human resources budget. Training may take the form of courses and on-the-job training. In some instances seminars and conferences are scoped into this performance criterion. The above diagram suggests that Government is achieving its targets. What the performance does not indicate is the quality and impact of the training programmes. The private sector, on the contrary, appears to be seriously lagging behind.

The aim of the Government’s skills development policies is to target capital and capacity at activities that maximise the creation of decent work opportunities. This necessitates the use of both macro and micro economic policies to create a favourable overall environment and to support more labour-absorbing activities. The main indicators of success will be:

- Jobs (number and quality);
- Growth (rate, labour intensity and composition);
- Equity (lower income inequality and poverty); and
- Developing scarce skills.

In the process of accelerating economic growth as well as allocation of more resources for

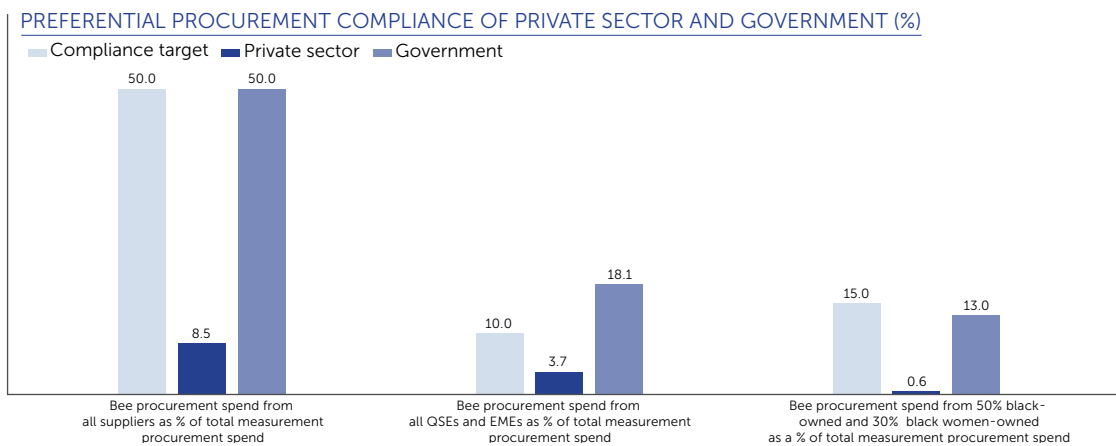
development of economic and social infrastructure, SOEs face a severe challenge of insufficient appropriate skills. SOEs need to focus on investing significantly in recruitment, development and retention of operational, technical and managerial skills. SOEs should thus be deliberate in their efforts to build skills and capacity. Where applicable, SOEs with academies that develop such technical skills should find ways of fast-tracking the development of previously disadvantaged individuals without impacting on the quality of the skills being developed. Academies can be sector specific and not only company-focused, such as the Aviation Academy that caters for the needs of Denel, SAA and SA Express. Another example could be a financial academy that could cater for the needs of IDC, NEF, Khula, etc. SOEs should adopt a mindset of training for the sector rather than solely for the company as part of driving developmental goals.

6.3.2.5.5 Preferential procurement

The data indicates that Government, when compared to the private sector, reports higher levels of compliance in all specified areas of the B-BBEE scorecard.

The preferential performance of selected SOEs generally supported a positive trend of compliance by Government and its entities.

Figure 22: Preferential procurement compliance of private sector and Government



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Figure 23: Compliance on preferential procurement for selected SOEs

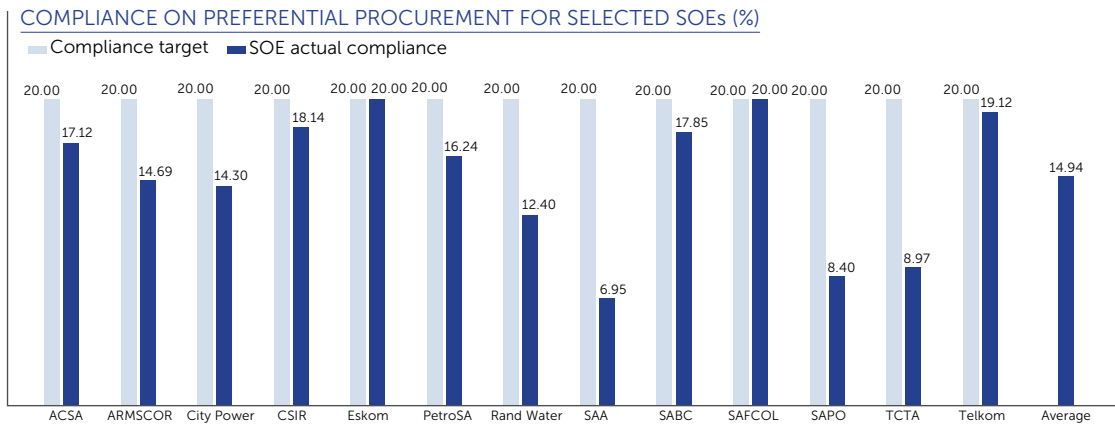
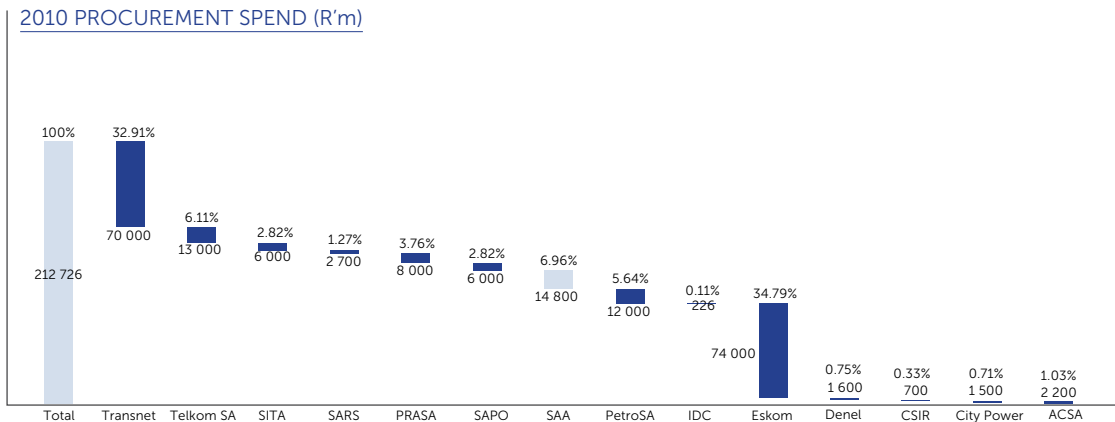


Figure 24: 2010 procurement spend



Source: SOEPF (2010).

The compliance on preferential procurement for selected SOEs is indicated in Figure 24:

Figure 24 shows an operational and capital spend of selected large scale SOEs.

- The total spend of all the SOEs in consideration is about R213bn.
- About 70% of the total spend is contributed by Eskom, Transnet and SAA.
- Eskom and Transnet spend in excess of 33% of the total spend each.
- SAA accounts for 7% of the total spend.
- Although a number of SOEs have ERP systems (data and performance reporting systems), data on total spend for operations and capital investments is not freely and readily available.

- Where data exists for a number of SOEs, it is often inaccurate; accuracy of data for the major commercial entities is relatively better than the other entities.
- There is no standard categorisation of the spend for commodity analysis; there is a need to harmonise spend categorisation.
- A spend analysis is seldom done, in other cases it is not done at all. A spend analysis is the foundation of a sound procurement strategy. The implication is that a procurement strategy does not exist for a significant number of SOEs.

Through the PRC review process, other outcomes are observed from a research project involving

18 SOE's, which was jointly undertaken, by SOEPF and Accenture. The research focused on procurement strategy; sourcing and category management; requisition to pay; supplier management; and workforce management. Performance of SOEs in these areas is compared to the average and an Accenture global benchmark. In addition to the research, we have also drawn relevant information from the roundtable discussions the PRC conducted with procurement executives from various SOEs. Roundtable sessions were conducted separately by Empowerdex and Africa Vukani Supply Chain Solutions.

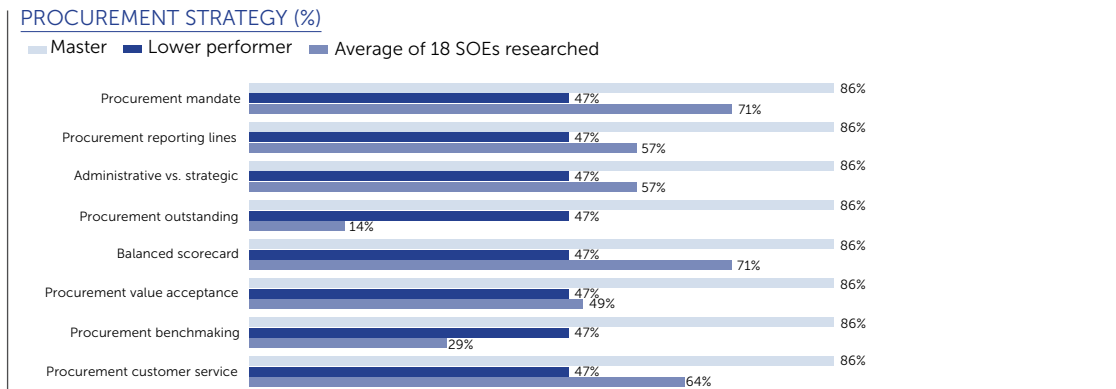
- Many SOEs believed they have a mandate to make change yet many did not have a clear strategy nor the skills, structure and tools to support the strategy (SOEPF; Accenture, 2010).
- According to the roundtable discussion, the State does not have clearly defined objectives for the procurement organisation. The strategic procurement objectives should flow through the shareholder compact, to the business, and finally to the procurement organisation (PRC; Africa Vukani, 2011).
- Most Chief Procurement Officer's (CPO's) report to the CFO. The roundtable discussion argued that where the SOE spend is significant, the procurement organisation should be represented at board level, reporting directly to the CEO and not to the CFO as is the case in many instances.

- SOE procurement organisations are perceived by the business to be administrative and back-office support functions.
- Procurement outsourcing is limited. There is opportunity for co-sourcing and collaboration for common categories across the SOEs.
- While SOEs confirmed that a balanced scorecard is used for individual performance, KPIs for departmental performance are lacking. A coherent strategy with measurable performance objectives aligned to Government objectives is required.

There are significant challenges that relate to SOE compliance with procurement requirements. These include:

- Lack of buy-in from the organisation regarding the strategic nature of procurement;
- Lack of strategic skills and competencies to conduct strategic sourcing activities;
- Lack of accurate spend data to target opportunities, inform decision making, conduct strategic sourcing and tracking;
- Limited utilisation of integrated ERP systems rendering procurement activities to manual processing;
- Lack of supplier segmentation, performance tracking and limited use of CSDP and BEE policies to enhance supplier development activities;

Figure 25: Procurement strategy



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- Limited use of procurement technologies, especially with high volume, less strategic commodities; and
- Little collaboration between SOEs.

In 2000, the Government enacted the Preferential Procurement Act. The act is premised on the recognition that Government, as the largest buyer of goods and services in the economy, has the responsibility to leverage its purchasing power in support of the economic policy objectives of broad-based black economic empowerment; small enterprise development; and labour-intensive construction. One of the intended outcomes of the act was to make the tendering process accessible to black people, women, the disabled and rural people in particular. Some of the mechanisms suggested include, among other things, unbundling tenders into smaller work tasks to enable participation in a broader sense. Preferential procurement has not been very effective in promoting women, disabled, and rural people to the extent intended. It is often easier for SOEs not to unbundle tenders because it is easy to manage one contract compared to various smaller contracts. This inevitably skews the award of bundled tenders to bigger, often international, companies to the disadvantage of the smaller companies. Information on larger companies who try their utmost to empower smaller local companies is often not shared among SOEs. If this

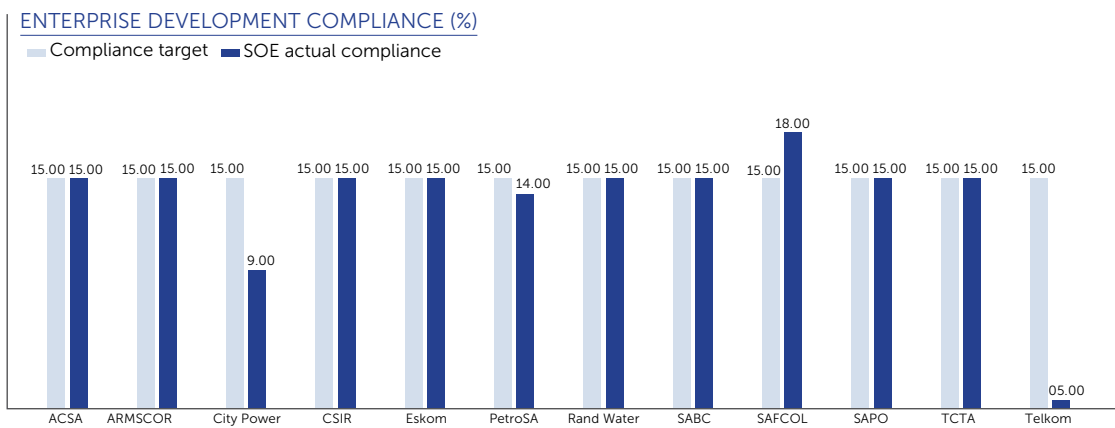
were done, SOEs could leverage the information to encourage transformational behaviour from bigger companies.

6.3.2.5.6 Enterprise development and socio-economic development

In both the above indicators, Government showed greater compliance and stronger performance compared with the private sector. Figure 26 reflects the performance of selected SOEs in enterprise development.

The element of socio-economic development focuses mainly on businesses supporting the socio-economic needs of society. This includes free advice or time to help black people develop the skills to move into organised business. This is the element that is most abused because it is easy to claim points against advice and time spent by the SOEs (or their employees) on such efforts as credible socio-economic development, without measuring its impact and sustainability. People in urban areas, where most of the business or SOE offices are located, are likely to benefit more from this element. There is a need for extensive monitoring and evaluation on the compliance on this element by SOEs first and then their suppliers. Often information about businesses that try their utmost to give effect to this element is not shared among SOEs so that correct behaviour can be encouraged. Greater benefit and impact can be achieved in instances where there is deliberate

Figure 26: Enterprise development compliance



and focused coordination of socio-economic programmes by SOEs.

The element of enterprise development is a challenging one for most SOEs and PEs because the implementation lies with people that are not necessarily entrepreneurs. Furthermore, the skill set required to develop enterprises might not reside within the organisation, which leads to constrained enterprise development activities. With the lack of funding for hiring people with the appropriate expertise; lack of commitment from leadership; and the cost containment programmes within the SOEs, this element of B-BBEE is applied on a limited basis. The adherence of most organisations to the tried and tested procurement methodologies and suppliers has curbed the innovative thinking that would allow enterprise development to be implemented.

Awareness programmes to people at schools and in the rural areas about the industries where SOEs operate, especially in the technical parts of the industry, are needed to increase the impact of socio-economic development (SED) programmes. The SED programmes can be leveraged for the other pillars of B-BBEE. The same approach can be applied for the enterprise development (ED) and preferential procurement pillars. For example, agencies that specialise in technology or technical areas exclusively tend to focus on the advanced western technologies as part of their daily work with no attention given to indigenous technologies. To meet SED requirements they have looked much wider into rural and indigenous technologies, and found value in doing so. There is now an increased drive to uncover some of these technologies because it gives the country a competitive edge of sorts. The lesson is that SED does not have to be on projects outside the value chain of the SOE or the PE. This approach actually contributes to the triple bottom-line of the entity as defined in the King Report on Corporate Governance.

The role of SOEs in complying with the transformation imperatives of Government is crucial. Not only should SOEs comply, but they

should lead in best-practice implementation of the codified policy of Government. The performance monitoring role of the owner/shareholder is a necessary and primary driver for the delivery of SOEs. Government's development and transformation agenda should be clearly articulated and commonly understood. The mandates should be aligned with Government's policy imperatives. The legislative framework should also be harmonised to improve the chances of SOEs achieving Government's transformation objectives.

The coupling of enterprise development (ED) with procurement can result in ED receiving less attention than preferential procurement. There should be a consideration of allocating specific responsibility for enterprise development away from procurement officers within the SOE without completely decoupling it from preferential procurement opportunities. This will help cement the attention that enterprise development receives within the SOE by having an enterprise development department with dedicated staff on hand to assist development of external enterprises.

RECOMMENDATION 10:

All Government entities and SOEs should be required to develop transformation plans.

The transformation plans for SOEs should:

- Have implementation time frames;
- Be included in the performance contracts of executives and management;
- Require boards to establish transformation sub-committees or add the transformation function in a dedicated fashion to an existing sub-committee;
- Include broad-based black economic empowerment performance indicators as part of the pre-determined objectives to be assessed by the Auditor-General; and
- Include the review of the current B-BBEE initiatives including charters, preferential procurement to determine their successes or failures.

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RECOMMENDATION 11:

SOEs should lead the South African economy in prioritising skills development.

This must be done by:

- Each SOE contributing to adequate sectorial;
- The development of skills needs assessment by every SOE to contribute to a national register of skills needs;
- collaborating with tertiary and further education institutions as well as private industry;
- The setting aside of dedicated funds as a percentage of total revenue to target staff/professional development from top to bottom;
- Championing and driving development of the technical, artisanal and managerial skills they require;
- Focusing on the development of scarce intermediate and high-level knowledge-based skills;
- Continuing support for work-based training programmes;
- Implementing structured and effective internships in collaboration with educational institutions;
- Establishing specialised and dedicated SOE sector academies;
- Implementing structured and effective learnerships that should be extended to at least two years;
- Being proactively involved in career guidance support services;
- Developing and implementing monitoring and evaluation guidelines for skills development; and
- Reviewing and augmenting the skills development funding model for SOEs to accommodate the extended training requirements. This must be done considering the following sources:
 - National Treasury;
 - SETA discretionary grants; and
 - The National Skills Fund.

RECOMMENDATION 12:

SOEs should ensure that the procurement process is transformational.

This should be done by:

- Taking into account local and historical factors;
- Monitoring the suppliers’ commitment to B-BBEE elements to ensure compliance by suppliers (this information should be shared among SOEs);
- Tracking and monitoring spend on black, rural, disabled, and women-owned businesses;
- Identifying opportunities within the value chain of SOEs that could be relevant to young people and companies owned by the targeted beneficiaries of B-BBEE;
- Creating an SOE network that would aggregate purchasing opportunities arising for SOEs;
- Creating an agenda for transformation in the sectors of the economy in which they operate and use these as leverage to drive transformation;
- Enhancing other elements of the B-BBEE scorecard by emulating the SOEs Procurement Forum, which is a group of SOEs that voluntarily collaborate in procurement;
- Encouraging Government to recognise and leverage SOE procurement networks like SOEPF; and
- Playing a greater role in enterprise development through the establishment of dedicated enterprise development units.

RECOMMENDATION 13:

SOEs should play a leading role in socio-economic development.

This should be done by:

- Identifying the pool of beneficiaries that could participate in a suite of SED initiatives within the SOE;
- Directing those beneficiaries seeking to be employed towards skills development initiatives such as learnerships, internships or mentorship programmes;
- Directing beneficiaries who might be school-leavers to a further education and training track;
- Directing beneficiaries interested in self-employment to benefit from the enterprise development initiatives; and
- Creating a consolidated SOEs corporate social investment fund to drive the macro impact and scale of social investments.

RECOMMENDATION 14:

Transformation should be an integral part of the contractual agreement between the executive authority and SOEs.

This should be done by:

- Formalising contracting on transformation plans, including targets and delivery;
- Ensuring that at a governance level the boards are structured to give primary attention to transformation delivery;
- Ensuring continual monitoring of transformation in SOEs; and
- Ensuring compliance monitoring of SOEs by the B-BBEE Commission and the Auditor-General.

6.4 TRANSFORMATION CHALLENGES

Numerous challenges are experienced by SOEs in their efforts to comply and meet the requirements of B-BBEE. Some of the challenges are highlighted in the following section.

6.4.1 Corruption

Corruption is a pervasive problem encountered by the SOEs, especially in the preferential procurement arena. Corruption can occur as a result of interference from leadership in certain transactions; this may retard effective implementation in certain circumstances. In many instances, it is not the best and well-suited suppliers that win business, but those who are willing to advance corrupt arrangements. While measures to curb corruption are sometimes implemented, it is necessary to improve interventions on an ongoing basis in order to combat procurement malpractices.

6.4.2 Cost considerations

The reality of economic recession affects business in general, and SOEs are no exception. Cost reduction in many areas of business is a normal reaction in most circumstances. The cost reduction mind-set impacts on SOEs in a number of ways. In particular, there are decreases in the spending on enterprise development and socio-economic development because these are not seen as part of normal business. Furthermore, the impact of these elements on the B-BBEE scorecard of PEs is not felt because most are not evaluated. Furthermore, there is also a mindset of seeing money spent on socio-economic and enterprise development as costs rather than investments.

The oversight authority should drive the inculcation of a culture that recognises the crucial role played by B-BBEE as a meaningful intervention of the State to drive significant economic transformation and sustainable growth in the country. B-BBEE is not just a compliance matter for SOEs, but a business imperative to assist the State on multiple

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fronts to redress the abnormal socio-economic divide; to drive economic transformation as an imperative; and to deal with the debilitating skills shortages. Offering economic opportunities to all is a worthy ideal to be driven by SOEs. They should take up active leadership in the delivery of national transformation imperatives.

6.4.3 Fronting

Fronting is a problem especially in situations where ownership is the sole criteria for determining the BEE status of companies that do business with SOEs.

RECOMMENDATION 15:

Sanctions for corrupt activities as well as fronting should be supplemented by a register of delinquent individuals and companies that are involved in corruption practices. The common register should be made available to SOEs.

6.4.4 Legislative limitation and conflicts

The biggest hurdle for the public sector until recently has been the lack of alignment between legislation that has a BEE impact in it and the B-BBEE Act and Codes of Good Practice. Some concerns about the regulations were expressed by the State-owned Enterprise Procurement Forum (SOEPF), a voluntary forum of Procurement/SCM Executives of SOEs and endorsed by the other procurement practitioners from the SOEs, in a workshop organised by the PRC. These are outlined in table 17.

Table 17: PPPFA regulatory requirements and implications

Regulatory requirements	Implications
1. Regulation 9 of the new regulations only focuses on local production and content to the exclusion of other transformational objectives.	<ul style="list-style-type: none">• SOEs seek to align their tendering processes with the full range of objectives outlined in the NGP. These include job creation, localisation, skills development, small business promotion, green economy, industrialisation, technology transfer, sustainability, rural integration etc.• SOEs wish to incorporate these areas as evaluation criteria in tender processes. Certain SOEs wish to apply a threshold for supplier development.• If SOEs are to be bound by this regulation, they would be severely limited in terms of their ability to deliver on their commitment of achieving developmental objectives.• SOEs wish to have more flexibility in determining an appropriate weighting for preference, particularly in sectors, which require accelerated transformation. Preferred mechanisms include:<ul style="list-style-type: none">o Applying minimum B-BBEE thresholds as qualification criteria to participate in the bidding process (e.g., Level 4 B-BBEE status). (Not a set aside.)o Awarding preference points only to those bidders whose B-BBEE level exceeds a minimum threshold.• In certain instances, SOEs may wish not to apply any points for preference e.g., where the likely bidders are international bidders.• SOEs will therefore not be allowed to adopt innovative strategies to accelerate the pace of transformation.
2. The regulations do not allow for preference points to be given for promoting all the aims and objectives of the NGP or the RDP (see section 2(1) (d) (ii) of the act).	
3. Regulation 5: For all tenders (including price quotations) equal to or above R300 000 and up to R1 million – apply 80/20 preference point system.	
4. Regulation 6: For all tenders above R1 million – apply 90/10.	
5. Add B-BBEE points to points for price.	
6. Award to bidder who scored highest number of points.	
7. Regulation 2(2): Organs of State must only apply a preferential procurement system, which is in accordance with the act and the regulations i.e., no deviations allowed.	

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Regulatory requirements	Implications
8. Regulation 9(5) states that where a tender has prescribed a minimum threshold for local production, the organ of State concerned may follow a two stage tendering process, where functionality and local production are assessed in the first stage and price and B-BBEE in the second stage, with price negotiations only with the short-listed bidders.	<ul style="list-style-type: none">• This regulation seems to allow for negotiations only in instances where a bid has stipulated minimum thresholds for local production. The ambit of the negotiations is limited to price negotiations only.• Given the requirement that SOEs remain self-sustainable, they require flexibility to conduct negotiations to yield further savings and achieve optimal value for money in line with commercial principles.• SOEs would like to have the option of conducting negotiations in almost all procurement activities, and not only those requiring minimum local content.
9. Regulations 5(5) and 6(5) state that the business must be awarded to the bidder who scores the highest points overall.	<ul style="list-style-type: none">• SOEs prefer to negotiate on a range of issues such as price, volume, functionality, supplier development etc.• SOEs are generally deprived of the benefit of negotiations and compelled to award to the highest scoring bidder, unless they can justify the award to another bidder on the grounds of "objective criteria" contemplated in section 2(1)(f) of the act.
10. Regulation 2(2): Organs of State must only apply a preferential procurement system which is in accordance with the Act and the regulations i.e., no deviations allowed.	<ul style="list-style-type: none">• It would be difficult to justify a decision not to award a bid to a bidder other than the highest scorer on the grounds that negotiations with the bidders should be considered as the 'objective criteria' referred to in section 2(1)(f).• SOEs sometimes need to approach multilateral funding agencies for funding.• Such agencies (e.g., African Development Bank) have strict rules pertaining to the application of preference in funded projects.• Preference granted on the basis of race is generally prohibited.• If SOEs are compelled to apply the regulations in all instances, they would be in conflict with the rules of such lending agencies.

Regulatory requirements	Implications
11. Regulation 4(5): Only tenders that achieve the minimum qualification score for functionality will be regarded as acceptable and evaluated further on price and B-BBEE.	<ul style="list-style-type: none">• Many SOEs operate in a unique procurement environment as they often have to acquire highly specialised goods or services.• In such instances functionality is of critical importance and SOEs require the flexibility to apply an evaluation methodology that will enable them to weight functionality appropriately.
12.This approach allows all bidders who meet the threshold to be evaluated only in respect of price and B-BBEE.	<ul style="list-style-type: none">• The approach adopted in the new regulations would compel SOEs to award business to a bidder who met the minimum threshold for functionality and who obtained the highest points on price and preference, but whose goods or services are of a much lower standard when compared to other bidders.
13. It does not allow for recognition of bids that are of a higher standard in terms of functionality.	<ul style="list-style-type: none">• May result in the selection of inappropriate suppliers and SOEs not achieving optimal value out of contracts.
14. Regulations 8(1) and 8(2): Unless at least one tender falls within the preference system advertised in the tender documents (i.e., either 80/20 or 90/10), the tender must be cancelled and re-issued stipulating the correct preference system.	<ul style="list-style-type: none">• Despite the best efforts of an SOE at estimating the value of a bid, all bids received in response to a specific tender may be well in excess of or below the estimated value.• If all tenders received are above threshold for the 80/20 system, SOEs would like to simply apply the 90/10 system without having to cancel the tender. Likewise, if all tenders received fall below the 90/10 system, the 80/20 system will be applied. This approach will be stated in the RFP document.
15. Regulation 8(4) allows cancellation of a tender if (a) due to changed circumstances there is no longer a need for the goods/services, (b) funds are no longer available or (c) no acceptable tenders are received.	<ul style="list-style-type: none">• SOEPF and the procurement practitioners say that compulsory cancellation on these grounds is unnecessary, costly, time consuming and disruptive.• These circumstances do not cater for instances when organs of State wish to cancel a tender , e.g., when a material irregularity has occurred in the tender process or where a fundamental change in scope is required, necessitating cancellation and re-issuing of the tender.

CHAPTER 6: STATE-OWNED ENTITY EFFICIENCY AND EFFECTIVENESS IN SERVICE DELIVERY continued

Regulatory requirements	Implications
16. Regulations 5 and 6: The amended regulations only make provision for awarding preference on the basis of an entity's B-BBEE status level. 17. However, the concept of 'preference' has a much wider application in the act than what is allowed for in the regulations. 18. In terms of the act, preference may also be awarded in terms of implementing the RDP. 19. Furthermore, according to the act, organs of State have the discretion to award preference points for other specific goals.	<ul style="list-style-type: none">• The approach adopted in the new regulations is highly prescriptive. Preference may only be given in respect of B-BBEE.• None of the other 'specific goals' for which preference points may be granted in terms of the act are accommodated in these regulations.• The regulations place severe limitations on SOEs to achieve their developmental objectives and also the misalignment between the act and the regulations.
20. Regulation 11(13) requires that where an organ of State requires a service that can be provided by one or more tertiary institutions or PEs and enterprises from the private sector, the appointment of a contractor must be done by means of a tendering process.	<ul style="list-style-type: none">• SOEs are prevented from using the services of other SOEs without following a competitive process, even if the services of such SOEs can be obtained at a much cheaper price when compared to the private sector.• Furthermore, SOEs, which have established subsidiaries in order to provide certain services, will be prevented from acquiring such services from their own subsidiaries without following a competitive tender process.• However, this is in conflict with section 238(b) of the Constitution, which states that an executive organ of State in any sphere of Government may exercise any power or perform any function for another executive organ of State on an agency or delegation basis (CEO, SASSA v Cash Paymaster Services (Pty) Ltd).

The table above suggests that there are challenges in implementing the regulations without compromising the intended objectives of the Preferential Procurement Policy Framework Act (PPPFA, No. 5 of 2000) in particular and that of the B-BBEE Act in general. In the transformation roundtable discussion, the participants who were mainly procurement practitioners noted that the PPPFA is not transformational because it favours the traditional suppliers over the historically

disadvantaged individual suppliers. Through SOEPF, SOEs were granted limited exemption from the PPPFA. As a result of the exemption, different SOEs have developed their own procurement policies to give effect to the objectives of the B-BBEE Act.

According to the SOEPF, the empowerment legislative framework is fragmented. Various empowerment instruments impose different and sometimes conflicting obligations on SOEs.

For example, 'the PPPFA was drafted to give effect to the empowerment objectives as outlined in Section 217(2) of the Constitution. However, regulation 11(13) of PPPFA provides that bidders should not be regarded as non-responsive for being a non-compliant B-BBEE contributor'. Section 217 (procurement) (1) and (2) of the Constitution states '(1) when an organ of the State in the national, provincial, or local sphere of Government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. (2) subsection (1) does not prevent the organs

of the State or institutions referred to in that subsection from implementing a procurement policy providing for:

- Categories of preference in the allocation of contracts; and
- The protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination.

According to SOEPF, there is a need to harmonise the empowerment framework in the country. There is a flurry of legislation and policies that SOEs need to comply with. These cause them to chase compliance rather than making a substantive contribution. This is a great limitation.

RECOMMENDATION 16:

The empowerment framework and legislation should be streamlined to facilitate substantial contribution towards transformation as opposed to box-ticking compliance.

- This should be done by:
- Harmonising the PPPFA and the B-BBEE Act;
 - Implementing changes proposed by the B-BBEE Advisory Council in the B-BBEE Amendment Bill emphasising compliance with the B-BBEE Act by organs of the State;
 - Regulating verification agencies;
 - Implementing sanctions and penalties for non- compliance;
 - Making BEE compliance certificates compulsory for all SOEs;
 - Implementing the appointment of the B-BBEE Commission as proposed by the Amendment Bill;
 - Revising the thresholds applicable from the 80/20 and 90/10 preference point systems to a uniformed 70/30 system;
 - Extending the current SOE exemption from PPPFA indefinitely until the legislative conflicts in the PPPFA and the B-BBEE Act are resolved;
 - Enacting provisions that enable targeted set-asides for marginalised groups such as cooperatives, SMMEs, women, the disabled, youth, and rural participants; and
 - The Department of Trade and Industry developing capacity to enforce and monitor implementation of B-BBEE of SOEs on an ongoing basis.

CHAPTER 6: STATE-OWNED ENTITY EFFICIENCY AND EFFECTIVENESS IN SERVICE DELIVERY continued

6.5 SKILLS DEVELOPMENT, SUSTAINABLE HUMAN CAPITAL DEVELOPMENT AND JOB CREATION

South Africa’s democratic dispensation requires the Government to commit to remedying the follies of the separate development system. Notably, a key component of economic empowerment is addressing the structural problems that block key macroeconomic policy initiatives. Undeniably, the skills shortages that holds South Africa at ransom ranks high among such structural problems. Government has actively and unrelentingly intervened with policies to effect change in the country’s skills situation.

Given the serious skills crisis and unacceptably high unemployment rate in South Africa, the PRC concludes that skills development is critical for economic growth and human social progress. SOEs can play a pivotal role and serve as a platform and catalyst for advancing skills development initiatives and sustaining human capital development.

The responsibility of a State-owned company such as Transnet is not only to provide rail and ports infrastructure and ensure that they perform efficiently, but also to ensure that they increase the participation of people in the mainstream economy. SOEs should be creatively utilised as important instruments of skills development and skills transfer.

The SOE’s executive authority should guide the entity through defined national frameworks for human resources and skills development. Coordination efforts initiated by the Department of Higher Education should be enhanced and embraced by other stakeholders in Government to fortify the strategic leadership required.

The effective operation of established skills development forums requires meaningful participation of key role players in skills development, Government, business and

SOEs. These forums provide an opportunity for engagement by stakeholders to share best practices in addressing skills development as well as collaborating in efforts to develop skills. The PRC supports the continuation of the established skills development forums. Such forums should be extended to all spheres of Government.

Work-integrated learning (WIL) is one of the critical components for skills development. SOEs should also play a role in facilitating this component of learning. In the higher education qualification framework (HEQF) ‘work integrated learning’ is defined more broadly as a characteristic of vocational and professionally-oriented qualifications. WIL may take various forms including simulated learning; work-directed theoretical learning; problem-based learning; project-based learning; and workplace learning.

Work experience is the exposure and interaction required to practice and integrate knowledge, skills and attitudes necessary in the workplace. Work experience provides the participant with in-depth knowledge of the specific working environment. SOEs should be the key providers of work experience opportunities for post-school candidates. Provision of this critical component of skills development will enhance employability of the unemployed learners that are being prepared for the world of work. Such contributions will go a long way towards assisting young school-leavers.

Artisan development is one of the priority areas in skills development. SOEs should be able to create a conducive environment for the development of artisan-related skills. SOEs can assist through provision of resources and facilities needed in the specific learning fields e.g., providing learning centres, as well as coaching and mentoring for practical learning.

- SOEs should focus on intermediate and high level knowledge-based skills.
- Human resources development plans should be well resourced and funded.

- Secondary social objectives should be separately funded; alternative funding from separate skills development funds should be considered for such training.

Workplace assessment centres are an integral part of work integrated learning. SOEs are well placed to establish assessment centres within the workplace to facilitate work-integrated learning. The Quality Council for Trades & Occupations (QCTO) and National Artisan Moderating Body (NAMB) will ensure the accreditation of these work assessment centres to ensure that standardised assessments are implemented.

It is critical for SOEs to invest on an ongoing basis in **research and innovation** for human capital development. Such research may also include (but is not limited to) impact evaluation studies on skills development programmes.

Career guidance is another strategic skills development goal. SOEs should proactively create awareness about the careers they require for their respective businesses.

Alternative funding sources should be considered to support extended skills development programmes in SOEs. Funding could be sourced from various sources, including, among others, the National Skills Fund (NSF) and Sector Education and Training Authorities (SETA) discretionary funds. A portion of PIVOTAL grants from SETA discretionary funds could be allocated to SOEs for skills development, particularly in instances where SOEs are required to train beyond their primary requirements.

Advocacy and inter-sector engagement should be prioritised by SOEs. The purpose of inter-sectorial engagement should include:

- Coordination and collaboration;
- Communication; and
- The forming of partnerships.

Executive authorities should track progress on

SOE skills development programmes and conduct critical analysis to:

- Ensure strategic level reporting on skills development;
- Monitor and evaluate progress;
- Track trends; and
- Facilitate collaboration with other stakeholders (both Government and business).

6.6 TRANSFORMATION INFORMATION AND INTELLIGENCE MANAGEMENT

A collective SOE database should be created to help executive authorities to develop strategic planning. The database would ideally comprise the following information:

- A talent pool;
- A beneficiary pool for enterprise development and socio-economic development;
- An inventory of SOEs and public entity suppliers; and
- A best-practices data bank on what works and does not work in the implementation of B-BBEE in SOEs and public entities; this information can be shared across the board.

CHAPTER 7: STATE-OWNED ENTITY FUNDING AND FINANCIAL VIABILITY

7.1 OVERVIEW OF THE CHAPTER

7.1.1 Background and problem statements

The question of whether SOEs are appropriately funded given their respective mandates, and in the context of a Developmental State, is a vital one. The case for the country's need to invest in SOEs and in infrastructure in order to facilitate economic growth is well made. What this chapter seeks to address is, on the basis of the SOEs' capital structure and the way they fund themselves, whether or not they can deliver the required infrastructure and services, ensuring access and affordability. This section of the report also briefly examines the role of the private sector in the provision of infrastructure, especially given the State's commitment to driving private sector participation (PSP) or Public Private Partnerships (PPPs) in the provision of infrastructure.

Various sources estimate infrastructure spending over the last five years (to 2010) at over R1 trillion. Most of this spending was motivated by either debilitating shortages in capacity (as in the case of Eskom, for example), or by the need to meet the requirements for hosting the 2010 FIFA World Cup, as in the case of the Airports Company of South Africa (ACSA). For the majority of the schedule 2 entities, the bulk of their funding requirements were met on the back of the strength of their balance sheets, many of which have improved considerably over the last few years. National Treasury, in its Budget Review of 2011, noted that between fiscal years 2010/2011 to 2014/2015, capital expenditure by the major SOEs is projected to be R623.6 billion, a 10% drop from estimates in the previous fiscal year.

In addition to direct Government funding, Treasury has issued a significant amount of guarantees, notably to Eskom in the 2010 fiscal year (R174 billion), to back on balance sheet debt funding by some SOEs whose requirements cannot be supported by their balance sheets on a stand-alone basis. Government exposure to SOEs

in the form of guarantees stood at just under 6% of GDP in fiscal, 2010, by no means an insignificant amount. Treasury has stated categorically (and not for the first time) that for SOEs to "... function sustainably, they need to borrow mainly on the strength of their balance sheets..." (National Treasury Budget Review, 2010).

7.1.2 Purpose of this chapter

The purpose of the chapter is to understand whether or not SOEs are funded adequately to enable them to achieve their objectives. An assessment is also made of the viability of SOEs.

7.1.3 Process and approach

The material for this chapter is derived from a number of PRC processes, including a PRC terms of reference position paper produced by the PRC's business case and value creation (BC) work-stream; surveys; seminars and numerous Government policy papers. Written public submissions were also made.

7.1.4 Structure of the chapter

The chapter is divided into two sections. Each section provides an overview; an assessment, relevant insight based on international experience; and recommendations on the various areas reviewed, which are:

- Funding of SOEs; and
- Viability of SOEs.

7.2 FUNDING OF SOEs

7.2.1 Background

SOEs fund themselves either on the strength of their balance sheets, or are aided further by Government guarantees; generation of trading revenues; and relevant subsidies and/or grants. The majority of the commercial entities listed in the PFMA schedules fund themselves on the strength of their balance sheets, with or without Government support, and sales revenues.

The balance of the entities, such as the Constitutional Entities (schedule 1), public entities,

water boards and the SETAs are funded mainly through partial sales, revenues, Government grants and subsidies. In the case of SETAs, additional special taxes are levied.

Schedule 2 SOEs have tended to rely on capital markets debt to fund their requirements, in particular their capital expenditures, with only a few of the SOEs able to inject long-term equity capital through the sale of non-core assets. Whether the Treasury permitted such asset sales proceeds to be retained by the SOEs, could not be conclusively ascertained. However, the assumption is that the SOEs were allowed to retain a portion of such revenues directly or indirectly.

Treasury issues a significant amount of guarantees to back up the balance sheet debt funding of the SOEs whose requirements cannot be supported by their balance sheets on a stand-alone basis. National Treasury has consistently upheld a policy which proclaims that commercial SOEs need to "... function sustainably, [that is] they need to borrow mainly on the strength of their balance sheets..." (National Treasury Budget Review 2010).

SOEs have generally been successful in obtaining tariff increase approvals from their respective regulators. The tariffs effectively increase income and ultimately their retained earnings, which are used by SOEs to finance their capital programmes. Such revenues are insufficient, hence some SOEs feel that alternative methods of funding should be explored in order to address the current debt burden and to reduce reliance on tariff increases that may in the long-term prove to be flawed.

The State's intricate funding challenges for the massive infrastructure backlog as well as other essential services are also due to historical circumstances, which include the following:

- Underinvestment in infrastructure was pervasive throughout the 1980s as a result of the apartheid Government's political challenges. The State simply stopped making the necessary

investments in infrastructure.

- The infrastructure backlog is exacerbated by the reality of the past unjust racial disparity and blatant neglect of the economic and social infrastructure requirements of historically disadvantaged communities.
- It is therefore likely that the investment required to redress the past under-investment and apartheid patterns of investment, as well as to correctly position the South African economy for growth and development, is grossly underestimated.
- The major SOEs that are charged with these infrastructure investments have limited ability to fund such fundamental transformational 'game-changing' requirements unless there is a relaxation of conservative fiscal policy and a direct Treasury injection of commensurate capitalisation.
- Arguably, the massive national requirements for investment – in social infrastructure such as schools, health facilities, communal infrastructure, public amenities, and roads as essential social goods and services – largely remain a direct responsibility of the State and cannot justifiably and sustainably be funded on a 'user pays' principle in a country where most citizens have limited means.
- Many SOEs were also debatably under-capitalised at the time of their post-1994 corporatisation. Many of these SOEs' balance sheets were poorly capitalised and many of them were saddled with a legacy of debt, which made it impossible to make the necessary investment in the ageing infrastructure. They had no capacity to access debt on a stand-alone basis.
- In many instances, SOEs that are crucial in the provision of basic infrastructure remain insufficiently capitalised to undertake the mammoth task of investing in infrastructure not only to increase capacity, but in some instances simply to maintain existing capacity

CHAPTER 7: STATE-OWNED ENTITY FUNDING AND FINANCIAL VIABILITY continued

- (i.e., entrenching the status quo). Thus, even with massive investment in infrastructure, the integration of previously marginalised areas into the broader economy is not being adequately addressed.
- Thus, under close scrutiny, significant DFI infrastructure funding capacity reveals that DFIs substantially fall short of the required capital injection. The financial capacity of DFIs is way below the projected infrastructure investment, implying that the manner in which they are currently configured can only play a limited role compared to their counterparts in countries like Brazil, Russia or China.
 - This implies that unless a drastic measure to inject more capital to expand their market capitalisation is immediately embarked upon by the Government, DFIs will be unable to discharge their national developmental finance goals optimally.
 - Meanwhile, there is a manifest opportunity for State and private sector partnerships in meeting the national infrastructure investment imperatives, a collaboration without which the Developmental State goals may take longer to realise.

Inevitably, recapitalisation is a key strategy consideration by Government. This is emphasised in both the 2012 State of the Nation address delivered by the President, and in National Treasury’s budget. Major SOEs and municipalities have projects in the pipeline in that will need an injection in excess of R3.2 trillion.

7.2.2 South African funding environment

Recently, in affirming South Africa’s credit rating of A3, Moody’s Investor Service observed that the South African structural fiscal position had deteriorated and is likely to remain so in view of the Government’s plan to only gradually lower the deficit in the years ahead (Lindow, 2011).

- The borrowing programmes of SOEs to finance their capital investment activities (some of

which debt is guaranteed by Government) contributes to an increase on the national debt burden.

- Although tariff increases will help strengthen public utilities payment capacity, lower growth potential in a less supportive global environment could mean an upward debt trajectory in coming years.
- Moody’s maintains an optimistic outlook that tariff increases will allow the State to continue with this trajectory, although this view is contradicted by growing resistance to tariffs and the groundswell calls for an alternative policy due to the fact that a dominant tariffs funding policy is unsustainable and is increasingly becoming a risk to national stability and developmental aspirations.
- Nevertheless, national infrastructure funding and spending challenges over the last five years to 2010 were successfully executed by the SOEs and National Treasury, and going forward that experience should augur well for the SOEs and the South African economy as it demonstrates their capability to rise to national challenges.

The following points should be noted with regard to such challenges:

- Most of this spending was motivated by either debilitating shortages in capacity, or by the need to meet the requirements for hosting the 2010 FIFA World Cup;
- For the majority of the schedule 2 entities, the bulk of their funding requirements were met on the back of the strength of their balance sheets, many of which have improved considerably over the last few years;
- National Treasury, in its Budget Review of 2011, noted that between fiscal years 2010/2011 to 2014/2015, capital expenditure by the major SOEs is projected to be R623.6 billion. Treasury further estimated

- that this funding requirement will be met by retained earnings (42%); Government (5%); domestic debt (28%); and foreign debt (25%);
- In addition to direct Government funding, Treasury has also issued guarantees, notably R174 billion to Eskom in the 2010 fiscal year;
 - Government exposure to SOEs in the form of guarantees stood at just under 6% of GDP in 2010; and
 - This has led to two notable developments. The first is the inevitable need to collaborate with the private sector in the development of basic public infrastructure. The second is the slew of infrastructure user tariff increases that are putting pressure on the inflation rate. These are expected to have an adverse socio-economic impact lasting for several fiscal periods and a possible increase in social discontent.

7.2.3 Issues and challenges

A number of schedule 2 SOEs continue to be dependent on Government support, whether in the form of explicit Government guarantees or subsidies. The sampled SOEs – SAA, Eskom, Denel, CEF, Pilansberg International Airport, Alexkor and SABC – expressed growing concern with regard to their ability to meet future funding requirements.

SOEs are also calling for a policy paradigm shift, demonstrated by their expressed interest in opening a national debate on alternative means of funding their capital investment requirements. This growing concern for funding sustainability is substantiated by the high correlation between the prices they charge for their services and their borrowings. They further argue that the burden of recovery is unfairly skewed towards the current consumers or users instead of spreading it across the fiscus through general/special purpose taxes or levies, and throughout the full useful life of each particular capital asset.

A number of non-commercial schedule 3(a) entities consider their funding models to be

limiting and they also indicated that they are not adequately funded. They argue that these constraints negatively impact on their capacity to undertake effective long-term planning. However, SETAs are an exception in this category as they run surpluses because of the policy, structural and execution challenges they face. Schedule 3(b) entities, mostly water boards and utilities, run their operations on a semi-commercial basis. They require, in addition to tariff revenues, permanent State subsidies to carry out their mandates, with many of them believing that they are not adequately funded.

7.2.3.1 International comparisons

A comparative assessment of some of the countries that have successful State capitalism and are assertively deploying SOEs to drive a Developmental State agenda leads to the following conclusions:

- Their SOEs tend to make up a sizeable GDP portion of the economy, including the national stock exchange (> 20%);
- Their Governments have strong controls on their currencies and capital flow;
- Most of the successful Developmental States have stimulated their overall economic growth by inviting foreign direct investment, amongst other strategies; and
- Such economies are characterised by dynamic commerce and trade activity with high economic growth rates.

In South Africa, SOEs make up only about 8% of GDP and have no equity listed on the domestic stock exchange. Government does not own any deposit-taking commercial banks, with its leverage limited only to the State-funded DFIs. Recently the Post Office Bank (Postbank) has been issued with a banking license, but its assets are trivial compared to the big five commercial banks.

Most countries that are driving State capitalism are either authoritarian (Singapore, Russia and

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China), or have a strong social consensus on how the country should be managed (Norway, France). Brazil and India are notable exceptions, and therefore potentially useful guides for an economy like South Africa.

7.2.3.2. Access to capital approach

Most SOEs depend exclusively on debt finance (to the exclusion of equity finance) procured in almost equal proportions from the domestic and international capital markets for, on average, just under 50% of their funding requirements.

Since 1994, and the first rated sovereign issue, South Africa has been able to take its place among its peers with respect to access to capital markets. South Africa did this by developing an excellent reputation for fiscal management, driven by the National Treasury. This vigilant fiscal management resulted in a steady decline in the country's cost of borrowing and a deepening of its investor base.

Owing to explicit Government guarantees in the past, and an implicit guarantee of State ownership, SOEs are major beneficiaries of a steady improvement in the country's rating.

7.2.3.3 Challenges to raising finance

South Africa's self-imposed limit on a debt/equity ratio of no more than 40% in order to preserve the country's investment grade credit rating inadvertently sets a ceiling that is a constraint on the extent to which the Government can realistically use SOEs to drive economic development.

- Schedule 1 entities are prohibited from borrowing funds and complain of insufficient funding. Most of their budgeted allocations are taken up by operating costs (PRC-PwC Survey 2011).
- Schedule 2 SOEs operate in highly competitive sectors, with a few, such as Telkom, enjoying State supported monopoly functions. Although permitted to borrow, they are concerned about their ability to meet future funding requirements.
- A number of schedule 2 SOEs continue to be dependent on Government support in the form

of explicit Government guarantees or subsidies (e.g. SABC, SAA, Denel, CEF, Pilanesberg International Airport, Alexkor and Eskom).

- The survey conducted by PwC on behalf of the PRC revealed that many schedule 2 entities perform below their return on assets hurdle rates and asset utilisation rates.
- Most of the capital expenditure is replacement, rather than expansionary; thus much of this capital expenditure cannot be 'transformational' (National Planning Commission).
- Schedule 3, mostly non-commercial entities, consider their funding models restrictive and they also indicated that they are not adequately funded, making it impossible for them to effect long-term planning.
- Schedule 4 entities, mostly water boards and utilities, run their operations on a commercial basis but require subsidies to carry out their mandates. Many believe they are inadequately funded.

Other issues and challenges faced by the State in funding SOEs are:

- The poor financial viability of some SOEs makes it difficult for them to raise funding;
- SOEs have balance sheet constraints because of insufficient capitalisation such as the reported case of R5 billion under-capitalisation of SAA;
- There are huge backlogs across most basic infrastructure, exacerbated by poor maintenance practices;
- There is poor asset utilisation and productivity, partly due to obsolete technologies. As a result, some of the SOEs lag behind their international peers;
- An international benchmarking study of South Africa's infrastructure performance – using access, affordability, pricing and quality as indicators – showed that in general South Africa compared poorly with its middle-income country peers (Bogetic & Fedderke, 2006);

- There have been a number of recent, costly and disastrous failed attempts at SOE partnership with the private sector. Examples are the case of the SA Post Office management contract with New Zealand Post; and the attempt to bring in a strategic equity partner (Aeroporto di Roma) to acquire 20% of ACSA;
- These investments cannot be made entirely on the balance sheet of the SOEs, or the National and Municipal budgets. National Treasury and DPE are both inclined to consider the 'user pay' principle for economic infrastructure. However, popular opposition to SANRAL's Gauteng Highway Improvement Project illustrates 'user' fiscal constraints; and
- Developing a balanced policy that seeks to have both broad public acceptance and at the same time is able to attract private sector investment to participate as equity partner with the State, appears to be the answer. This would then enable the State to access capital for long-term infrastructure projects to achieve a close match with asset life.

7.2.3.4 Comparative finance capacity of development finance institutions

There is a view that has been put forward on DBSA and IDC as possible financial partners to the commercial SOEs in the drive to achieve an increase in infrastructure investment similar to other Developmental States that have successfully used their DFIs for this purpose. However, compared to the situation in South Africa, successful Developmental States tend to control a much larger share of capital in their economies than the DBSA and IDC combined. In the South African financial market, these two major national DFIs' capital resources are a fraction of those of the big five banks and the capital markets as illustrated in the table 18.

Table 18: Comparison of DFIs, commercial banks and capital markets

Institution/capital (2010)	(R'm)
IDC	80
DBSA	51.3
Standard	782
ABSA	663
FirstRand	578
Nedbank	547
Investec	202
JSE	4,640
PIC	1,032

Prior to 1994, the apartheid State used a regulation known as prescribed assets to stipulate that pension funds should invest a minimum of 30% of their funds into Government bonds. The PIC, because of its status as a State entity at the time, invested a disproportionate share of its assets in Government bonds. Soon after the advent of the democratic dispensation, this regulation was done away with. Following the abolition of exchange controls, bond holdings by life assurers declined to just 8% of total assets; the PIC to approximately 36% from a high of 44%; and banks to a meagre 4%.

The PIC, with assets under management of just over R1,032 million, is often cited as a source of capital, which the State could tap into for infrastructure development. However, there is a paradox involved in using the PIC to fund comparatively riskier SOE infrastructure projects, since the majority of the funds under PIC management belong to State employees' pension funds, with 89% attributable to the Government Employee Pension Fund and 5% to the Unemployment Insurance Fund.

There is also a moral dilemma with the idea of the State deploying employee pension funds to meet its policy objectives. If the returns are not competitive the opportunity cost may be unjust to the pensioners. However, one could argue that this is muted because the GEPPF is a defined benefit fund, with all risk of underperformance borne by

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the employer. In a typical case, Transnet is still engaged in long-standing battles with its pension fund members whose benefits were compromised because of the chronic underfunding of the Transnet Pension Fund.

Financial institutions have also expressed concern about the role of DFIs, who in their view should mainly address ‘market failures’. In their opinion, it is highly debatable that much of the economic infrastructure, which forms the bulk of the R1.3 trillion budget, could be characterised as needing DFI financing and support. In addition, they complain that the playing field is not level, citing the DBSA’s relationship with the municipalities, and questioning Government’s commitment to the principle of competitive neutrality.

7.4.2 Observations and recommendations

7.2.4.1 Rationalisation of State holdings

Given the constraints of both the deployment of taxes, the balance sheets of the large SOEs and the ‘user pays’ approach, it is vital to consider the rationalising of State holdings. Leveraging State resources means focusing on those SOEs that provide public goods, address national priorities and interests in the first instance, and then considering a phased diversification from those sectors where market failure no longer exists. Where the national interests mandate can no longer be established, and where the SOE is competing unsuccessfully against private sector competitors, this will support the overall SOEs sustainability with reduced losses to be absorbed by the State, and without conflict, while optimising competitive neutrality in the economy.

There is also an argument to be made that with an estimated 715 entities, the State has reached a point where such prudent rationalisation will allow the State to be focused in order to improve delivery effectiveness and a strategic approach to mobilise limited financial resources, in much the same way that many other emerging economies have done, including Brazil, China and Malaysia.

RECOMMENDATION 17:

Government should rationalise its holdings by focusing on those SOEs that provide public goods and those deemed to be strategic, namely serving national interests, national security and priority sectors.

This must be done either by:

- Exiting from those sectors where market failure no longer exists and/or that can be adequately provided for by the private sector, or the mandate is no longer justifiable; or
- Divesting either fully or partially from those SOEs observed to be under-performing that are competing unsuccessfully against private operators; or
- Absorbing those entities whose functions can be cost-effectively carried out by Government departments by incorporating them into line function department programmes.

7.2.4.2 Effective oversight structures for rationalised commercial SOEs

The South African oversight management of the commercial SOEs is characterised by an ad hoc and fragmented managerial approach. There is no consistent rational and principled valid basis for the current location of these SOEs with various oversight authorities. International best-practice points to the fact that those successful commercial SOEs are managed by some form of central authority, either at ministerial level or through a central State agency.

There is also a need for the Government to maximise the effectiveness of policy execution with respect to service delivery. Such sophisticated technocratic know-how is best centralised in one authority with a common repository of scarce but relevant skills. In addition, lessons learnt and successfully applied in one entity are more widely leveraged by the ease of being applied across the various entities if housed under one roof.

A centralised authority approach would also dislodge the current counterproductive SOE fragmentation and will create an environment that is conducive to developing a funding model for the commercial SOEs. This would provide them with a bargaining power and market influence to secure improved finance and trading terms. Their national strategic importance, geo-political influence and transformation leverage would be enhanced and their value creation would be of national interest.

RECOMMENDATION 18:

The Government should develop a consolidated funding model for commercial SOEs and DFIs.

- This should be done collectively by the central authorities for commercial entities and DFIs as well as National Treasury, with the concurrence of the SOE Council of Ministers.
- National Treasury, in terms of its mandate, must exclusively marshal and manage all liabilities of SOEs, both commercial and non-commercial, because they are in the end the State’s contingent liabilities.

7.2.4.3 SOE funding: Public and private sector

The majority of the commercial entities listed in the PFMA schedules fund themselves on the strength of their balance sheet, with or without Government support. These funds are raised from open markets in the form of debt such as loans and bonds.

The balance of the entities such as the constitutional entities (schedule 1) and the SETAs are funded mainly through Government grants, subsidies and, in the case of SETAs, a tax on the private sector. There is less clarity on the funding of local and provincial entities because collecting that information has proved far more challenging.

The majority of schedule 2 entities ‘believe that alternative methods of funding should be explored in order to address the current debt burden’. Some describe themselves as being in a ‘debt trap’ (PRC-PwC Survey, 2011). Schedule 2 SOEs have tended to rely on capital markets debt to fund their requirements. With the recent ramp-up in the infrastructure investment programme, large SOEs have mostly been able to fund these requirements on their balance sheet without Government support, with the notable exception of Eskom. Data from the JSE indicates the extent of dependence of the large SOEs on domestic capital markets.

Table 19: Large SOE dependence on domestic capital markets by sector and nominal in issue

Issuer/ nominal	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Government	333.0	351.6	332.3	371.1	403.9	427.3	440.0	428.4	437.3	504.9	643.4
Municipalities	1.3	1.1	0.2	0.1	2.1	2.7	3.9	3.9	8.1	11.4	15.0
SOEs	50.0	38.9	35.5	38.6	44.1	45.1	54.9	60.5	81.2	122.8	155.9
Water	13.3	16.3	17.7	18.4	19.4	20.5	17.0	18.3	18.6	19.2	17.4
Securitisations	0.8	2.7	10.4	26.6	39.0	69.4	108.8	134.2	122.1	91.6	74.3
Banks	9.8	16.2	25.0	27.3	37.7	46.6	63.5	85.4	104.2	134.6	159.4
Corporates	8.8	18.2	19.0	24.4	23.8	36.0	49.0	58.4	69.7	64.0	67.3
Total	417.0	445.1	440.0	506.5	569.9	647.7	737.1	789.0	841.1	948.6	1,132.9

Source: JSE, 2011.

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7.2.4.4 SOE debt

While the private sector leads in the number and size of issue, listed domestic debt by the SOEs and water utilities increased from R63.3 billion to R183.3 billion in 10 years. The debt in issue by these SOEs comprises just over 16% of total nominal in issue of R1.1 trillion.

- This is higher than the proportion of the number of these SOEs in the overall economy, but not unexpected, given that they cannot access equity markets.
- An increasing number of SOEs are managing their domestic debt through registration of domestic medium-term note (DMTN) programmes, whereby they can issue a range of instruments cost effectively – issues include vanilla fixed rate debt instruments; commercial paper; floating rate notes; and inflation linked debt.
- The KPMG study of SOEs commissioned by the PRC found that from 2006 to 2010, the total debt of schedule 2 entities increased from R225bn to R723bn, an increase of over 220% (R498bn); all of this on balance sheet.
- Over the same period, only R101.4bn (20%) of debt was issued to these entities on the domestic capital markets.

The balance is probably being met by a combination of unlisted domestic issues and the issue of listed and unlisted debt in the international domestic markets.

Table 20: Schedule 2 entity debt profile: PRC-KPMG report (2011)

Year	Annual increase (R'm)	Cum debt (R'm)	Change (%)
2006	–	225 500	–
2007	46 163	317 826	20.47
2008	89 226	496 278	28.07
2009	62 958	622 194	12.69
2010	50 512	723 218	8.12

The scale of this debt is not sustainable, so SOEs will have to pursue other options for funding the projected colossal infrastructure requirements. There are less onerous, attractive and easily accessible options that can be explored, because there are limits to the amount of foreign currency debt that many of these SOEs can put onto their balance sheet without incurring unacceptably high costs or higher debt risks.

These include the policy shift towards a greater mix debt finance and possible equity finance through partial listing of SOEs on the JSE, whilst astutely preserving Government control and maximising investor appetite. The other option is the use of PPPs. Government should develop a clear framework for the proposed partnerships to ensure better success.

It is important to note that South Africa’s BRICS partners and flourishing Developmental State counterparts are successfully pursuing such mixed SOEs finance policies.

RECOMMENDATION 19:

The Government should develop and adopt a policy shift towards a greater mix of debt finance and equity finance.

This must be done by:

- Where relevant, after consideration by the SOE Council of Ministers and approval by Cabinet, consider possibilities of listing select SOEs on the JSE while astutely preserving Government control and maximising investor participation in SOEs; and
- Instituting a flexible policy that discourages SOEs from raising private funds to provide capital to those SOEs where private sector involvement is not desirable (e.g., natural monopolies).

7.2.4.5 Public Private Partnerships (PPPs)

One option is the use of public/private partnerships (PPPs). Such an approach would promote direct private sector investment in projects. This could take a number of forms.

- The first would involve the private sector investing equity into selected projects in order to achieve the outcomes listed above. This investment can be in the form of classic PPPs – ‘build, operate, own and transfer’, as an example – but with a higher stipulated level of equity capital in order to increase affordability for users.
- A second would be for the private sector to invest in certain SOE operations through vertically separating certain infrastructure and operations.
- Finally, the users of infrastructure can invest ‘equity’ in the form of long-term irrevocable ‘take or pay’ contracts, with the provision that the extent that this works will be subject to the credit quality of the issuers of these contracts.

In a consultation held between the PRC, Standard Bank and BUSA, general frustration was expressed that despite Government’s stated commitment to attracting private sector participation, SOEs were generally not inclined to undertake PPPs on ‘good’ assets, preferring instead to do these deals on the poor assets.

This preference by the private sector to cherry pick the best performing assets is to be expected given their mandate to maximise returns. Similarly the reluctance of SOEs is also reasonable as this would result in them losing their key ability to cross-subsidise loss-makers by the more profitable businesses.

Private sector participation also gets more complicated when it plans both to fund and operate services at the same time. To maximise chances of success, several considerations are essential.

- If an asset targeted for PPP is a monopoly, an economic regulator must be in place, especially to regulate provision of so-called economic infrastructure on a ‘user pays’ basis.
- Where there is more than one user of a monopoly economic infrastructure, the private partner selected should not also be a user of that infrastructure.
- This is only possible in non-networked infrastructure such as prisons, hospitals, power generation, telecoms or on flexible network infrastructure rather than rigid infrastructure such as rail infrastructure.
- The management of SOEs must be sophisticated in order to execute PPPs in the best interests of the economy and society, and ensure that the PPP results in the appropriate transfer of risks from the State/SOE.

In general, PPPs can be a useful tool for a rapid expansion of economic and social infrastructure, but must be handled with extreme care. The PRC was unable to commission an authoritative study of South Africa’s PPPs, well over 300 according to KPMG, owing to resource constraints.

RECOMMENDATION 20:

Private sector participation in partnering with SOEs to deliver on the provision of both economic and social infrastructure should be encouraged and expanded.

This involvement must be through direct partnerships between the private sector and the SOEs or the Government, such as Public Private Partnerships, joint ventures, or other forms of public-private collaboration.

7.2.4.6 Open market listing on the Johannesburg Stock Exchange (JSE)

Partial listing on the Johannesburg Stock Exchange (JSE) can offer the equity finance option. Of concern is the JSE’s rejection of

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the use of the Golden Share, which effectively gives the Government additional rights that other shareholders do not enjoy. Following PRC consultation with the JSE, the JSE indicated that they would be willing to reinstate the golden share for a limited period for listings by SOEs. This JSE policy relaxation development would effectively give Government two levels of control:

- On its policy-making leverage, namely shareholder control through retaining a controlling interest/majority stake; and
- The exercise of a golden share.

This is an option that can be further researched should Government consider this as a possible part of the diversified SOE funding options.

7.2.4.7 User-pay tariffs system

Much of the capital raised to fund infrastructure investments is of too short duration in relation to the assets being funded. It is unusual that basic infrastructure is funded such that the servicing of that debt must rely on exorbitant increases in tariffs as exemplified by funding methods being use for infrastructure development by Transnet, Eskom and ACSA, and those proposed by SANRAL for Gauteng’s freeways.

Other countries like China have chosen an economic development policy in which Government takes full responsibility for infrastructure investment. The Chinese users are not required to pay directly for infrastructure investments through tariff structures that do not reflect the useful life of that infrastructure. Further, their policies do not rely on relatively short duration debt to fund the long duration development infrastructure assets.

7.2.5 Towards a SOE model for funding

7.2.5.1 SOE funding model

In order to eradicate the effects of decades of development and social amenities disparities, the investment requirements run into trillions of rands. Such magnitudes of capital injection into SOEs seem to lack a robust funding strategy. There is

a strong view that South Africa lacks a distinctive funding model for the development of economic and social infrastructure.

- The PRC engagements with both National Treasury and the Department of Public Enterprises revealed that a model is still evolving with inadequate policy convergence among them. National Treasury distinguishes between social infrastructure (to be funded from the fiscus) and economic infrastructure (to be funded on a user pays basis). Thus national roads are considered economic infrastructure that should be tolled to fund their development and other roads as social infrastructure.
- However, South Africa’s small tax base and high unemployment rate limits the power of tariffs, because it is generally the same people being taxed as the ‘users pay’ principle.
- National Treasury also raises other issues that result in SA’s funding model being rudimentary such as:
 - Limiting capital budget to classic public goods;
 - The lack of prioritisation of capital budget items according to an agreed set of criteria that seeks to maximise the impact of public sector spending;
 - The emphasis on taxes and user pays funding model alone, which in the South African context has serious limitations due to skewed income distribution and wealth control. As such, this policy is both retrogressive and unsustainable; and
 - There also appears to be little alignment between policy making and policy instruments, perhaps due to a top-down budget policy approach characterised by limited line function departments’ inputs.
- Finally, there has been sustained pressure on SOEs to reduce their gearing even when this results in the disproportionate reliance on equity capital, which is more expensive. As an example, internationally, the gearing of rail

companies is in the region of 80%, while TFR’s gearing is significantly below that. This may have been appropriate in the period immediately after the start of the democratic dispensation, but this is arguably no longer the case, and with the recognition that economic infrastructure is just as crucial for the further development of South Africa, there is room for SOEs to gear themselves considerably higher than current levels.

Additional capacity on the balance sheets of SOEs can also be created by extending the South African yield curve by issuing longer dated paper. In the latest budget, the Government announced that it will issue new bonds, which will extend the yield curve from the current 30 years to 36 years. Hopefully this presages a focused project of extending the yield curve even further in the near term, up to 50 years, so that we can approach a better match of the life of the assets being financed with the modified duration of the financing portfolio of the SOEs.

Most social infrastructure is funded from tax receipts and levies and there are peculiar challenges that arise at provincial and local level, where exorbitant increases in the cost of service delivery to individual homes are occurring. Most municipalities suffer from tenuous finances as a result of poverty, unemployment and poor collection systems, forcing them to hike service delivery costs. High levels of unemployment and the relatively small proportion of the population that pays taxes (less than 400,000), at effective rates exceeding 50%, limits this policy. Thus other means of funding will have to be found, including:

- Finding ways to increase the debt capacity of municipalities and metros;
- Finding ways to lengthen the duration of the debt profile of municipalities; and
- Centralising the delivery of services in municipalities, thereby decreasing the budget proportion spend on operational expenses like salaries.

RECOMMENDATION 21:

A funding model for the funding of public infrastructure based on a distinction between economic and social infrastructure must be developed.

The following principles must apply:

- Economic infrastructure, where relevant, must be funded on a ‘user pays’ basis. Such a funding approach should be complemented by, for example, a portion of the proposed resources tax.
- Funding of social infrastructure, including roads, should have less reliance on the ‘user pays’ principle, and more on taxes.
- The emphasis on taxes and the ‘user pays’ funding model as the only sources of generating capital for infrastructure must be reviewed, moderated and blended with other diverse policy options. Such funding should be considered and approved by the SOE Council of Ministers guided by National Treasury.
- To adopt a relatively expansionary gearing policy, the Government must signal unambiguously to financial markets its implicit backing of this form of SOE debt because SOEs are strategic.
- The future pricing of services and retention of earnings must take into account ongoing maintenance requirements and the eventual need to replace obsolete infrastructure to avoid future scrambles for capital to address deterioration.

7.2.5.2 National Endowment Fund (mineral resources tax – mining sector)

The historical record points to a relatively poor policy in the leveraging of the country’s comparative advantage in natural resources and contribution to the local economic beneficiation. South Africa is a major source of some key industrial minerals and commands a dominant

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primary supplier position in the world resources market. Furthermore its resources are strategic to global economic expansion.

Most of the plans for infrastructure investment corridors are still export oriented, reinforcing the colonial pattern of infrastructure development which is focused on exporting raw ore, rather than developing new industrial centres for benefiting our ore and greater regional integration.

- Investment in economic infrastructure is primarily designed to support the mining industry. This raises the questions of whether the mining industry as users pay a fair price for this infrastructure, and that allegation of high logistics costs are not supported by evidence.
 - Rail costs are 23 US cents per ton km (2008/09) in SA compared to 19 cents in Brazil; 25 US cents in Australia; and 53 US cents in Germany.
 - Average distances travelled are much higher in SA (590kms in 2008/09) than Australia (290kms).
 - In addition, more of South Africa’s cargo goes by road than rail (59%; US.41%), resulting in a higher transport cost for a twenty-foot equivalent unit (TEU) exported (US\$1445) than Australia at US\$1,200. In Brazil, with comparable distances and imbalances to South Africa, the cost per export TEU is US\$1,430 (McKinsey).

However, Brazil receives considerably more revenues from its natural resources than South Africa – this rental can be used to fund infrastructure investments – because of significant State ownership in this sector. In South Africa no such national windfall exists, most of the rental from mineral resources has historically been captured by the mining houses. South Africa has also been less successful in recent time with attempts at beneficiation with the country being essentially a price taker of the resource it produces.

Given that South Africa (with Zimbabwe) controls 100% of the world’s platinum resources, as well as a good deal of its chrome and manganese, it seems that the success of this economy will depend not only on leveraging SOEs, but also astute policies suitable for the competitive advantage of a country endowed with such vast strategic natural minerals, policies similar to those oil producing countries have pursued since the 1970s.

- Banning the importation of finished products from resources that originally left South Africa as unrefined ore.
- Introducing mineral resources taxes and royalties in order to capture a fair share of the rent proceeds emanating from mining. Mineral resources are wasting assets, and their exploitation exacts a heavy toll on the country for which the mining houses do not contribute fairly.

Therefore there is merit in the national discourse proposing a resources tax and to utilise those proceeds as an additional endowment to fund national priorities such as redressing socio-economic imbalances and investing in infrastructure development.

RECOMMENDATION 22:

Mining as a strategic sector and a significant economic user of infrastructure in line with practices from other mining communities around the world should contribute fairly to the development of infrastructure for economic use. This entails that in addition to tariffs that are based on user pay principle for economic use of infrastructure, consideration of the use of various policy tools to achieve fair contribution by the mining sector should be examined; these could include mandatory local beneficiation and ring-fencing of a portion of the proposed resources tax to develop infrastructure.

7.3 SOE VIABILITY

7.3.1 Background

The role of a State in an economy is subject to each country’s economic policy choices. SOEs are created by various Governments as alternative structures to deliver service instead of directly using Government departments. The analysis of the viability of SOEs seeks to measure how effectively and efficiently SOEs are utilising available capital to deliver on their developmental mandate. This exercise is therefore vital for the determination of whether or not the goods and services provided by the SOEs are delivered cost effectively to both the State and the economy. It must be noted from the outset that the viability of some SOEs should be on commercial basis, whereas for other entities, additional non-commercial attributes will be of equal or even more significance in determining viability. Most importantly, the assessment of viability is about ascertaining the financial performance of the SOEs collectively and individually.

Since 1994, the number of large SOEs has declined, and the competition they face has increased. However, the increase in the number of provinces and local authorities has led to a proliferation of smaller entities, bringing the total number of SOEs to almost 715. Some SOEs were created to attract private sector capital. Others were created as a result of constitutional requirements, while a number were created to address perceived market failures (e.g., the SETAs) and in some instances to bypass bureaucratic impediments.

The risk arising from the proliferation of SOEs is that, by design, it becomes difficult for the owner/ shareholder to effectively and efficiently manage these numerous assets. In particular, a country with limited management capacity such as South Africa, ownership oversight is exacerbated by such a numerically huge span of control compared to South Africa’s counterparts abroad.

In some instances, without a firm management grip, the owner risks losing control of the SOE(s) and exposure to incurring immeasurable damages. SOEs created to address certain needs end up taking on a life of their own, where decision-making ends up defending the management of that SOE even when it has become clear that the decisions of that SOE may be counterproductive to the broader national policy objectives of the State. For example, SANRAL was originally conceived to seek solutions to the development and maintenance of major national roads through partnerships with the private sector. Its subsequent decisions on e-tolling, although legitimate within its narrow mandate, may not be in the national interest. Submissions expressed by some municipalities are that they are experiencing increased deterioration of roads due to heavy traffic using alternative routes to avoid tolls without commensurate additional funding to address this unintended consequence.

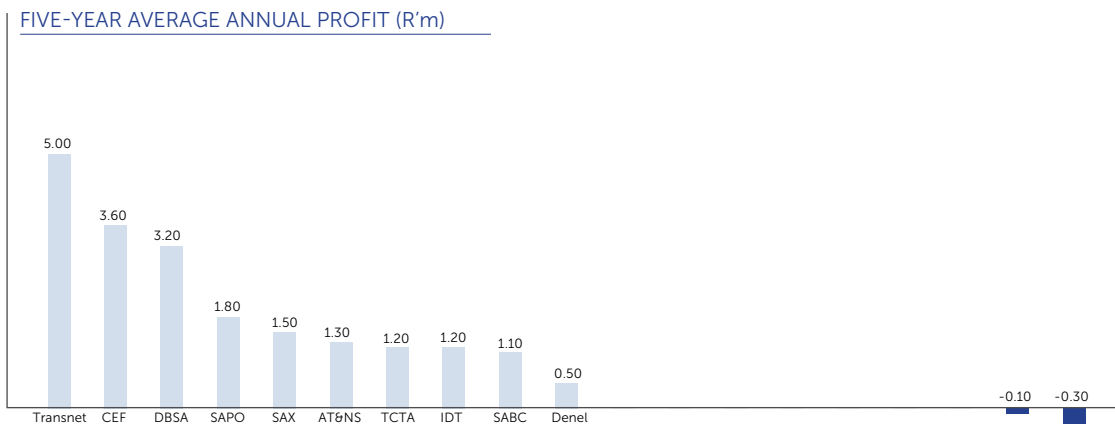
7.3.2 Viability issues and challenges

SOEs’ viability is a measure of how well they are delivering on their mandates and Development State objectives, taking into account that some SOEs have profit and financial returns as a primary motive (e.g., SAA), while in others their primary motive is service delivery (e.g., IEC) and they are permanently dependant wholly or partially on State funding.

In South Africa, SOEs have historically been a significant vehicle for developing the South African economy and creating jobs. Economic theory posits various rationales for State involvement in the economy, namely natural monopoly; capital market failure; externalities (the public good argument), or a need to achieve equity (Chang, 2006). Much of the analysis of the PRC on the role SOEs can play in driving the development agenda assumes that the State is the appropriate vehicle to achieve such objectives as a result of market failures that require Government intervention.

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Figure 27: Average annual profit (2006 – 2010) (PRC-KPMG data)



An alternative argument is that the lack of growth in employment in South Africa is more symptomatic of policy deficiencies, the poor skills profile, and pervasive barriers to entry, that have discouraged entrepreneurship. Moody's Investor Services identifies 'intractable constraints' as the reason for South Africa's economic situation. These include 'profound education and skills shortages, labour market rigidities, inefficient, corrupt bureaucracy, infrastructure shortages [and] crime'.

The ANC NEC sub-committee that reviewed the schedule 2 SOEs also identified the following as critical challenges:

- Massive under-investment in infrastructure;
- The complex regulatory and policy framework;
- The challenge of balancing low prices with sustainable investment and security of supply;
- The challenge of diversifying sources of funding;
- Policy uncertainty hampering the infrastructure investment programme;
- Rising levels of corruption; and
- The high salaries of SOE management that do not generally attract the best talent.

The management of SOEs also experience distortions that conflict with their service delivery mandates and the ability to run their entities efficiently, such as political directives to provide

jobs, services and social investments that are based on no mandate, service delivery performance merits and funding. The environment of SOEs is made more difficult when there are irregular political and board influences on the procurement practices of the SOEs.

Nevertheless, schedule 2 SOEs play a significant role in the economy, contributing in excess of 8% of GDP. However, this is a declining trend (from 9.3% in 2006 to 8% in 2010) in spite of increased revenue provided to SOEs and illustrates the declining impact of SOEs in the stimulation of economic growth. This may change if the planned massive infrastructure undertakings are realised in the next few years.

Figure 27 above shows that overall performance of SOEs is positive in that a few SOEs are delivering significant returns. However, others have performed poorly in financial terms, and some have destroyed value over the last five-year period.

A detailed analysis of schedule 2 SOE financial statements up to 2010 reveals concerns such as:

- SAFCOL and the SABC made significant losses for two out of the last five years;
- In the last two years of the five-year period, significant profits have been generated by Eskom due the recently instituted tariff increases;

- After two years of successive losses during the last five years, SAA has also posted another year of profits;
- Alexkor has made an annual average net profit margin of -31% for the last five years; and
- Denel delivered no profits between 2006 and 2010. The R111m profit in the 2011 financial year is attributable to an accounting gain of R463m resulting from the restructuring of a pension fund.

National Treasury has classified the top 20 SOEs into three broad management categories:

- **Urgent Management Attention (Red Zone):** Eskom, SABC, Sentech, Denel, CEF, SAA, Transnet, IDT.
- **Close Monitoring (Yellow Zone):** Land Bank, DBSA, ACSA, TCTA, ATNS, Infraco, SAX.
- **Ongoing Monitoring (Green Zone):** Armscor, SAPO, IDC, SAFCOL, NECSA (Presentation by the National Treasury, 22 October 2010).

The PwC commissioned report highlights some areas that are also of concern to the SOEs:

- The challenge of containing costs and optimising returns, while delivering on mandates;
- There is a high degree of uncertainty regarding funding strategies to deliver on mandates;

- There is a degree of uncertainty regarding the revenue tariffs policies resulting in financial sustainability insecurity for certain SOEs; and
- There is high earnings volatility over the past 10 years.

There is also a need to recognise that the manner in which SOEs are funded needs cautious assessment, given the respective commercial and non-commercial mandates within the context of ensuring Developmental State outcomes, and noting that:

- South Africa's structural fiscal position has, in the past few years, deteriorated and is likely to remain so in view of Treasury's non-expansionary fiscal plan aimed at gradually lowering the deficit in the years ahead.
- The uncertain international financial outlook might also have an adverse impact. Already SOEs have undertaken massive borrowing to finance their infrastructure spend (with some of the debt being underwritten by the national Government): accordingly the public sector debt burden no longer appears as favourable as it did prior to the global financial crisis.

A diagrammatic representation of the domestic debt capital markets share per sector is presented in table 28.

Figure 28: Domestic debt market share by sector



Source: JSE (2011).

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- The World Bank (2011) has identified the low savings rate in South Africa as being another key constraint in achieving developmental objectives (this is also highlighted in the New Growth Path):
 - The most successful Developmental States have minimum savings rates of 25%, which is substantially above the 16% that South Africa averaged between 2006 and 2010.
 - The high unemployment rate amongst young people caps the savings rate at levels that will limit the developmental potential.
 - Savings levels juxtaposed with South Africa’s limited access to international capital that would supplement the country’s low savings rate – particularly the short-term nature of the capital flowing to South Africa to purchase mainly bonds and equities, as opposed to long term capital such as FDI – means that it is not a reliable source of capital for investment in long-term infrastructure.
- There is also sufficient evidence that in a Developmental State, the State can successfully steward a mixed economy for dual purposes, namely to address instances of market failure and national strategic importance, as well as to create conditions that are conducive to private sector partnerships in developing the economy and infrastructure. Capobianco and Christiansen (2011) argue that this should be done in such a way that the State does not give SOEs an unfair advantage. Thus, some countries, in conformance with OECD policy recommendation, have introduced policies that ensure ‘competitive neutrality’ (defined in Australia as ‘requiring that Government business activities should not enjoy net competitive advantages over their public sector ownership’).

The other multiple considerations in the assessment and formulation of a viability strategy and policy for SOEs should include the following:

- The fundamental determinant of development is not natural resources or capital investment, but the choice of institutions, which depends heavily on the Government’s development strategy. As Lin argues, successful developmental economies are those that recognise that their policies and strategies should be ‘comparative-advantage-following’ (CAF) rather than ‘comparative-advantage-defying’ (CAD) (Lin, 2009).
- Conditions that prevailed from the 1960s to the 1980s that facilitated the rapid development of the Developmental State economies of the Far East are changing. Evans (2007) suggests that “...21st century development will depend on generating intangible assets (ideas, skills, and networks) rather than on stimulating investment in machinery and physical assets oriented to the production of tangible goods. This trend prevails even in typical developmental economies such as China and Brazil. Since the 1990s, in both Brazil and South Africa, the majority of jobs have been created in the service sector. This is reflected in the falling number of jobs in SOEs; the implication being that ‘for most workers, a shift from employment in manufacturing to service sector jobs, lacks the promise of the earlier shift from agriculture to industry.”
- In addition, economic growth depends on political institutions and the capacity to set collective goals (Evans, 2007). Even the most liberal economies are planned, albeit at a micro-level, “...and therefore the question is not whether you plan or not. It is about planning the right things at the right levels” (Chang, 2010a).

The World Bank identifies a ‘virtuous cycle for inclusive growth’, starting with increased production coming from labour employment intensity, which in turn leads to higher labour productivity because of improved skills, which in turn would lead to a higher savings rate.

The jobless growth of the last 15 years has kept this virtuous cycle of inclusive growth elusive. Despite evidence of high investment returns in South Africa across a range of industrial sectors, investment, especially in ‘employment intense productive capacity’, has been very low.

Table 21: Real returns to capital in South Africa

Sector	1993-1999	2000-2010
Construction	65%	85%
Trade	40%	60%
Manufacturing	17%	25%
Agriculture	22%	25%
Finance	10%	20%
Mining	8%	16%
Transport	5%	10%

Source: World Bank, 2011.

The World Bank further identifies several challenges, namely:

- Relatively weak industrial competition in the South African economy;
- Poor skills development at all levels, from basic to higher and technical education levels; and
- Contentious labour relations; as a result, South Africa ranks 132 out of 137 countries in the Labour Relations Index.

The World Bank points out that between 1980 and 2008, only nine countries in the world achieved growth rates greater than 6%, the target South Africa has set itself in order to create five million jobs. The only way to fix this cycle is to increase employment of the youth, and to increase productivity. Investment in job creation needs to be accompanied by improved total factor productivity¹ for it to be sustainable.

7.3.3 Observations and recommendations
7.3.3.1 SOEs performance findings based on PRC (KPMG) data

The following findings on the performance of commercial SOEs are based on data gathered by a research team commissioned by the PRC. Table 22 presents some important data and trends of the financial performance of major SOEs over the last five years.

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Table 22: Financial performance of major SOEs (2006-2010)

Global	2006	2007	2008	2009	2010	Average	CAGR
Total revenue	163,575,065,941	180,384,498,550	199,090,086,279	208,689,429,583	213,869,753,887	193,121,766,848	6.9%
Net profit margin %	14.5%	18.2%	10.3%	4.0%	22.6%	13.9%	
Total assets	434,664,492,226	480,293,899,460	588,784,062,144	660,788,925,816	723,065,582,214	577,519,392,372	13.6%
Total liabilities	249,718,758,766	255,667,224,148	311,381,132,529	380,110,778,057	415,506,150,982	322,476,808,896	13.6%
Cash and cash equivalents	43,436,443,057	45,129,191,802	54,350,715,843	64,785,755,027	61,763,172,745	53,893,055,695	9.2%
Revenue as % of GDP	9.3%	8.9%	8.8%	8.7%	8.0%	8.7%	
Return on assets	0.5%	1.4%	0.9%	-0.1%	0.8%	0.7%	
Current ratio	2.1	1.8	2.4	2.7	3.2	2.4	
Solvency ratio	5.7	4.0	3.4	3.1	3.9	4.0	
Interest coverage ratio	(764.0)	(37.5)	10.8	(1.6)	(153.5)	(189.2)	
Debt service cover ratio	5.1	0.9	3.5	2.1	10.5	4.4	
Gearing ratio	1.9	2.9	9.7	1.6	1.1	3.4	
Taxation paid							
Dividends paid	5,240,482,000	4,989,890,000	5,944,000,000	3,795,000,000	11,733,000,000	6,340,474,400	22.3%
Cash flow from operating activities	38,886,781,212	38,468,064,388	30,930,643,603	38,196,180,992	23,737,788,469	34,043,891,733	-11.6%
Cash flows utilised for cap-ex	8,225,182,679	19,198,515,613	26,617,586,707	53,087,733,056	55,111,788,648	32,448,161,341	60.9%
Government subsidy	615,400,000	699,039,000	779,400,000	999,600,000	911,993,000	801,086,400	10.3%
Government subsidy as % of revenue	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	3.2%
Government guarantees	16,576,233,000	18,285,959,000	7,051,147,000	210,572,452,295	211,036,345,000	92,704,427,259	88.9%
Number of employees	163,948	161,546	160,564	151,526	150,359	157,589	-2.1%
Revenue of employees	997,725	1,116,614	1,239,942	1,377,252	1,422,394	1,230,785	9.3%

¹Improvements in human capital (quantity and quality) and technological innovation result in increasing productivity. Without these conditions being met, investment will always lead to diminishing returns.

- The revenue contributions amounted to an average of 8.7% of GDP from 2006 to 2010.
- The total aggregate revenue grew by a compound annual growth rate (CAGR) of 6.9% from 2006 to 2010.
- The average net profit margin was 13.8% for the four year period.
- Total assets grew by a CAGR of 13.4% from 2006 to 2010, amounting to R723 billion in 2010.
- The average net profit for the population sample of SOEs analysed was 13.9%, for the five-year period. However, the 2010 figure is materially distorted by the proceeds from the unbundling of Vodacom, which amounted to approximately R44 billion. This was reflected in Telkom's net profit for 2010.
- If this profit is excluded from net profit (ignoring any tax effect), the 2010 net profit margin reduces to a meagre 2% in 2010. (Net profit margin measures the company's overall profitability as opposed to its operating profitability. The net profit margin is sensitive to changes in financial leverage and tax impact. The finding seeks to confirm that the overall profitability of major SOEs fell dramatically i.e., from 14,5 % in 2006 to 2% in 2010).
- Global return on assets figures are disappointingly low, showing an average of 0.7% from 2006 to 2010. (Return on assets measures the return generated by a company's asset base, thereby providing a barometer of the asset efficiency of a business. By most cross-sectorial standards, this data would suggest that capital, particularly in such large quanta, is not being optimally deployed).
- Conversely, an average liquidity ratio of 2.4x is encouraging, particularly when buttressed by commendable average solvency ratios of 4.0x for the periods 2006 to 2010. (The liquidity ratio is a proxy for a company's ability to pay back its short-term liabilities with its short-term assets. The benchmark for most companies is

a current ratio of 2:1. Global liquidity ratio for SOEs is above the minimum benchmark and reflect the SOE's ability to meet their short liabilities from their short-term assets).

- Major SOEs' global solvency ratio was on average 4.0x for the period 2006 to 2010. (The solvency ratio is a proxy for a company's ability to meet its long-term debt obligations. A ratio of 1 is satisfactory. Global solvency ratio seeks to confirm the healthy state the SOEs are in to meet its long term debt obligations).
- Curiously, given the above statistic, debt service coverage ratios have remained strong though erratic, improving from 5.1x to 10.5x from 2006 to 2010, with an average of 4.4x in the same period. (The debt service coverage ratio could be described as the amount of cash flow available to meet annual interest and principal payments on debt. Most lenders would require the ratio of 1.15 to 1.35 times to ensure that cash flow is sufficient to cover loan payments on an ongoing basis. A ratio of 10.5 times seeks to confirm the healthy state that the major SOEs are in respect of this metric).
- On the other hand, Government guarantees have grown by a CAGR of 89% from R16.6 billion in 2006 to R211 billion in 2010.
- Total employee numbers have generally remained constant, with a slight negative CAGR of -2.1% from 2006 (163,948) to 2010 (150,359).
- In contrast, revenues per employee have shown a steady and slight upward trend growing by a CAGR of 9.3% from 2006 (997,725) to 2010 (1,422,394). Revenue per employee is a proxy for productivity. This is a significant number since it includes employee data for all the largest entities, including ACSA, Eskom, SAA, the South African Post Office, Telkom and Transnet. This ratio is most useful when compared with other companies in the same industry. Ideally, a company wants the highest revenue per employee possible, as it denotes higher productivity. An increase in the ratio due

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- to a reduction in staff (i.e. a CAGR of -2.1%) and the increase in revenue (i.e. a CAGR of 6.9%) outpaced the reduction in staff.
- Total liabilities grew by a CAGR of 13.6% in the same period, presumably largely to fund significant increases in capital expenditures (particularly given the dominance of capital intensive sectors), which grew by a CAGR of 32.1% from 2006 to 2010, levelling off at R74 billion for the 2010 year.
 - Interest coverage is abysmal, peaking at -764x in 2006 and settling at -154x in 2010.
 - Debt service coverage ratios have been very poor and erratic, improving from -57.7x to -18.9x from 2006 to 2010, with an average of -61.7x in the same period.
 - Though variable, with a peak of 9.7x in 2008, understandably, gearing ratios are generally trending downward and levelled off at 1.1x in 2010, averaging 3.3x from 2006 to 2010.
 - Taxation paid has shown an erratic trend, with a negative CAGR of -3.2%, levelling off at R8.4 billion in 2010.
 - Dividend payments increased by a CAGR of 22.3% from 2006 to 2010, accruing to

- R11.7 billion in 2010 and averaged R6.3 billion over the five-year period.
- The major SOEs' cash position has increased significantly from R43.4 billion in 2006 to R61.7 billion in 2010, growing by a CAGR of 9.2% (inclusive of proceeds from Vodacom's unbundling).
 - Global cash flows from operating activities have been positive, though growth has trended downward with a -12.7% CAGR from 2006 to 2010.
 - Government subsidies have grown by a CAGR of 10.3% from 2006 to 2010; however, even in 2010, they remained below R1 billion.
 - Government subsidies as a percentage of revenue have been relatively constant at an average of 0.4% from 2006 to 2010, also remaining below R1 billion.
 - Government guarantees have grown by a CAGR of 89% (2006:R16.6-bn; 2010:R211-bn).

7.3.3.2 Viability of water boards

The table 23 presents some key data and trends over the last five years for the financial performance of water boards.

Table 23: Financial Performance of water boards (2006-2010)

Global	2006	2007	2008	2009	2010	Average	CAGR
Total revenue	5,319,280,967	6,329,767,288	6,910,046,144	7,754,775,000	7,850,385,000	6,832,850,880	10.2%
Net profit margin %	15.6%	18.8%	20.0%	16.7%	12.0%	16.6%	
Total assets	10,117,832,770	12,693,838,440	15,364,647,000	17,032,706,000	16,051,445,000	14,252,093,842	12.2%
Total liabilities	4,811,405,020	5,593,932,052	5,758,385,252	6,079,959,000	5,627,371,000	5,574,210,465	4.0%
Cash and cash equivalents	692,621,266	1,452,132,534	2,060,810,516	2,160,288,000	1,394,581,000	1,552,086,663	19.1%
Revenue as % of GDP	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	
Return on assets	1.8%	1.3%	1.5%	0.7%	2.8%	1.6%	
Current ratio	1.9	3.4	2.2	2.1	1.9	2.3	
Solvency ratio	4.0	4.9	6.0	5.5	4.5	5.0	
Interest coverage ratio	26.9	189,931.7	41,074.2	0.3	(35.8)	46,199.5	
Debt service cover ratio	(4.3)	2.8	1.3	4.2	126.9	26.2	
Gearing ratio	1.3	0.9	0.4	0.3	0.9	0.7	
Taxation paid							
Dividends paid	-	-	-	-	-	-	
Cash flow from operating activities	1,501,009,844	1,971,973,551	2,226,886,842	1,947,059,714	1,541,304,000	1,837,646,790	0.7%
Cash flows utilised for cap-ex	407,281,697	187,029,466	444,974,000	651,075,000	450,271,000	428,126,233	2.5%
Government subsidy	-	-	21,348,000	36,226,000	42,934,000	20,101,600	
Government subsidy as % of revenue	0.0%	0.0%	0.3%	0.5%	0.5%	0.3%	
Government guarantees	-	-	-	-	-	-	
Number of employees	1,140	1,436	1,407	2,225	2,102	1,662	16.5%
Revenue of employees	4,666,036	4,407,916	4,911,191	3,485,292	3,734,722	4,241,722	-5.4%

- All major water boards as defined in schedule 3b made revenue contributions amounting to an average of 0.3% of GDP from 2006 to 2010. Of the 27 entities in schedule 3b, this report covers all 14 of the water boards or water companies as defined in the PFMA schedules.
- Net profit margins have declined from 15.6% in 2006 to 12% in 2010. They have, however, averaged at 16.6% for the same period. Net profit margin measures a company's overall profitability as opposed to its operating profitability. The finding seeks to confirm that the overall profitability of water boards fell dramatically over the period.
 - Return on assets has had a 'U' shape performance curve, peaking at 2.8% in 2010. Whilst low on a relative basis, it reflects the nature of the good that these water boards provide.

- Capital expenditures have shown moderate growth increasing by a modest CAGR of 2.5% from R407 million in 2006 to R450 million in 2010. The above suggests that the water boards generally invest in replacement and maintenance capital expenditures and do not invest heavily in building capacity or in stretching themselves.
- Cash flows from operating activities have been consistently positive, though they grew at a meagre CAGR of 0.7% from 2006 to 2010.
- Water boards have, however, maintained respectable liquidity ratios averaging 2.3x from 2006 to 2010. Global liquidity ratio for water boards is above the minimum benchmark and reflects their ability to meet short liabilities with their short-term assets.

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- Similarly they demonstrated impressive solvency ratios averaging 5.0x from 2006 to 2010. Solvency ratio is a proxy for a company's ability to meet its long-term debt obligations. A ratio of 1 is satisfactory. Global solvency ratio for the water boards confirms the healthy state that these SOEs are in with respect to their ability to meet long-term debt obligations.
- Government subsidies as a percentage of revenue have been relatively constant at an average of 0.3% from 2008 to 2010.
- Water boards received no Government guarantees in the period 2006 to 2010.
- Total employee numbers have increased by a CAGR of 16.5% from 2006 to 2010, levelling off at 2,102 employees in 2010.
- Revenue per employee declined by a CAGR of -5.4% with an average revenue contribution per employee of R4,2 million. This ratio is most useful when compared against other companies in the same industry.

7.3.3.3 Viability of Sector Education and Training Authorities

The table 24 presents some key data and trends over the last five years for the financial performance of Sector Education and Training Authorities (SETAs).

Table 24: Financial performance of SETAs (2006–2010)

Global	2006	2007	2008	2009	2010	Average	CAGR
Total grants received	4 151 838 000	4 434 548 691	5 286 746 928	5 855 285186	4 960 710 160	4 937 825 793	4.6%
Total assets	3 902 979 000	4 259 686 000	5 179 946 802	5 892 963 131	4 964 760 258	4 840 067 038	6.2%
Total liabilities	1 719 619 000	1 111 081 000	1 933 363 130	1 122 686 107	960 268 153	1 369 403 478	-13.6%
Cash and cash equivalents	3 159 825 000	3 577 087 000	4 721 615 026	4 481 161 471	3 758 569 577	3 939 651 615	4.4%
Accounts payable	645 354 000	699 409 000	725 098 710	1 298 336 043	474 301 246	768 499 800	-7.4%
Grants received as % of GDP	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	
Current ratio	4.1	5.4	6.0	6.3	5.8	5.5	
Cash on hand as a % of grants received	76.1%	80.7%	89.3%	76.5%	75.8%	79.7%	
Cash on hand as a % of total assets	81.0%	84.0%	91.2%	76.0%	75.7%	81.6%	
Accounts payable as a % of grants received	15.5%	15.8%	13.7%	22.2%	9.6%	15.4%	
Cash flow from operating activities	(582 234 000)	570 744 766	1 032 175 824	911 250 159	583 916 655	503 170 681	
Cash flows utilised for cap-ex	5 352 000	(19 914 991)	7 160 000	4 605 000	7 149 000	870 202	7.5%
Government subsidy	985 686 000	1 033 913 000	1 051 140 000	1 153 769 548	1 021 372 362	1 049 176 182	0.9%
Government subsidy as % of grants received	23.7%	23.3%	19.9%	19.7%	20.6%	21.4%	-3.5%
Government guarantees	616 000	–	200 000	–	–	163 200	-100.0%
Number of employees	710	594	1 073	756	1 103	847	11.6%
Grants received per employee	5 847 659	7 465 570	4 927 071	7 745 086	4 497 471	6 096 571	-6.4%

- All SETAs in schedule 3a of the PFMA received an average of R4.9 billion per annum in grants from 2006

- to 2010. This amounted to an average of 0.2% of GDP for the same period.
- Total grants received grew by a CAGR of 4.6% from 2006 to 2010. Total assets grew by a CAGR of 6.2% from R3.9 billion in 2006 to R5 billion in 2010.
- By contrast, total liabilities have declined from R1.7 billion in 2006 to R960,000 in 2010, a CAGR of -13.6%.
- SETA liquidity is very strong, averaging 5.5x from 2006 to 2010. The liquidity ratio is a proxy for a company's ability to pay back its short-term liabilities with its short-term assets. Global liquidity ratio for SETAs is above the minimum benchmark and reflecting the SOE's ability to meet its short liabilities with its short-term assets.
- Cash on hand increased moderately from R3.1 billion in 2006 to R3.8 billion in 2010. Of note is that cash on hand as a percentage of grants received is high, averaging 80% from 2006 to 2010, which suggests that corporate claims are low, resulting in low disbursement rates. Cash on hand as a percentage of assets, peaked at 91% in 2008 and averaged 81.6% from 2006 to 2010. This metric is indicative of a poor industry-wide balance sheet and requires further interrogation into why these cash balances are not being optimally disbursed.
- Accounts payable as a percentage of grants received has averaged 15.4%. Accounts payable, though a monthly metric, is included as a directional proxy to try and ascertain whether SETAs are disbursing claims timeously, given that the major creditor would be the companies that need to claim for training services rendered.
- Government subsidies remained relatively flat from 2006 to 2010 growing by a meagre CAGR of 0.9%. The average subsidy amount during the period was R1 billion, which amounts to a meaningful contribution of 21.4% of total grants received.
- Government guarantees are generally immaterial in this sector, averaging a very low R168 000 from 2006 to 2010.
- The 2010 staff complement of SETAs was 1 103. Employee numbers have grown by a CAGR of 11.6%. In the same period, grants received per employee are showing a declining trend from R5.8 million to R4.5 million. The average from 2006 to 2010 was R6 million.

RECOMMENDATION 23:

The Government should turn select SOEs into national world-class State commercial (industrial and economic) flagships.

This must be done:

- On the basis of overall performance with respect to service delivery and financial returns;
- By adequately capitalising them;
- By structurally and managerially consolidating them;
- By focusing their operations on core strategic objectives in the context of the Developmental State; and
- By setting their targets for financial and operational performance comparatively with their domestic and global peers.

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RECOMMENDATION 24:

Government should address the issue of non-financially viable commercial SOEs.

This must be done by considering some of the following options:

- Rationalisation of SOEs based on certain criteria; or
- Limit State involvement where technology disrupts natural monopolies; or
- Retaining and adequately funding them as non-commercial entities; or
- Injecting private sector practices and therefore gradually phasing them into commercial entities with a mix of public and private equity ownership; or
- Completely disposing of them as State entities; or
- Absorbing them into the line function department where there is a case for running them less costly as a Government line function.

The final determination should be done in concurrence with the SOE Council of Ministers.

PART 4:
ENHANCING STATE CAPACITY

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8.1 OVERVIEW OF CHAPTER

The envisaged role of the South African State as an active owner and shareholder in the context of a Developmental State requires appropriate capacities. These capacities are necessary in different areas of ownership function management, i.e.:

- Oversight authority;
- Executive authority;
- At governance and board level; and
- Executive management.

The essence of a Developmental State is premised on the need for the State to possess requisite strategic, organisational and technical capacities in all spheres of Government and within its entities. These include the following six capacities observed by the PRC as critical for South Africa (see Figure 29 for illustration):

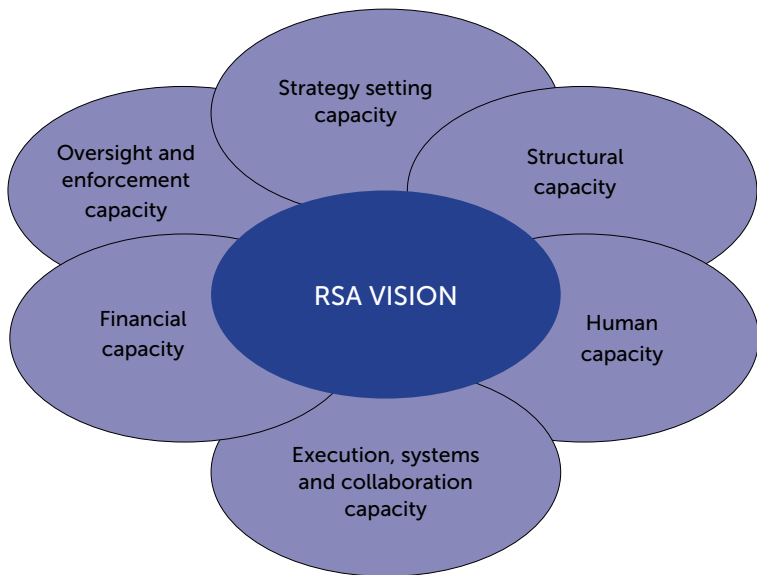
- Visioning and strategy setting capacity;
- Legislative, policy and structural capacity;
- Human capacity;
- Financial capacity;
- Execution, systems and collaboration capacity; and
- Oversight and enforcement capacity.

“States that have been effective in promoting growth and structural change do not generally inherit the right capacities or bureaucracies for development. They build them.” (UNRISD, 2010).

For the South African Government to generate an overarching strategy for SOEs that is conducive to equitable growth; development and transformation; service delivery; and the types of structural changes and performance in the SOE environment as discussed in this report, the State must possess certain capacities. The PRC’s view of the required State capacity takes into consideration some of the following drivers:

- The ability to set and articulate a common plan and vision and align the people’s talents and efforts, keeping them focused on the set vision by motivating and inspiring them;
- The capability to generate intelligent strategies that drive measurable changes and bring about appropriate outcomes aimed at alleviating South Africa’s challenges;
- The ability to set up controlling systems and procedures which are used to ensure that SOEs are disciplined in delivering on their mandates;
- The capacity to drive SOE alignment and compliance and to deal proactively with corruption;

Figure 29: Critical South African State capacities in relation to SOEs



- Ensuring active collaboration with various stakeholders in the private sector and civil society;
- The State should be responsive to South Africa’s socio-political and economic circumstances;
- The staffing of entities must be driven by adequately paid and competent individuals committed to the vision of the country; and
- There should be the requisite governance capacities for implementation and enforcement of strategies.

Chapter 10 of the Constitution enjoins the public service (applicable to all spheres of Government, organs of State, and public enterprises) to the following:

- A high standard of professional ethics must be promoted and maintained;
- Efficient, economic and effective use of resources must be promoted;
- Public administration must be development-oriented;
- Services must be provided impartially, fairly, equitably and without bias;
- People’s needs must be responded to, and the public must be encouraged to participate in policy-making;
- Public administration must be accountable;
- Transparency must be fostered by providing the public with timely, accessible and accurate information;
- Good human resource management and career-development practices must be cultivated to maximise human potential; and
- Public administration must be broadly representative of the South African people, with employment and personnel management practices based on ability, objectivity, fairness, and the need to redress the imbalances of the past to achieve broad representation.

8.1.1 Purpose of this chapter

The purpose of this chapter of the PRC report is:

- To provide an overview of capacity challenges facing the State in relation to SOEs; and

- To make recommendations based on international experience and views from experts and policy makers on how the State could improve its capacity to transform the SOE sector and optimise their performance.

8.1.2 Structure of this chapter

The next sections of this chapter provide an overview of capacity challenges and recommendations with regard to six capacity areas:

- Visioning and strategy setting;
- Legislative, policy, and structural capacity;
- Human capacity;
- Financial capacity;
- Execution, systems, and collaboration capacity; and
- Oversight and enforcement capacity.

8.2 AN OVERVIEW OF STATE CAPACITY CHALLENGES

8.2.1 Background context

Whilst the debate about the role of the State in the economy has subsided, and there is now general recognition that the State needs to play a more active and coordinating role in economic and social development, the State’s capacity to intervene in the economy remains a challenge for African Governments in particular. South Africa is no exception after seventeen years of democracy.

In terms of formulation of policy initiatives to build State capacity, the South African Government has been meticulous. One such initiative was the Reconstruction and Development Programme (RDP), from which the National Skills Development Strategy in 1998 and other subsequent policies were created. These saw a major overhaul of the skills development system, for example, including the formation of Sector Education and Training Authorities (SETAs), among others. The RDP could be regarded as a broad capacity enhancing programme that sought to achieve five priorities:

- **Meet the basic needs of people**, including jobs, land, housing, water, electricity,

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CHAPTER 8: ENHANCING STATE CAPACITY continued

- telecommunications and transport, a clean and healthy environment, nutrition, health care and social welfare.
- **Involve the people in these programmes** by being made part of the decision-making on where infrastructure was located, by being employed in its construction and by being empowered to manage and administer these large-scale programmes. Crucial here was an education and training programme designed to build the human resources of the country.
 - **Build the economy**, which included, among other things, addressing racial and gender inequalities in ownership, employment and skills; removing all repressive labour practices; overcoming the previous neglect of training and isolation from the world economy; excessive concentration of economic power that led to low levels of investment in research and development; low and inappropriate skill levels; high costs; low productivity and declining employment.
 - **Be involved in the democratisation of State and society, with an emphasis on the role of the Constitution and Bill of Rights.** This also entailed democratisation of national, provincial and local Government; the administration of justice; the public sector; State-owned enterprises; the police and security forces; social movements and NGOs; and a democratic information system in facilitating socio-economic development. What is relevant here is the RDP proposal that parastatals, public corporations and advisory boards must be structured and run in a manner that reinforces and supports the RDP.
 - **Implement the RDP with proposed strategies for improving the capacity of the financial sector to mobilise more resources and to direct these to activities set out in the RDP,** from housing to small and medium-sized enterprises; ensuring that electrification and telecommunications would be self-financing;

reallocating and rationalising of existing funds needed for implementation of the RDP; improving and reforming the tax systems to ensure that more tax was collected without having to raise tax levels; and raising new funds in a number of areas. Most importantly for the purposes of this discussion, the RDP proposed that the programmes of the democratic Government and State-owned enterprises should be based on publicly-determined priorities in line with the RDP.

The State therefore made its intention to build the capacity of the society and the economy very clear. The RDP gave rise to new national policies, new institutions and agencies, new priorities for SOEs and a change in their management structures and regulation.

To facilitate delivery of the national development policies and strategies, the State has had to deal with a myriad of strategic, human, structural, and systems capacity challenges, some inherited from the apartheid era and others as part of general ‘teething’ problems common to young democracies throughout the world.

The ability to implement policies effectively, as well as sustained monitoring and evaluation, remains a major challenge. In the course of the PRC review, some stakeholders lamented about the lack of continuity and long-term planning as a common problem. The State is seen to be trapped in a perpetual ‘starting’ mode. Every time a new leader takes over, new and different objectives are introduced and previous efforts are often shelved. Long-term planning will ensure continuity and common purpose in implementing, policy, plans and strategies of the State.

We now look at the six capacities (as stated in 8.1) constituting major ‘teething’ problems for the South African democracy in relation to SOEs.

8.2.2 Visioning and strategy setting capacity
8.2.2.1 Introduction

Visioning and strategy setting capacity in simple terms refers to the ability to inspire people, organisations or institutions (in our case society and SOEs) to share and commit to a long-term goal and make them engage in direction(s) and activities that will enable them to achieve the vision. The vision and strategies are cascaded through different levels of society and require appropriate competencies and commitment to the vision at each sphere of Government. No society, democratic or undemocratic, can succeed or prosper if it does not share the vision and leadership to carry through the vision.

While formulating and embracing a common vision is important, so too is choosing the right course to achieve the vision. Leadership and commitment to reach goals are crucial drivers.

In its diagnostic document, the National Planning Commission (NPC) highlighted the unevenness in State capacity, which leads in turn to uneven performance in local, provincial and national Government. The NPC notes that the uneven performance of the public service results from the interplay between a complex set of factors, including:

- Tensions in the political-administrative interface;
- Instability of the administrative leadership;
- Skills deficits;
- The erosion of accountability and authority;
- Poor organisational design; and
- Inappropriate staffing and low staff morale.

It further notes that there have been many individual and uncoordinated initiatives to address these problems. However, there is a tendency to jump from one quick-fix or policy fad to the next, rather than pursuing a long-term sustained focus on tackling the major obstacles to improving the performance of the public service. These frequent changes have created instability in organisational

structures and policy approaches that further strain limited capacity, exacerbating the problem of uneven performance.

The SOEs are no exception to these challenges of visioning, strategy setting capacity, lack of continuity and human factor aspects.

8.2.2.2 PRC observations on visioning and strategy setting capacity

Because of the complexity and often conflicting objectives within a Government, a clear strategy is often difficult to craft for an individual SOE, and even more difficult for a portfolio of SOEs that may operate in different industries and locations. Recognising these challenges, we propose that the State take some of the following into account to build the active shareholding capacity:

- Be a dedicated owner/shareholder, with the capacity to coordinate efforts with other ministries to determine and deliver on a common SOE strategy;
- Be an effective owner/shareholder by delivering knowledgeable, informed and effective advice to the State as owner;
- Be a transparent owner/shareholder by ensuring integration of the multiple requirements of other stakeholders as well as engendering collaboration and participation;
- Be an efficient owner/shareholder by focusing on continuous improvement to ensure effectiveness of SOEs;
- Be an owner who ensures that adequate and relevant resources both financial and human are available for SOEs; and
- Be an executive authority that is highly professional and technical to offer dialogue and advice to SOEs.

Gigaba, (5 December 2011) argues that the role of ownership/shareholder oversight is vital. The mandate of an owner/shareholder is to leverage SOEs as strategic instruments of the Developmental State – that is, to guide SOEs to become catalysts in creating jobs and growing the

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economy so that their impact is optimised for the rest of society. SOEs must be viewed in relation to the broader impact they have on the economy and society as a whole. Through SOEs, the State seeks to facilitate participation and push for an increased stake in the economy by the majority of citizens – either through access to labour markets or productive activities.

The shareholding role is construed as that of continuing to provide economic governance (policy coordination) tied to SOE-multiple goals which include: attracting and driving investments; enhancing efficiencies and the transformation programme of all State-owned enterprises, their customers and suppliers; creating jobs; building the industrial capacity of the economy; linking small and medium businesses to markets either through communication platforms or transport; and developing responsive skills to economic or supplier demands.

To implement the shareholding function effectively, Gigaba argues that there are five key challenges to reckon with:

- Firstly, develop an investment planning framework that is linked to long-term strategic economic priorities of the country that are not determined by balance sheet constraints.
- Secondly, expand and diversify sources of funding for the investment plan beyond the balance sheet and the fiscus to include, for example, development finance institutions and the private sector.
- Thirdly, boldly support localisation in the procurement programmes in order to support local suppliers and hence promote investments in national industrial capabilities by entering into longer-term sustainable contracts. This will reduce dependency on imports for intermediate goods and promote stable relationships.
- Finally, enhance coordination between SOE programmes and all levels of Government to ensure that SOE capabilities are fully leveraged;

that implementation is accelerated; and the impact of the programmes is optimised, provincial and municipal entities included.

In order to implement the oversight vision outlined and the associated enabling initiatives, the owner/ shareholder should build a range of institutional capabilities to play a number of roles. These are described as follows:

- Firstly, the capability of the owner/manager that has to ensure the financial sustainability and the governance integrity of the enterprises.
- Secondly, the capability of the owner/manager that builds partnerships between the SOEs and key stakeholders and oversees the impact of the SOEs on the economy as a whole.
- Thirdly, the capacity to play the role of a change manager to provide direction and support the SOEs in building new organisational capabilities to drive economic growth and transformation.
- Finally the owner/shareholder manager needs to play the role of a nation-builder providing decisive economic leadership to align stakeholders behind SOE strategies so that effective developmental coalitions can be built. Intrinsic to this process is developing the SOE strategies to ensure that the overlaps between commercial, developmental and political objectives are optimised.

State-owned enterprises are the Government's specialist intervention instruments in the economy and the extended arm of Government for delivery of critical services. These companies further the country's domestic and foreign policy (regionalisation and internationalisation), in pursuit of both infrastructure rollout and other commercial plans.

A further crucial operational capacity requirement is that of entities being repositories of the specialist skills and expertise necessary to execute the mammoth building programme. Improving capacity and efficiencies in service and product delivery is key at operational levels. A high-

quality economic and managerial establishment is necessary for the management of SOEs. Such executive authority capacity cannot be built overnight, but it is possible to build one within a relatively short span of time, if there is political will and sound economic investment. Positioning State-owned enterprises as critical agents for development is crucial, therefore acquiring some of the outlined capacity will assist in changing the way the SOEs are operated and optimise their efficient management.

The PRC's review of SOEs has established that there is a degree of fragmentation and multiplicity of SOE related policy frameworks, legislation, and ownership and oversight structures at different spheres of Government. Each of these SOE ownership structures are driving different agendas, which are in many instances conflicting with the State's intention. This has resulted in the proliferation of SOEs, unclear and duplication of mandates and misaligned strategic objectives.

The PRC notes the absence of SOE central and coordinated management and therefore recommends the following:

RECOMMENDATION 25:

The Government should actively promote a common national understanding and commitment to a Developmental State vision.

Thus should be done by:

- A strong communication and popularisation drive;
- Reaching a clear determination and understanding of the role of SOEs in the Developmental State agenda; and
- Monitoring and evaluating the implementation of the vision by Government departments and SOEs.

To undertake the above successfully, the State needs comprehensive enablement and capacity.

RECOMMENDATION 26:

The Government should build its capacity to develop and implement an overarching strategy for SOEs.

This must be done by:

- Structurally empowering the central SOE's authorities to formulate, monitor and facilitate implementation of the SOE overarching strategy;
- Capacitating the central SOE authorities (as recommended in this report) with sufficient funding and highly qualified and competent individuals with specialised experience in the SOE sector;
- Ensuring collaboration of the central SOE authorities with international institutions such as the OECD, ADB, and the UN, and with countries that have successfully managed visioning and strategy-setting for SOEs;
- Providing for the representation of the central SOEs authorities in the National Planning Commission and any other agency whose responsibility it is to drive the planning and implementation of the Developmental State vision and plan; and
- Targeting capacity development at all three spheres of Government.

8.2.3 Legislative policy and structural capacity

The structural capacity refers to the ability, knowledge, skills, and authority to change, adjust or create new structures, laws, and policies that enable performance and the attainment of the vision of SOEs and the country. Legislation and policies should be aligned to the Constitution of the country and to the proposed overarching strategy for SOEs. In that regard, a number of proposals are made by the PRC. These include;

- The creation of a State-owned entities Act (a single source for SOE governance and shareholding);

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- Formation of an SOE Council of Ministers;
- Formation of the central SOE authorities (for commercial entities and for DFIs);
- Development of a State-ownership Policy;
- Formation of the central remuneration authority for SOEs;
- Non-commercial SOEs and statutory corporations remain within line function ministries.
- The formation of a principled SOE governance framework; and
- Consider appointing an executive authority to establish a framework for economic regulation and to oversee harmonisation and the implementation of core regulatory principles. it is also necessary to standardise regulatory methodologies.

The PRC observed that while previous commissions have made many good recommendations, their implementation has been poor and inconsistent and should be facilitated.

RECOMMENDATION 27:

A transitional SOEs Reforms Committee (Execution Management and Monitoring Task Team) must be established to drive the implementation of the PRC’s recommendations.

This appointment must:

- Take effect as soon as the PRC recommendations are adopted and continue until the SOE reforms are fully implemented and/or handed over to the responsible executive authority;
- Be constituted by an expert nominated by the President and the central authorities, namely DPE, Treasury, DTI, EDD, the National Planning Ministry and other relevant Government stakeholders;
- Be provided with the commensurate powers and funding to effect its mandate; and
- Report progress to the President.

8.2.4 Human capacity
8.2.4.1 Introduction

This is perhaps the most important of all capacities the State must possess. Aspects such as organisational culture; shared vision; knowledge; output rate or productivity; leadership; management; skills; technology; and training are critical components of human capacity. In a Developmental State context these must be harnessed so that they are aligned and targeted towards attaining the Developmental State vision.

A Developmental State is capable and earns its credibility by facilitating and implementing service delivery, and being seen to be effective and making progress. This is a State that does not tolerate corruption and is not influenced by powerful interest groups. It maintains its integrity by upholding democratic, patriotic, and meritocratic values, amongst others. It encourages continuous learning and the culture of excellence in the public service. The draft national development plan (National Planning Commission, November 2011, p. 365) describes a ‘capable State’ as: “If we are to address the twin challenges of poverty and inequality, a State is needed that is capable of playing a transformative and developmental role. This requires well run and effectively coordinated State institutions staffed by skilled public servants who are committed to the public good and capable of delivering consistently high quality service for all South Africans, while prioritising the nation’s developmental objectives. This will enable people from all sections of society to have confidence in the State, which in turn will reinforce the State’s effectiveness.”

8.2.4.2 Human capacity challenges in the SOE environment

The PRC has made a number of observations in relation to the human capacity in the SOE environment, which includes the following

- There is a recognisable lack human of capacity at owner management/oversight, governance,

board, and executive management levels. One of the challenges is that there seems to be no institutionalised human capacity development and retention principles and processes based on a well-defined and standardised merit system that takes into account the state of our nation. As a consequence, the SOE environment is characterised by high employee turnover, lack of transparency and questionable quality in recruitment systems in some instances. Furthermore there is an unstructured approach in deployment, and erosion of institutional memory due to the short-term nature of contracts currently given to most executives.

- SOEs, in addition, experience transformational challenges, in particular in achieving ‘gender parity’. The Commission for Employment Equity reflects that SOEs, like many other companies, continue to reflect a disproportionately high number of male employees against female employees (Department of Labour, 2011).
- Absence of a skills programme on regulation: Government should consider a ‘cadet programme on economic regulations’ – using people with experience in relevant industries.

Other capacity challenges faced by SOEs include the following:

- There is a capacity/skills deficit. The SOEs face a shortage of staff and specialised skills, especially in infrastructure planning, engineering, finance and information technology. This impacts adversely not only on service delivery but also long-term planning and coordination.
- SOEs have since reduced their role in being catalysts for experiential learning and skills development to drive skills supply and employment in the economy. Consequently, SOEs have competed for scarce executive and management skills with the private sector, driving the remuneration levels of SOEs above those of the private sector. There are also challenges with succession planning in SOEs, and a high staff turnover.

- Capacity constraints in the exercise of Parliamentary oversight over SOEs are also evident. Allegations of incompetence and corruption are also noted in the SOE environment.

The PRC acknowledged various initiatives to remedy challenges in the education and skills development arena and made a number of recommendations that tackle the above human capacity challenges in SOEs, including external challenges and those that are internal.

RECOMMENDATION 28:

The proposed SOE Council of Ministers and the central SOEs authorities should develop customised human capacity building programmes.

This must target the following areas:

- The State as an owner;
- The State ownership representative (executive authority);
- The board (appointed by the executive authority to give externalised oversight); and
- Operations (executive and operational management).

The executive authority’s oversight role is complex and highly specialised. it requires the ability to mediate between enterprise strategic, financial and risk concerns. The oversight authority should further mediate sector, industrial, national economic policies as well as social development imperatives. Shareholder coordination is yet another critical consideration.

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RECOMMENDATION 29:

The Government should ensure that the Executive Authorities' SOE strategic management and relationship is professional by aiming at the following:

- Maintaining strategic relations and exchange within and between the executive authorities and the management of the entities;
- Improving the governance of the SOEs;
- Enhancing the capacity of the State to act as an effective owner;
- Being an effective State advisor on the affairs of the SOEs;
- Ensuring transparency in dealing with Parliament, and other ministries and stakeholders;
- Ensuring quality delivery of services in line with the Developmental State agenda; and
- Ensuring accountability and safeguarding of the Government's assets.

Such processes should take into account balance of merit and transformation.

Government must have competent people at the leadership, oversight, board, and executive levels. Two processes feed into the frontline. The first is from the development and grooming platform, that is, by recruiting talented people, introducing training, mentorship, exposure, etc. The second process is to tap into the repository of skilled workers, comprising people who have experience and are experts, including retirees. People from within the repository will also contribute to the development and grooming processes to grow this platform. Also deployment processes should be structured along similar processes.

Government should also have a retention policy across the board. This will ensure that the State maintains its capacity and has a repository of its expertise. It should include ensuring continuity at various levels of SOEs, in particular the contracts of CEOs. CEO contracts should be designed to

extend beyond the current practice of five years, based on vigorous performance contracts.

8.2.5 Financial capacity

8.2.5.1 Challenges and Issues on financial capacity

The PRC observed the following challenges, among others, on the State's financial capacity and its impact on SOEs:

- Funding and financial resourcing of SOEs is not informed by a common point of departure (the process is currently performed at the discretion of the National Treasury). The lack of capacity of different ownership and oversight centres in the different spheres of Government compromises the State's ability to leverage funding through partnerships and collaboration (e.g., private sector, and foreign direct investment, etc.).
- Financial capacity also has a bearing on unfunded SOE mandates and resultant opportunity costs, in particular those aimed at achieving social objectives.
- The absence of transparent funding methodologies and policies, particularly around economic and social infrastructure development and maintenance, can also affect financial resourcing of SOEs.

RECOMMENDATION 30:

The Government should improve financial decision-making capacity in all departments dealing with SOEs.

This must be done in the following areas, among others:

- Facilitate optimisation of overall financial and social benefit in the benefit of its assets;
- Unfunded mandates and negotiated trade-offs with the owner in this regard;
- Exploration of alternative funding sources; and
- Capacity to leverage funding from equity finance, PPPs and multi-lateral institutional funding sources.

8.2.6 Execution, systems, and collaboration capacity

8.2.6.1 Introduction

SOEs are an integral part of the State's service delivery arm. In South Africa, SOEs take two broad different forms, namely commercial and non-commercial. The commercial entities are mainly large in size, have huge assets, and operate along commercial principles. They are thus expected to be profitable, self-sustainable and not to rely on the Government's fiscus. The non-commercial entities vary in size, but are mostly agencies that provide services, which would ordinarily have been provided by Government departments, either at national, provincial or local Government level. These entities, irrespective of form, have been established to address a Government objective and are owned by the Government. It is therefore fundamental that the Government, as the 'owner', is able to oversee the performance of these entities.

As an 'owner', the State's oversight role can be simplified into one key question: Are SOEs delivering in accordance with the reasons for their existence?

8.2.6.2 Challenges regarding State execution, systems, and collaboration capacity

We have already noted the following challenges in earlier chapters:

- There is no consolidated repository of information on SOEs (no central database) which renders the owner weak in terms of managing entities;
- The free flow of information across stakeholders is inadequate, which is compounded by inadequate systems to enable effective management of institutions; and
- In terms of capacity to collaborate, the major issue is that SOEs, by and large, are not operating cohesively. Their activities are conducted in silos and can be characterised as territorial.

8.2.7 Oversight and enforcement capacity

8.2.7.1 Introduction

For the State to assess the performance of SOEs in meeting their service delivery obligations requires an understanding of the SOEs' outputs on strategic planning and execution of their strategic plans. This means continuous monitoring and evaluation that enables appropriate intervention where required by the State as an owner.

From the assessment carried out it can be argued that the State's capacity to oversee the SOEs as an owner is questionable. The following observations and findings were made by the PRC.

8.2.7.2 Challenges regarding oversight and enforcement capacity

Overall, in terms of SOE oversight and enforcement capacity, the oversight ministries do not have the capacity to oversee and enforce performance, policy, and regulations on SOEs. This is partly due to decentralised and fragmented oversight centres and approaches. The following represent some of the PRC findings as discussed in detail in the chapters dealing with the efficiency and effectiveness of SOEs in service delivery:

- There is a lack of technical capacity to engage the SOEs during the drafting of shareholder compacts;
- There is a lack of sufficient skills to perform effective oversight;
- The organisation of oversight functions within some of the departments may also not be optimum;
- The State's capacity to assess the strategic planning of SOEs is inadequate;
- The State's capacity to monitor performance of SOEs is inadequate;
- There is inconsistency in the measurement of performance by SOEs and the oversight authorities; and
- There is no standard reporting framework while there are substantial differences in the quality of reporting across SOEs.

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RECOMMENDATION 31:

The Government should develop an integrated reporting, monitoring and evaluation capacity for SOEs across all spheres of Government.

This should be done by:

- Introducing a compulsory electronic reporting and performance management system with access to verifiable source documents for monitors and evaluators;
- Providing commensurate skills and funding to undertake these tasks;
- Ensuring optimum information access and transparency; and
- Including essential information such as mandates; shareholder compacts/statements of intent; corporate plans; key performance indicators; asset base; equity and liabilities; income; the total return on capital (RoC); return on equity (RoE); operating margin; net Debt/EBIDTA or net debt/equity; profits if any; dividends paid to the Government; and the total number of employees by gender, race and disability employed by each SOE.

PART 5:
IMPLEMENTATION OF STATE-OWNED ENTITIES
REVIEW RECOMMENDATIONS

PART 5: IMPLEMENTATION OF STATE-OWNED ENTITIES REVIEW
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CHAPTER 9: IMPLEMENTATION OF THE STATE-OWNED ENTITIES
REVIEW RECOMMENDATIONS

9.1 INTRODUCTION

The purpose of this chapter is to guide Government on the implementation of the PRC recommendations. The implementation process proposed in this chapter can only serve as a guideline to the implementation team and relevant stakeholders. It is the PRC’s considered view that the report should follow the best-practices in order not to lose the momentum.

Overall, the PRC recommendations are contained in the five focal areas illustrated in figure 30, i.e. a strategy for SOEs; an enabling environment; SOE performance; and the enhancement of State capacity. All these focal areas are framed by the development State agenda or plan.

The implementation of the PRC recommendations should be viewed as a reform process or programme, not as a once-off event. Hence, the PRC proposes phased implementation processes of SOE reforms as detailed below. There are three phases proposed:

- **First phase** – implementation of short-term recommendations.
- **Second phase** – implementation of medium-term recommendations.
- **Third phase** – implementation of long-term recommendations.

Appropriate institutional arrangements would have to be put in place to ensure effective implementation across all spheres of Government and departments.

9.2 INSTITUTIONAL ARRANGEMENTS

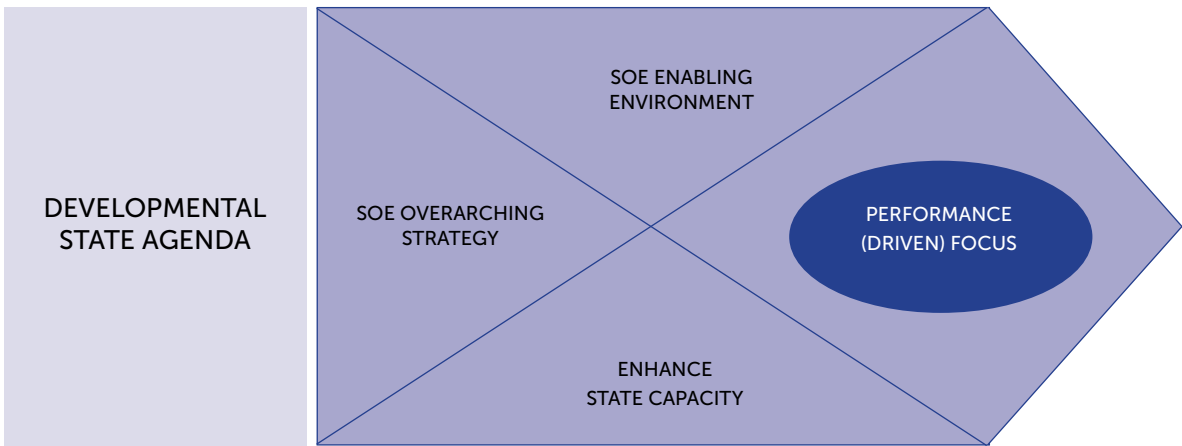
It is critical that there is effective collaboration amongst stakeholders in all spheres of Government to implement SOE reforms. The PRC recommends that the President of the Republic of South Africa appoints a SOE Reforms Committee (or Execution Management and Monitoring Task Team) after the PRC report is approved or adopted. The committee should comprise representatives from SOEs as well as Government structures. These structures must include key departments such as the following:

- The Presidency;
- Public Enterprises;
- National Treasury;
- Economic Development; and
- Trade and Industry.

Political oversight of the work of the SOE Reforms Committee and secretariat should be provided by the President of the Republic of South Africa.

The role of the committee will be to implement the recommendations of the PRC along the proposed phases detailed below. The phasing is

Figure 30: Focal points of PRC recommendations



informed by the assessment of the feasibility and urgency of each recommendation (see Table 26, for detailed estimated timelines for each of the recommendations).

In addition, as and when new or existing structures embrace the PRC’s recommendations, the committee will hand over such responsibilities fully, in particular to the new central structures recommended by the PRC.

The SOE Reforms Committee should programmatically implement the various recommendations and ensure continuous monitoring and evaluation of implementation, as well as lessons learnt for each phase of the process. Sufficient funding should be provided for the reform projects.

Once established, the SOE Reforms Committee would be required therefore, to undergo the following activities, among others:

- Full-orientation on the PRC report’s findings and recommendations;
- Develop a comprehensive master plan and budget on the SOE reforms programme;
- The master plan should include change management aspects in all current structures that will be directly affected by the SOE reforms such as executive authorities and executive management; and
- Undertake a comprehensive stakeholder management and communication plan.

9.3 FIRST PHASE: SHORT-TERM

The short-term phase is estimated to be a period from the date of the appointment of the SOE Reforms Committee for up to two years. The committee should determine a schedule portfolio of key deliverables and outcomes that need to be undertaken within this phase. A number of recommendations can be implemented during this phase, depending on how well the committee is led and resourced. Implementation will include ‘quick-wins’; urgent Interventions; and targeted

troubleshooting (‘burning platforms’). The following recommendations, among others, must be implemented during this phase (in random order):

- A common understanding of a Developmental State vision within the SOEs and their structures;
- Strategy for SOEs must be formulated and communicated;
- SOE categorisation framework should be adopted;
- A white paper for SOEs must be drafted and adopted by the Cabinet;
- The process of formulating an SOE Bill must be initiated;
- A framework for the appointment of boards must be developed;
- Performance agreements with transformation targets must be made mandatory;
- A register of non-compliant individuals and companies must be initiated;
- Prioritisation of managerial and technical skills must be introduced; and
- Vision and strategy-setting capacity building must be undertaken.

Expected key outcomes in this phase are:

- Strategy for SOEs (with strategic objectives, sectors and categorisation);
- Clear SOE performance targets aligned to Developmental State plan e.g., sustainable jobs; transformation targets; competitiveness (viability) targets etc.;
- Signed performance agreements with transformation targets;
- Consistent quality of boards;
- White paper outlining the restructuring and rationalisation of SOEs, including new SOEs structures and the relevant legislation;
- Increased supply of managerial and technical skills; and
- Reduction of corruption.

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9.4 SECOND PHASE: MEDIUM-TERM

The second phase is estimated to be a five-year period from the date when the SOE Reforms Committee begins its work. The following recommendations must be implemented during this phase:

- SOE Council of Ministers and the SOEs central authorities for Commercial Entities and for DFIs must be established;
- An ownership, governance, and oversight policy must be developed;
- A common performance management system must be introduced;
- Integrated reporting, monitoring and evaluation must be introduced;
- A framework for effective collaboration must be developed;
- The central remuneration authority must be established;
- Transformational procurement must be introduced;
- SOEs’ mandates must be reviewed;
- Rationalisation of SOEs must be finalised;
- Partnerships with the private sector on infrastructure development must be entrenched;
- Improved infrastructure funding methodologies and models must be in place; and
- Customised human capacity building programmes must be implemented.

Expected key outcomes during this phase are:

- New structures are set-up (SOE Council of Ministers and SOEs authorities for commercial entities and one for DFIs);
- Ownership, governance, and oversight frameworks and policies are implemented;
- Ability to monitor, evaluate, and report SOE performance in an integrated fashion is accomplished, including a comprehensive database of SOEs;

- Improved collaboration practices and value created;
- Remuneration authority is established and remuneration practices are standardised;
- Mandates are reviewed and aligned;
- Rationalised and manageable portfolio of SOEs;
- Improved economic regulation;
- Improved momentum on infrastructure funding; and
- Improved transformation targets achievements and overall performance of SOEs.

9.5 THIRD PHASE: LONG-TERM

The final phase of the SOE reform process should ensure that all reforms are fully implemented, in particular:

- SOE policies and legislation implemented, including streamlined transformation legislation;
- Uniform economic regulation framework introduced; and
- Selected world-class commercial SOEs are in place.

In this phase, the SOE sector would have:

- A strategy for SOEs aligned to Developmental State vision;
- An enabling environment, i.e., legislation, structures, policies;
- SOEs will be meeting their performance targets in a balanced manner; and
- The State owner/shareholder and oversight capacity appropriately enhanced.

The entire SOE reform process is illustrated in Table 25:

Table 25: SOE reforms

SHORT		MEDIUM		LONG	
2012	2015	2020	2025		
PRC – Review of SOEs <ul style="list-style-type: none">• Appoint SOE Reforms Committee.• A common understanding of a Developmental State vision within the SOEs and their structures.• A strategy for SOEs must be formulated and communicated.• SOEs categorisation framework is adopted.• A white paper for SOEs must be drafted and adopted by the Cabinet.• The process of formulating an SOE Bill must be initiated.• A framework for the appointment of boards must be developed.• Performance agreements with transformation targets must be made mandatory.• A register of non-compliant individuals and companies must be initiated.• Prioritisation of managerial and technical skills must be introduced.• Vision and strategy-setting capacity building must be undertaken.		Set-up SOE Council of Ministers and SOE authorities <ul style="list-style-type: none">• New legislation for SOEs must be developed.• An ownership, governance, and oversight policy must be developed.• A common performance management system must be introduced.• Integrated reporting, monitoring and evaluation must be introduced.• A framework for effective collaboration must be developed.• The central remuneration authority must be established.• Transformational procurement must be introduced.• SOEs mandates must be reviewed.• Rationalisation of SOEs must be finalised.• Partnerships with the private sector on infrastructure development must be entrenched.• Improved infrastructure funding methodologies and models must be in place.• Customised human capacity building programmes must be implemented.		<ul style="list-style-type: none">• SOE policies and legislation are implemented, including streamlined transformation legislation.• Uniform economic regulation framework is introduced.• Selected word-class commercial SOEs are in place.	
OUTCOME		OUTCOME			
<ul style="list-style-type: none">• Strategy for SOEs (with strategic objectives, sectors and categorisation).• Clear SOEs performance targets aligned to Developmental State plan e.g.: sustainable jobs; transformation targets; competitiveness (viability) targets; etc.• Signed performance agreements with transformation targets.• White paper outlining the restructuring and rationalisation of SOEs, including new SOEs structures and the legislation.• Increased supply of managerial and technical skills.• Reduction in corruption.• Improved transformation targets achievements and overall performance of SOEs.		<ul style="list-style-type: none">• New SOE Act is promulgated.• New structures are set-up (SOE Council of Ministers and SOEs Authorities for Commercial Entities and one for DFIs).• Ownership, governance, and oversight frameworks and policies are implemented.• Ability to monitor, evaluate, and report SOE performance in an integrated fashion is accomplished, including a comprehensive database of SOEs.• Improved collaboration practices and value created.• Remuneration authority is established and remuneration practices are standardised.• Consistent quality of boards.• Mandates are reviewed and aligned.• Rationalised and manageable portfolio of SOEs.• Improved economic regulation.• Improved momentum on infrastructure funding.		<ul style="list-style-type: none">• STRATEGY FOR SOEs ALIGNED TO DEVELOPMENTAL STATE VISION.• AN ENABLING ENVIRONMENT, I.E., LEGISLATION, STRUCTURES, POLICIES.• SOES MEETING THEIR PERFORMANCE TARGETS IN A BALANCED MANNER.• THE STATE OWNER/ SHAREHOLDER AND OVERSIGHT CAPACITY IS ENHANCED.	

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Table 26: PRC recommendations implementation plan

Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 1 The Government should develop an overarching, long-term strategy for SOEs.	Appointment of SOE Reforms Committee	Short-term (6 to 24 months)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 2 The Government should enact a single overarching law ('State-owned Entities Act') governing all SOEs.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 3(a) Board appointments: The Government should develop a framework for the appointment of SOE boards.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 3(b) CEO appointments: The appointments of the CEO shall be done by the Minister in concurrence with Cabinet, at the recommendation of the Board.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 4 The Government should develop a mandatory framework for effective collaboration among SOEs, and between SOEs and national, provincial as well as municipal authorities.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 5 The Government should establish a Central Remuneration Authority (CRA).		Medium-term (2 to 5 years)	SOE Reforms Committee.

Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 6(a) The Government should develop a uniform framework for economic regulation.		Medium-term (2 to 5 years)	SOE Reforms Committee.
Recommendation 6(b) Government should undertake a process of identifying policy inconsistencies and policy conflicts; clarify the role of economic regulators; and develop a blueprint to guide regulatory designs.		Medium-term (2 to 5 years)	SOE Reforms Committee.
Recommendation 7 The Government should develop a common performance management system.		Long-term (5 to 10 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 8 The mandates of SOEs should be subject to critical strategic review every five years and the requirements thereof should be factored into the SOE Act.		Medium term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).

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Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 9 The agreement and sign-off of statements of strategic intent and corporate performance plans (chapter 6) should be: <ul style="list-style-type: none">made mandatory for every executive oversight authority; anddeveloped within a specified timeframe. There should be a focus on a dedicated, deliberate training and development programme for oversight functionaries. In addition, strong sanctions and accountability measures should be in place to deal with non-compliance and ensure accountability and productivity.		Short-term (6 to 24 months)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 10 All Government entities and SOEs should be required to develop transformation plans.		Short-term (6 to 24 months)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 11 SOEs should lead the South African economy in prioritising technical and managerial skills development.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 12 SOEs should ensure that the procurement process is transformational.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 13 SOEs should play a leading role in socio-economic development.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).

Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 14 Transformation should be an integral part of the contractual agreement between the executive authority and SOEs.		Short-term (6 to 24 months)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 15 Sanctions for corrupt activities as well as fronting should be supplemented by a register of individuals and companies that are involved in such non-compliant practices. The common register should be made available to SOEs.		Short-term (6 to 24 months)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 16 The empowerment framework and legislation should be streamlined to facilitate substantial contribution towards transformation as opposed to box-ticking compliance.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 17 Government should rationalise its holdings by focusing on those SOEs that provide public goods and those deemed to be strategic, namely serving national interests, national security and priority sectors.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 18 The Government should develop a consolidated funding model for commercial SOEs and DFIs.		Short-term (6 to 24 months)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).

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Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 19 The Government should develop and adopt a policy shift towards a greater mix of debt finance and equity finance.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 20 Private sector participation in partnering with SOEs to deliver on the provision of both economic and social infrastructure should be encouraged and expanded.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 21 A model for the funding of public infrastructure based on a distinction between economic and social infrastructure must be developed.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 22 Mining as a strategic sector and a significant economic user of infrastructure in line with practices from other mining communities around the world should contribute fairly to the development of infrastructure for economic use. This entails that, in addition to tariffs that are based on user pay principle for economic use of infrastructure, consideration of the use of various policy tools to achieve a fair contribution by the mining sector should be examined. These could include mandatory local beneficiation and ring-fencing of a portion of the proposed resource tax towards the development of infrastructure.		Medium-term (2 to 5 years)	SOE Reforms Committee.

Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 23 The Government should turn select SOEs into national world-class State commercial (industrial and economic) flagships.		Long-term (5 to 10 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 24 Government should address the issue of non-financially viable commercial SOEs.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 25 The Government should ensure a common national understanding and commitment to a Developmental State vision.		Short-term (6 to 24 months)	SOE Reforms Committee.
Recommendation 26 The Government should build its capacity to develop and implement the overarching strategy for SOEs.		Short- to medium-term (6 months to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 27 A transitional SOEs Reforms Committee (Execution Management and Monitoring Task Team) must be established to drive the implementation of the PRC's recommendations.		Short-term (6 to 24 months)	The President of the Republic of South Africa.

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Recommendation	Response by the President	Estimated timeframe	Proposed responsibility
Recommendation 28 The proposed SOE Council of Ministers and the central SOE authorities should develop customised human capacity building programmes.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 29 The Government should professionalise the executive authorities' SOE strategic management and relationships.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 30 The Government must build its capacity to improve financial decision-making capacity in all departments dealing with SOEs.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).
Recommendation 31 The Government should develop an integrated reporting, monitoring and evaluation capacity for SOEs across all spheres of Government.		Medium-term (2 to 5 years)	SOE Reforms Committee (once established this will be the responsibility of the central SOE authorities in consultation with SOE Council of Ministers).

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