



Mr PJ Gordhan

Minister of Public Enterprises

SONA DEBATE

25 JUNE 2019

Honourable Speaker of the National Assembly
Honourable Chair of the NCOP
Mr President
Mr Deputy President
Cabinet Colleagues
Honourable Members

Sanibonani

Introduction

Mr President, we commence the Sixth Administration in a democratic South Africa with a determination to deliver our vision of a better South Africa.

The ANC, has a clear and unequivocal vision for a democratic, just, non-racial, non-sexist South Africa. A democracy, as you said Mr President, that works for all 57 million South Africans.

A democracy that continues to build on the achievements and successes of the past 25years; while having the humility to admit the weaknesses and mistakes of the past.

The ANC's Strategy and Tactics document points out that:

“South African society requires an effective state, both technically and in terms of its orientation. In other words, continuing transformation and strengthening of state machinery, including State-owned Enterprises, is fundamental to speeding up the implementation of programmes of social change in the context of the second phase of radical socio-economic transformation.”

As you have pointed out, in order to achieve our goals, we must ensure:

- No hunger
- Higher economic growth
- Employment for 2 million young people
- Every 10 year old able to read for meaning
- Halve violent crime (and “all violence”)

We need bold and ethical leadership to implement the seven priorities. We must nurture a common passion, a common purpose.

This SONA debate sets out a visionary and clear roadmap for a different, better South Africa for all. Now we must implement our plans with urgency. And know that we must do things differently. We commit to, as Ben Okri says, “remake” ourselves so that we “remake the world...”

The Economy & An Ethical, Developmental State

Two of the seven priorities you have outlined, Mr President, are absolutely vital at this stage of the development of our young democracy: Robust, just, inclusive economic growth and a capable, ethical and developmental state.

As the SONA points out:

“It is only when we reach consistently high (inclusive) rates of growth that we will be able to reverse the economic damage of our past”.

We must give social justice real meaning in the daily lives of all South Africans.

State-owned enterprises are part of a capable, ethical and developmental state.

SOEs must play a vital role in generating inclusive growth, in providing efficient and cost effective network services and deliver public services to both those who can afford to pay and those that can't.

As the National Development Plan has outlined:

“SOE’s are central to advancing national objectives through providing economic and social infrastructure. If this is done in an equitable and cost-effective way, SOE’s can contribute to both deliver a quality and reliable service at a cost that enables South Africa to be globally competitive. To live up to these expectations, SOE’s will require clear public-interest mandate, which are consistently enforced.”

Global approach to SOE's

The rationale for the state's ownership of public enterprises varies among countries and industries.

It can typically be said to comprise a mix of social, economic and strategic interests.

Over the last few decades however, globalisation of markets, technological changes, and the deregulation of previously monopolistic markets, have led to readjustment and restructuring of the state-owned sector in many countries.

Moreover, SOE participation in international trade and investment has grown significantly. They are an influential and growing force globally.

The proportion of SOE's among the Fortune Global 500 has grown from 9% in 2005 to 23% in 2014, driven particularly by the growth of Chinese SOE's.

The OECD recently conducted a third review of SOE's amongst its members. It found that:

- Countries with the largest SOE sectors by share of national employment, were in Europe (led by Norway with almost 10% non-agricultural employment);
- Countries with the largest SOE sectors in absolute terms by corporate valuation are: China (US \$29.2 trillion), India (US \$338.5 billion), Korea (US \$217.8 billion) and Italy (US \$207.5 billion);
- There was a concentration of SOEs in the network industries (telecoms, gas, electricity and transportation industries).

The review observes that:

“With many countries experiencing lower economic growth and finding their fiscal space diminished, governments face growing challenges to ensure well-functioning SOE sectors... good governance of SOEs is critical to ensure their positive contribution to economic efficiency and competitiveness...”

This describes our situation as well.

In our context, the NDP vision for 2030 is that South Africa must be served by a set of efficient, financially sound and well-governed state-owned companies that address the country's developmental objectives, in areas where neither the executive arm of Government nor the private sector are able to do so effectively.

A year ago

Major SOE's were decimated and find themselves in all sorts of difficulties because of malfeasance that enabled state capture, and rampant corruption:

- Victimisation of ethical black leaders and professionals
- Operational decline and indiscipline
- Financial crises: characterised by a mismatch between revenue and costs, a shortage of liquidity and high debt in some cases
- Deliberate mismanagement
- Negligible board and executive fiduciary accountability for poor performance – and collusion with corrupt activities
- Many are unable to trade their way out of their difficulties.

A path to recovery

Over the past sixteen months our work with respect to restoring good governance, stabilizing operations, appointing new boards and directly confronting corruption, proceeded with efficiency, speed and purpose.

- New Boards: appointed for Denel, Eskom, Transnet, SA Express, Safcol, Alexkor
- Management: Work in progress; huge responsibilities
- Operations: Improving but not optimal
- Finances: Only partly resolved
- Fiscal burden Not solved; many still too dependent on the fiscus or borrowing

There is much more to do.

At the same time, we can find both joy and encouragement from the passion, commitment and excellence among the thousands of South Africans who really make these entities work – the locomotive and power station operators; the maintenance crews; the staff and crew at our two public airlines – SAA and SA Express.

We salute them and all those who have responded to the 'Thuma Mina' call!

The Sixth Administration

We must now continue to reposition and revitalise our SOEs.

Presidential SOE Council

Mr President, as you've pointed out, the SOE Council will take on the formidable, but important task of repositioning and reforming our SOE sector.

- Align SOEs to the national priorities and goals

- Decide which SOEs are strategic and what new SOEs to establish, for example, the 4th Industrial Revolution
- Reform procurement by SOE's to reduce the likelihood of corruption
- Appoint competent individual of unquestionable integrity through a transparent and robust process to Boards and senior management
- Review the business models, capital structure and sources of financing for SOE's
- Identify opportunities for private sector participation to better advance the national developmental agenda of the country (not privatisation)
- Closely monitor the financial and operational performance of SOE's.

Our goals for SOE's

More specifically, we will strive to:

- Promote greater transparency and accountability to overcome poor governance
- Restore financial sustainability and prudence
- Create an environment in which “skilled and professional public servants of the highest moral standards dedicated to the public good” can thrive and contribute to a “best in world” culture
- Remove all vestiges of State Capture and ensure there are harsh consequences for malfeasance.

The public, Mr President and Honourable members, wants to see action from us.

Our citizens, those who have voted for all of us, judge all of us by the services we deliver, the prudence with which we spend public funds, by our actions to defeat corruption and whether SOE's reduce the cost of living and doing business (particularly small businesses).

In particular, whether we empower women, train and provide opportunities for young people.

Some of our SOE's operate in sectors that are and will undergo dynamic and profound change. Both government, and the leadership in Boards and management, need to be alive to these changes and proactively build in the necessary resilience and agility to respond to these.

For example:

- a) Energy Sector: the balance between renewables and fossil fuels (including nuclear) is constantly evolving, and rapidly so
- b) Logistics: new challenges and opportunities are emerging for increased regional trade from the Africa Continental Free Trade Area agreement

- c) Aviation: what is the future design for the State's aviation assets; new types of fuel efficient aircraft; consolidation of airlines, long haul routes by low cost airlines
- d) Environment: how do we reduce our dependence on non-renewable sources of energy; reduce carbon emissions; introduce new carbon capture and battery technology

I will provide some details of a few of the SOE's here with more in information to follow in the budget vote of the Department of Public Enterprises.

SAA

SAA is in a precarious financial position. The airline has persistently incurred losses over the past 12 years due to:

- Mismanagement;
- State Capture;
- Its inability to service its debt - commercially its cost structure is unsustainable;
- Incorrect fleet configuration; and
- Many cumbersome approval processes

A Long Term Turnaround Strategy (LTTS) was developed in 2017 to transform the airline. Progress was made with route optimization and other cost efficiencies.

But ultimately, we need to create an airline that is '*fit for purpose*' and able to compete effectively in a dynamic market and ready to negotiate with a strategic equity partner.

We have reviewed the investment case for SAA.

Based on comparisons with its peers there is an investment case for SAA if reforms are well implemented, and if inefficiencies in its systems are eradicated.

The airline must undertake the following urgent actions:

- An accelerated LTTS is being developed for approval by 8 July 2019
- We are in the process of strengthening the company executive and the Board to ensure stability in the organization
- A Joint Implementation Committee has been established between Management, the Board and my Department to accelerate implementation, accountability and enable quick decision making.

SAA is required to appoint appropriate local and global commercial and aviation skills, it must change the culture of entitlement, embed accountability, streamline approval processes, secure funding and ensure an accelerated implementation plan.

Denel

Honourable members: you would have seen news headlines this morning that Denel can only pay 85% of staff salaries for June, due to liquidity constraints.

The latest update is that a lender has come to the assistance of Denel and full salaries will now be paid.

There is no clearer example of the damaging effects of state capture than the financial strain and uncertainty the 3 500 Denel employees and their families may face each month if the company's liquidity problems continues.

Denel, our producer of military and aerospace equipment, is a crucial and strategic state entity that was substantially harmed by state capture.

- The company is improving the way that it contracts as well as renegotiating existing contracts to improve the margins it earns on such business
- A new, permanent CEO was appointed in December last year, on recommendation of the Board
- Governance improved and steps are being implemented to improve the reliability of the company's financial accounting and reporting.
- Denel is reviewing its supply chain and procurement processes to reduce costs and streamline processes.
- The company has reduced employee costs through voluntary severance packages
- Importantly, the company has a pipeline of potential contracts in excess of **R30 billion**

Transnet

Transnet's core mandate is to assist in lowering the cost of doing business in South Africa, ensuring security of supply through providing appropriate ports, rail and pipeline infrastructure.

The systematic weakening of state-owned enterprises over the past nine years was characterised by the misallocation of resources, the weakening of leadership and the breakdown of control systems within Transnet.

A new Board of Directors was appointed in May 2018. Transnet core mandate is to:

- Enable a large scale shift of freight from road to rail in order to reduce costs, improve predictability and reduce the carbon footprint of the freight system
- Improve regional inter-connectivity. This has become an urgent challenge in light of the African Continental Free Trade Area agreement

- Reduce supply chain costs for customers importing and exporting containerised goods
- Review port pricing to shift towards a pricing regime that better supports industrial policy. This includes a review of tariffs for bulk unprocessed exports and for value added and regionally traded goods.

Transnet plans to invest R153.5 billion over the next five years with additional investment through public private partnerships.

The Board and management of Transnet has committed to the following targets for 2019/2020 —

- Grow rail market share in general freight from 29% to 32%
- Rail general freight tariffs to average 5%
- Limit Port Terminals container tariffs to 6%
- Reduce the Ports Authority tariff by 6%
- Generate cross-border revenue of R3.6 billion
- Increase the total number of artisan, engineering, technician and sector-specific trainees by 11%
- Achieve a local procurement spend greater than 75%

Eskom

Mr President, on Thursday last week, you pointed out that:

“one reason for the lacklustre economic performance has been load shedding early this year, together with the continued uncertainty in the supply of electricity and the state of Eskom. The lesson is clear: for growth, we need a reliable and sustainable supply of electricity.”

I will elaborate on some of these issues:

- Today, Eskom has successfully managed the system in terms of its Winter Plan, for 94 days without load-shedding;
- A new Head for Generation was appointed last week;
- Of Eskom’s fifteen coal-fired power stations, ten now have permanent power station managers with full authority;
- Soon, the Minister of Finance we will be able to announce the appointment of a Chief Restructuring Officer (CRO) – following consultations in government;
- The new CRO will specifically focus on the utility’s financial distress, the company’s cost structure and the cost effectiveness of its capital and operational expenditure and debt, among other financial matters.

Eskom challenges

The Eskom Board will address the following challenges in the months ahead:

- Eskom has Installed capacity: 45 000 MW vs ±32 000 MW readily available
- Has an Electricity Availability Factor (EAF) of between 65% →71% - needs to get to 80%
 - On the Generation side: outages at power stations remain erratic/unpredictable
 - Needs better operational discipline
 - Focus on power stations must:
 - Employ operations and engineering staff
 - Reduce outages – planned and unplanned – and maintain below 9 500 MW
 - Ensure timeous maintenance and quality of work
 - Ensure appropriate, good quality coal and adequate supply

Restructuring Eskom

The recommendation to restructure Eskom of the Presidential Sustainability Task Team was based on both international trends, and a study of Eskom itself.

Eskom has begun to develop a road map to implement the proposals in the February 2019 SONA: to separate its Generation, Transmission and Distribution functions into three separate business entities, wholly-owned by the State.

There is no deviation from this strategic path – not in Cabinet or in government – contrary persistent public speculation.

Eskom's separation will provide a number of other benefits, including greater transparency of financial and operational performance, in each entity.

Some of the details being looked into, are:

1. Power transfer policies and contracts;
2. Internal structural reorganization (governance, organizational structure, policies and procedures);
3. Financial reporting and auditing processes per business division;
4. Create detailed cost allocations and Service Level Agreements within the holding company.
5. Implement auditable financial statements (including governance and support services); and
6. Transfer assets to subsidiaries whilst considering the tax and regulatory implications.

Engagements with organized labour, following the February SONA announcements, were conducted at Board level, and with the Minister and the President.

Government will ensure that appropriate consultations will occur, in particular with organized labour on the implementation of the Separation Project.

Eskom's Finances:

a) Revenue vs Costs

b) Liquidity

- Current cash will last until end October
- It is important to position Eskom to access markets

c) Special Appropriation Bill

- Timeframes will be announced by the Minister of Finance

SOE's: What will be different in the Sixth Administration

- We shall exercise our shareholder oversight role with increased vigour and will require the same of the Boards.
- The current urgency relates to the financial, operational and governance crises. Measures considered, include the establishment of a Chairpersons Forum, a joint Board Forum and regular on-site visits to SOE's.

Quality and composition of Boards

We shall be appointing new members to fill vacancies in some Boards in the months ahead, which will be composed of the right mix of technical experience and knowledge, as well as the commitment and courage to ensure that management delivers on requirements.

Board members themselves will be required to function at the highest ethical standards.

Monitoring performance

The DPE is planning a new live performance monitoring system of the financial, operational, legal, and governance indicators.

Governance

The situation within our SOE's requires special measures, which shall include greater intervention from the Shareholder if the Boards and Management do not take the steps needed to deliver on the outcomes expected of each SOC.

Such intervention is in keeping with the Companies Act and the Public Finance Management Act.

Moral Hazard

The Boards and Management of SOE's will be required to stabilise company finance and operations, and to put each entity on a path of sustainability.

They will be required to show how dependency on the fiscus will be reduced, and how entities will be placed on a path of recovery.

SOE's require leadership that is mindful of the state of our economy and the limitations of our national fiscus.

We require leadership that is courageous and prepared to take difficult decisions such as cost-containments and revisiting wrong procurement decisions.

Commission of Inquiry: State Capture

The Commission of Inquiry has heard evidence of a discernible pattern of widespread corruption and mismanagement that have severely undermined the effectiveness and the mandates of our biggest state-owned entities.

Former and current officials and board members from Eskom, Transnet, SAA and South African Express have testified before Deputy Chief Justice Zondo.

Law Enforcement

- The SIU Special Tribunal is envisaged to begin its work in August 2019.
- Should evidence uncovered by the SIU indicate that funds have been taken out of the country as a result of crime, the Special Tribunal process will be subjected to the Mutual Legal Assistance process administered by the Department of Justice to follow the money.

I trust that, between the SIU and the Special Tribunal, urgent attention will be given to SOE contracts that are already in the purview of the State Capture Commission, including:

- **Transnet:** the 1 064 locomotive deals and other acquisition tenders. The Neotel-Homix transaction
- **Eskom:** coal contracts, in particular the Tegeta/Oakbay transaction to acquire Optimum and Koorfontein mines
- **SAA:** the appointment of BNP Capital to restructure the airline's debt

In these matters we expect that there *should* be asset recovery: that the money stolen from South Africans will be returned and that there will be palpable consequences for corruption.

Just Transition

The transition is linked to the decommissioning of older Eskom power stations, and to identify social interventions to secure the futures of communities and workers clustered around these power stations.

The debate about the energy transition that we anticipate for the future must a balanced one where energy security for our country is the most important consideration.

A Just Transition will form part of Eskom's shareholder compact. We need to create a forum that brings together mine-workers, organized labour, business and mining companies in particular, coal transport- and freight companies, departments like Energy, Environmental Affairs and Social Development and communities, to plan for:

- jobs and social security
- re-skilling of workers
- other social interventions

A Just Transition requires that we leave no one behind.

Grow South Africa together

Our common purpose is to serve South Africa's 57 million people!

The goal to create a just and fair society remains our ideal.

A society in which we strive to advance socio-economic rights and opportunities for all.

A society in which the social, intellectual and economic worth of individuals is enhanced.

We will realise our goals through a growing and inclusive economy.

If, together:

- With **Labour**: we have to find practical solutions rapid changes in the nature of work. Collectively, we need to remove the barriers to growth for our economy.
- With **Business**: continue to invest in the economy. Government is working to repurpose our institutions, put them on a path of renewal and to provide policy certainty. Businesses must lead in showing confidence in the prospects of our

economy and help build ethical institutions that shun corruption and malfeasance.

- **Vigilant Civil Society:** Without a free, independent media and sections of the civil society, we would not have exposed corruption and state capture to the extent that it was. Civil society has played a critical in resisting malfeasance. For this, we commend your efforts. We urge this sector to be part of and be visible in the process of renewing our institutions and help grow SA.
- **Professionals:** past, present and future – use your skills to ensure clean governance, ethical business practices and nurture black talent.

The ANC's 2019 Election Manifesto stated:

This is a moment of renewal. It is an opportunity to restore our democratic institutions and return our country to a path of transformation, growth and development... Together with the people of South Africa, the ANC is ready to write the next chapter in our country's history..."