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Making SOEs Great Again

1. Introduction

'SOE' is not a four letter word, but mentioning it could invite stares from South Africans, as if you had just uttered an expletive. This is so because over the last two decades state-owned enterprises (SOEs) have been synonymous with inefficiency, maladministration, corruption, and dubious corporate governance. With a sigh of exasperation, South Africans often ask: "Why do we even bother with them?"

On the other hand, the value of SOE's is recognised globally as a key driver of economic growth. In his June 28th *From the Desk of the President* newsletter, President Ramaphosa said that SOEs "should be at the forefront of economic and social transformation."[1] Philip Armstrong, a senior advisor at the International Finance Corporation (IFC) observes that "the value of SOEs lies in their potential to provide efficient, reliable and affordable critical products and services in key sectors, such as power generation and water supply, transport, oil and gas and hospitals. They enable expensive and expansive investments that are often beyond the private sector's capacity."[2] However, to extract this value, SOEs must be well run.

This paper will provide an overview of how South Africa's SOEs are governed; what the governance problems are; and what can be done to transform them.

2. SOEs' Legal Framework

In South Africa, a SOE is defined as an enterprise registered as a company in terms of the Companies Act, 2008[3] read together with the Public Finance Management Act, 1999[4] (PFMA).This includes those enterprises owned by a municipality, as contemplated in the Local Government: Municipal Systems Act, 2000.[5] There are more than 700 commercial and non-commercial SOEs in South Africa. The commercial SOEs are categorised into four types, namely, state-owned companies (SOCs) operating under the Companies Act; state interest companies (SICs) in which the State has a material interest but no control (such as Telkom); statutory corporations (SC) that provide goods and services of a strategic nature; and financial intermediaries.[6] Non-commercial SOEs include research entities and regulatory entities. The most important SOEs listed in Schedule 2 and 3 of the PFMA are the 21 state-owned companies (SOCs) that operate on a national level. These SOCs provide services in key sectors such as infrastructure, finance, national security, and social development. They include, Eskom, Denel, Transnet, the Water Boards, Alexkor, the South African Post Office, the Land Bank, the Development Bank, etc.

The government, as an owner and shareholder in these entities, is represented by a Cabinet Minister. Section 66(1) of the Companies Act requires a SOE to have a Board of Directors, which has the authority to exercise all of the powers and perform any of the functions of the

SOE, and which is accountable to the shareholder for the performance and affairs of the SOE. SOEs also fall within the ambit of the PFMA, which provides, for example, that the Board reports to the Minister to which the SOE is accountable and that it must seek, within limits, to prevent any prejudice to the financial interests of the state.

The legal framework adds to the difficult task of running an SOE because the various pieces of legislation sometimes create confusion. Besides the cited two pieces of legislation, all of the SOEs also have their founding statutes. Furthermore, some SOEs are incorporated in terms of the Companies Act (and are thus termed state-owned companies).

3. The Challenges of Running SOEs

Government's relationship with SOEs as owner and shareholder, and as policymaker, is at the heart of the challenges associated with running these organisations. As owner and shareholder, its main concern is obtaining a suitable return on investment, and as the policymaker, its main concern is with ensuring that SOEs play a pivotal in providing services to its citizens. The governance structure challenges are also exacerbated by the regulatory role Government must play, ensuring that pricing structures are balanced against the interests of consumers. For example, raising the price of electricity or water may make commercial sense, but it would create hardships for the poor.

SOEs are often vehicles for governing parties to pursue developmental goals, and herein lies the biggest governance challenge. SOEs are accountable, in terms of the governance structure, to the government, and not the governing political party, which often uses the appointment of boards and senior management to further its developmental goals. When these appointments are made outside of the accepted corporate governance rules, procurement practices are impacted, corruption thrives, and company performance is adversely affected. In South Africa, the executive authority (Minister) has the power to constitute boards and appoint directors in the event of an SOE not performing satisfactorily. The appointment of directors is, however, one of the biggest weaknesses, since there is no uniform set of criteria for the recruitment of SOE board members.[7] South African SOEs like Eskom, SAA, and Denel are but a few examples of this governance weakness. Indeed, the failure of these SOEs arguably has less to do with whether they are privately owned or in public hands, but rather with the fact that have been badly governed.

Another governance flaw is the issue of how easy it is for SOEs to avoid Parliamentary scrutiny.[8] SOEs, via the controlling national government department, must provide annual reports to Parliament, and Parliament plays an oversight role in overseeing the performance of government departments and appropriating funds to them. However, as Luke Muntingh points out, "SOEs often raise their own revenue, thereby avoiding a key component of Parliament's oversight power. However, they return to Parliament to [request] emergency bail-outs. This disjuncture finds expression in at least the appointment procedures."

It is clear that the different relationships that government has with SOEs requires from it three different roles, i.e. as owner, shareholder and policymaker, that are often in conflict with each other. While directors, for example, are supposed to be independent, the political interplay often results in appointments based on political connectedness rather than skill. This is one of the reasons why SOE governance is so weak, despite the existence of a good corporate governance framework such as the King IV Report on Corporate Governance.[9] The Report contains codes and practices that reinforce the notion that good corporate governance is a holistic and interrelated set of arrangements to be understood and implemented in an integrated manner – good governance is not a tick-box or compliance exercise.

4. Reforming SOEs

Fixing the governance challenges of SOEs will result in curbing corruption and improving performances. However, fixing the governance challenges should be only one part of a reform strategy that includes restructuring ownership, increasing competition, and improved public-private partnerships. Examples from Chile, Israel, Lithuania, India and Brazil[10] suggest that requiring that SOE board directors hold relevant professional degrees in finance, economics or law, and that a significant percentage of the board are independent members, improves the governance of SOEs.

In 2020, the National Planning Commission (NPC) commissioned a series of papers on the role of SOEs in the South African economy. These papers were to provide the government with tools to review and "align the SOEs to better support government's long-term economic strategy."[11] What emerged from these papers were recommendations on governance, financial, policy and structural reforms. For this briefing paper, the focus is on the governance and structural reform recommendations.

Governance reform recommendations included:

- Streamlining and refocussing the core mandates of the SOEs, by cutting out the non-essential activities. For example, Transnet should only focus on providing a service that would move goods in a reliable and cost-efficient way via road, rail and ports. This process has already begun at some SOEs;
- Replacing boards and senior executives at underperforming SOEs with competent and fit for purpose individuals; and
- Enhancing transparency and governance practices by publicly disclosing corporate governance policies, board charters, and board committee terms of reference.

However, governance reforms will mean nothing if the ownership structure of SOEs is not also reformed. The NPC recommended that an autonomous, separate entity be created to govern all SOEs. The creation of a single ownership entity could be done in three ways:[12]

- Option 1 is to create a state holding company that is a commercial company "staffed with high-calibre resources (including those with private sector/commercial experience)". The board will consist of the Presidency, the National Treasury, the relevant line departments, and a minority of technical appointments from the private sector and key stakeholders.
- Option 2 involves a pilot holding company that would have stewardship over a few selected strategic SOEs, such as Eskom, while the Department of Public Enterprises (DPE) still has control over the rest of the SOEs.
- Option 3 suggests that the DPE retains its ownership oversight role but that the Presidential SOE Council be given the task of overall coordination and oversight. The appointment of boards will be outsourced to a subsidiary staffed with skilled professionals drawn from the public and private sectors.

These options are consistent with the standard OECD benchmark implemented in the Nordic countries and Singapore. The Nordic model allows the holding company to act as a shareholder, but the SOE must still account to Parliament, where board effectiveness and service delivery efficiency are scrutinised against tight performance criteria.[13]

It is uncertain which option if any, Government will lean towards. However, there are signs that the recommendations are being taken seriously. For example, last year the President appointed a ten-person Presidential State-Owned Enterprises Council (PSEC) to support government in repositioning SOEs as "effective instruments of economic transformation and development."[14] The PSEC members are Monhla Hlahla, ex-Denel Chairperson, Joel Netshitenzhe, Executive Director and Board Vice-Chair of the Mapungubwe Institute for Strategic Reflection (MISTRA); Vusi Khanyile, Thebe Investments chair; Michael Sachs, Wits University adjunct professor; Marion Marole, non-executive director, MTN Group and Development Bank of SA; Bajabulile Tshabalala, vice-president finance and Chief Financial Officer at African Development Bank; Sipho Nkosi, Sanlam director; Kandimathie Ramon, Anglo Gold Ashanti Chief Financial Officer; Ian Kirk, Sanlam Group Chief Executive Officer and Executive Director; and Nazmeera Moola, economist and head of investment at Ninety One plc.

Perhaps option 3, where the PSEC will play a pivotal role, will be the option chosen. Other recent examples of government's commitment to addressing the SOE challenges are the sale of a majority stake in SAA to a private equity partner; the imminent restructuring of Eskom into three separate business units - generation, transmission and distribution; and the announcement around the commercialisation of Transnet's ports division – but it is clearly too soon to evaluate the success or otherwise of these moves.

5. Conclusion

The value-add of a well-functioning, efficient and profit-generating SOE that delivers on the State's developmental goals is clear. After years of neglect, government has finally shown some mettle in addressing the many challenges SOEs are facing. President Ramaphosa recently said: "These reforms are not intended to weaken the public sector or to reduce its role, but to make it a more dynamic and effective part of our economy."[15] Hopefully, the reforms will go far enough, and come quickly enough, to save those SOEs that we cannot do without.

Kenny Pasensie
Project Co-ordinator

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[5] Local Government: Municipal Systems Act, 32 of 2000. Available online at https://tinyurl.com/9ef9c3sw
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[9] IODSA (2016): *King IV - Report on corporate governance for South Africa.* Available online at https://tinyurl.com/v8rb5j4r
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