



# PARLIAMENT

OF THE REPUBLIC OF SOUTH AFRICA

## COMMITTEES

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## Department of Public Enterprises Budget Vote Sector Analysis

### 1. Introduction

The mandate of the Department of Public Enterprises is to exercise shareholder responsibility over the following State Owned Companies (SOCs) that are central to the developmental objectives set out in the New Growth Path (NGP), the Industrial Policy Action Plan (IPAP) and the National Development Plan (NDP): Alexkor, Broadband Infraco, Denel, Eskom, South African Forestry Company Limited, South African Airways, South African Express Airways and Transnet.

The Department is a custodian of all legislation relating to the establishment of the SOC's. The department aims to ensure the sustainability of the SOC's and supports government's strategic priorities of economic growth, expanding employment and developing infrastructure.

#### 1.1 Strategic Goals

The department's strategic goals over the medium term are to:

- Provide decisive strategic direction to the SOC's by ensuring they have credible business and expenditure plans
- Ensure the reliable generation, distribution and transmission of electricity
- Support the logistics system through oversight of the implementation of Transnet's Market Demand Strategy (MDS)
- Mobilize external funding sources
- Strengthen the SOC's Competitive Supplier Development (CSD) programmes to contribute to the reindustrialization of the economy
- Monitor implementation of skills development programmes within SOC's
- Develop and implement programmes with SOC's that contribute to social economic transformation.

The Department of Public Enterprise has in order to execute its mandate and strategic goals identified the following three programmes: Administration, Legal and Governance and Portfolio Management and Strategic Partnerships. These programmes provide strategic management, legal services and align the corporate strategies of SOC's with government's strategic intent, monitor and benchmark their financial, operational and capital investment plans.

### 2. Environmental Analysis

#### 2.1 Social Environment

The demographics of South Africa encompass about 52 million people of diverse origins, cultures, languages, and religions. The last census was held in 2011 and the next will be taken anywhere from 2016-2021. South Africa's population still face the triple challenges of poverty, inequality and unemployment which continue to affect the lives of many people. Out of this 52 million population 25, 2% is unemployed. Since 1994, the living conditions of South Africans has significantly improved with 73,4% of the

population having access to piped water and 84,7% of the population having access to electricity.

According to the Broad Based 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 resources development;
- Achieving equitable representation in all occupational categories and levels in the workforce;
- Preferential procurement; and
- Investment in enterprises that are owned or managed black people.

SOCs have a role in ensuring that there socio-economic imbalances in the economy are addressed. The B-BBEE framework lays the basis for ensuring that their developmental mandate is achieved. It is imperative for the Department of Public Enterprises to constantly monitor the SOC's environment to ensure that the above listed socio-economic strategies are achieved through its resources. Currently the expanded mandate makes it difficult for the Department to constantly monitor these strategies due to its limited resources.

The instruments that are used in assessing the SOC's environment are Shareholder Performance Agreements entered between the Department and SOC's. The implementation of the shareholder performance agreement is intended as a business tool and is not only matter of compliance, even where it required by law (such as in South Africa where it is known as a 'shareholder compact'). This instrument is intended to empower the Department as a shareholder to have more involvement in the running of the entity and encourages more increased shareholder activism.

SOCs operate within market fundamentals of realizing commercial objectives but not separated from dynamic responsibility of meeting the national developmental objectives, these should be considered in the development of shareholder compacts. Furthermore, a framework in which this should be adopted by all SOC's need to be created in order to guide Boards (of SOC's) to constantly monitor the commercial role and the development impact made by SOC's.

## **2.2 Economic Environment**

The Monetary Policy Review presented in June 2014 states that there advanced-economy banks responded to the global financial crises with extraordinary stimulus, including zero interest rates, large-scale asset purchases and unprecedented policy co-ordination. South Africa's current account-deficit is not funded exclusively by non-resident inflows. As global capital flows have grown scarcer and more erratic, South Africa's large current-account deficit over the past decade stems from disappointing export performance, linked to falling terms of trade and production disruption, and rising imports. South Africa will still need to attract significant capital inflows. An important risk here is the declining terms of trade of trade, likely linked to China's slowdown, could place further pressure on the current-account deficit. There is a danger

that elevated inflation outcomes will cancel out the effects of the exchange rate depreciation, depriving South Africa of solely needed competitiveness.

Chronic electricity shortages hinder private capital formation and economic growth. Although new electricity-generating capacity is now scheduled to come on line during 2014, construction of the requisite power stations has faced repeated delays.

Employment creation remains significant challenge to longer-term economic stability and growth. In the first quarter of 2014, unemployment increased to a high 25,2 per cent in a declining growth environment.

The other concern in the labour market is the antagonistic labour relations and persistent strikes. In particular, changes in the structure of the mining unionization over the past few years have caused multiple, often violent disruptions to production, with the most recent example being the record-length and ongoing platinum-sector strike. These events have been costly in several ways, depriving households of wage income and retailers of customers, damaging exports, and ultimately compromising investment and employment. The Chamber of Mines estimates the cumulative loss of wages from the mining strike to be R9 billion.

### **3. Policy Environment**

#### **3.1 Highlights from the State of Nation Address (SONA) 2014**

The President in his State of Nation Address emphasized his commitment to the radical socio-economic transformation to push back triple challenges, amongst these were the following:

- Government has put in place a programme of action based on the ANC Manifesto and the National Development Plan.
- The economy takes centre stage in this programme.
- The economy remains an effective weapon in the campaign against poverty, is the creation of decent work, and creating work requires faster economic growth.
- Government has set a growth target of 5 per cent by 2019. To achieve this government will embark on various measures and interventions to jump-start the economy.
- The economy has grown below its potential over the past three years and many households are going through difficulties.
- The slow growth has been caused in part by the global economic slowdown and secondly domestic conditions, such as the prolonged and at times violent strikes, and also the shortage of energy.
- Given the impact of the untenable labour relations environment on the economy, it is critical for social partners to meet and deliberate on the violent nature and duration of the strikes.
- The social partners will also need to deliberate on wage inequality. Government will during this term investigate the possibility of a national minimum wage as one of the key mechanisms to reduce the income inequality.
- To prepare for the implementation of the energy plan, we need to finalise the legislation that relates to the restructuring of energy industry as envisaged by the Independent Systems Market Operator Bill, the Integrated Resource Plan and other policies affecting the Energy Sector.
- Utilization of the renewable energy sector, the manufacturing of buses, Transnet's R50 billion locomotive contracts and PRASA's rail projects among others to promote local content and boost growth.
- Commitment over the next five years to prioritise small business, as well as township and informal sector businesses in particular, thus using the SMME development programme to boost Broad Based Black Economic Empowerment.

- Sharpening the implementation of the amended Broad Based Black Economic Empowerment Act and the Employment Equity Act, in order to transform ownership, management and control of the economy.
- Youth empowerment will be prioritized in our economic transformation programme.
- South Africa will continue to support regional and continental processes to respond to and resolve crisis, promote peace and security, strengthen regional integration, significantly increase intra-African trade and champion sustainable development in Africa.
- There is a commitment to deepen economic development, trade and investment partnerships with the BRICS through the work of the BRICS Contact Group for Economic and Trade Issues.
- Each Minister will sign a performance agreement with the President outlining what each department will do to deliver on the programme of action.

### **3.2 National Development Plan (NDP)**

The key major macro-economic shift has been the National Development Plan (NDP). It makes proposal that South Africa needs to invest in a strong network of economic infrastructure designed to support the country's medium- and long-term economic and social objectives. This economic infrastructure is a precondition for providing basic services such as electricity, water, sanitation, telecommunications and public transport, and it needs to be robust and extensive enough to meet industrial, commercial and household needs.

The country needs to make large investments to propel economic activity. These investments need to be made in a structured, considered manner to prevent inappropriate initiatives, protect South Africa's resources and ensure that prioritized investments are efficiently implemented. Poor investment decisions commandeer the state's financial resources and hinder other important investments, ultimately constraining economic growth. Greater use of public-private financing is likely to bring about better decision-making and improved spending discipline, resulting in more rigorous assessment, shareholder accountability and reporting. These factors will, in turn, ensure easier access to capital.

### **3.3 Presidential Review Committee (PRC) on State-Owned Entities (SOEs)**

A major milestone was the review of SOEs; this was meant to address the role of SOEs in addressing economic, social and service delivery challenges facing the country. These challenges include access to quality service delivery, globalization, unemployment, skewed distribution of income, access to land and housing, access to finance and poor infrastructure-the burden of which is disproportionately borne by the majority of the population.

With South Africa aspiring to be a Development State, the PRC envisioned a framework for SOE reforms and optimal contribution to equitable growth, development, transformation, and service delivery in South Africa. The PRC suggest twenty-one (21) principles to be endorsed by Government to guide SOE reforms. It also provides thirty-one (31) recommendations. The 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, 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 be in place.
- The State, as owner should define the purpose of SOEs. Standardised monitoring and evaluation criteria modeled on best practice should be adopted to make performance monitoring more effective. Such performance criteria should be supported by relevant economic 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 development objectives in a cost effective manner. SOEs should have sufficient operational independence, which should be articulated in the shareholder compact. The State, 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.

#### **4. Synopsis of SOC Environment**

##### **4.1 Alexkor**

Alexkor is a schedule 2 public enterprise, incorporated 1992 in terms of the Alexkor Act No. 116 of 1992 (the "Alexkor"), and now trading as Alexkor SOC Limited ("Alexkor"). The government of South Africa, through the Minister of Public Enterprises, is the sole shareholder in the company. The company's operations changed when the Richtersveld community successfully instituted a land claim against Richtersveld community and successfully instituted a land claim against Alexkor and its shareholder. On 14 October 2003 the Constitutional Court held that the community was entitled to restitution. The parties agreed on the nature and extent of the intended restitution. The parties agreed on the nature and extent of the intended restitution and signed a formal and binding Deed of Settlement (DoS) on 22 April 2007, which was made an order of court later that year. The outcome of this land claim settlement impacted the company's mining and non-mining operation as the settlement agreement stipulates, inter alia, the following:

- All land and buildings subject to the land claim will be transferred to the Communal Property Association (CPA);
- Certain erven and erected buildings with the to-be-established township of Alexander Bay will be transferred to various social institutions and government authorities to normalize the social and governmental structures; and
- The land mining rights will be transferred to the Richtersveld Mining Company (RMC), whilst the company will retain its marine mining rights.

A new role for the SOC has been developed and this will need support from the Department of Public Enterprises.

##### **4.2 Broadband Infraco**

Broadband Infraco was established to ensure broadband connectivity is available to underdeveloped and under serviced areas at an affordable cost. Its ability to meet this mandate fully has been hindered by the lack of an Electronic Communications Service (ECS) licence. Broadband Infraco has been working in this uncertain policy environment since its inception in 2009. The current Broadband Policy proposed by the Department of Communications (DoC) seeks to, among others, provide for an integrated approach in

for SAFCOL. More support from the Department is required in ensuring that the SOC is sustainable over a time period.

#### **4.6 South African Airways (SAA)**

SAA exists within a developmental state and has a mandate to support the country developmental agenda, while continuing to operate optimally as a business, returning to an operating profit and improving efficiencies. The airline contribute 0.3% of South Africa's Gross Domestic Product (GDP) and is, directly and indirectly responsible for 35 000 jobs in South Africa.

The airline is challenged with bad publicity; profit losses, governance and performance challenges. Critical is the development of the SAA's Long-Term Turnaround Strategy (LTTS) which will encompass other airlines such as Mango and South African Express Airways. This strategy is envisaged to implement strategic response to a highly competitive operating environment and to address specific weaknesses and inefficiencies with the business. The LTTS will require support from the Department in terms of dedicated resources to ensure that implementation is monitored, evaluated and reported.

#### **4.7 South African Express Airways**

SA Express is an airline operating primary and secondary hubs between domestic and regional destination within Southern Africa. The airline's objective to improve intra-Africa travel is in line with South Africa's mandate to increase aviation's contribution to sustainable economic growth and job creation. The airline is challenged with profit losses, annual reporting challenges and stability at management levels especially in finance department. The Department of Public Enterprise will be required to play an active shareholder management role in ensuring that the airline is sustainable. All improvement should also be aligned and considered in line with SAA's LTTS as part of long term turnaround plan for airlines in South Africa.

#### **4.8 Transnet**

Transnet is wholly owned by the Government of the Republic of South Africa and is the custodian of the country's freight railway, ports and pipelines infrastructure. In line with Government's New Growth Path, Transnet adopted the MDS in 2012, committing the Company to invest R300,1 billion in infrastructure to support a ramp up in freight volumes, operational efficiencies, jobs and skills while championing transformation and delivering sustainable economic, social and environmental outcomes. The MDS capital investment target was raised further in 2013, committing Transnet to invest R307, 5 billion by 2020. The Department will need to dedicate resources in the implementation of the Transnet's Market Demand Strategies.

### **5. Budget Implications to the Department of Public Enterprises.**

The Department of Public Enterprises does not directly transfer allocated funds to SOCs. The budget allocated to the Department is allocated for its operational requirements. It is imperative that the Department of Public Enterprises execute its shareholder management responsibility to SOCs through adequate resources that includes: human, processes and systems. There is a need to consider the following observations:

- Radical economic transformation programmes remains the focus of government. SOCs are central in this economic transformation programme. In order to ensure that they serve the mandate of government in this regard the Department of

- Public Enterprises should strengthen its project management capabilities, economic forecasting skills, monitoring and evaluation.
- The global risks and local socio-economic imperatives have constrained the level of competitiveness of SOCs. There is a need for Department of Public Enterprises to ensure it starts processes and participates in processes such as those initiated by the President to kick start the economy. A policy framework to stimulate the level of competitiveness should be development and constant platforms of engagements on ways to ensure SOCs sustainability should be created.
  - The massive programmes of SOCs such as the Eskom's built programme, Transnet' Market Demand Strategy and airlines (SAA, Mango and SA Express's) Long Term Turnaround Strategies require key capabilities to be built with the Department of Public Enterprises in order to continuously monitor implementation.
  - It is imperative for the Department to also develop key expertise to assist other SOCs such Alexkor, SAFCOL and Broadband Infracore in defining their new roles. It is important that mechanisms that will assist these entities to be sustainable over time should be communicated clearly.
  - The Department must continue to support Denel to remain profitable. Critical in pursuing that objective will be to ensure that the South African Police, the Department of Defence and Military Veterans and other security agencies of the State utilize the strategic capability of Denel in their operations. There is a need to also find a role for Denel in resourcing the South African National Defence Force as envisaged by the Defence Review Commission.
  - The Department of Public Enterprises should improve its Inter-Ministerial/Inter-Departmental cooperation with policy and impact Departments in order to ensure long term sustainability and competitiveness of SOCs. This should be institutionalized and supported by secretariat in order to operationalise policy implementation coordination.
  - The Department should align its stakeholder engagement efforts with the intentions of government and align them in line with institutional mechanisms such as Cabinet Clusters and Cabinet in order to fast track decision making process. In the same vein for buy-in it is critical to align efforts such as those provided by PICC, NEDLAC, Presidential Working Groups and international platforms such as BRICS Contact Group for Economic and Trade Issues.
  - The Department of Public Enterprise should improve on drawing shareholder compacts with SOCs. Commercial objectives and development mandate should be appropriately captured and backed with proper analysis on sustainable gains. A key requirement is the ability to develop business and expenditure plans as well while understanding the financial models existing within SOCs.