



DPE Strategy and Annual Performance Plan

Presentation to the Portfolio Committee on Public Enterprises

25 March 2015



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2	Challenges affecting the performance of the portfolio
3	DPE Strategy
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6	Success indicators for the strategy



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1.1	Policy imperatives
1.2	Institutional model
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South Africa is a developmental state and should thus place emphasis on key areas to drive and sustain economic change

South Africa is a developmental state...

- Developmental state is typically characterised by the act of **governments intervention** in economic processes and direct the course of development **rather than relying only market forces**
- **Industrialisation and economic nationalisation** key drivers of developmental states
 - **Industrialisation**- growing manufacturing sector and promoting foreign direct investment
 - **Economic nationalism**- stimulate export led growth and increase beneficiation
- **South Africa places a strong focus on economic development and enables this development through the necessary policy measures to accomplish high level national objectives**

... thus, focus needs to be placed appropriately

What does this mean?

- For South Africa to grow its economy focus must be placed on the three key drivers of growth, specifically:
 - **Investment in the economy**- strong investment in infrastructure and capital projects
 - **Stable economic growth**- reduce unemployment, enable and maintain a high aggregate growth
 - **Positive trade balance**- South Africa needs to ensure a trade surplus through driving its export economy



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Reversing past trends across key economic focus areas are pivotal to influencing our economic agenda

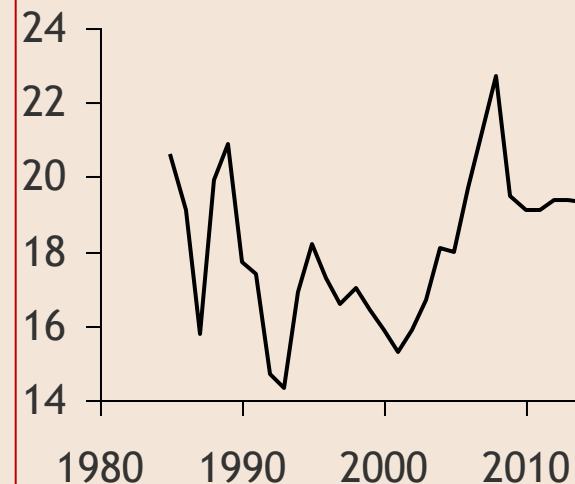
Past trends suggest that meeting these targets will be difficult

Historic GDP growth
South Africa (%)



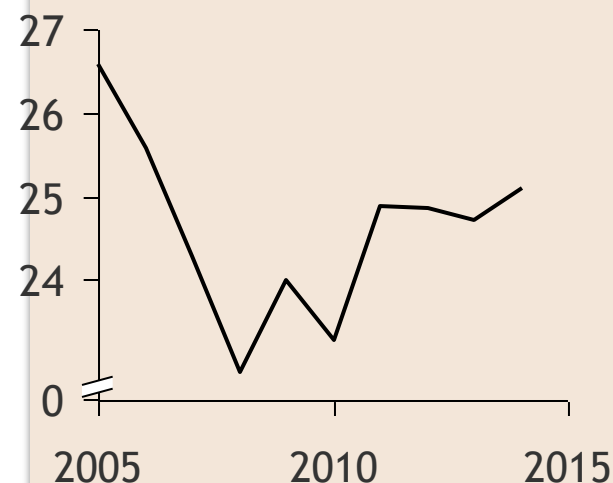
- South Africa has experienced **weak economic growth** in the recovery from the 2008 recession. Growth has **failed to meet target levels** of between 3%-5%

GFCF in
South Africa as % of GDP



- Capital formation has **not been a priority** leading up to 2008, this has resulted in slow growth, **negative impact** on local industry, skills and reduced manufacturing capabilities

Unemployment rate in South
Africa (%)



- South Africa ranks 3rd in the world in terms of **high youth unemployment, sub standard education**, poorly located and inadequate infrastructure, ailing public health system, and **uneven public services**

Trade balance in
South Africa (% of GDP)



- South Africa's balance of payments has remained low over the past 10 years reflected in **weak economic environment** and a depreciating currency



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The state can leverage State Owned Companies as its primary tool to deliver on its developmental role

The State has a development role to play ...

- The developmental role should support a number of economic and development goals including:
 - Delivery of **strategic infrastructure** that will unlock growth potential in the country
 - **Support of the wider economy** and marginal business sectors
 - Support of **economic recovery** where needed
- The State requires **strategic, organisational and operational capacity** to play its developmental role
- SOCs fulfil the States operational role in this requirement, acting as the **implementing agents** for national strategy

... and can utilise key SOCs to deliver

- **SOCs are central** to the South African economy, they enable economic growth through **key activities**:
 - Implementation of national policy to drive **infrastructure expansion** ranging from energy supply and transportation, to water, sewage and spatial planning to meet and further increase **economic demands**
 - SOCs raise the **technology base** of the economic industrial sectors driving **competitiveness** of the country on a local and global scale
 - SOCs are also required to be **good employers** and to exhibit a sense of **social responsibility**

Ensuring SOCs are able enabled to perform these requirements should be prioritised by the State, such that systemic impact can be achieved



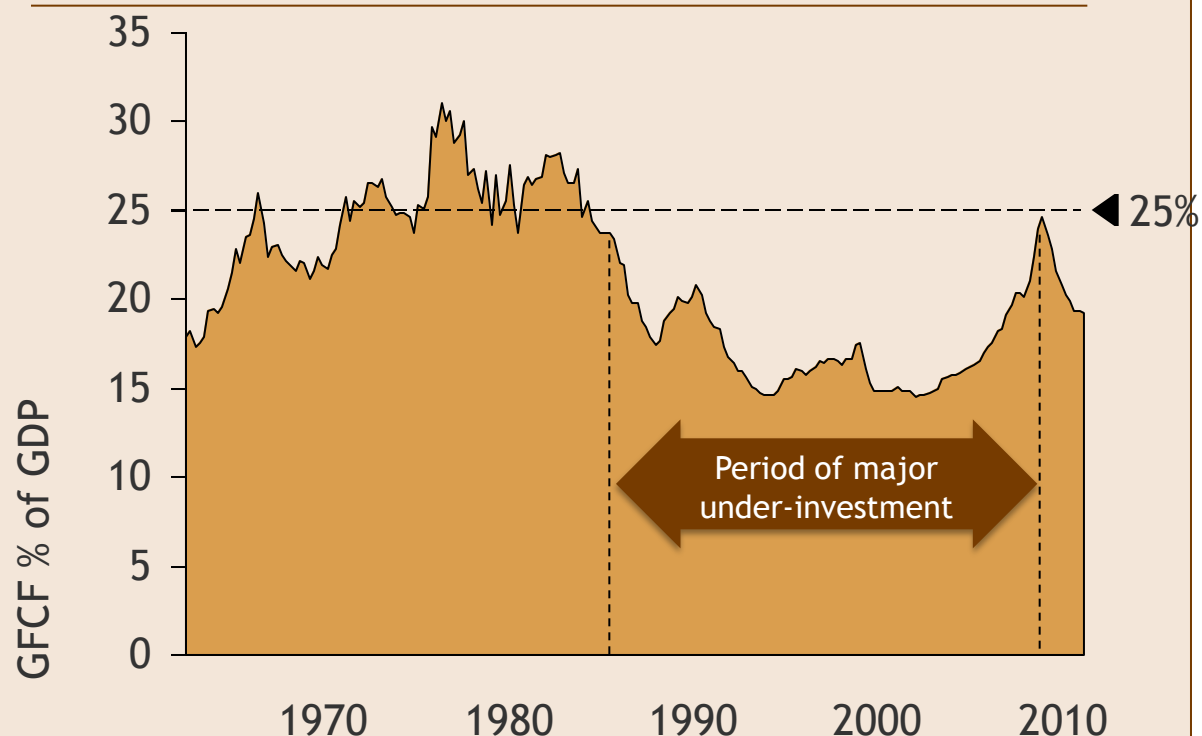
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A period of major under-investment in South African infrastructure has left some SOCs in a compromised situation

Historically, investment in infrastructure in South Africa has been relatively low

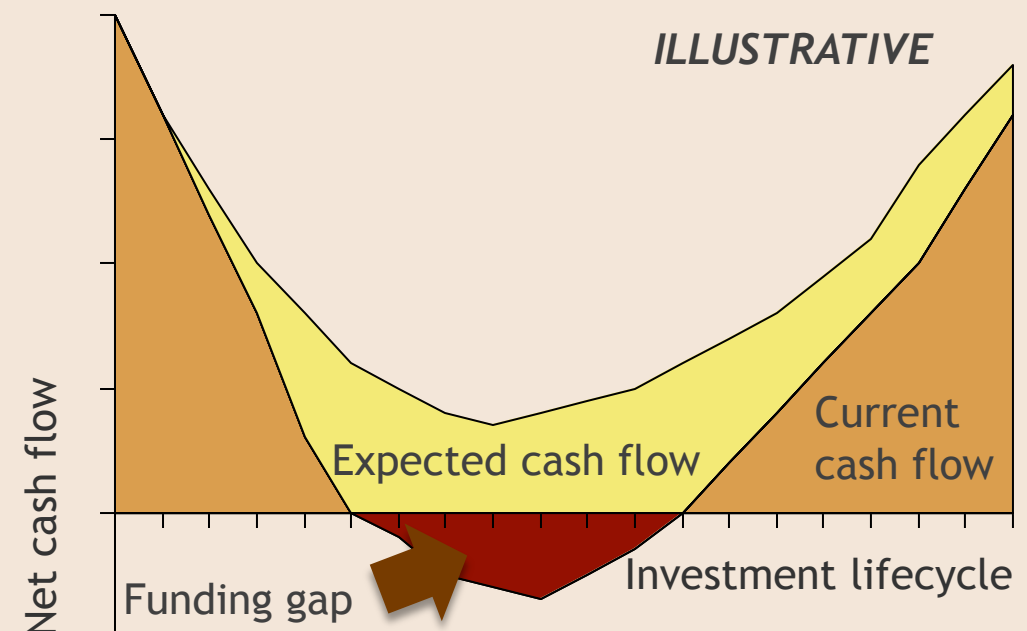
Gross Fixed Capital Formation as % of GDP



- Recent recovery in fixed capital formation has largely been **infrastructure led** rather than in new productive assets
- Key infrastructure projects still need to be completed before **capital costs** can be recovered

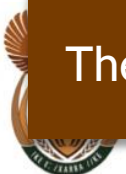
South African SOCs are dealing with a major funding GAP that is affecting their current operations

Cash flow during a period of high capital investment



- A **funding GAP** currently exists within South African SOCs, as a result of a historic period of **under investment** alongside growing demand as well as **inefficient capital deployment**

The funding GAP within the SOC environment needs to be addressed in order to secure future revenue



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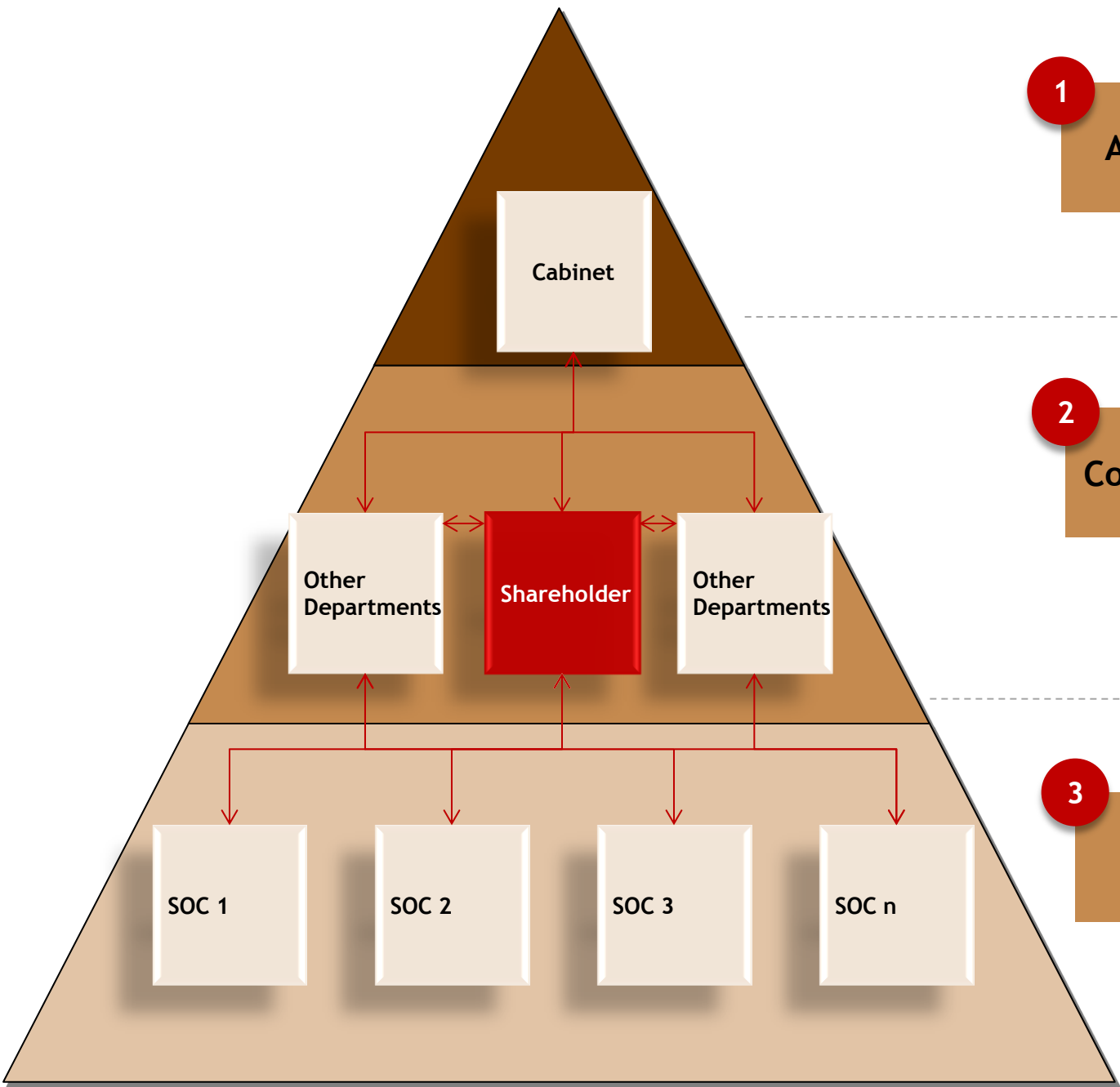


The Shareholder, as “owner” of the SOC, should be the essential link between stakeholders at the various levels ...

CONCEPTUAL

The Shareholders interaction within the institutional model

Primary tasks of the shareholder



1

Alignment

2

Collaboration

3

Oversight

Purpose of the Shareholder

- Ensure alignment with national policy based on SOC capability and capacity
- Intercede and manage Executive expectations in respect of SOC
- Leverage synergies and collaborate with peer Governmental Departments
- Intercede and mediate on behalf of SOC in respect of Policy Makers and Regulator
- Manage and monitor performance of SOC
- Primary link between SOC and other levels of State
- Translation of national policy and objectives to SOC level through an iterative process upwards and downwards



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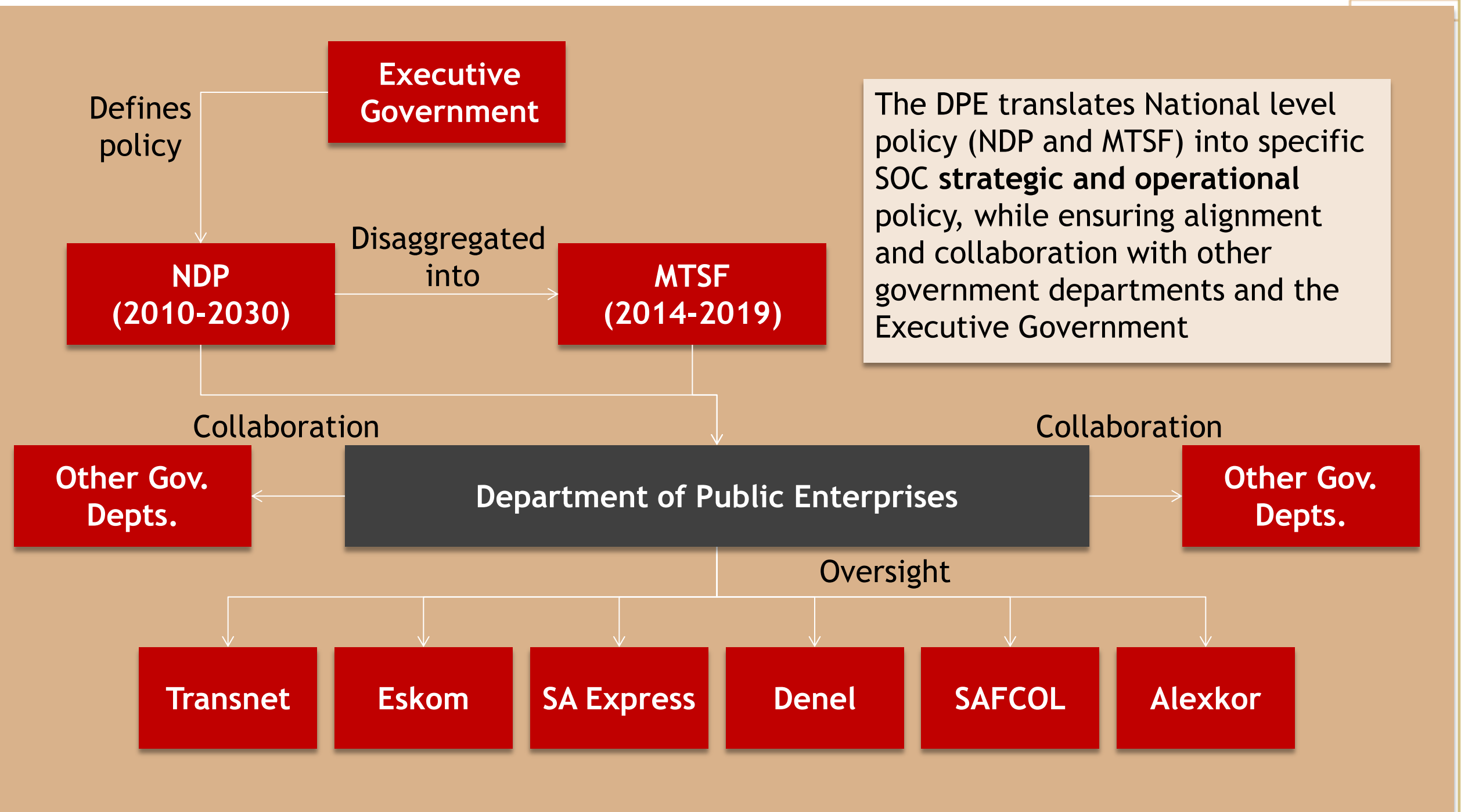
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1	Context
1.1	Understanding the Environment
1.2	Understanding the Players & their Roles
1.3	The DPE in context



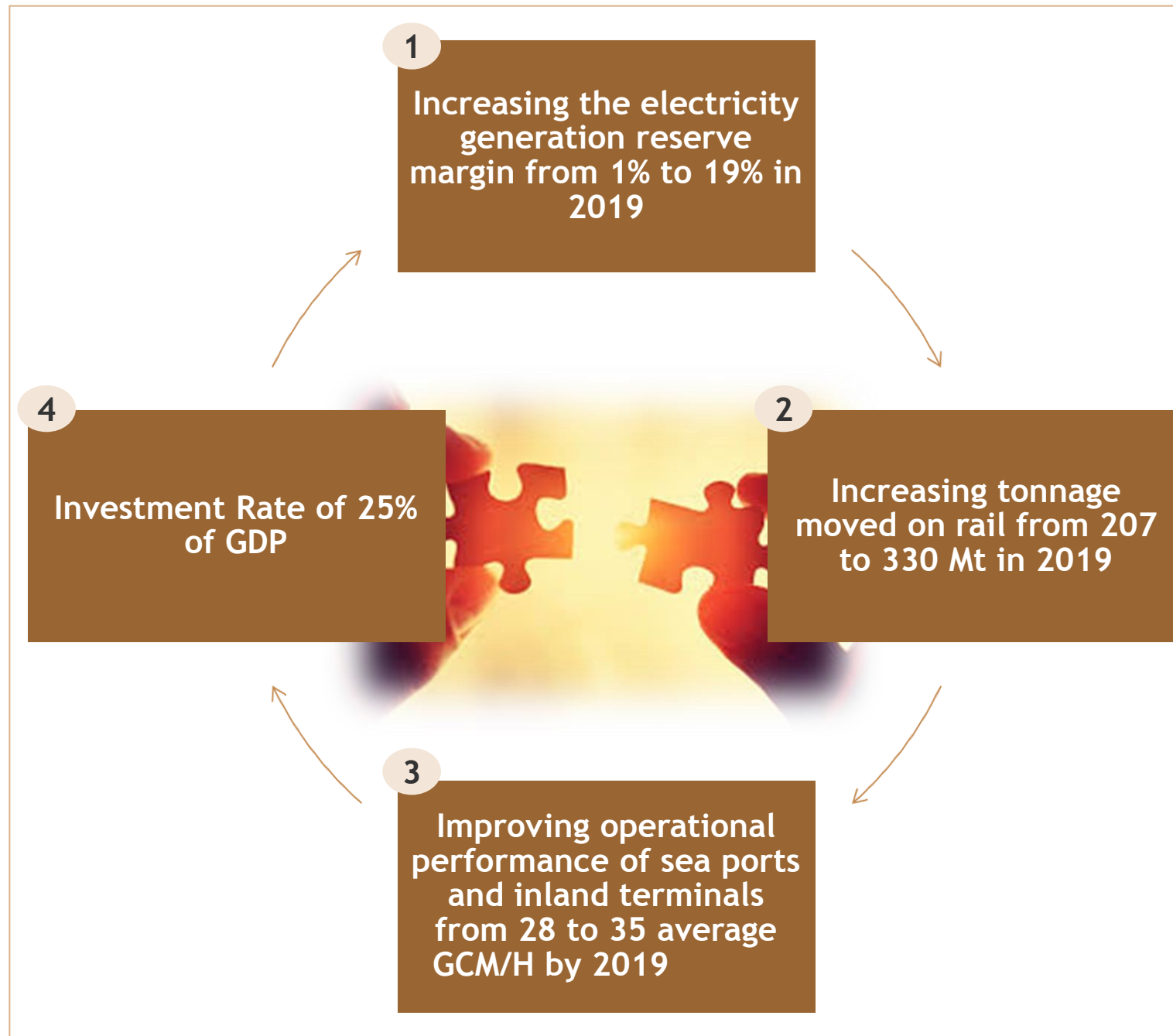
The State's strategic shareholder, the Department of Public Enterprises, plays a critical role in driving national policy



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The MTSF identifies four critical areas that the Department must contribute to drive economic recovery and adjustment to investment driven growth



Insights

- The 2014 - 2019 MTSF focuses on infrastructure development as it is the enabler to future economic growth
- This infrastructure expansion relies heavily on two SOCs in particular... Transnet and Eskom
- In order for this infrastructure programme to be successful, all stakeholders are required to perform their role in enabling SOC execution



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Transnet and Eskom thus play a vital role in the success of MTSF

Breakdown of the SOCs overseen by the DPE (Rbn)



Focus

Breakdown of SOCs overseen by the DPE by Revenue, Profit and Asset Value (Rbn)

Name	Sector	Revenue	Profit	Asset Base Value
Eskom	Energy	139.5	7.1	504.9
Transnet	Transport	56.6	5.1	240.1
SAA	Transport	30.0	-0.4	15.2
Denel	Defence	4.6	0.2	8.0
SAX	Transport	2.2	0.01	1.4
SAFCOL	Agriculture	0.9		0.1
Alexkor	Mining	0.15	0.04	0.9
BBI	Communication	0.2	-0.2	1.6
Total		234.2	11.9	772.2

~84% of the total revenue generated by the DPE's SOCs can be attributed to Transnet and Eskom collectively

These sectors contribute significantly to the economy:
Transport: 9%
Energy: 2%
Mining: 5%
Agriculture: 2%
Manufacturing: 15%

- The DPE is the sole shareholder of some of the largest SOCs in the country, including Eskom and Transnet
- The collective Asset Value for the DPE's SOCs is over R770bn, with Eskom and Transnet accounting for R740bn, ~96% of this value
- The DPE thus plays a critical role in shaping the outcomes of the MTSF and ultimately the NDP



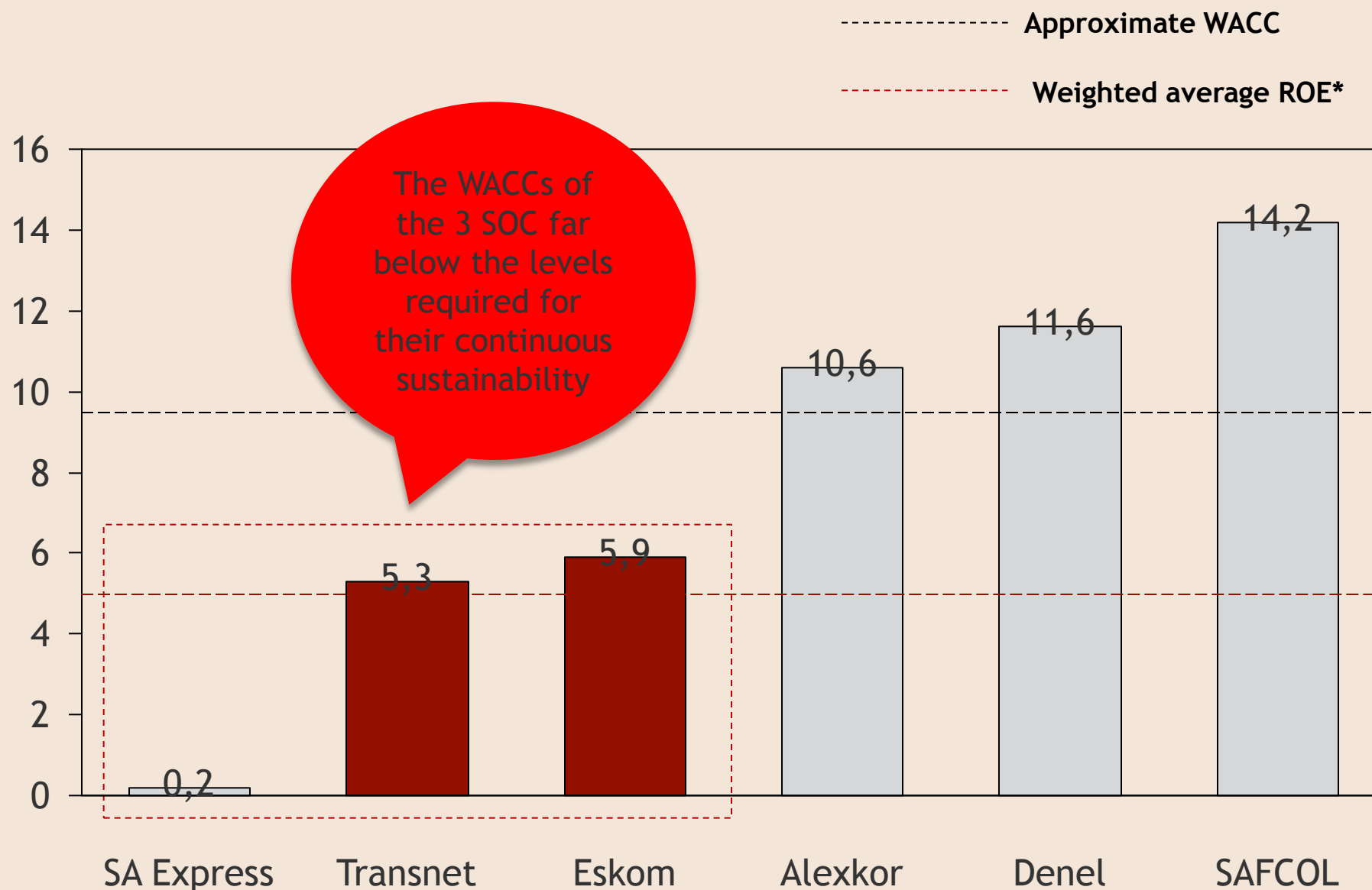
Note: Assumption being made is that due to scale of Transnet and Eskom as collective, interventions applied to these two entities can ensure the success of MTSF

Source: relevant SOC financial statements; DPE.gov.za; Team Analysis

These organisations are, however, not providing sufficient returns on investments made

2014 year end - ROE (%)

Diminishing value (ROE < WACC)



Key Notes

- The **return** generated by SOCs **does not cover** the **cost** of the capital invested this is the case across a number of SOCs
- **Lower returns** by SOCs have been brought about by **lower earnings**, and **persistent losses** over the period and many **SOCs are under-capitalised**
- Current expansions by SOC is heavily **reliant on debt** with the following impact:
 - **Higher cost of debt funding**
 - **Reduced flexibility in servicing capital** – debt poses an obligation to pay interest
 - **Unable to hedge exposures properly**

Note: *Weighted average ROE is the average ROE measured against a weighting of the total asset base of DPE's SOCs

... Key SOC's are struggling to execute on their mandates at present, impacting on the ability to meet targets

SOC

Challenge



Insufficient power producing capacity, thus unable to meet current demands of the South African economy



Inability to meet demands of the market, resulting in reduced accessibility to certain industries

Insights

- Infrastructure-related challenges within these organisations need to be addressed as a matter of urgency (maintenance, new build) as these provide a platform for the economy to grow
- Given the current situation of these entities, Eskom requires attention more urgently to resolve its current sustainability issues
- Transnet requires attention to address risks potentially affecting their potential sustainability



Furthermore, these organisations’ less-optimal performance pose significant risk to the economy at large and the fiscus

Key risks



1

Country-wide blackout



2

Continued load shedding



3

Further credit downgrading



4

Call-up on government guarantees



5

Continued heavy reliance on road transportation



6

Constrained overall volumes

Impact

- Economy could suffer damages amounting **significant loss of GDP, civil unrest** and potentially, an **overall shutdown**
- Load shedding between stages 1 an 3 **costs the economy** anywhere between **R20bn to R80bn per month**
- **Inability to raise the remainder of the funding required to complete the build programme and bridging of covenants**
- **Volumes transported lower than expected projections, thereby constraining exports**
- **GDP growth targets of 3% - 6% will likely not be met in short to medium term**

Ultimately, the objectives of the NDP will not be realised



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Challenges within the State are those that are Core to stemming economic growth and those within the Enabling Environment

In the context of the various levels of State and the overarching policy ...

- South African Environment - South Africa is a developmental state and should thus focus on three areas in particular:
 - Investment in the economy
 - Sustained growth (GDP)
 - Positive trade balance
- SOC's Performance - A number of SOC's are experiencing financial difficulties, as well as are operationally inefficient, therefore are unable to execute upon policy requirements
- Institutional Model - Existing framework in place within the context of a developmental state is complex and requires all stakeholders to work synergistically to ensure impact is achieved
- NDP and MTSF - Emphasis to be placed onto infrastructure to drive investment

... two distinct themes of challenges are identified

1

Core challenges

- Core challenges exist predominantly at the level of execution, i.e. the SOC
- These challenges affect the ability of the State to deliver on its requirement of creating and sustaining economic impact

2

Institutional challenges

- Institutional challenges exist within the enabling environment that support the State in implementing national policy
- These challenges are evident within executive bodies, government departments and the SOC's themselves
- These challenges limit the efficiency of policy implementation

The DPE has a role to play within both challenge themes and should act as the mediator across the system in the journey to their resolution



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These themes can be broken down further to identify key challenge areas

Challenge Theme	Challenge area	Description
Core challenges <ul style="list-style-type: none"> SOC environment focused on delivery of national economic growth policy 	Inability to meet demand	<ul style="list-style-type: none"> SOCs, in particular Eskom and Transnet, are not able to meet current levels of demand, directly influencing their ability to support stable and sustainable growth in the South African economy, these challenges related to inefficient delivery of new build projects and their struggling existing fleet
	Financial instability	<ul style="list-style-type: none"> Weak financial position of SOC's has resulted in limited ability to fund commercial and expansion activities and thus they are not delivering on NDP and MTSF strategies. These challenges focus on revenue collection, SOC's cost base and their financial planning
Enablement challenges <ul style="list-style-type: none"> State institutional model focused on delivering support to SOC's 	Shareholder interactions	<ul style="list-style-type: none"> Shareholders interactions relate to standardisation within the institutional model limiting collaboration, alignment of the shareholder model and duplication of functions
	Internal DPE	<ul style="list-style-type: none"> Internal DPE challenges are related to the structure, processes, capacity and systems resulting in limited ability for the shareholder to effect systemic changes to performance of SOC's
	Government departments	<ul style="list-style-type: none"> Challenges at government department level specifically relating to overlaps that exist within the states model resulting in limited separation of function and inefficiencies evident in poorly structured delegation of authority



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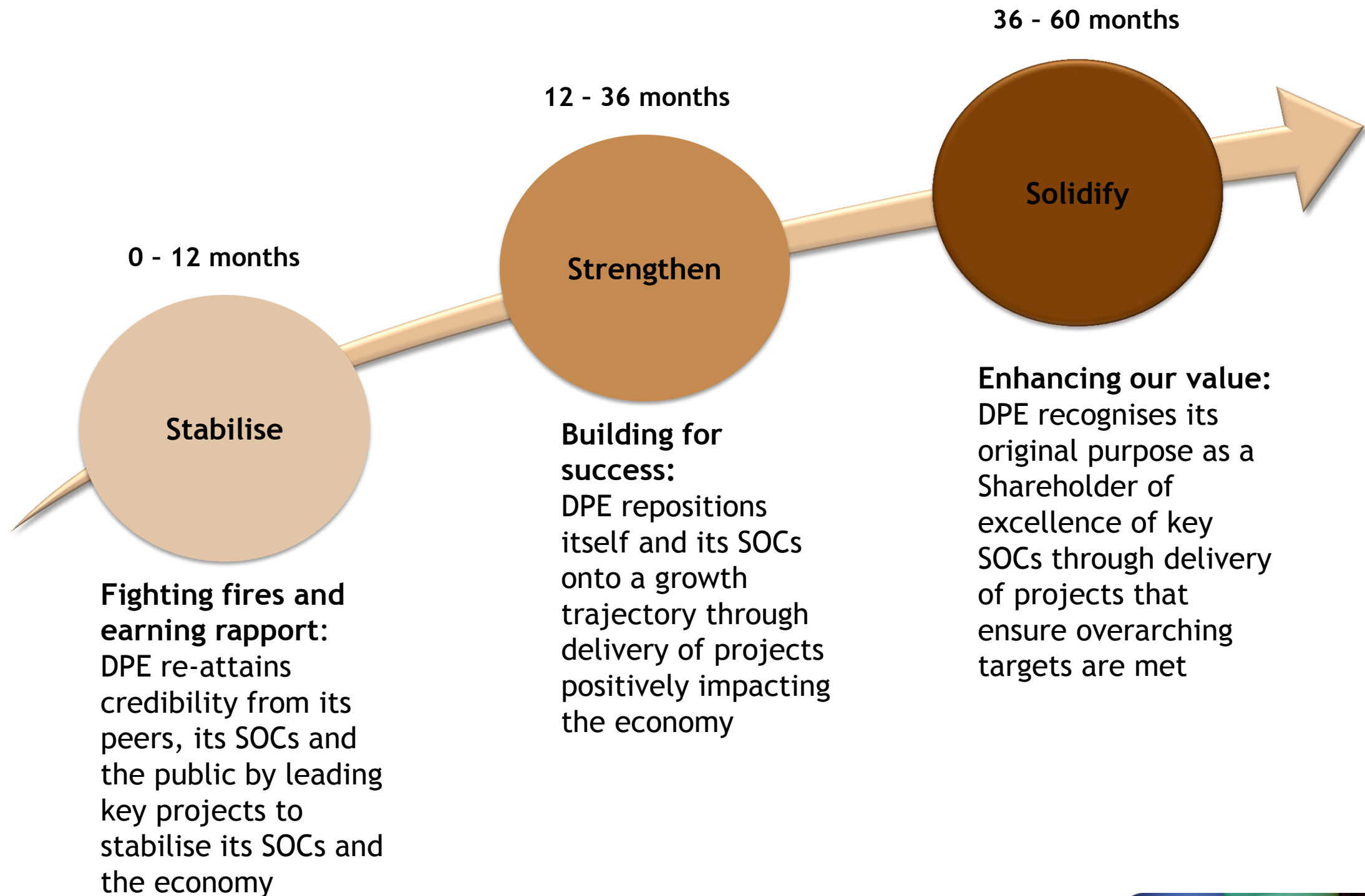
New strategy

- is focused on improving the performance of the portfolio to ensure that the companies can efficiently and effectively carry out their mandates
- recognises the role that SOC needs to play in the current economic context to support the aspirations of the developmental state.
- builds on the progress that has been made in the Department to promote good governance to turnaround the portfolio.
- Build the capacity of the shareholder through internal re-organisation using existing resources

THEREFORE: Once strong performance has been established, the DPE can promote ways and means to keep moving South Africa forward such that the goals set out within the NDP and MTSF are met, ensuring a better life for all South Africans.



The definition of victory for the DPE is to be recognised as a Shareholder delivering on a strong purpose



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This journey incorporates an internal turnaround of the DPE, as well as its SOC's and ensures that capacity is created within these SOC's to deliver on the demands of the economy

The success of the Strategy can be realised by the achievement of 5 critical outcomes

Key strategic outcomes

Description of outcome

i	Core Outcomes	Financial Sustainability	<ul style="list-style-type: none">SOCs are entirely capable of funding their own operations, without requiring State interventionFocus can be placed on running of efficient operations as the financial pressure has been alleviated
		Commercially viable operations	<ul style="list-style-type: none">Operations that are efficient and effective such that desired operational target levels are achieved, allowing for expansion of operational capability and capacity to occur
		Capital projects delivery	<ul style="list-style-type: none">Capital project targets are met, in line with strategic and policy expectations, thereby enabling the rest of the economy to prosper, driving up investment, GDP and exports
ii	Enabling Outcomes	Strong Shareholder	<ul style="list-style-type: none">DPE's oversight of SOC's is strengthened, allowing it to play a more integral role and have a greater say in decisions going forwardDPE is internally, a robust and flexible organisation, that acts as the benchmark for its peers
		Alignment and efficiency across institutional model	<ul style="list-style-type: none">Stakeholders are aligned across the institutional model, ensuring a collaborative and synergistic approach to delivery of policyImproved ability to fast-track major decisions

Interventions within this segment are intended to resolve core capacity challenges, particular within Transnet and Eskom*, which directly impacts MTSF targets

Interventions that enable the institutional model to perform effectively, whilst supporting core outcomes as well

*Financial sustainability is to be a key focus area across all of the SOC's under the DPE's span of control
Source: Team analysis

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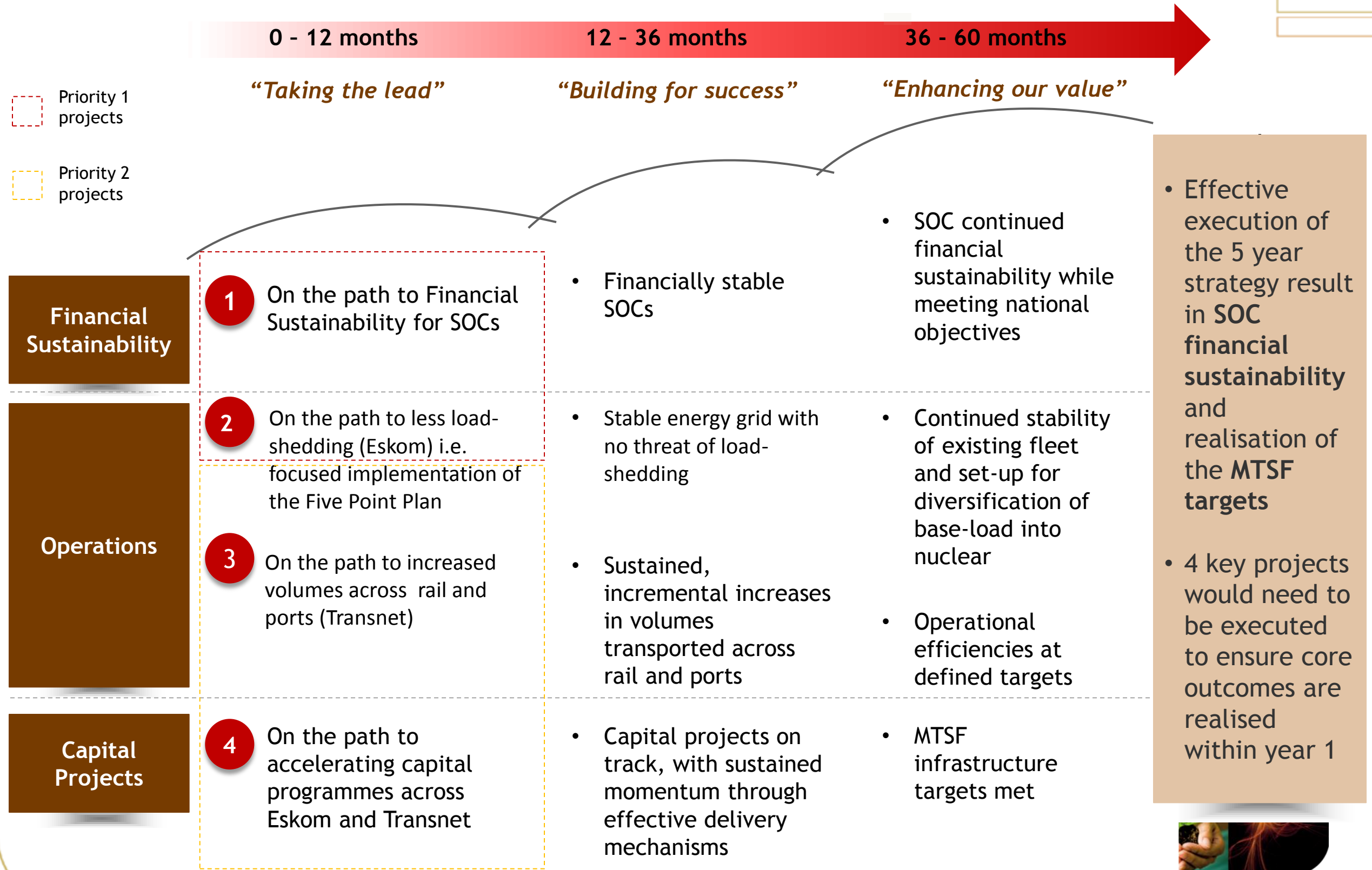


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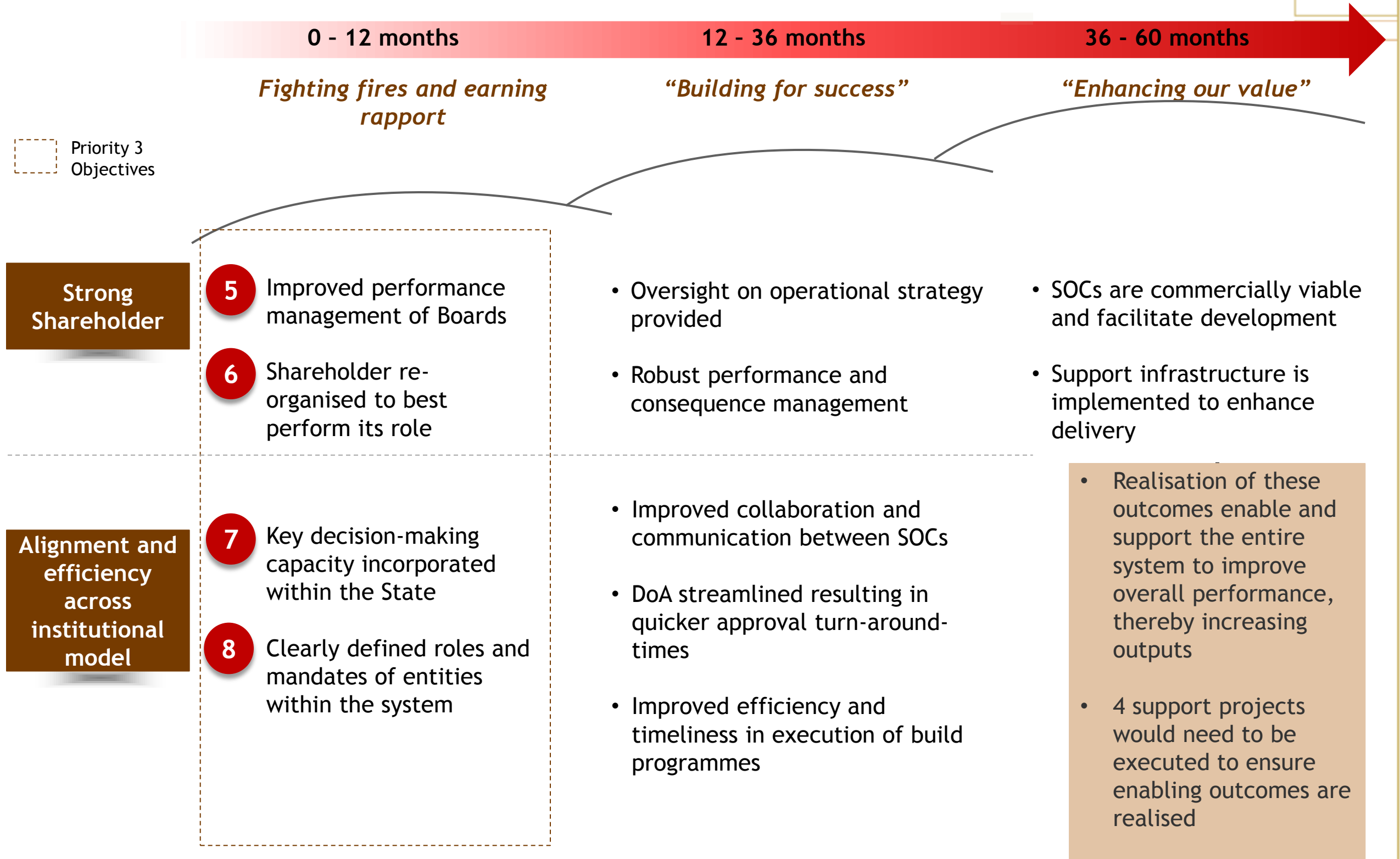


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8 strategic projects have been defined to achieve the outcomes of the strategy over the next 12 months..



ii 8 strategic projects have been defined to achieve the outcomes of the strategy over the next 12 months



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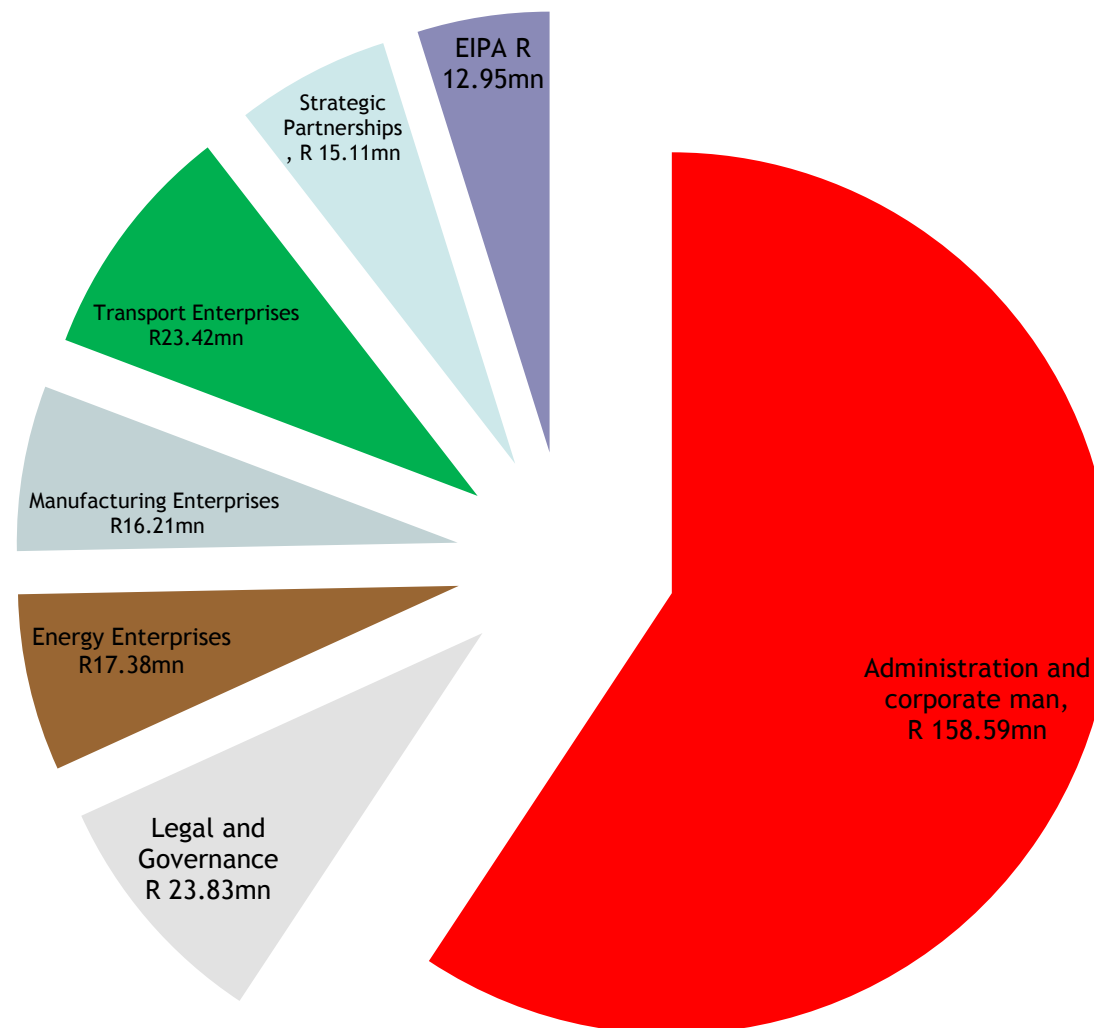


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The resourcing of the oversight function remains a challenges that require a comprehensive response



Insights

- There is a major imbalance between the budget allocated to the Department and the Assets it oversees
- For the 2015/16 financial year the Department has been allocated R267.5 million to oversee R772.2 billion
- The current head count will remain unchanged and innovative capacity building approaches are necessary
- The resourcing and the overall structure of the Department is not optimum. The review of the institutional model will present options that can be pursued to strengthen the oversight function



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The DPE needs to shift its focus internally to ensure a new, more robust future state is acquired

Current DPE

- Inward looking
- Focus placed on governance and compliance, with current activities predominantly revolving around monitoring and reporting
- Reactive management and oversight of SOCs
- Limited consequence placed on poor performance
- Cumbersome processes that inhibit quick and flexible decision-making
- Limited specialised skills to execute on projects with requiring high degree of specialisation

Future DPE

- Externally focused (SOCs / industries/State / suppliers/customers/other Government Departments)
- Defined by positive systemic impact that the Department enables in creating
- Focus placed on key strategic initiatives, with robust monitoring and reporting to measure and track performance
- Pro-active and innovative SOC management
- Tough consequence management for poor performance
- Flexible approval processes, allowing for speedy decision-making
- Strong internal contingent of skills and expertise to draw upon

Radical interventions and key, strategic decisions taken to ensure change

Conclusion



The Department's strategic plan is based on the need to significantly shift the performance of the SOC's to support the aspirations defined in the NDP

The Annual Performance Plan has been developed to show how the objectives or outcomes of the strategy will be realised.

The successful implementation of the Department's Strategy is dependent on the following:

- Creation of a supportive regulatory framework that will support the operational effectiveness of our SOC
- Developing appropriate capacity within the Department including forming strategic partnerships with the private sector, and higher education institutions
- A clear decision on the interface between the three critical functions performed by the government i.e. Policy, shareholder and regulator
- Recovery of the economy to ensure that the current infrastructure projects in the rail sector, in particular, can be fully utilised.

Backup



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SOCs are currently overseen by various government departments, each with a different mandate and function

A review of current industry and oversight relationships at SOC's indicates a potential for greater collaboration and leveraging of competencies

SOC	Industry	Shareholder Oversight DPT.
CEF	Energy	DOE
Eskom	Energy	DPE
NECSA	Energy	DOE
Transnet	Logistics/Rail	DPE
Prasa	Logistics/Rail	DOT
South African Airways	Logistics/Aviation	National Treasury
South African Express	Logistics/Aviation	DPE
Broadband Infraco	ICT	DTPS
Telkom SA	ICT	DTPS
Denel	Defence	DPE
Alexkor	Mining	DPE
AEMFC (CEF subsidiary)	Mining	DOE
SAFCOL	Forestry	DPE

SOCs within the same industry are **overseen by different shareholders**, which have different mandates

Achievement of **specific goals** relating to a particular industry thus **do not leverage the entire industry**

Industry-specific decisions **do not consider all industry players** at the same time and tend to have either a regulatory, policy or shareholder view but almost **never a consolidated approach**



19 interventions have to ensure the DPE can realise its 5-year strategy

Interventions	Challenge Areas			
	Financing	Operations	Strategy	Governance
Leverage Government Financing		NA		
Sell off non-core SOC assets				
Adjust Rates and Tariffs				
Establish platform for SOC collaboration	NA			NA
Develop a Government decision-making model		NA		
Amend and develop policies		NA		
Manage dual mandate			NA	
Review and enforce legislation				
Recruit and develop skills based on requirements			NA	
Strengthen performance management systems	NA			
Simplify and strengthen DoA processes				
Separate and clearly define functions		NA		
Strategically plan maintenance	NA			NA
Review and align operational strategies				
Upgrade system/Technology	NA			
Identify areas for viable PSPs				NA
Implement PMO for all build programmes	NA			
Implement demand management initiatives				
Re-organisation of the DPE				

