Brief on Challenges Governance Facing SOCs.

18 August 2020

1. Introduction

The State has a developmental role to play and uses State Owned Companies (SOCs) as the primary tools for fulfilling this role. 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 and support of economic recovery where needed. The State requires strategic, organizational and operational capacity to play its developmental role. State Owned Companies (SOCs) fulfil the state's operational role in this requirement, acting as the implementing agents for national development strategy.

2. Departmental Programme

The Department has a programme dealing with governance related issues.
Programme 2: State-Owned Companies Governance Assurance and Performance
The purpose of this programme is to provide state-owned companies' governance, legal assurance, financial and non-financial performance monitoring, evaluation and reporting systems, in support of the shareholder to ensure alignment with government priorities.

The objectives of the programme are to ensure effective shareholder oversight of state-owned companies on an ongoing basis by:

- Providing governance and legal systems
- Developing and maintaining shareholder risk profiles and mitigating strategies for government's state-owned companies
- Monitoring, evaluating and reporting on financial and non-financial performance of state-owned companies, and proposing intervention measures when required.

The programme has four sub-programmes namely:

- **Management** comprises the office of the deputy director general, which provides strategic leadership and management for the programme's personnel.
- **Legal** provides external legal services and support, including transaction and contract management support, to sector teams and the commercial activities of the state-owned companies within their portfolio.
- **Governance** develops, monitors and advises on legislative, corporate governance and shareholder management systems for the department and its portfolio of state-owned companies. The sub-programme develops and implements risk and compliance management guidelines and systems for shareholder risk.
- **Financial Assessment and Investment Support** analyses state-owned companies' capital planning, operational performance, execution of capital programmes and proposed restructuring proposals, and advises on appropriate action.

The sub-programme Management constitutes the smallest unit of the programme at 6.3 per cent of the budget over the medium term. The largest unit is Financial Assessment and Investment Support at 33.2 per cent of the budget followed by the sub-programme Legal at 32.2 per cent and Governance at 28.4 per cent of the budget. The overall budget for the programme increases by 13.7 per cent from R41.6 million in 2019/20 to R61.1 million in 2022/23.

Over the medium term, 68.1 per cent of the programme 2 budget is allocated for spending on compensation of employees over the medium term, with the number of personnel expected to increase from 34 employees in 2019/20 to 36 employees over the medium term. Compensation of employees increases by 8.8 per cent over the medium term, from R31.7 million in 2019/20 to R40.7 million in 2022/23. Expenditure on consultants is expected to increase by 50.8 per cent over the medium term from R3.5 million in 2019/20 to R12.1 million in 2022/23. Legal services increase by 4.5 per cent over the medium term, while travel and subsistence increased by 30.7 per cent from R2.0 million in 2019/20 to R4.5 million over the medium term.

3. Institutional, Legal and Regulatory Framework

3.1 Institutional framework

The seven major SOEs in the network industries fall under the jurisdiction of the Department of Public Entities (DPE). The ownership of the remaining SOEs is dispersed across a number of line ministries including those that cover sector policies in telecommunications, agriculture, transport, water affairs, defence, trade and industry, minerals and energy and finance. (APRM, 2007) DPE is responsible for reporting to the cabinet and which in turn reports to the Parliament. The Ministry of Finance and Treasury play a financial oversight role. For those SOEs under DPE's oversight, the Department is responsible for overseeing the government's shareholders interest in the company, including co-ordinating with SOEs to maximise financial performance, as well as on strategic non-commercial objectives that it has been assigned. The government expresses its policy objectives through a "Strategic Intent Statement" which in turn informs the shareholder's compact communicated by DPE to the SOE Boards and executive management. The Board sets a "Corporate Plan" with specific objectives and performance targets to which all board members commit and includes possible remedial action in the case of non-performance. It also holds boards accountable to the transparency and disclosure requirements of the JSE. Performance is monitored through an electronic "dashboard." DPE, as the coordinating body of the eight enterprises under its portfolio, also is involved in a host of other aspects of SOEs governance including informing the public procurement policies of SOEs, overseeing the implementation of skills development; board appointment processes; board induction; and determining board remuneration. The recommendations of the Presidential Review Commission alluded to new institutional arrangements that could be considered, consolidating the oversight of SOEs falling outside the current portfolio of the Department of Public Enterprises.

3.3 Legal and regulatory framework

The relevant SOE legislation includes SOE Enabling legislation, the Companies Act, the Public Finance Management Act (PFMA) (1999) and other Treasury regulations (TR), sector legislation and policies (e.g. Electricity Act, Electronic Communications Act), Public Audit

Act, and other general legislation. SOEs are encouraged to adhere to the King III Corporate Governance Code (which is mandatory for listed companies). The PFMA provides the financial framework which gives managerial and operational autonomy to the SOE. It also establishes reporting mechanisms (such as the shareholder compact) to guide the SOE in its strategic thinking. Not all PFMA provisions apply to all SOEs, different types of entities with various commercial or non-commercial objectives are categorised according to “Schedules” under the Act.

4. State Owned Companies

The first challenge facing SOC governance is reforms necessary to effect growth. SOCs currently do not have an overarching framework to govern them. This has been stated as a challenge by multilateral institutions. The Department of Public Enterprises provide oversight to Alexkor, Denel, Eskom, SAFCOL, South African Airways, South African Express Airways and Transnet.

4.1 Alexkor

In 2018/19, Alexkor experienced financial challenges due to the poor performance of the Alexkor Richtersveld Mining Company Pooling and Sharing Joint Venture. The company reported a loss of R149.6 million in 2018/19 compared to a profit of R34.2 million in 2017/18. Therefore, in 2019 the department appointed an administrator to oversee the business and ensure that the company is appropriately restructured. As such, the department’s immediate focus is to review the current operating structures of Alexkor to restore the sustainability of its operations. The entity was placed under Administration in September 2019, and has since then submitted the 2019 annual financial statements, in which the entity received a disclaimer of opinion due to its going concern status as well as a lack of diversification which represents a sustainability risk as it only has one major revenue source in the form of its 51 per cent stake in the Pooling and Sharing Joint Venture (PSJV). Since then the entity has also embarked on retrenchment of staff due to the lack of funding. The entity is also finding it hard to pay the retrenchment packages due to staff as revenue has fallen due to adverse weather conditions affecting the mining of diamonds on the seabed. The entity does not seem to have made any progress in addressing its operating model.

4.2 Denel

Denel is also in the process of restricting its business due to the company's steady decline in revenue over the past four years. The company's restructuring process, is focused on optimising labour, consolidating its group structure, reviewing its property portfolio and plant utilisation, and introducing strategic sector participation. Denel CEO's resignation has brought with it doubt on whether the turnaround plan is going to be successfully implemented. This follows liquidity challenges at the SOC.

4.3 Eskom

With COVID-19 Eskom was able to keep up with maintenance. However, with the reopening of the economy the demand will be higher on the grid. Eskom has a R454 billion of rising unsustainable debt level. Load shedding continuing threat to all economic sectors, especially mining, retail, manufacturing and agriculture. The unaffordable tariffs impact upon workers, pensioners, mining and other industries, SADC. Eskom debt threat to survival of the state and national sovereignty.

4.4 SAFCOL

The South African Forestry Company Limited (SAFCOL) has a challenges with almost 67% of its land under claims. This is a challenge to its future sustainability. There are challenges with its Mozambican subsidiary IFLOMA. The company has not achieved operational excellence in its saw mills, pole manufacturing plant and business development expansion. The company fails to achieve its development mandate as it does not meet most of target on BBB-EE.

4.5 SAA and SAX

In December 2019, South African Airways was placed under business rescue to restore confidence in the airline and safeguard the company's assets. Over the medium term, the airlines future will be guided by the recommendations of its business rescue practitioners. South African Express' current business model is unsustainable and is being reviewed as part of the plan to consolidate the two state-owned airlines. The placing of South African Airways under business rescue provides a structured opportunity to reorganise state aviation assets to better position them as sustainable and attractive to investors.

4.6 Transnet

Transnet adopted a new strategy. The SOCs has stabilised its leadership with a permanent CEO and divisional heads. In its integrated reporting framework, Transnet has identified group executive governance structures. The SOC has Governance and assurance processes to oversee execution of strategy and structures in accordance with policy and regulation.