Governance and performance of State-owned enterprises in South Africa

I. Purpose

In this policy brief, the governance and performance of State-owned enterprises in South Africa is explored. A discussion of the general developmental (or non-commercial) role of such enterprises worldwide is followed by an examination of how they have influenced socioeconomic development in South Africa. Using case studies of six State-owned enterprises in the country, insights are offered into the challenges that they face and the opportunities awaiting them if good governance principles are implemented successfully. The brief closes with a set of recommendations for a reform agenda.

The basis for this policy brief is a study by the Economic Commission for Africa (ECA), conducted in 2020 and published the following year, “Governance of State-owned enterprises in South Africa: enhancing performance, efficiency and service delivery“. The study was validated by experts at a meeting held in January 2021, with follow-up through a high-level policy dialogue in July 2022 involving government ministers and other senior officials, and representatives from State-owned enterprises, the labour movement, the private sector, civil society and academia, and independent experts from South Africa and the rest of the continent.

II. Developmental role of State-owned enterprises

State-owned enterprises, also known as parastatals or public entities, have played an important role in the development of many countries (Heo, 2018; Qi and Kotz, 2020; Taghizadeh-Hesary and others, 2019; World Bank, 2021; Yu, 2014). Generally defined as legal entities that are owned or controlled by a Government, and created to engage in commercial or non-commercial activities on its behalf (Bolton, 2010; ECA, 2021), some State-owned enterprises rank among the largest companies in the world, dominating major sectors and commanding a substantial share of public resources (Taghizadeh-Hesary and others, 2019; World Bank, 2021). In many countries, State-owned enterprises are essential contributors to crucial public services and infrastructure (including air, rail and sea transport, water, nuclear energy, and telecommunications), boosting new industries and supporting infant industries. Such entities also contribute to diversifying industrial output, providing employment, filling gaps in markets, developing key sectors or regions and supporting national macroeconomic strategies (ECA, 2021; Kane and Christiansen, 2015; World Bank, 2020). Furthermore, State-owned enterprises promote economic growth by enhancing national productive capacity and facilitating technical progress through investment in riskier areas of technology (ECA, 2021; Qi and Kotz, 2020). In countries with high-quality institutions, the positive impact of such enterprises on growth and development is even more pronounced (Szarzec and others, 2021). Notably, robust institutions enable State-owned enterprises to improve public service delivery, correct market failures and create fairer, more competitive markets (Kane and Christiansen, 2015).
Notwithstanding the starring role of many State-owned enterprises in promoting development and providing public services, such entities also face challenges that undermine their capacity to fulfil their mandates. A review of the literature shows that State-owned enterprises face financial, managerial, regulatory and political challenges that make them inefficient and less transparent, so that they become a burden on the budgets of their respective Governments (ECA, 2021; Heo, 2018; Moreno de Acevedo Sánchez, 2016; Thomas, 2012).

III. State-owned enterprises in South Africa

A. Background

South Africa has approximately 700 State-owned enterprises at the national, provincial and local levels, operating in industries including utilities, infrastructure, transport, mining, telecommunications and development finance (ECA, 2021). These State-owned enterprises are of varying sizes and levels of importance to the economy; many were established during the apartheid era, whether for socioeconomic reasons or to counter the impact of international sanctions against the country. In the new, post-apartheid South Africa (that is, beginning in 1994), several reforms were introduced at State-owned enterprises, the most crucial being the inclusion of previously marginalized groups, principally the Black communities. Notably, in addition to carrying out their mandates, South Africa’s State-owned enterprises were expected to play a transformational role, including promoting the equitable reordering of the economy through the internal transformation, employment equity, training and supplier development.

Over the ensuing decades, State-owned enterprises have represented a significant part of the South African economy and advanced the country’s industrialization. Specifically, such entities have contributed to inclusive growth and job creation, promoted economic transformation and skills development, industrialized the economy, enhanced productive capacity and supported regional integration (ECA, 2021; World Bank, 2018). At their core, as part of their developmental mandate, State-owned enterprises were intended to provide economic infrastructure and services in an efficient, cost-effective and reliable manner, thereby driving down the cost of doing business, along with ensuring the inclusion of all previously excluded groups.

B. Role in national development

A number of State-owned enterprises have made significant contributions to the socioeconomic development of South Africa over the years. For instance, the freight logistics company Transnet has played an important role in lowering the cost of doing business and contributing to industrialization, international competitiveness and economic growth through trade, and has delivered a reliable supply of coal for the Electricity Supply Commission (Eskom), among other functions (ECA, 2021). Eskom, for its part, was mandated to provide reliable and competitively priced electricity to the mining and manufacturing sectors and to businesses in general, and to extend affordable access to electricity to households at all income levels. In the area of commuter transport, the Passenger Rail Agency of South Africa was tasked with providing public transport, which is a critical component of efforts to alleviate poverty through increasing the mobility of low-income households.

State-owned enterprises in South Africa have certainly improved the lives of those who had been excluded in the past. For example, more people than ever before have access to electricity, housing, transport and water, while access to finance for emerging Black farmers and entrepreneurs has greatly improved. The goal of “a better life for all” could be greatly facilitated by well-functioning State-owned enterprises.

C. Selected South African State-owned enterprises

To identify the challenges that State-owned enterprises face in South Africa, this policy brief focuses on six such entities, which are critically important to the country’s economy and have suffered governance and performance problems.

1. Eskom

Dominating the energy sector in South Africa, the utility giant Eskom generates more than 95 per cent of the country’s electricity, and approximately 40 per cent of the entire electricity supply on the continent. In terms of revenue, Eskom is regarded as the largest State-owned enterprise in Southern Africa (ECA, 2021). On a global scale, Eskom ranks among the world’s top 20 power utilities in terms of installed generation capacity.

2. Denel

The aerospace and military technology conglomerate Denel designs, develops and manufactures defence materiel, and is thus regarded as a national security asset.
Governance and performance of State-owned enterprises in South Africa

3. South African Airways
In terms of air transport, South African Airways, the country’s flag carrier, has been crucial to facilitating the movement of both goods and people within and outside South Africa.

4. Transnet
The integrated freight transport company Transnet is classed as one of the largest players in the freight logistics business and the transport of goods in South Africa and other parts of the continent.

5. Water Research Commission
Since the early twentieth century, the Water Research Commission has played a major role in expanding South African national development plans, meeting the demands of many sectors of the economy, including agriculture and industry (Tempelhoff, 2017).

6. Land and Agricultural Development Bank of South Africa
Known as the Land Bank, this development finance institution has made a major contribution to the growth of the South African agricultural sector since 1912, and since 1994 has had the additional mandate of promoting small, emerging Black-owned farms.

All six of these State-owned enterprises have faced a number of challenges, including financial issues, mismanagement, maladministration and reliance on bailouts from the Government, which caused growing public controversy. By 2020, the combined guarantees by the Government on debts owed by State-owned enterprises in South Africa had reached 500 billion rand (28.66 billion dollars), or 10 per cent of the country’s GDP (ECA, 2021). In addition, in 2021 the National Treasury of South Africa reported that, between 2008 and 2020, South African Airways alone had accumulated total losses of 32 billion rand (1.83 billion dollars) and received 60 billion rand (3.44 billion dollars) in guarantees from the Government (Smit, 2021).

IV. Prerequisites for good governance of State-owned enterprises
Through their commercial and non-commercial mandates, State-owned enterprises are expected to embrace a number of fundamental governance enablers to reach their developmental and operational targets, which include the following:

1. Clear institutional governance
Under a good institutional governance system, the responsibilities of the policy ministry, the shareholder ministry and the funding ministry, along with responsibilities for regulatory oversight, are all clearly delineated.

2. Well-defined written mandate
A clear, well-defined written mandate (or shareholder compact) should set out the State-owned enterprise’s role, the precise public goods it provide and how it serves the public interest. The mandate must be publicly known to promote accountability.

3. Credible senior leadership
Senior leadership of State-owned enterprises must be stable, behave ethically and build a corruption-free culture.

4. Long-term strategy
State-owned enterprises are expected to formulate and implement a long-term strategy to develop the technical expertise that they need to carry out their mandates.

5. Effective partnership framework
State-owned enterprises should have an effective framework in place to partner with the private sector.

6. Environmental sustainability
With rising environmental concerns, State-owned enterprises should support the transition to a low-carbon economy and observe other environmental standards.

V. Challenges undermining the efficacy of State-owned enterprises in South Africa
An analysis of the six selected enterprises can be used to understand the challenges that undermine the performance and governance of State-owned enterprises in South Africa in general, which in turn impairs their ability to fulfil their mandates. The analysis reveals the following challenges:

1. Lack of a clear framework for restructuring and governance
Although recently there have been positive developments towards creating a State holding company that would streamline governance and insulate State-owned enterprises from narrow sectoral interests, the absence of a credible governance framework has exposed such entities to political interference. Undue interference tends to undermine the processes and activities of

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1 Exchange rate (at the time of writing): 1 rand = 0.057 dollars.
State-owned enterprises, resulting in weaker financial and operational performance, unclear multiple lines of management accountability, compromised duty of care and a higher risk of malfeasance (Bajpai and Myers, 2020; Richmond and others, 2019) in eastern and southeastern Europe. For example, without a clear framework to regulate board appointments, State-owned enterprises may end up appointing poorly qualified boards of directors and executive management, thus weakening operations and performance.

2. High dependence on State guarantees and bailouts to operate
Notably, the presence of soft budget constraints and the high probability of bailouts from the Government encourage a culture of lax management within State-owned enterprises, create the wrong incentives for managers, who expect the Government to intervene when the State-owned enterprise underperforms, and lead to the poor financial performance of such entities (Baum and others, 2020; Marimuthu, 2020). This dependence creates a high burden on public finances (Gumede, 2019; Marimuthu, 2020; Organisation for Economic Co-operation and Development, 2021). The evidence also shows that, despite receiving State subsidies and other financial privileges, many State-owned enterprises still remain unproductive.

3. Absence of a well-defined mandate
Clear mandates would enable State-owned enterprises to develop effective corporate strategies and translate those mandates into identifiable objectives, thereby improving performance (Ibarguen and others, 2021). However, ambiguous or outdated institutional mandates for such enterprises weaken their accountability and transparency, making regulation and oversight difficult (World Bank, 2020).

4. Unclear lines of accountability
One of the deep-rooted problems in State-owned enterprises is lack of accountability. Evidence from the six selected enterprises indicates that their accountability frameworks are weak; for example, there is no clarity regarding the expectations concerning the relationships between the shareholder departments and the State-owned enterprises under them, and for the engagement between political principals and the boards of directors. This creates confusion and erodes the value and performance of State-owned enterprises.

5. Corruption and State capture
Corruption remains a leading contributor to the deterioration of State-owned enterprises, and is often widespread in sectors or areas where such entities have exclusive rights or operate as monopolies (Bajpai and Myers, 2020). The preferential treatment (such as State subsidies, bailouts and debt write-offs) afforded to State-owned enterprises also reinforces corruption. Knowing that they are less likely to face the same consequences for corrupt practices as their private sector counterparts, State-owned enterprises are more prone to engage in unethical and corrupt practices (Bajpai and Myers, 2020). Corruption by powerful networks that have political influence can destroy value in such enterprises, weaken their credibility, hamper the planning of growth strategies, discourage both domestic and foreign investment, create delays in the implementation of some of the State-owned enterprises’ proposed plans, slow down economic growth and increase unemployment. In cases where the rule of law is weak and acts of corruption go unpunished, there can be a dissipation of physical, financial and human capital.

A form of corruption that has been found to undermine State-owned enterprises in South Africa is State capture, whereby powerful figures significantly influence a State’s decision-making processes to their own advantage. Evidence indicates that State capture hollows out critical elements of the Government and weakens the rule of law, causing institutional failure (Chipkin and Swilling, 2018).

6. Lack of strategic purpose
Since 1994, State-owned enterprises in South Africa have struggled to define their purpose, with no overarching strategy in place (ECA, 2021). This lack of guidance has been exacerbated by the separation of major State-owned enterprises from their policymaking ministries when they were placed under the Department of Public Enterprises as the shareholding ministry. Under this system, the Department of Public Enterprises represents the interests of the Government of South Africa as a shareholder, while the relevant ministries focus solely on policy.

7. Weak internal controls, compliance and risk management systems
The absence of risk management systems and internal controls in South Africa facilitates unethical behaviour within the country’s State-owned enterprises (Bajpai and Myers, 2020).
VI. Opportunities for State-owned enterprises in South Africa

All these challenges notwithstanding, State-owned enterprises can also capitalize on a range of opportunities. According to the study conducted by ECA, State-owned enterprises in South Africa could partner with the private sector and development finance institutions to aggregate capacity and capitalize on a defined set of market opportunities to achieve certain strategic outcomes (ECA, 2021). For example, to produce more exportable goods without consuming more electricity, these entities could leverage renewable energy sources, such as wind and solar energy.

External shocks, including the coronavirus (COVID-19) pandemic, also present certain opportunities. For instance, the pandemic has provided South Africa with a rare opportunity to drive major economic change, including reforming State-owned enterprises, which could be at the forefront of capacity-building to facilitate research into the development of vaccines for current and future pandemics. Similarly, the potential food crisis, due to fertilizer shortages associated with the war in Ukraine, could be addressed by State-owned enterprises through research and development to increase productive capacity through meaningful engagement with the private sector. The growing push for regional integration in general, and for such continental initiatives as the African Continental Free Trade Area in particular, offer additional opportunities for State-owned enterprises to leverage the enhanced production and diversification, financing and increased trade made possible by the creation of the free trade area.

The study by ECA pointed to several key lessons that can also be gleaned from other regions and countries (ECA, 2021). In Asia, for example, the success of State-owned enterprises is ascribable to a separation between their ownership and management functions. Moreover, these entities must chart clear and quantifiable short- and long-term goals and appoint autonomous and competent managers who are charged with achieving those goals. The management of State-owned enterprises must institute transparent and independent monitoring and evaluation mechanisms, share regular performance reports with all their key shareholders, and make improvements whenever needed. Finally, State-owned enterprises must attract qualified, talented people to join their ranks by offering competitive salary packages. These employees should be rewarded for better performance and penalized for chronic underperformance to establish a professionally competitive work culture, thereby improving the efficiency and profitability of State-owned enterprises (Asian Development Bank, 2017).

In the European Union, modifications made to the regulatory framework have had important implications for State-owned enterprises, as their exposure to increased competition provides incentives for better management and efficiency gains. This is particularly important in network industries, where high entry costs have often resulted in incumbents seizing a dominant position. Some lessons learned from past privatization experiences suggest that transferring public monopolies into private hands may incentivize rent-seeking (European Commission, 2016).

VII. Recommendations

The study (ECA, 2021) on State-owned enterprises in South Africa, and the high level-policy dialogue on the same subject, organized in July 2022 by the ECA Subregional Office for Southern Africa and the Wits School of Governance of the University of the Witwatersrand, identified key action points for the reform agenda of State-owned enterprises in the country, as follows:

1. Establishing clear, well-defined mandates and translating them into identifiable objectives;
2. Changing the boards and management structures of State-owned enterprises and installing robust governance frameworks;
3. Appointing the boards of State-owned enterprises based on merit and appraising their performance periodically;
4. Installing a centralized high-level structure to supervise and monitor the performance of State-owned enterprises, ensuring that they are transparent and accountable to all stakeholders;
5. Eliminating corruption and political interference in the operations of these entities to maintain their integrity;
6. Promoting collaboration between State-owned enterprises and the private sector for effective service delivery;
7. Creating competition among State-owned enterprises and promoting research and development;
8. Adopting proper policy instruments that build resilience and facilitate the competitiveness of State-owned enterprises;

9. Investing in technology and innovation to ensure the long-term survival and improved performance of State-owned enterprises;

10. Incorporating relevant stakeholders, such as civil society, trade unions and legal professionals, into the service delivery model to make State-owned enterprises more competitive and enhance their performance.

**VIII. Conclusions**

The findings in the present policy brief show that State-owned enterprises in South Africa have experienced major governance challenges, including the following:

1. Lack of clear frameworks for restructuring and governance;

2. Over-dependence on State guarantees and bailouts;

3. Absence of well-defined mandates;

4. Unclear lines of accountability;

5. Corruption and State capture;

6. Lack of strategic response to governance challenges and operational inefficiencies;

7. Weak monitoring systems and controls.

This policy brief has highlighted a number of key lessons that can be learned from the case study by ECA, which has shown the importance of State-owned enterprises in development, of periodically reviewing their performance, and of good and effective governance. It has also outlined the adverse impact of corruption and rent-seeking, over-reliance on State guarantees and bailouts, and an absence of clear mandates and frameworks for managing State-owned enterprises.

To address the governance challenges faced by State-owned enterprises in South Africa, there is a need for the Government to effectively and efficiently restructure such enterprises, appoint boards based on merit, allow them to enjoy independence from politicians, shield them from political interference, set clear and well-defined mandates, ensure transparency and accountability, and eliminate corruption within State-owned enterprises.
References


