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commission**

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The Presidency  
REPUBLIC OF SOUTH AFRICA



# The role of state-owned enterprises in achieving economic transformation and inclusive growth

## Paper 3/4:

### Institutional Governance Review

Prepared for the African Development Bank and  
National Planning Commission of South Africa

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## Main abbreviations

| Abbreviation | Definition   |
|--------------|--|
| <b>AfDB</b>  | African Development Bank                               |
| <b>AGM</b>   | Annual general meeting of shareholders                 |
| <b>CEO</b>   | Chief Executive Officer                                |
| <b>CFO</b>   | Chief Financial Officer                                |
| <b>DoE</b>   | Department of Energy                                   |
| <b>DoT</b>   | Department of Transport                                |
| <b>DPE</b>   | Department of Public Enterprises                       |
| <b>ExCo</b>  | Executive Committee                                    |
| <b>INED</b>  | Independent Non-Executive Director                     |
| <b>JSE</b>   | Johannesburg Stock Exchange                            |
| <b>KPA</b>   | Key performance area                                   |
| <b>KPI</b>   | Key performance indicator                              |
| <b>MoU</b>   | Memorandum of Understanding                            |
| <b>MTSF</b>  | Medium-Term Strategic Framework                        |
| <b>NDP</b>   | National Development Plan                              |
| <b>NED</b>   | Non-executive Director                                 |
| <b>NGP</b>   | New Growth Path  |
| <b>NPC</b>   | National Planning Commission                           |
| <b>NT</b>    | National Treasury                                      |
| <b>OECD</b>  | Organisation for Economic Co-operation and Development |
| <b>PFMA</b>  | Public Finance Management Act                          |
| <b>PRASA</b> | Passenger Rail Agency for South Africa                 |
| <b>PRC</b>   | Presidential Review Commission                         |
| <b>PSEC</b>  | Presidential SOE Council                               |
| <b>PSO</b>   | Public Service Obligations                             |
| <b>SA</b>    | South Africa   |
| <b>SCOPA</b> | Standing Committee on Public Accounts                  |
| <b>SOE</b>   | State owned enterprise                                 |
| <b>WBG</b>   | World Bank Group                                       |

## Introduction

### Mandate

1. This report covers Part 3 of the overall project, commissioned by the African Development Bank (AfDB) on behalf of the National Planning Commission (NPC). It seeks to respond to the following core query:

*"Using electricity, freight rail and commuter rail as examples, how can the institutional / governance/policy cascade between the organs of the State as Shareholder and State-Owned Enterprises (SOEs) in electricity, freight rail and commuter be clarified with a view to improving SOE performance and contribution to the NDP for electricity, freight rail and commuter rail? What general structural lessons can be learned for SOEs?"*

2. The report's overall objective is to provide fit-for-purpose recommendations for the South African context, informed by best practice standards such as the OECD Guidelines on Corporate Governance of State-Owned Enterprises ("the OECD Guidelines" or "the Guidelines") which are recognised as the global benchmark for government SOE oversight and are used by developed and emerging markets alike. The OECD Working Party that follows the guidelines and their implementation around the world includes South Africa as one of its key participants<sup>1</sup>, suggesting that the South African government aspires to implementing those principles. The report is also informed by other best practice inputs, including proposals from the World Bank<sup>2</sup>, and insights from the governance practices followed in several developed and emerging markets.
3. The resulting recommendations focus on reforming the institutional framework for SOE governance oversight and strengthening the State's position in this respect, with a view to creating the conditions for enhanced SOE performance, both commercially and in achieving the goals set in the National Development Plan (NDP) and other public policy goals.

### Context

4. The present institutional/governance/policy cascade between the organs of the South African State and SOEs is anchored on several national policy and planning documents. The most senior is the National Development Plan (NDP) whose overall goal is to eliminate poverty and reduce inequality in South Africa by 2030. Other relevant national planning documents include the Government's New Growth Path (NGP) which sets a target of creating 5 million additional jobs by 2020 and specifically calls on SOEs to support this key developmental objective; the Medium-Term Strategic Framework (MTSF); and the Industrial Policy Action Plan.

<sup>1</sup> OECD Guidelines on Corporate Governance of State-Owned Enterprises, Paris, 2015 edition.

<sup>2</sup> Key documents here include (i) the World Bank Group (2014) *Corporate Governance of State-Owned Enterprises: A Toolkit* and (ii) Kikeri, Sunita (2018). *Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English)*. Washington, D.C.: World Bank Group.

5. In addition to these generalised policy documents, SOEs operate within a context of general or company-specific documents and plans relating to corporate governance. These range from the King IV Report on Corporate Governance; the Department of Public Enterprises (DPE) Logical Planning, Monitoring and Evaluation Process; the DPE Protocol on Corporate Governance; plans and white papers of various line ministries<sup>3</sup>; guidelines in the Public Finance Management Act; and the specific Shareholder Compacts for each SOE agreed between the SOE boards and the State's representatives. Together, these documents form the general institutional background for SOEs, and form the expectations and directions for each company.
6. Notwithstanding the comprehensive institutional framework, SOEs have faced significant challenges in pursuing developmental goals. In a number of cases, they had been "captured" by special interests. Political appointments of boards and senior management, outside internationally accepted corporate governance rules, have severely impacted procurement practices and company performance. The recent changes instigated by the Government in governance and board appointments in SOEs are a recognition that the existing system of institutional oversight has not managed to counter corruption and mismanagement, and is a determined attempt to reform.
7. The specific background and details of this "state capture" have been well documented in multiple research pieces<sup>4</sup> and discussed widely, leading to parliamentary investigations and government action. It is not the aim of this report to repeat the story behind this capture but to provide recommendations that can underpin the establishment of a new institutional governance framework under which a repetition of this capture is difficult, as well as to improve the operational and financial performance of SOEs.

### Methodology and scope

8. In assessing the "governance/policy cascade", the following analytical points have been considered, which form the scope and structure of this report:

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<sup>3</sup> This includes for instance the *National Rail Policy* and *Department of Energy Strategic Plan*.

<sup>4</sup> See for example Prof Haroon Borat et al (2017). *Betrayal of the Promise: How South Africa is Being Stolen*. The State Capacity Research Project.

| Analytical area   | Elements  |
|---|---|
| A. The institutional and ownership framework for SOEs                       | <p><i>A1. The State's role as owner</i></p> <ul style="list-style-type: none"> <li>○ Structure for holding the ownership stake</li> <li>○ Rationale for ownership of SOEs</li> <li>○ Main responsibilities of the ownership entity</li> </ul> <p><i>A2. The State's role as policy maker</i></p> <ul style="list-style-type: none"> <li>○ Approach to setting policy objectives and public service obligations for SOEs</li> <li>○ Role and coordination among ministries and government agencies on policy setting and SOE oversight</li> <li>○ Linkage between policy objectives and SOE strategic objectives</li> </ul> <p><i>A3. The State's role as regulator and overseer</i></p> <p><i>A4. The State's approach to funding decisions</i></p> |
| B. SOE board leadership   | <p><i>B1. The State's approach to SOE board composition and nomination process</i></p> <p><i>B2. The State's approach to SOE board leadership: Chair versus CEO</i></p> <p><i>B3. Role, responsibilities and authorities of SOE board (vis-à-vis State)</i></p> <p><i>B4. Functioning of the SOE board</i></p>  |
| C. Information flows, transparency, accountability and reporting of the SOE | <p><i>C1. Transparency and reporting of SOE to owner and key State agencies</i></p> <p><i>C2. Transparency and reporting of SOE to the public</i></p>   |




9. In line with the AfDB's and NPC's requirements, the report derives general insights and lessons for the institutional framework from the experiences of three SOEs in particular: Eskom – the state integrated electricity producer, whose stake is managed by the DPE; PRASA – the passenger rail services provider, whose stake is managed by the Department of Transport (DoT); and Transnet – the operator of the national ports authority, fuel pipelines, freight railway services and rail engineering, whose stake is also managed by the DPE.
10. In this context, the report analysed the SOE institutional governance framework using public disclosures from the SOEs, state reports and papers, and other policy documents. A list of documentation is provided in the Appendix. External sectoral experts also helped clarify technical questions on the operations of the three SOEs under scope.
11. The document review was complemented by interviews with government and SOE personnel shedding light on the actual practices of the Government and of SOEs under the present institutional governance framework, beyond what is provided in official policy documents and guidelines. Interviews with a range of senior officials familiar with the SOE framework and current governance reform efforts from the DPE, National Treasury, NPC and PRASA were conducted while interview inputs with Eskom, Transnet, and the DoT. were sought at length but, unfortunately, these were not forthcoming in time for the

preparation of this report. Anonymised quotes from the interviews conducted are provided in light green boxes to support the analysis.

## Report structure

12. The report is structured as follows:

- Firstly, there is an executive summary;
- Secondly, there is a discussion of the strengths, areas for improvement and reform, and recommendations across the analytical areas outlined above: the institutional and ownership framework for SOEs; SOE board leadership; and information flows, transparency, accountability and reporting of SOEs. To facilitate prioritisation in their potential implementation, recommendations have been categorised according to the following colour coding:

|   |                         |
|---|-------------------------|
|  | High priority           |
|  | Medium priority         |
|  | Relatively low priority |

- The appendix provides (i) the key document sources used in the preparation of the Report; (ii) within each area, a brief gap analysis against benchmark expectations informed by judgment, based on diagnostic inputs and the experiences of Eskom, Transnet and PRASA; and (iii) a consolidated table relating the strengths and areas for improvement identified in the three analytical areas to the recommendations made in the report. It should be noted that this table basically provides an overall outline of the report.



## Executive Summary

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13. Sound institutional and corporate governance is critical for the performance of state-owned enterprises. The ability of SOEs in economic areas like electricity, freight rail and commuter rail, to reach societal goals depends on the proper functioning of the institutional, governance and policy cascade between the organs of the State and SOEs.
14. The cascade has three layers:
  - how the state performs a function as owner and steward of the SOEs (distinct from its functions as policy-maker and regulator);
  - how the leadership of SOEs is organised to ensure proper direction and control via a high-functioning independent board with the right skillset;
  - and how the whole system is held accountable at each layer.
15. The reform of the institutional governance framework is a necessary condition for addressing the challenges faced by SOEs. In general, and with notable exceptions, SOEs have in the last decade been characterised by poor governance and financial sustainability, as well as operational inefficiency. Moreover, corruption, patronage, rent-seeking and “state capture” have been common, which led to the establishment of a Judicial Commission of Inquiry Into Allegations of State Capture, Corruption and Fraud in the Public Sector.<sup>5</sup> A World Bank report in 2018<sup>6</sup> summarised the challenges as:
  - lack of a clearly defined state ownership framework combined with a decentralised and heavy oversight structure;
  - politicised boards and management with rising levels of corruption;
  - multiple and competing objectives, such as balancing commercial and developmental objectives outside the core mandate;
  - uncertainty on funding strategies and tariff policies resulting in lack of financial sustainability for SOEs;
  - lack of a proper performance management system and disclosure practices to ensure transparency and accountability.
16. The Presidential Review Commission on State Owned Enterprises (PRC), established in 2010 highlighted similar challenges in the report endorsed by Cabinet in 2013: excessive politicisation, lack of accountability and of appropriate oversight, severe weaknesses in board composition and functioning, the need to professionalise further SOE boards and to increase transparency.

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<sup>5</sup> See <https://www.sastatecapture.org.za/>.

<sup>6</sup> Kikeri, Sunita (2018). Corporate governance in South African state-owned enterprises : background note for the South Africa systematic country diagnostic (English). Washington, D.C. : World Bank Group.

17. The PRC recommendations<sup>7</sup> include a number aimed at improving the institutional governance framework. These relate to:
  - developing an overarching long-term strategy for SOEs and enacting a single overarching law for their mandate, supervision and operation;
  - developing a framework for appointing SOE Boards;
  - developing a uniform regulatory framework;
  - critically reviewing SOE mandates on a regular basis;
  - addressing the procurement process;
  - rationalising holdings to focus on strategic SOEs; and
  - developing an integrated reporting, monitoring and evaluation capacity for SOEs across government.
18. These are all addressed in the context of this report.
19. The Ramaphosa administration has started with SOE reforms. The President has promised “a new era in the management of State-owned companies”<sup>8</sup> and announced the establishment of the Presidential SOE Council (PSEC), which aims to provide political oversight and strategic management to reform, reposition and revitalise SOEs. Moreover, there have been recent changes to the boards and executive leadership of a number of SOEs, including the three under scope. In short, the administration is aware of the issues facing SOEs and is actively seeking to address them.
20. Using a “bottom up” approach that looks at the system from the perspective of three important and challenging SOEs, this report proposes revised institutional governance framework that can underpin reform.
21. The objective is to create an environment that:
  - limits political intervention in SOE operations;
  - improves accountability for weak performance;
  - enhances transparency of SOEs for other parts of the State and the public;
  - builds checks and balances into the system;
  - improves co-ordination between NDP outcomes and SOE performance; and
  - provides systematic opportunities to review opportunities for rationalising the SOE portfolio.
22. It is recognised that, given the severity of the problems, changes in institutional governance represent only part of the broader reforms required.

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<sup>7</sup> See Report on the Presidential Review Committee on state-owned entities.

<sup>8</sup> See <https://www.engineeringnews.co.za/article/half-of-ramaphosas-soe-council-to-be-made-up-of-people-from-outside-of-government-2018-05-23>.

### *Main themes*

23. Two main themes arise in the recommendations to address the above challenges: better oversight and performance through professionalisation; and better co-ordination.
24. Many SOEs are fully state-owned but loss-making companies (of the three SOEs in the scope of the report, Eskom and PRASA are loss-making), struggling to balance broader public policy objectives with commercial viability. Since they are largely operating in monopolistic markets, they function in an environment where market discipline is replaced by bureaucratic, regulatory and administrative scrutiny that in the past was susceptible to “capture” by interest groups. This implies a stronger need for ownership oversight to be more professionalised. This includes the overall SOE strategic oversight, board appointments, functioning and accountability; reporting rules and practices “up” the cascade; and broader transparency of operations. In this context, **professionalisation** is a key theme in the recommendations.
25. In addition, part of the SOE problem seems to have arisen from the existence of **multiple objectives**: commercial objectives vs. broader developmental goals, and often competing objectives of different government departments and agencies. These have not been effectively synthesised and adjudicated, making for opaque accountability along the governance and policy cascade. Thus, better **coordination** of objectives is the second theme in the recommendations.
26. In summary, the current system is too politicised in its decisions regarding SOE boards; and weak in coordinating multiple objectives. Objectives and priorities are set by different parts of the political system, with the administration entrusted with coordination having neither the requisite skills nor the authority that could result in an effective prioritisation mechanism. The system of SOE oversight is effectively run by civil servants who are by definition more vulnerable to direct political pressure and less inclined to be practical in addressing emerging problems; at the same time they are less accountable in their relatively protected positions and not incentivised to pursue stewardship performance for which they would be accountable. The imperatives of effective coordination and professionalisation are designed to remedy these tendencies.

### *Synthesis of strengths and areas for improvement*

27. **Institutional and ownership framework:** As it currently stands the institutional and ownership framework has a number of strengths:
  - 27.1. There is a centralised government agency (the DPE), separate from sectoral policy-making line ministries for Eskom and Transnet; and the DPE has assumed several international best practice responsibilities expected of a state-ownership entity;
  - 27.2. There is also a system of shareholder compacts to set, cascade and monitor policy objectives for each SOE;
  - 27.3. Parliamentary bodies provide another layer of oversight over SOEs on behalf of the public; and
  - 27.4. The National Treasury currently provides active financial oversight of SOEs.
28. There are a number of areas for improvement and reform. Chief amongst these are:

- 28.1. The institutional framework is not providing an integrated oversight structure and professionalisation of this function to effectively fulfil the State's role as owner/shareholder;
  - 28.2. It does not provide a shield for the SOEs from the political process as it stands;
  - 28.3. There are also signs of inadequate coordination in setting objectives between the state ownership entity and line ministries;
  - 28.4. The process/indicators used for monitoring and evaluating SOE performance can be strengthened (in this regard see Paper 1 in this series);
  - 28.5. The framework for SOE procurement practices is in need of review;
  - 28.6. A clearer process on the costing of Public Service Obligations (PSOs) is needed, as well as in a more explicit link between financial assistance by the State and requirements for SOEs to fulfil PSOs.
29. **SOE board leadership:** In terms of the second layer of the cascade relating to SOE board leadership, strengths of the current framework include:
- 29.1. The Government has taken steps to restructure the composition of the SOE boards, particularly for Eskom and Transnet;
  - 29.2. The role of the CEO and Chair are separate for the three SOEs under scope in the report;
  - 29.3. SOE boards appear on paper to exercise significant authority, while the DPE protocol provides guidance on SOE board functioning; and
  - 29.4. Board evaluation seems to be a common practice in Eskom and Transnet (but not PRASA).
30. There are however areas for improvement in board functioning, as well as addressing corruption and mismanagement involving politically appointed boards and executives:
- 30.1. The State's approach to board nomination is lacking in transparency, operating in an ad-hoc fashion and overly politicised, as is the process for appointing SOE CEOs;
  - 30.2. There is high turnover on SOE boards which undermines both accountability and strategy;
  - 30.3. There is poor review of internal and external audit frameworks by boards;
  - 30.4. More support for induction and training for SOE directors by the ownership entity could be established.
31. **Information flows, transparency, reporting of the SOE:** The system for information flows, reporting and transparency has a number of strengths:
- 31.1. the DPE protocol covers disclosure to State and there appears to be regular information flows to the state ownership entity;

- 31.2. There are also a number of reports prepared by the State aggregating SOE performance.
32. The main areas for improvement in the system of accountability and transparency involve:
- 32.1. The absence of a state ownership policy which could contribute to both clarity and accountability regarding the State's general approach as a shareholder;
- 32.2. The process for assessing information flows which needs to be unified and improved;
- 32.3. Lack of clarity in public reporting against objectives in the shareholders' compact (which themselves are not public) or on public service obligations;
- 32.4. Disclosures on SOE websites on corporate governance which could be further enhanced;
- 32.5. Limited involvement of multiple stakeholders in evaluating SOE performance and service delivery.

### ***Synthesis of recommendations***

33. The proposed recommendations are informed by the two recurrent reform themes: improving oversight and performance through more professionalisation; and better co-ordination across government entities.

### ***Recommendations at the state and owner level***

34. Given the strengths and areas for improvement in the present system, the **first set of reform recommendations** concerns the top layer of the governance/policy cascade: reforms to the institutional environment for SOE ownership and stewardship that underpin the distinct roles of the state as owner, policy maker and regulator. Recommendations are driven by the need to create a system which:
- **combats excessive politicisation** and "state capture" with institutional safeguards that provide strategic guidance while protecting SOE operations from political influence;
  - **improves coordination** across government, with a more centralised SOE oversight framework following international best practice, including more checks and balances;
  - provides more **professionalism and accountability**, thereby bridging the existing gap between formal processes in place and the reality on the ground.
35. This report argues that these goals would be best served with the creation of a separate "ownership entity" to exercise stewardship for State participations in SOEs. It proposes three options in this respect:
- 35.1. **Option 1: a comprehensive "SOE holding company"**: this would entail the creation of a holding company to hold all shares of strategic SOEs, including Eskom, Transnet and PRASA. This holding entity would take over many of the functions presently undertaken by the DPE: it would appoint and dismiss SOE boards, and ensure professionalism and the right skill-set in SOE board appointments. The holding

company board would institutionalise high-level inter-ministerial cooperation on SOEs being composed of senior representatives of the main ministries (including the Treasury in a leading role) and the NPC, and a minority of independent directors from the private sector, while the company would operate with professional staff from government departments and qualified personnel from the private sector.

35.2. **Option 2: a pilot holding company:** The DPE's remit would remain for the bulk of the companies while a "pilot" holding company would be assigned stewardship of a few selected strategic companies including Eskom and Transnet. Main governance characteristics would be the same as in option 1, but the DPE would play a leading role on its board.

35.3. **Option 3** (closer to the **current institutional arrangements**-enhanced professionalisation and accountability): The DPE would retain ownership oversight over its current portfolio but under the coordination and oversight of the Presidential SOE Council. It would assign some of its current functions related to board appointments and evaluation to a subsidiary staffed with highly skilled professionals drawn from the public and private sector.

36. In addition to this overhaul of the ownership framework, the report recommends:

36.1. Clarifying costing and linkages between public service obligations (PSOs) assigned to SOEs and the financial assistance provided by the State, with SOE commercial and developmental activities ring-fenced into separate accounting systems;

36.2. Norms for strengthening SOE audit and internal controls, including overhauling procurement systems, and clear rules for public-private partnerships aimed at leveraging private capital for public infrastructure needs;

36.3. Strengthening the overall financial oversight of SOEs, with a stricter reporting framework for companies that receive financial assistance; and

36.4. Reviewing the process and indicators for monitoring and evaluating SOE performance as well as the consequences for deviation from performance against objectives.

#### Recommendations at the board level

37. The government has recognised deficiencies in the existing system for the selection, nomination, appointments, induction, operation and evaluation of SOE boards. As it stands, the system can be politically influenced especially in the preferred system of cadre deployment, ad hoc rather than systematised, and lacking in transparency as a process. Most importantly, it does not create strong accountability lines to the appointing institutions; in the past this has allowed boards to pursue their own self-serving objectives. In order to address such deficiencies and inject professionalism into the system, it is proposed to embed reform proposals in the overhaul of the institutional environment for SOE ownership and stewardship as outlined above.

38. These reforms should include:

- 38.1. the elaboration of a **director nominee framework** providing guidelines on board nomination, requirements for respecting board skills matrices, achieving diversity as well as appropriate balance of independent directors, ownership entity, and state representatives;
- 38.2. Guidance on the transparent appointment process for SOE CEOs, respecting the central role of SOE boards in this process;
- 38.3. Mechanisms for supporting the induction process and training of SOE board members;
- 38.4. A review and a strengthening of the relationship between performance and remuneration in executive appointments;
- 38.5. Regular board evaluations run by the boards of large SOEs with the help of external expertise, as well as reviews of internal and external audit processes.

#### Recommendations on transparency and accountability

39. The **third set of recommendations** is aimed at improving transparency and accountability, which are at the core of the concerns of the Government as it seeks to enhance the framework for SOE operations and their contribution to the country's development.
40. First among these is the elaboration of a **state ownership policy document** (the "Policy") which would make the whole institutional cascade transparent and operational (the preparation of an equivalent document by the DPE is under discussion. The Policy would provide general principles and a unified approach to the elements of SOE governance, the structure of oversight entities, the roles of the ownership entity towards individual SOEs, as well as the framework for board appointments and their accountability to the stewards. It would also provide a process for the periodic review of the rationale for the State's ownership of SOEs and examine options for asset divestment and privatisations.
41. The report also proposes a number of practical steps to improve information flows and reporting of SOEs, involve stakeholders and increase public disclosure at a level that would not undermine the effectiveness of various governance processes. These include:
  - 41.1. More systematic public disclosure of the main objectives from SOE Shareholder Compacts, as well as of an assessment of the achievement of these annual objectives in public reporting and to Parliament, to facilitate public scrutiny and SOE accountability;
  - 41.2. Public disclosure of corporate governance policies, board charters, and board committee terms of reference to enhance transparency on governance practices; and
  - 41.3. Involving systematically multiple stakeholders beyond the executive and the legislative (from industry, consumers and civil society representatives to labour, creditors and affected communities) in evaluating SOE performance and service delivery, possibly in the form of a stakeholder forum, especially for large utilities.

## A. The institutional and ownership framework

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### A. 1. The State's role as owner

#### Background and best practice

42. The OECD Guidelines provide the internationally agreed benchmark for how governments should organise the institutional and ownership framework for SOEs. The Guidelines envision that, for SOEs established with a predominantly commercial purpose – the delivery of sustainable financial returns, it is best to enshrine a clear separation of roles played by the State: (i) State as owner; (ii) State as policy maker; and (iii) State as regulator. In particular, (ii)/(iii) should be the mandate of separate entities from (i), in order to ensure there is a strong mechanism for objective and “independent” pushback/challenge on setting costly public policy objectives that could harm SOE performance. This separation engenders a fairer playing field for other commercial players in the sector with State policies/regulation being set more objectively in view of the wider sector.
43. The Guidelines have been developed in the context of the OECD Working Party on State Ownership and Privatisation Practices, with the participation of the World Bank and a number of non-OECD countries, including South Africa. South Africa has also collaborated with the OECD in formulating more specific guidelines in the Southern African context, thereby underlying the Government's adherence to those principles and desire to implement the recommendations in the SA context<sup>9</sup>.
44. While in earlier periods, the main ownership functions for SOEs were discharged in a decentralised fashion by line ministries, this trend changed significantly in recent years, especially after the publication in 2015 of the OECD Guidelines. Today, an increasing number of countries adopt a centralised approach. The objective of this centralisation is to provide better oversight and greater consistency and coordination in the approach of national governments towards the management of state assets as distinct from policy and regulation in the relevant sector.
45. Several countries differentiate their approach based on whether enterprises are commercial SOEs (with a for-profit objective including the distribution of dividends to the State) or SOEs set up primarily to deliver public policy objectives without any significant commercial aspect. The latter may be overseen by line ministries. Exhibit 2 summarises the OECD's classification of ownership model structures internationally.

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<sup>9</sup> OECD (2014), Guidelines on the Governance of SOEs for Southern Africa (<https://www.oecd.org/daf/ca/SOE-Guidelines-Southern-Africa.pdf>).



### Exhibit 1: Ownership model structures internationally <sup>10</sup>

|                           |   |
|---------------------------|---|
| Centralised model         | One state institution carries out mission as shareholder in all state-owned entities. The ownership entity is either a specialised ownership body or designated government ministry. Central ownership entity monitors SOE performance including financial targets, technical and operational issues. |
| Dual model                | Two government institutions – often one line ministry per SOE and the ministry of finance – share the ownership function. Usually, one ministry sets financial objectives and other formulates operational strategy.  |
| Coordinating agency model | A specialised government unit acts in an advisory capacity to other shareholding ministries on technical and operational issues; most important mandate of this unit usually consists of monitoring SOE performance. Autonomy remains with line ministries.   |
| Decentralised model       | No single state entity discharges the responsibilities of the ownership function. Line ministries de facto run SOEs.  |

46. The following Exhibit provides a more in-depth summary of practices across a sample of countries in each classification for purposes of illustration:

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<sup>10</sup> Adapted from OECD (2018), Ownership and Governance of SOEs: A Compendium of National Practices.

Exhibit 2: National approaches to exercising the ownership function<sup>11</sup>

| Country  | Overall Model                                | Comments on Ownership Model Organisation (if necessary)  | Name of Institution(s) exercising ownership function(s)  | Government's and ownership entity's high-level involvement in the objective setting process   | Existence of state holding company? |
|----------|--|--|--|---|-------------------------------------|
| China    | Centralised /<br>Centralised with exceptions | Other state managing authorities exist at various levels of government. The Ministry of Finance still has a role in overseeing financial SOEs.       | The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) has been established to exercise the ownership function.   | Objectives are formulated by the State Counsel and communicated to the SASAC. The SASAC prepares annual investment plans for SOEs.  | No                                  |
| Egypt    |  | Hybrid state holding company model – there are several state-owned holding companies functioning in different sectors.                               | Ministry of Investment exercises ownership stake over approximately 150 SOEs; non-trivial portfolio of SOEs held by central state holding companies under Ministry of Investment.  | Objectives are developed by Ministry of Investment which oversees state-holding companies.  | Yes                                 |
| Finland  |  | 8 ministries have SOEs under management including Ministry of Finance, Ministry of Employment and Economy, Ministry of Transport and Communications. | Ownership Steering Department in Prime Minister's Office is responsible for preparation and implementation of the state ownership policy.<br><br>There are also 2 state holding companies to manage the state's interests in companies. These report to the Prime Minister's Office. | Objectives can be set by the Ownership Steering Department in consultation with line-ministries as required.  | Yes                                 |
| France   |  |  | Agence des Participations de l'Etat (APE) is the government body which exercises the ownership of strategic SOEs. It reports to Ministry of Economy and Finance.   | The performance goals of SOEs are established with consideration of the government policies. By law, each SOE must develop medium and long-term management goals and then submit them to Ministry of Economy & Finance and the related line ministries. | No                                  |
| Hungary  |  |  | The Hungarian National Asset Management Inc., state-owned company limited by shares is in charge of the management of state assets, as well as other institutions designated by law or ministerial order. It reports to Ministry of National Development.                            | Hungarian National Asset Management Inc. communicates annual planning principles, approved by the Minister of National Development.   | Yes                                 |
| Slovenia |  | There is state holding company, by the Ministry of Infrastructure retains responsibilities over electricity companies.                               | Slovenian Sovereign Holding (SSH) is an independent joint-stock holding company owned by the state.  | The objectives are calibrated to certain sector policy but coordinated on cross-government level. Agreed objectives are published on the SSH website.   | Yes                                 |

<sup>11</sup> OECD (2018) Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

|           |                     |   |  |   |    |
|-----------|---------------------|---|--|---|----|
| Sweden    |                     |   | The Division for State-Owned Enterprises   | Objectives are developed by the Division for State-Owned Enterprises and Division for Corporate Governance and Analysis in coordination with SOEs.  | No |
| Brazil    | Dual Model          |   | The state ownership function is carried out by (i) the Department of Co-ordination and Corporate Governance of State Enterprises (DEST) within the Ministry of Planning and Budget and Management and (ii) the Ministry of Finance. This is done in coordination with line ministries. | Objectives for individual SOEs are developed by line-ministries. DEST establishes corporate governance guidelines and remuneration, and approves bylaws and capital injections.   | No |
| India     | Coordinating agency |   | The Indian Department of Public Enterprises acts as the "nodal" agency for all SOEs.   | SOEs' vision, mission and long/short term objectives are developed by line-ministry and in a "consultative manner" with SOEs, keeping in view the overall policy direction of the government.<br><br>The Department formulates all policies pertaining to performance improvement and evaluation, financial accounting, personnel management and related areas. | No |
| Argentina | Decentralised       |   | Line ministers perform most of the ownership functions in majority-owned SOEs.   | The objectives of every SOE is defined in its own statute. The majority of SOEs have adopted commercial law and are required to operate in practice as a private company.   | No |
| Kenya     |                     | The Presidency establishes state corporation which are then assigned to respective Line Ministries. | Different line ministries perform the ownership functions in majority-owned SOEs.  | Line Ministries set out the objectives for SOEs. All state-owned companies follow State Corporations Act.   | No |

## Strengths

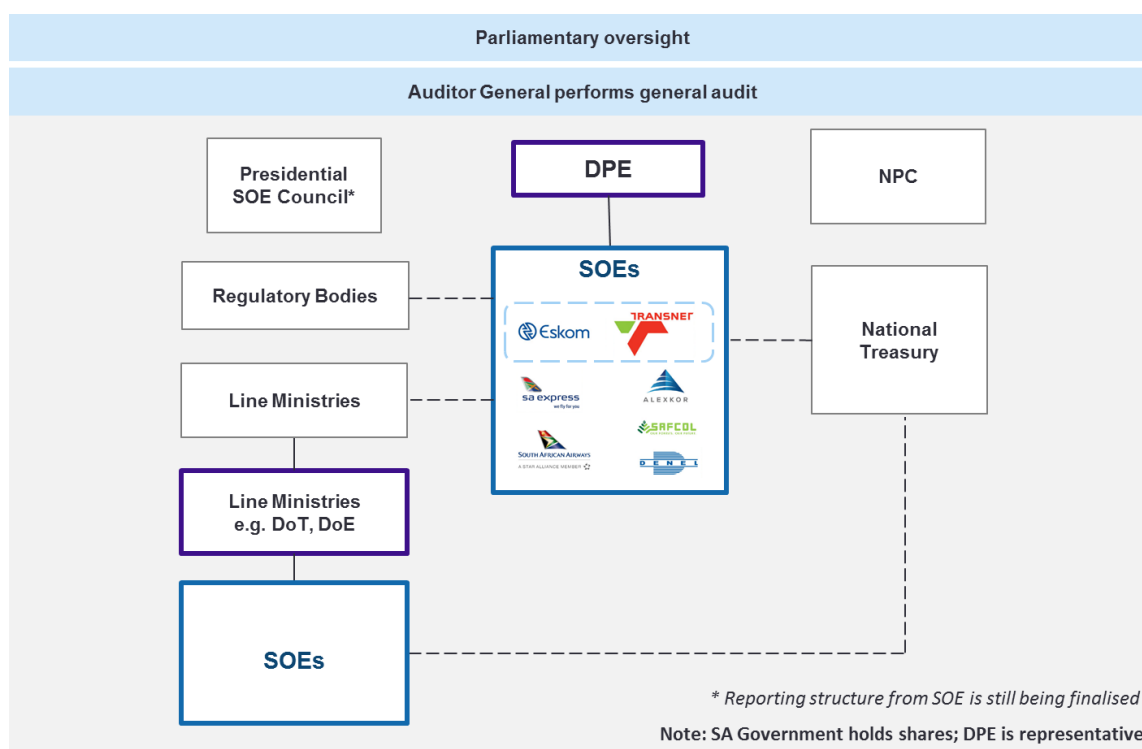
**Strength 1.** *There is a centralised government agency, separate from sectoral policy-making line ministries, which is clearly responsible for the ownership function with respect to Eskom and Transnet.*

*“The exercise of ownership rights should be clearly identified within the state administration. The exercise of ownership rights should be centralised in a single ownership entity, or, if this is not possible, carried out by a co-ordinating body.”*

OECD Guidelines, 2015

47. South Africa’s approach is “centralised with exceptions” as per the OECD classification<sup>12</sup>. The DPE is the ministry acting as the “shareholder representative” of the Government and fully exercises the State’s stake in Eskom and Transnet (see Figure 1).

**Figure 1 – Current state ownership/oversight structure**



48. For Eskom and Transnet, the respective line ministries, the DoE and the DoT, are consulted by the DPE as required on policy matters. This approach is driven by Eskom and Transnet being classified as schedule 2 entities<sup>13</sup> and expected to operate as “commercial SOEs” on the strength on their own balance sheet without any significant government support.

<sup>12</sup> See OECD (2018). Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

<sup>13</sup> SOE categorisation is purely based on the PFMA Act. There are (i) Schedule 1 entities; (ii) Schedule 2 entities (all commercially oriented); (iii) Schedule 3A SOEs (they receive direct fiscal transfers – not necessarily commercial enterprises but may generate revenues; and (iv) Schedule 3B SOEs.

There are also some other Schedule 2 SOEs under the DPE; they are generally expected to have a commercial orientation as a DPE focus is returns on investment.

49. As the OECD classification suggests, the model is actually a hybrid between centralisation and decentralisation with the vast majority of SOEs not being classified as Schedule 2 and thus placed under line ministries. For instance, PRASA, which used to be part of Transnet and therefore the DPE, is currently under the DoT. There are about 800 SOEs in South Africa; 8 or so strategic SOEs are under DPE.

***Strength 2. The DPE has assumed several responsibilities expected from a state ownership entity as per best international practice.***

50. The OECD Guidelines indicate a set of best practice responsibilities for a state ownership entity:

*“The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Its prime responsibilities include:*

- *Being represented at the general shareholders meetings and effectively exercising voting rights;*
- *Establishing well-structured, merit-based and transparent board nomination processes;*
- *Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;*
- *Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;*
- *Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;*
- *[...] maintaining continuous dialogue with external auditors and specific state control organs;*
- *Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.”*

**OECD Guidelines, 2015**

51. Exhibit 4 below provides responsibilities of state ownership entities in countries where ownership is closer to centralisation:

### Exhibit 3: Main responsibilities of state ownership entity<sup>14</sup>

| Country              | Ownership entity  | Main responsibilities   |
|----------------------|---|---|
| France <sup>15</sup> | Agence des Participations de l'Etat   | <ul style="list-style-type: none"> <li>• Consulted on appointments / dismissals of members of the boards of SOEs.</li> <li>• Evaluates activities performed by the executives of SOEs.</li> <li>• Provides control oversight over the activities of the SOEs including financial management, and after consulting with the Minister in charge of the budget, proposes changes regarding the procedures of exercising control over SOEs.</li> <li>• Implements capital transactions with respect to SOEs.</li> </ul>   |
| China <sup>16</sup>  | State-owned Assets Supervision and Administration Commission of the State Council (SASAC) | <ul style="list-style-type: none"> <li>• Supervises and manages the state-owned assets (excluding financial SOEs) and enhances the management of SOEs.</li> <li>• Guides and pushes forward the reform / restructuring of SOEs.</li> <li>• Improves corporate governance.</li> <li>• Appoints and removes board members of SOEs.</li> <li>• Appoints and removes top executives of SOEs; evaluates their performance; establishes a selection system and improves incentives systems.</li> <li>• Responsible for working out the state-owned capital operational budget and final account and their implementation.</li> <li>• Responsible for the fundamental management of state-owned assets of enterprises, the drafting of laws and regulations on the management of state-owned assets, and the establishing of related rules and regulations.</li> </ul> |
| Greece               | Hellenic Holdings & Assets SA (HCAP)  | <ul style="list-style-type: none"> <li>• Appoints/removes SOE board members.</li> <li>• Agrees objectives for each SOE's activities taking into account decisions related to the participation of the SOE in the State's development policy.</li> <li>• Approves the transfer and the terms of transfer of assets from a direct subsidiary of a Company to any other subsidiary or to the Greek State.</li> </ul>   |

52. In South Africa, with respect to Eskom and Transnet, the DPE discharges most of the responsibilities that international best practice suggest should be expected from an ownership entity. These include<sup>17</sup>:

52.1. **Strategic guidance:** DPE units include financial and advisory services, business enhancement services and from a broader perspective, a strategic planning and monitoring unit. The DPE Business Enhancement unit is divided by key sectors e.g. energy resources, transport and defence etc., which engages with SOE strategies. In addition, Shareholders' Compacts are elaborated – a “mandate” reviewed and agreed annually between the State and SOE board – which set the agreed strategic objectives to form the basis for SOE multi-year strategic plans.

52.2. **Performance oversight/monitoring system:** The DPE uses the Shareholders' Compact to monitor and evaluate the performance of SOEs. For example, for 2019/2020, interviews conducted suggest that the DPE plans to contract the

<sup>14</sup> Source: Websites.

<sup>15</sup> France: Decree of 9<sup>th</sup> September 2014 establishing the Agence des Participations de l'Etat.

<sup>16</sup> China: State-owned Assets Supervision and Administration Commission of the State Council (2018) “What we do” web page.

<sup>17</sup> We were unable to consult with the DoT to directly assess how it discharges its shareholder role with respect to PRASA in practice.

boards, through the Shareholder Compacts, to ensure that key performance areas are agreed on and are supportive of the NDP. For Transnet, under the National Rail Policy, the DPE is supposed to engage with the DoT in overseeing implementation of rail policy objectives that may be included in the Compact.

- 52.3. **Governance oversight:** The DPE has well-articulated rules on governance of SOEs – the DPE governance protocol. There is also an SOE governance unit under DPE. This is responsible for SOE governance, assurance and performance.

### Areas for improvement and reform

**Area for Improvement 1.** *The current institutional framework may not be providing for the integrated oversight structure and required professionalisation to shield the process from politicisation and capture and to fulfil effectively the State's role as owner/shareholder.*

*"In our SOE governance process, there is a problem of the political nature of the shareholder."*

*"We need to move towards professionalisation. The value of this exercise is to identify triggers to make us move in that direction."*

*"Part of our current reform initiative is to identify the ideal model for the shareholder institution."*

53. Based on the background research for this report and the interviews conducted with relevant stakeholders (some quotes highlighted above), there seem to be three core problems in the prevailing institutional arrangements:
- 53.1. **Excessive politicisation:** Despite some safeguards in place, it has proven difficult to distinguish between providing the necessary strategic direction to SOEs and undue political influence and interference in their operation. This is particularly evident in procurement practices that have favoured specific private interests.
- 53.2. **Weak coordination:** Under the current arrangements, achieving alignment between line ministries and shareholder ministries has relied on an ad-hoc process of meetings and working groups for particular SOEs. This low key cooperation does not allow for a transparent synthesis of state views at a high level to adjudicate between different objectives as well as provide the necessary transparency and checks and balances. It is an institutional weakness that has allowed forces from the top of the political hierarchy to "enforce" corruption at SOE level.
- 53.3. **Formality and professional skills:** There is often an observed gap between formal processes in place and reality on the ground ("ticking the boxes"), as well as a lack of accountability at different levels. This could be traced to the fact that under current oversight arrangements, the DPE as a ministry cannot recruit adequate professional staff with private sector/commercial experience.

54. Discussion is already taking place in the heart of the Government to identify the ideal model for the shareholder institution, while in the past alternative institutional set-ups have been debated. The key concerns relate to building a system that is impervious to capture and which includes institutional safeguards and checks and balances to protect SOE operations from undue political influence whilst ensuring SOEs are well set up to deliver on agreed State objectives. Cases such as that of Eskom where the political system was able to appoint board members and senior management and corrupt the company procurement process have further motivated this discussion.
55. The recent creation of the Presidential SOE Council<sup>18</sup> seems an important attempt to respond to the capture problem. Its thrust would appear to be three pronged: (a) *coordination* among different stakeholders on the governance side: its members include shareholder Ministers, business people and experts; (b) what could be called the “*mutual surveillance*” model, with various different stakeholders directing the process, which significantly lowers the probability of capture by one corrupt political operative; (c) non-government perspectives that help *depoliticise* the process at least at the very top.
56. Working alongside the DPE, the PSEC’s aim is to improve governance in SOEs considered to be at the heart of state capture/corruption allegations. Many of its stated objectives align with addressing the governance weaknesses that motivate this report’s recommendations: inter alia, to appoint competent individuals of integrity through a transparent and robust process to boards and senior management; decide which SOEs are strategic; reform SOE procurement; review the business models, capital structure and sources of financing for SOEs; identify opportunities for private sector participation; closely monitor SOE financial and operational performance; and promote greater transparency and accountability to overcome poor governance.
57. The PSEC’s oversight mandate and its mixed government-private sector composition are a recognition of the current system being too politicised in its decisions regarding SOE boards, as well as weak in coordinating multiple objectives. Hence the need to bring in many government stakeholders around the table (“**coordination**”) and create a framework with **checks and balances**. The latter include the “mutual surveillance” at the top by various stakeholders that the PSEC addresses. But they also include the capacity of the teams that ensure day to day, firm-by-firm oversight to be accountable to such a synthesis of political interests and agendas—not to a single minister<sup>19</sup>. This leads to the need for **professionalisation** of the actual execution of the government’s stewardship role so that accountability of SOE boards and executives is held to a standard of rigour that has been significantly higher than the one enforced in the past by DPE and others.
58. In an environment where SOEs are fully state-owned but often loss-making, market scrutiny is replaced by bureaucratic, regulatory and administrative scrutiny. Civil servants are often competent and experienced, and the team interviewed from the DPE certainly gave this impression. However, they are by definition not “independent” as they need to

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<sup>18</sup> We have relied on press reports on the SOE Council and official twitter account of the South Africa Government for information since the workings of the SOE Council is not yet fully disclosed - <https://twitter.com/governmentza/status/1093572509537046534>.

<sup>19</sup> This is an institutional imperative and does not imply any misgivings about the current DPE minister who is recognised by commentators for his integrity.



follow direct ministerial instructions and, conversely, are not subject to reputational hazard as they are not “in the market”. For the same reasons, they are less accountable, as their jobs are usually protected (on the downside), while (on the upside) they are usually underpaid, and their pay is not linked to performance.

59. This implies a need for stewardship and ownership oversight to become professionalised in the context of an ownership entity that is composed by highly qualified staff, whose operation is removed from the political system, and which is also making use of private sector expertise. By “stewardship”, what is meant is the overall SOE strategic oversight, board appointments, functioning and accountability; reporting rules and practices “up” the cascade; and broader transparency of operations.
60. Coordination is also key. Part of the SOE problem seems to have arisen from multiple objectives: commercial objectives vs. achieving broader developmental goals, and often competing objectives of different government departments and agencies. These seem to have never been effectively synthesised and adjudicated, thereby breaking the chain of accountability of key players along the governance and policy cascade.
61. International experience suggests that strengthening the governance framework for SOEs entails the creation of a separate “ownership entity” which can then best address these three imperatives of professionalisation, check and balances and coordination. The approach adopted to this effect in many OECD and emerging economies with different characteristics, such as Finland, Greece, Slovenia, Hungary and Indonesia<sup>20</sup>, has been to establish an independent **state-owned holding company** (the “HoldCo”).
62. A state-owned holding company that acts as the owner of SOEs on behalf of the government is typically intended to separate political influence from state-owned enterprises, while being subject to political direction by the government. Through the HoldCo model, the government attempts to distance the enterprises from the state and permit them greater operational freedom, while at the same time introducing external expertise and greater professionalisation into the oversight process related to the shareholder function of the state.
63. Such holding companies or funds have sometimes had additional roles; undertaking the restructuring of the enterprises below them, stimulating the capital market through share trade, and increasing the returns on shareholdings in their enterprises through active portfolio management. Sometimes, they may prepare SOEs for strategic disinvestment, in all or in part<sup>21</sup>.
64. In the South African context, and in light of existing institutional arrangements, this report proposes three alternatives for the creation of a separate “ownership entity” to exercise stewardship for State participation in SOEs:

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<sup>20</sup> In April 2019, the Indonesian Government announced plans to set up a super state holding company controlled by the Presidency: <https://www.thejakartapost.com/news/2019/04/15/super-holding-company-to-replace-function-of-soes-ministry.html>.

<sup>21</sup> Although in some countries (e.g. Greece), this task is assumed by a different holding company.

- 64.1. Option 1: the creation of a comprehensive “SOE holding company” where the State would transfer the shares it currently owns in strategic SOEs;
  - 64.2. Option 2: a “pilot” HoldCo of a few strategic companies with a primarily commercial perspective, including from the SOEs under scope in this study;
  - 64.3. Option 3 (closest to the current institutional arrangements): the DPE retaining ownership oversight but assigning key functions, for instance those related to board appointments and evaluation to a subsidiary.
65. **Option 1.** The creation of a state holding company could help address some of the problems which the government itself (as well as international institutions like the World Bank) have identified in the governance framework for SOEs as it currently stands. A **comprehensive HoldCo** would make the “policy cascade” more effective, because it would by design address the problems identified earlier:
- 65.1. Its “hand-off” operation as an independent agency, removed from the political process and government departments, would allow it to address the problem of excessive politicisation.
  - 65.2. Staffing it with high-calibre people (including those with private sector/commercial experience) and allowing for a remuneration that attracts and retains them would allow the HoldCo to address the current gap between formal processes in place and reality on the ground. A commercial company structure would also allow for more results-based accountability than a public sector organisation.
  - 65.3. Institutionalising high-level inter-ministerial cooperation through the HoldCo board would address issues relating to weak coordination across government and lack of checks and balances.
66. In operational terms, the HoldCo should have certain characteristics (see Figures below for an indication of the proposed overall structure and different roles/responsibilities):
- 66.1. **Shares of SOEs:** The State would transfer to the holding company the rights to the shares it currently owns in primarily commercial SOEs, with the HoldCo representing the State as the owner. The scope would include strategic businesses that have in the past suffered from capture issues, such as Eskom, Transnet and possibly PRASA, but would build a broad portfolio of assets across different sectors, spanning energy, transport and infrastructure.
  - 66.2. **Holding company board:** In order to perform its oversight role, the board of the holding company would need to fulfil two functions: represent and synthesise the various facets of State interests; and avail itself of the outside, professional expertise required for its operation. This would involve:
    - 66.2.1. *Balanced representation:* The HoldCo board would be comprised of a) a majority of high-level government officials appointed on a merit basis as representatives of the main ministries (including the National Treasury with a leading role in order to safeguard hard budget constraints), including the NPC as the key development policy driver; and b) a minority of “independent non executive directors”, i.e. highly respected individuals

with relevant skill-sets from the private sector/academia as civil society representatives. Composition would obviously promote race and gender representation as per SA best practice.

66.2.2. *Oversight and transparency of the appointment process*: Overall oversight and validation of appointments to the HoldCo board could be entrusted to the Presidential SOE Council. Government representatives would be nominated by individual ministers (or equivalent), while private iNEDs would be identified and nominated by the PSOE, supported by the Presidential administration. While a parliamentary vote on the nominees could unduly complicate and politicise such appointments, the nominees could be subject to Parliamentary scrutiny at a Q&A session prior to their appointment to ensure an open, public, meritocratic and transparent process.

66.3. **Operation**: The operation of a SOE holding company would need to rely on a team of professional staff, some of it drawn from current government departments such as the DPE, together with highly qualified personnel recruited externally. Its remuneration might include incentives and contractual employment conditions which would not be those of the public sector.

66.4. **Responsibilities**: In terms of responsibilities, the holding company would take over many of the functions currently undertaken by the DPE for SOEs within its remit: the elaboration of shareholder compacts for SOEs containing KPIs based on strategy and public service obligations, as well as the review of SOE corporate & business plans and their quarterly reports. It would have the power to appoint and dismiss the board of an SOE, would ensure that the appropriate mix of executive/non-executive directors are appointed and that SOE directors have the required skills.

67. Such a holding company would translate into a clear institutional set-up the role currently played by the DPE, whereby “the Government’s relationship to its SOEs is similar to the relationship between a holding company and its subsidiaries”<sup>22</sup>. In contrast to the current set-up however, it could help address the problem of a “missing” shareholder incentive: it could be argued that in the current arrangement, DPE (and DoT for PRASA) may have an implicit vested interest in maintaining the companies it oversees, as they are not ultimately responsible for funding shortfalls and bail-outs of underperforming SOEs. Explicitly including Treasury in a leading role in the board of the holding company would address that concern and better hold SOEs to account for poor financial performance.
68. One concern expressed regarding the creation of a HoldCo is that it would represent an additional “layer” of governance. In reality, it would represent a different allocation of responsibilities. The HoldCo would take over a number of the “strategic goals” in SOE oversight currently held by the DPE: strengthening the shareholder role; safeguarding financial sustainability; ensuring SOEs maintain commercially viable operations; and assisting in delivery of capital projects. The DPE would then retain responsibility for those “strategic goals” which relate to broader government goals: supporting the acceleration

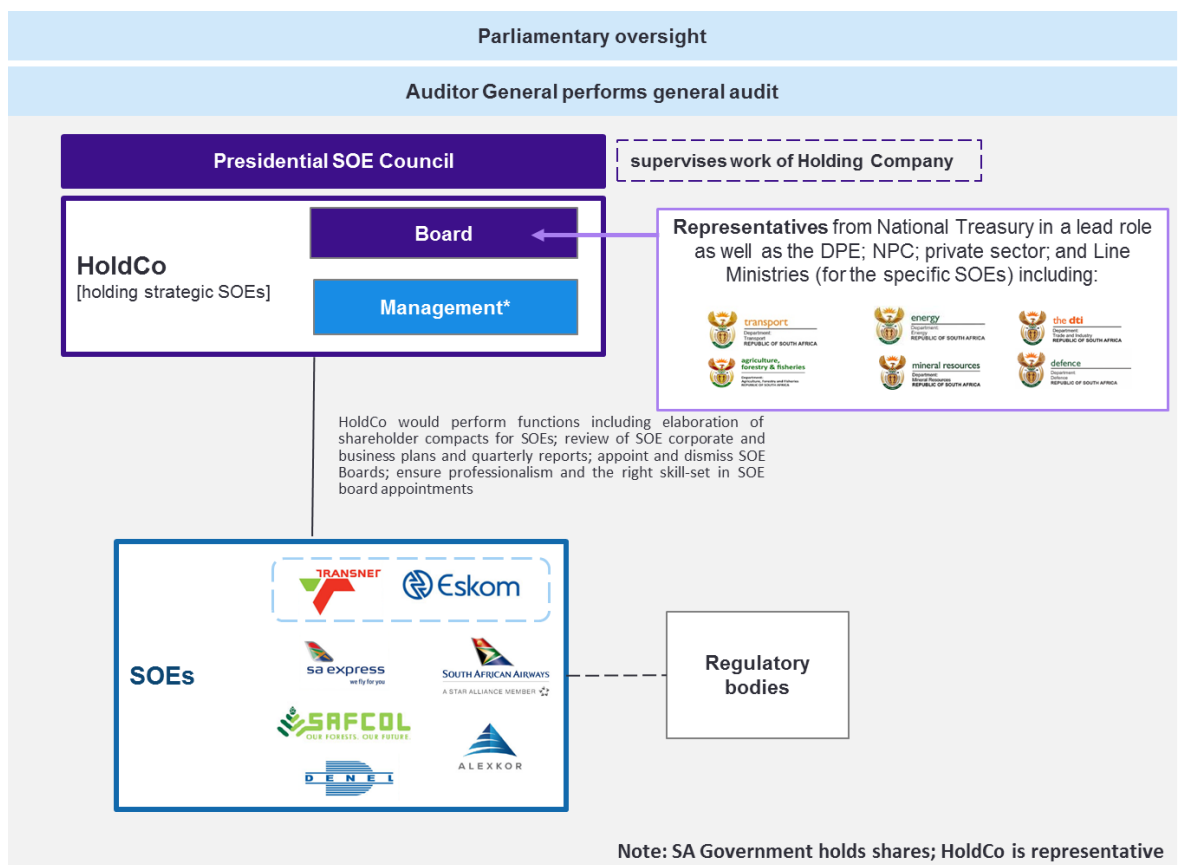
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<sup>22</sup> From DPE Protocol.

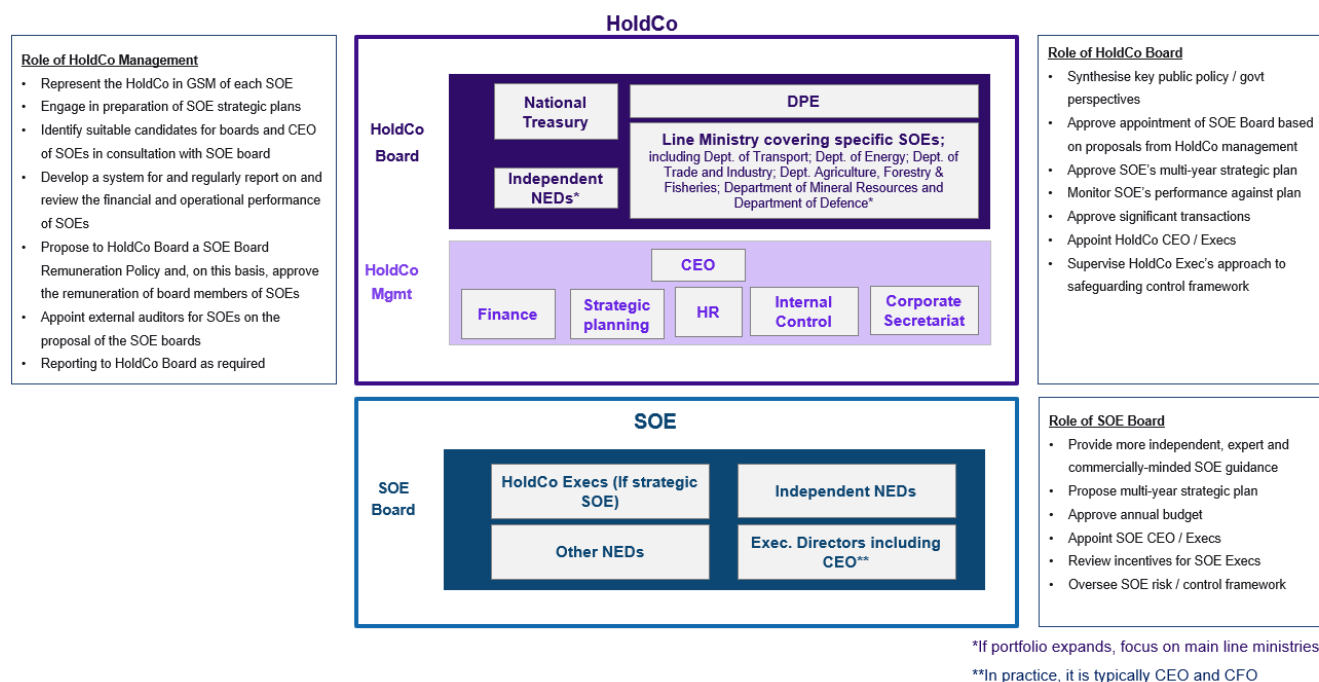
of transformation of the economy; accelerating the development of skills to support the needs of the economy; and advancing the re-industrialisation of the economy.

69. In this new environment, the government would fully retain the political decision-making on the strategic orientation for SOEs and their contribution to the broader NDP goals. This could be explicitly expressed in a “state ownership policy” prepared under the guidance of the DPE (see below), and including choices for potential full or partial privatisations if this becomes government policy. This would be implemented by the HoldCo.

**Figure 2 – Holding Company option: proposed overall structure – Option 1 (Comprehensive)**

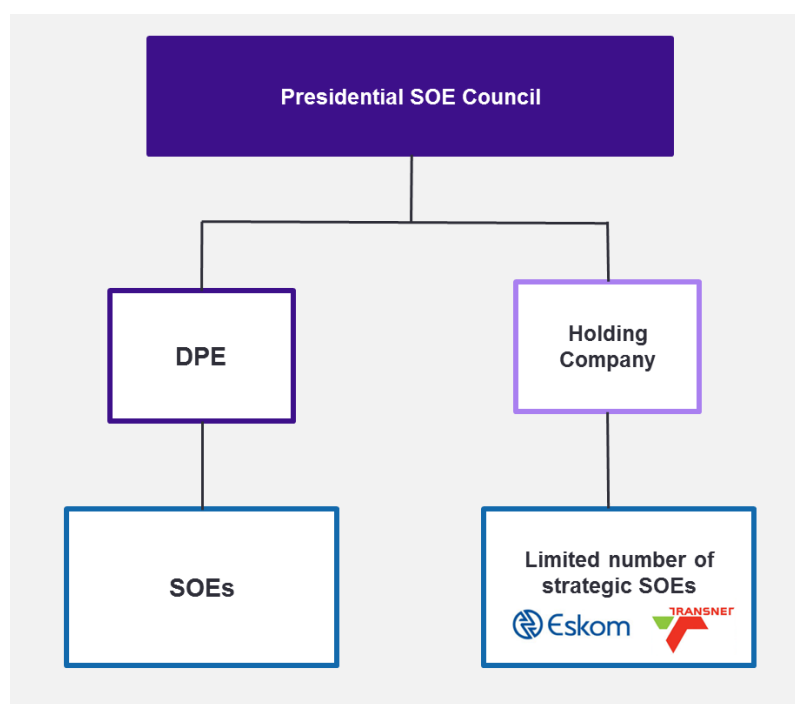


**Figure 3 – Holding Company option: roles and responsibilities – Option 1 (Comprehensive)**



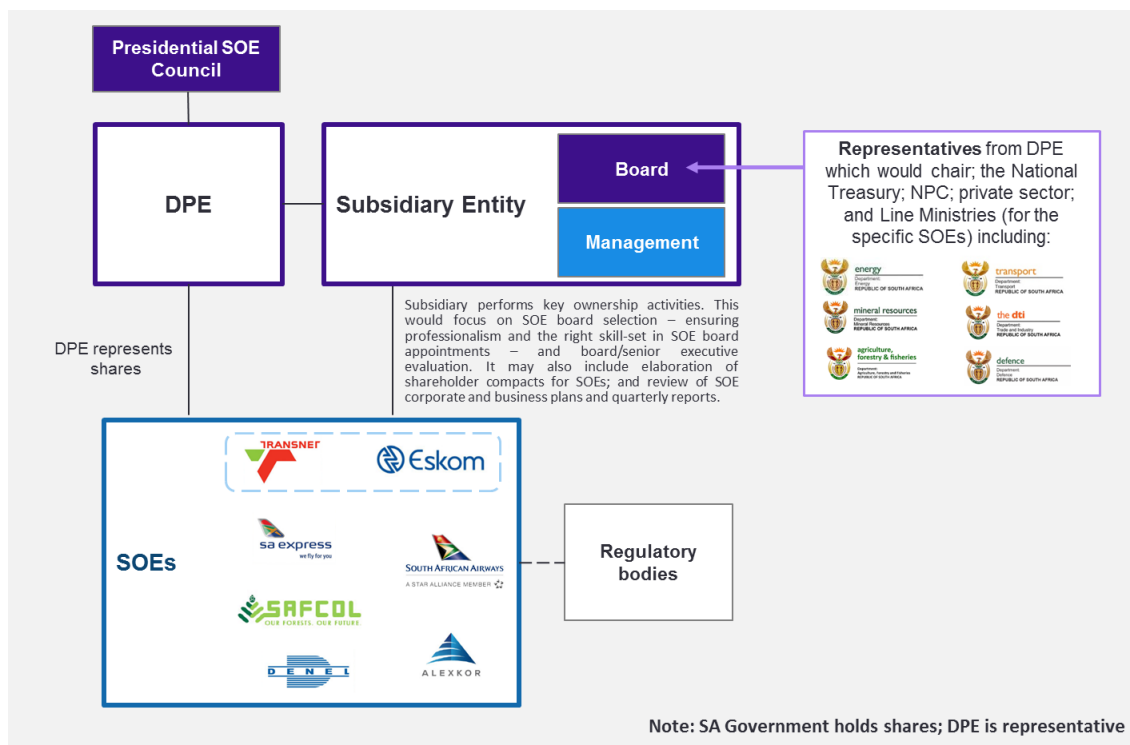
70. Nevertheless, it should be recognised that a transition to such a substantially different oversight arrangement for SOEs as a holding company has transaction costs and involves some institutional dislocation. The Government may instead want to pursue alternative means for establishing a state ownership entity with the same goals of coordination, checks and balances, and professionalisation.
71. **Option 2.** An alternative to a comprehensive HoldCo is to create a “**pilot Holdco**” with only a few strategic companies (or in dire need of financial discipline due to previous capture issues) in its scope, possibly in one or few sectors, and most probably including the three under scope in this study. Its main governance characteristics would be the same as in option 1, but the DPE would play a leading role on its board. This more gradual approach would allow Government to establish the principle, test its operation and eventually, if proven successful, expand it to a fully-fledged “comprehensive” holding company at a later stage.

Figure 4 – Option 2 (Pilot HoldCo)



72. **Option 3.** The third alternative form for a state ownership entity proposed is to have the DPE retain ownership oversight but “subcontract” some of its current functions to a subsidiary with highly skilled professionals (Figure 5 below). This avoids the political and other problems involved in creating an independent holding company and is closer to solutions adopted in some countries where such an entity is specifically attached to the Prime Minister’s office or the Finance Ministry.
73. For such a solution however to be able to tackle the issues of excessive politicisation, coordination and professionalism outlined above, it would require two elements, one at the top and one at the bottom of the cascade. The first element is a coordination forum that would make sure that various government objectives are coordinated at the highest level: the newly created Presidential SOE Council could play this role. It would assume the overall oversight and broad strategic direction of the system with the DPE being responsible for running execution like today.
74. The second element is a professional team (that could include civil servants on secondment) that would be recruited, paid and held accountable for, delivering specific tasks that mostly have to do with SOE board selection and board/senior executive evaluation. These tasks require some autonomy and professional skills and a level of autonomy that might not be available to the civil service as discussed above. The subsidiary’s operations will be run along the same lines as the HoldCo option. Its board could be chaired by a senior DPE with representatives of the National Treasury and a few INEDs appointed by the PSEC, as per the process outlined above

**Figure 5 – DPE subsidiary option: overall structure – Option 3 (DPE subsidiary)**



75. Given the central role of the DPE in the current oversight arrangement, it is important to summarise its potential new role under the three report proposals. Under Option 1 (comprehensive DPE), it would have no direct SOE oversight (except in being represented on the HoldCo board). The DPE would become a smaller department with responsibility of developing and owning the SOE ownership policy. Under option 2 (“pilot” HoldCo), it would retain oversight of the large number of SOEs not under the pilot HoldCo (where it would have a key role in its board). Under Option 3 (DPE subsidiary), it would transfer part of its functions to its own subsidiary but would retain overall responsibility for the execution of SOE oversight.

### Proposal and recommendation – statement

**Rec. 1.** The Government should overhaul the institutional framework for state ownership, with the creation of a separate “ownership entity” to exercise stewardship for State participations in SOEs. Three options are proposed:

- Option 1: Creation of a comprehensive “holding company” where the State would transfer the rights to the shares it currently owns in strategic SOEs, including Eskom, Transnet and PRASA. This entity would take over many of the functions undertaken by the DPE (such as the elaboration of shareholder compacts, review of SOE corporate & business plans and quarterly reports); it would appoint and dismiss SOE boards, and ensure professionalism and the right skill-set in SOE board appointments. Its operation would rely on a team of professional staff, drawn from government departments and recruited externally. The HoldCo board would be composed of senior representatives of the main ministries (including the Treasury in a leading role) and a minority of INEDs from the private sector. The DPE would become a smaller department with responsibility of developing and owning the SOE ownership policy for Government approval — with the PSEC having an overall consultative role, including on INED appointments.



- b. Option 2: The DPE's remit would remain as is for the large bulk of the companies but a "pilot" HoldCo would be assigned stewardship of a few strategic companies with a primarily commercial perspective (or in dire need of financial discipline due to previous capture issues) including Eskom, Transnet and possibly PRASA. Its main governance characteristics would be the same as in option 1, but the DPE would play a leading role on its board.
- c. Option 3 (closer to the current institutional arrangements): The DPE would retain ownership oversight over its current portfolio but under the coordination and oversight of the PSEC. It would assign some of its current functions related to board appointments and evaluation to a subsidiary staffed with highly skilled professionals.

## A. 2. The State's role as policy maker

### Background and best practice

- 76. In executing its role as policy-maker, the state in developed and emerging markets alike typically pursues performance objectives and targets for SOEs in the context of formal high-level documents ("mandates") that may be supported by more detailed documents (with specific annual or multiyear performance measures) e.g. business plans etc.
- 77. "Mandates" come in a variety of forms and are called differently across various national jurisdictions. Names used include statements of corporate intent, performance contracts, memorandums of understanding, statements of expectations, and letters of agreement. SOE mandates usually define the sector and lines of businesses for SOE operations, with multiple goals. SOE mandates specify broad goals or constraints on financial sustainability and include a description of the scope of public service obligations for the SOE (e.g. employment commitments for local citizens etc.). Mandates thus typically explicitly identify the agreed combination of commercial and policy objectives for the SOE. SOE mandates should ideally be linked to the purpose and rationale for having SOEs; SOEs are suitable and have a purpose under certain circumstances<sup>23</sup>.
- 78. Based on its mandate, each SOE develops its own strategic plan, subject to board approval (and explicit or implicit approval of the ownership entity). Strategic plans clarify trade-offs in the overall direction and running of the SOE, and provide a clear basis for measuring SOE performance. In practice, incorporating SOE mandates into the strategy-setting process for SOEs often reveals inherent contradictions between commercial and non-commercial objectives which need to be addressed. The typical components of SOE mandates or performance agreements include:

#### *Exhibit 4: Typical components of SOE mandates or performance agreements*

- The scope of activities that the SOE will undertake. Here, SOE mandates offer two benefits:
  - providing clear guidance and direction to the SOE; and

<sup>23</sup> Please see the Part B report: Framework for the suitability of state-owned enterprises. This report discusses the circumstances more.



- serving as a constraint on SOEs, by imposing discipline against State (e.g. policy makers or line ministries) encouragement of SOEs to undertake irrelevant activities not in the best interest of the SOE or its owners.
- A short description of the SOE's vision and strategy.
- A clear description and explicit financial cost estimate for the SOE's non-commercial objectives.
- Financial and nonfinancial performance indicators / targets for the SOE.
- Frequency and procedures for reporting by the SOE.
- Statement describing the State's approach to the dividend policy for the SOE.

## Strengths

### ***Strength 3. South Africa has a system of shareholder compacts to set, cascade and monitor performance and policy objectives for each SOE.***

#### **(i) Setting mandates and performance objectives:**

*"The DPE tries to make sure that certain pillars of the NDP are cascaded into the Shareholders Compact and Strategic Intent document."*

*"Shareholder compacts try to sum up expectations of the State to the SOEs in terms of its developmental objectives."*

*"One could lose sight of bigger picture and the Shareholder Compacts, when properly implemented, could take us where we really need to be."*

*"The shareholder compact of SOEs has a dual mandate (commercially sustainable and also developmental mandate, i.e. job creation)."*

79. In SA, objective setting begins with the Cabinet, which decides on the broad policy in the context of the NDP. This policy is then issued as a directive by the Minister through the applicable policy department, to the relevant SOE charged with implementing and delivering against that policy. The Public Finance Management Act (PFMA) is the main legislation that gives the executive branch its authority over SOEs. The PFMA indicates that, for the SOEs under them (e.g. Eskom and Transnet in scope), the DPE reviews the SOE corporate and business plans, agrees the SOE shareholder compacts and quarterly reports from the SOEs.
80. The SOE shareholder compact, renewed annually in consultation with the State, translates NDP policies into commitments. The preamble of the Compact would typically mention the NDP, and sum up what is expected by the State for SOEs in terms of developmental objectives. There are a number of pillars for the Compact: operational; financial (e.g. KPA – "Key performance areas" which might have a number of Key Performance Indicators - KPIs); socio-economic KPA (training; localisation; indicators under HR; transformation plans; supply development programme; job creation); industrialisation. Key performance areas of Eskom's 2014 shareholder compact included, for example: focusing on safety; being customer centric; delivering capital expansion; ensuring financial stability.

81. For Transnet, its strategic focus is guided by the Statement of Strategic Intent (which covers a number of years) issued by the Minister of Public Enterprises and the yearly Shareholder's compact, which stipulate medium-term strategic objectives, such as: reducing the total cost of logistics as a percentage of transportable GDP; leveraging the private sector in the provision of both infrastructure and operation where required; or optimising the social and economic impact of all interventions undertaken by the company in the achievement of these objectives.

**(ii) Negotiating mandates and performance objectives:**

*"The Shareholder Compact is a negotiation between the State and the SOEs on objectives."*

*"Shareholder compacts are initiated by the shareholder, so the input of SOEs is quite limited as to what goes into the Compact."*

*"SOEs can only "clear things around the edges."*

82. How mandates or performance agreements are prepared and negotiated varies among countries. The World Bank Group<sup>24</sup> indicates that, in South Africa, a performance agreement (i.e. the shareholder compact with each SOE) is used as an "expectations document" rather than an effort to establish a formal contract. Moreover, this agreement may to some extent be top-down, imposed by the ownership entity (in this case the DPE) on SOEs, with little input from SOEs in defining objectives. By contrast, in New Zealand, the World Bank indicates that the spirit of mandate negotiations is "bottom-up" – SOEs have a more pronounced role in proposing performance objectives/targets to the ownership entity for consideration.
83. With respect to monitoring and tracking performance objectives, indicators and targets, best practice calls for the monitoring to be done at least annually. In practice, however, for strategically important SOEs, more regular monitoring (bi-annual or quarterly) may be warranted. In South Africa, the main process seems to be composed of confidential quarterly reports to the ownership entity on progress. At times of crisis, however, monitoring of specific aspects of SOE operations, such as financial and liquidity positions by the Treasury, occurs much more frequently, even daily.

**Areas for improvement and reform**

***Area for Improvement 2. SOEs may face multiple policy objectives (not all cohesive/coordinated) whose prioritisation and translation into specific operational objectives is not always successful.***

*"[It's] difficult to interpret NDP targets."*

<sup>24</sup> World Bank Group (2014) Corporate Governance of State-Owned Enterprises: A Toolkit.

84. The existence of a large number of objectives as expressed in a variety of policy documents, including the National Development Plan – NDP (the main plan); New Growth Path - NGP; the Medium-Term Strategic Framework - MTSF; the Industrial Policy Action; and the National Transport Master Plan), which may be evolving and shifting, may make it difficult for SOEs to understand what is required of them from the State and follow a cohesive strategy that focuses on implementation of policy objectives.
85. It is in fact not always clear how individual SOE strategic objectives embodied in compacts, business plans and budgets are aligned with the state’s multiple policy objectives. Often, the reference in SOE strategic documents to higher level policy documents is made in general terms, sometimes simply paying lip-service to the broader goals of the NDP, without translating these into real NDP-focused specific, actionable KPIs at the level of the SOE, and without drawing out the operational and financial implications for the SOE. The “cascade” in place seems to put emphasis on aspirational narratives rather than execution-focused substance.
86. As noted in the Performance Framework paper (one of the reports of the project) prepared by Genesis Analytics, while the disclosed “mandates” of the SOEs under scope may be aligned with broader NDP goals, such alignment is not always obvious in the ways by which the SOE performance is actually measured in the shareholder compact. The mandates which the entities in question have adopted for themselves tend to be short, operationally focused and transformative; in contrast, the performance measures in shareholder compacts are over five pillars and the NDP framework has 11 thematic areas for performance. Hence effectively, SOEs are being assessed against much more than their specific core mandate.
87. There is therefore a clear case for streamlining the various “cascade” links (NDP, MTSF, PMFA, Logical Framework, Compact etc), with a “cycle” for the cascade that would go through the holding company board as adjustment to the overall direction of an SOE. In this cycle, a clear and recognised mechanism, e.g. the Shareholder’s Compact, should be used as an anchor and means for the State to clearly communicate what is expected from SOEs each period so that SOEs work towards this, making reference to developmental goals and their implications for SOE performance. This mechanism should be respected by all players in communicating the relevant objectives to SOEs via the ownership entity.

***Area for Improvement 3. There is a need for more effective coordination among different government stakeholders and in setting objectives.***

*“The short answer is that NPC does not get involved in implementation. We could consider an invitation to an implementation roundtable.”*

*“It is not clear that DPE gets NPC and SOEs around the table on how to implement the NDP. The direction of the shareholder does not appear to work – it is very ad hoc and anecdotal.”*

*“There is absolutely no alignment on policy. Each body doesn’t know what is happening.”*

88. From interviews in the context of preparing this report, there is evidence of insufficient coordination among key players in the State, such as the NPC, DPE, line ministries, in the

definition of policy objectives for SOEs. This may betray a lack of coherence, as social-economic indicators and targets come from different departments. Communication channels between the NPC and state-ownership bodies are often weak and the discussions around Shareholder Compacts seem not to be used by government agencies to synthesise policy perspectives for specific SOEs.

89. Furthermore, it appears that the ownership entity (e.g. DPE for Eskom and Transnet, DoT for PRASA) simply engages with the SOE on objectives, without a clear process of consultation. As put in a DoT White Paper: “A material weakness [in the current arrangement] is that the Department of Transport, as custodian of national rail policy, is not consulted in mandating key performance measures and indicators (i.e. shareholder’s compact) to be attained by Transnet’s Freight Rail division.”<sup>25</sup>
90. In the context of the recommendations offered in the previous section of this report, the preferred means in practice for achieving coordination between line ministries and shareholder ministries is having line ministry representatives sit on the board of the ownership entity under which ownership is centralised (for example, in the case of a holding company), though not on the boards of the underlying SOE. Through participation in this board, line ministries agree with the shareholder ministries on relevant public policy objectives for underlying SOEs. An example in the case of a Supervisory Council can be seen in Croatia below:

#### *Exhibit 5: Croatia: CERP<sup>26</sup> - Centre for enterprise restructuring and privatisation*

The CERP was established in the Republic of Croatia as the legal successor of the State Assets Management Agency. The responsibilities of CERP pertain to managing shares and business interests in companies owned by the Republic of Croatia that are not of strategic importance. The CERP is headed by a Supervisory Council composed of the following:

- i. the Minister responsible for Ministry for State Assets i.e. the shareholder ministry (who serves as president of the Supervisory Council);
- ii. the Minister responsible for finance;
- iii. the Minister responsible for tourism (line ministry for some SOEs under CERP);
- iv. the Minister responsible for maritime, traffic and infrastructure (line ministry for some SOEs under CERP);
- v. the Minister responsible for agriculture (line ministry for some SOEs under CERP);
- vi. the Minister responsible for energy (line ministry for some SOEs under CERP);
- vii. the Minister responsible for justice affairs;
- viii. a representative of the Office of the Prime Minister of the RoC;
- ix. a representative of the unions (without the right to vote);
- x. a representative of higher-level employer associations without the right to vote.

The Supervisory Council coordinates on matters such as nomination and appointment of SOE board members, as well as decisions pertaining to which SOEs are to undergo restructuring or be sold. Questions pertaining to the use of state budget resources are also considered by way of the Minister of Finance being part of the Supervisory Council. The Supervisory Council meets on an ad-hoc basis.

#### **Proposal and recommendation – statement**

<sup>25</sup> National Rail Policy White Paper (2017).

**Rec. 2.** In order to better prioritise objectives for SOEs and improve coordination, the Government should ensure all key objectives including financial discipline and developmental goals are prioritised and aligned with the specific financial and operational objectives in SOE shareholder compacts. This could be made operational through:

- a. Mandating that the acceptance of shareholder compacts is contingent on the inclusion of clear financial implications involved in meeting specific developmental and other goals.
- b. Establishing a regular forum among senior policy makers from different government stakeholders to achieve this—for example the board of the HoldCo or the PSEC.
- c. Ensuring that individual SOEs have an opportunity to present and discuss their perspective in the mix and prioritisation of objectives.

**Area for Improvement 4.** *The appropriate balance between commercial and development objectives for SOEs requires review. A clearer process on the treatment and costing of PSOs is also necessary.*

*“You could allow SOEs to be part of shaping / aligning what these objectives [Public Service Obligations] should be.”*

*“The Shareholder cannot be writing policies and making pronouncements, without at least giving a heads up to SOEs.”*

*“[...] the ownership entity should also communicate more specific financial, operational and nonfinancial performance objectives to SOEs, and regularly monitor their implementation. This will help in avoiding the situation where SOEs are given excessive autonomy in setting their own objectives or in defining the nature and extent of their public service obligations.”*

**OECD Guidelines 2015**

91. SOEs across the world typically face governance problems that include multiple and competing objectives, such as balancing commercial and developmental objectives outside their core mandate and preventing interference in SOE management. Unfunded PSO mandates with PSOs that are not always explicitly defined tend to be an important contributor to poor SOE performance. A clear costing of PSOs and demarcation between commercial and non-commercial activities and objectives is this an important factor in good SOE governance practices.
92. There seems to be no clearly defined and unified policy guidance for the treatment of PSOs in South Africa, leading to the use of various approaches across different ministries. In addition, the NDP, prepared by the NPC, does not appear to sufficiently balance financial sustainability considerations with public interest aspirations for SOEs. It also appears that there is not always enough discipline in the process: for example, the PRC

Review of water boards under the Ministry of Water Affairs indicates that 10 percent of compacts (which include such PSO obligations) were not signed off by the board and minister; 65 percent were signed by the board but not the minister; and only 25 percent were signed by both. This low joint signature rate (especially at the political level) suggests a limited technical competence and capacity in oversight authorities to review and sign off on compacts.<sup>27</sup>

93. In terms of the SOEs under scope in this report, Eskom does have a "developmental mandate" through building new capacity, executing DoE's electrification programme, and supporting skills development and job creation. Eskom's mission is *"To provide sustainable electricity solutions to grow the economy and improve the quality of life of the people in South Africa and the region"*. Similarly, Transnet's mandate is *"to assist in lowering the cost of doing business, to enable economic growth and to ensure security of supply by providing a pipeline infrastructure in a cost-effective and efficient manner, within acceptable benchmarks."*
94. In the case of PRASA, its purely public-service oriented mandate has contributed to it finding itself in a difficult financial position: a serious cash shortfall on its operational expenditure budget, which has accumulated over several years, caused by rising operational costs, declining revenues, heavily subsidised ticket prices and a stagnant operational subsidy.
95. More generally, the oversight entities provide general guidelines to SOEs regarding public services and broader socio-economic objectives which however are not necessarily linked to specific funding or provisions to allow them to fulfil such mandates. According to the DPE Protocol for example, "SOE's corporate plan should, inter alia, ensure that the SOE contributes to job creation, rural development, urban renewal, poverty alleviation, empowerment of women, skills and management development and education".
96. Having a clear policy and process for PSOs, as well as proper costing of PSO-related services, in a process regularly undertaken within each of these SOEs with the help of external expertise, will avoid SOEs facing unfunded mandates, and in the process improve the governance framework for SOEs, their sustainability and ultimately also their ability to deliver public services. This is also important in assessing management performance – underperformance can in certain cases be simply due to deficits related to State-mandated policy objectives.
97. In this context, it might be appropriate to give more responsibility to SOE boards on tariff policies with more reliance on user pay tariff systems. While in natural monopolies, the regulator remains the ultimate arbitrator of tariffs, more responsibility to boards in proposing such tariffs would make the cost of PSOs more transparent.

### Proposal and recommendation – statement

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<sup>27</sup> Kikeri, Sunita (2018). Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English). Washington, D.C.: World Bank Group.

**Rec. 3.** The government should consider reviewing the overall PSO framework to provide SOEs with the appropriate balance between commercial and development objectives and involve a clearer process on the costing of PSOs. In this direction:

- a. Line ministries and the ministry of finance should agree on the clear definition and costing of SOE-specific PSO obligations.
- b. Such SOE-specific PSO obligations should become part of the holding company compact development and agreement.
- c. The commercial activities of the SOE and the developmental activities should be ring-fenced into separate accounting systems.

***Area for Improvement 5. The process and indicators used for monitoring and evaluating SOE performance could be strengthened.***

98. The process for monitoring and evaluating SOE performance in terms of service delivery and contribution to national developmental or sectoral outcomes in South Africa does not appear to be as sophisticated as in some other countries. While the DPE attempts to ensure that certain pillars of the NDP are cascaded into the Shareholders Compact and Strategic Intent document, it seems the KPIs for the SOEs could be better defined and have clearer measurement criteria. The impression is that these are too broad and not specific enough, making assessment difficult and too subjective. It seems that SOE output indicators, of a developmental nature, could be more clearly defined in shareholder compacts. In addition, no systematic evaluation system seems to be in operation.
99. Countries use a variety of instruments for monitoring and evaluating SOE performance. Ownership entities often require SOE management to document reasons for unexpected variances from objectives in the mandates. The SOE leadership may be called to provide explanations in face-to-face meetings with the ownership entity for large variances from planned results. Public disclosures on SOE performance against agreed objectives or relevant benchmarks are also used to instil a culture of accountability and can act as a strong incentive for managers and boards to improve performance.

***Exhibit 6: Performance agreements and indicators: guidelines for performance agreements and indicators in New Zealand***<sup>28</sup>

In New Zealand, SOEs negotiate a statement of corporate intent with their shareholding minister each year. The company board is required to prepare a draft statement and submit it to the minister for review. The statement should include the company's objectives, specific financial indicators, basic financial policies, and key targets. Performance indicators (financial and nonfinancial) must also have other characteristics:

- Be meaningful for the SOE's business and SOE law.
- Be specific and measurable, with no ambiguity.

<sup>28</sup> World Bank Group (2014) Corporate Governance of State-Owned Enterprises: A Toolkit.



- Be timely and capable of being audited, where appropriate.
- Be within the SOE's responsibility or power of control.
- Be consistent with and influence, as appropriate, the SOE's purpose and principles of operation or business.
- Respect commercial sensitivity, where appropriate.

The board negotiates the draft statement of corporate intent with the shareholding minister formally and informally. It considers any comments on the draft by the minister; then the board delivers the final statement to the minister before the start of the company's financial year. The board can modify the statement through written notice to the shareholding minister as long as it first gives written notice of the proposed modification and considers any comments provided.

100. The ownership entity may also use external parties to assist in tracking SOE performance. In Thailand for example, SOEs have performance agreements with KPIs and targets, and the State Enterprise Policy Office (SEPO) monitors these with the Thailand Rating Information Service, contracted by SEPO for this purpose. New Zealand issues guidelines on the indicators to be included in mandates. KPIs should be meaningful, specific, measurable, capable of being audited, within the control of SOEs, and respect commercial sensitivity (see Exhibit above).
101. As regards performance evaluation mechanisms, countries use a number of methods to evaluate the progress and achievement of SOEs with respect to performance objectives indicated in the mandates. Some use independent experts or external committees for the evaluation process. In India, for instance, task forces or committees composed, at least in part, of outside experts are used. The aim is to increase the independence of the process and introduce more sector expertise. In Thailand, the evaluation process is contracted to an institution outside the government.
102. In the Republic of Korea, a sophisticated business performance evaluation system has been set up for SOEs. The Ministry of Strategy and Finance has established an evaluation team consisting of about 130 civilian experts – professors, consultants, and accountants. Indicators in three categories (leadership and strategy, management system and management result) are evaluated. Agreed qualitative and quantitative indicators within each category are weighted and grades are assigned to the SOEs. Incentives are decided for SOE leadership based on the grade. For public corporations, incentives vary from 250 to 500 percent of the basic salary, based on the grade given. SOEs with poor results receive little or no bonuses, while the Minister of Strategy and Finance may recommend the dismissal of the CEO (on remuneration issues, see also section B below).
103. It would be useful for SA to consider more sophisticated methods such as these for SOE performance evaluation versus agreed objectives in the Shareholder Compacts, with an emphasis on injecting external expertise into the process, but always tailored to the specificities of the country.

***Area for Improvement 6. The consequences of significant SOE deviation from performance against policy objectives are unclear, and so is relevant remedial action.***

*"Consequence management is something the Shareholder struggles with."*



104. In the SOEs under scope in this report, performance has lagged behind expectations for a significant number of years; this has concerned both financial results as well as service delivery. In PRASA, for example, service delivery is considered poor, unreliable, and unsafe. From a financial standpoint, PRASA faces a massive cash shortfall on its operational expenditure budget, accumulated over several years, and caused by rising operational costs, declining revenues, and a stagnant operational subsidy. PRASA's poor performance has resulted in the decline of customer and stakeholder confidence the company's capability to deliver on its mandate.
105. In general, countries link performance incentives/variable remuneration to performance evaluation against objectives in SOE mandates. In South Africa, the DPE protocol does include provisions indicating that there would be consequences of SOE deviation from the shareholder's agreed strategic plan. In principle, according to interviewees, if goals are not met the ministries now employ a number of options: fire the board; refuse a remuneration increase or bonuses for the board; try to understand the skills missing and required at the board. Although it was recognised that implementation in practice is more difficult due to an ad-hoc performance criteria.
106. Agreeing on indicators against which performance is judged is the way for ministries to link the Shareholder Compact with bonuses and provide the system with more transparency and accountability. It is however unclear how processes in place have sought in practice to incorporate such deviation from performance against policy objectives and what remedial action has in fact been taken.

#### Proposal and recommendation – statement

- Rec. 4.** The government should consider reviewing the process and indicators used for monitoring and evaluating SOE performance. This would involve:
- a. Developing more granular performance indicators for specific SOEs through a dialogue of the ownership entity, also using external expertise.
  - b. Including indicators linking performance to remuneration in an explicit and transparent fashion.
  - c. Making clear and binding the consequences for SOE leadership and ownership entity management for deviation from performance against objectives set in Shareholder Compacts and in the NDP.

#### ***Area for Improvement 7. The framework for SOE procurement practices needs to be reviewed and strengthened.***

107. SOE procurement practices across many countries present a source of inefficiency and weak economic performance, as well as an area where political and economic "capture" of the governance process manifests itself. In South African SOEs, procurement practices have in effect been the main avenue for corruption.
108. Given the widespread abuse and cases of corruption relating to procurement in Eskom and other SOEs, the Government has attempted to address weak procurement practices.

Aside from legally pursuing those responsible at all levels for their past actions, it is critical to thoroughly overhaul the system which allowed corrupt individuals to use procurement for personal gain. In this context, the efforts made could be bolstered by a codification of regulations on procurement. This could be undertaken in the context of the planned SOE bill, or by reviewing the PMFA to provide SOEs with explicit uniform guidelines on procurement and clear directions on methods, practices and expectations in this area based on international best-practice.

109. Experience from other countries suggests that rarely is the solution lowering approval thresholds and, in the process, having the board become a procurement committee. The effect of lowering procurement thresholds is often exactly the opposite of what one is trying to achieve: a huge standstill and slowdown of business and a culture of lack of responsibility. Rather the focus should be on a clear committee structure at management level, and continuous auditing by a high-quality audit team that reports to the independent audit committee. In this context, one should note Treasury's plans to create a Chief Procurement Officer position, in an attempt to keep oversight of certain liability-inducing transactions.

#### Proposal and recommendation – statement

- Rec. 5.** The framework for SOE procurement needs to be overhauled so that procurement practices are competitive, non-discriminatory and transparent. In this context:
- a. SOEs should be provided with explicit uniform guidelines on procurement organisation and controls.
  - b. Regular audits of procurement practices should be put in place based on such guidelines.
  - c. Transparency requirements should include a system for a review of complaints.

### A. 3. The State's role as regulator and overseer of SOEs

#### Background and best practice

110. Central to international best practice recommendations of the OECD and the World Bank is the need for states to separate the functions of owner, policy-maker and regulator in their oversight of SOEs. The argument is based on the requirement for the legal and regulatory framework for SOEs to ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities. It follows that the public-purpose regulation of economic activities in critical activity areas such as energy and transport which have a large state presence need to cover all companies (currently and potentially) operating in the relevant markets, not just publicly-owned ones.
111. This suggests two distinct policy needs: first, a clear separation of the function of owner from that of the regulator, by for example assigning the SOE ownership and regulatory responsibility to different parts of government; and second, the existence of independent regulators, at a "hands-off" distance from the government department responsible for policy-making in a particular area. Hence, for example, in the transport sector, the relevant Ministry of Transport should be responsible for transport policy, transport SOEs

should be overseen by a different principal, and an independent regulator should address issues such as delivery standards and pricing.

112. Furthermore, in addition to regulatory activities and oversight of SOEs by the executive in the different forms discussed above, a system of checks and balances is best served by additional oversight by parliament (aside from judicial oversight). The form this takes differs widely across countries, according to the parliamentary system in place. Effective parliamentary scrutiny is necessary but also often difficult to ascertain and to achieve. It is therefore important that the right balance is struck on the level of granularity of regular scrutiny by Parliament – which of course should always have the right to demand detailed information from specific SOEs and hold them accountable.

## Strengths

### ***Strength 4. The State regulatory function is separate from the ownership function for Transnet and Eskom.***

113. For both Eskom and Transnet, the state regulatory function (exercised in the context of the relevant line ministry) is distinct from the ownership and policy functions exercised respectively by the DPE and the line ministries. This is particularly important in the case of Eskom in the context of a growing presence of Independent Power Plants in the sector which have increased the level of competition in generation.

### ***Strength 5. There are parliamentary bodies which provide another layer of oversight over SOEs on behalf of the public.***

*“The value of parliament is to enhance accountability and transparency.”*

*“I have been to parliament with SOEs. They do not always focus on the right things.”*

114. In Parliament, the Standing Committee on Public Accounts (SCOPA) oversees financial issues and the Portfolio Committee considers service delivery.
115. SCOPA’s responsibility in reviewing the audit reports of the Auditor General covers a broad area: issues raised in the General Report on Audit outcomes; financial probity as highlighted in the audit report or disclosed in the management report; compliance with the PFMA, Treasury Regulations, the Audit Committee and the management report of the accounting officer; evaluation of unauthorized or irregular expenditure; functioning of risk management systems; and corporate governance of departments, public entities and constitutional institutions.
116. In turn, the Portfolio Committee exercises oversight of the service delivery performance of SOEs. Their mandate includes reviewing non-financial information contained in the annual reports of SOEs. These Committees are intended to exercise oversight as to whether entities have delivered on the service delivery commitments made in corporate plans.

117. While these committees are mandated to exercise parliamentary oversight over SOEs, the engagement of DPE with the parliamentary bodies is unclear; at the same time, government representatives have expressed doubts regarding the substantial (as opposed to simply procedural) oversight of SOEs exercised in this context.

### Areas for improvement and reform

#### ***Area for Improvement 8. The combination of regulatory and ownership functions for PRASA needs to be reviewed.***

118. Unlike Eskom and Transnet, in the case of PRASA the regulatory and ownership function is currently combined under the DoT. In essence, PRASA's operation is directly aimed at satisfying transport policy requirements, without the hands-off approach generally recommended by governance best-practice and no ownership perspective separate from regulation and policy making. There is no economic regulation for PRASA at present, only safety regulation (National Railway Safety Regulator Act).
119. Trade unions have argued for PRASA to be put under DPE to allow separation from the Railway Safety Regulator (RSR) which is under the DoT so the RSR can be more objective in regulating PRASA. A unified regulator currently being set up should create a degree of separation of PRASA from DoT (in case DoT continues to retain ownership of PRASA). This unified regulator is being created on the basis of an MoU between DPE and DoT; eventually, it will address economic as well as safety regulation including road and rail.

### Proposal and recommendation – statement

- Rec. 6.** In the case of case PRASA, ensure a clear division of ownership/regulatory roles through the effective and timely establishment of an independent regulator for transport, covering both economic and safety regulation.

## **A. 4. The State's approach to funding decisions for SOEs**

### Background and best practice

120. The economic rationale for public funding of SOEs internationally rests on their pursuit of public policy objectives in parallel to their commercial activities. Across a number of countries, SOEs are loss-making as a result of pursuing such objectives (and often as a result of mismanagement); depending on the nature of the SOE, states directly subsidise operating or capital expenditure, provide equity or guarantee loans. The need for robust financial oversight of SOEs is in such situations self-evident, and tends to emanate from national treasury departments, since often they end up acting as the lender of last resort to avoid bankruptcy and the wider societal costs from a SOE, with strategic importance for the social and economic activity in a country, ceasing operations.

### Strengths

**Strength 6. The National Treasury currently provides financial oversight of SOEs.**

*“Treasury has an oversight role of the Compact and looks at funding needs. At the end of the financial year, the NT looks at how SOEs perform considering the circumstances.”*

*“The NT normally has regular meetings with PRASA and Department of Transport. The same applies to Eskom where the National Treasury regularly meets with DPE and Eskom.”*

121. The SA National Treasury is responsible for financial support in terms of all requests from SOEs, including equity requests as well as government support in terms of their debt. The Treasury exercises financial oversight through setting reporting guidelines to promote and enforce transparency in revenue, expenditure, assets and liabilities of SOEs, oversight over the funding/borrowing programmes of SOEs, controlling the utilisation of contingent liabilities and effective treasury management models.
122. In principle, Schedule 2 entities such as Eskom and Transnet, are large SOEs that are supposed to operate on the strength of their own balance sheet with limited assistance and no direct government support; Schedule 3 entities such as PRASA are necessarily dependent on fiscal allocation. In practice, given the current financial situation of the SOEs, the Treasury appears to be hands-on on funding and works both with SOEs and ownership entities, while also playing a role in providing final approval of significant strategic transactions (co-approved by shareholder ministry and Treasury).
123. In cases such as Eskom where a SOE is of critical importance and faces particular financial difficulties, the National Treasury will continuously (even daily) monitor the liquidity position and cash requirements, while having regular meetings with both the DPE and the company. Any strategic transactions (e.g. significant loans, investments etc.) for ESKOM have to go to the Treasury for approval.
124. The broader environment within which the Treasury operates is one where Cabinet is responsible for overall decision making on funding, with several cabinet ministries taking funding decisions together. The Treasury is directly responsible for the categorization of SOEs into schedule 2 or 3 through legislation of the PFMA, but it appears this needs to be approved by parliament, following a joint proposal by Treasury and the Shareholder Ministry. This is done based on assessing the financial position of the SOE and the assets and assistance that may be required in each case.

**Strength 7. There appears to be a relatively clear approach on SOE dividend policy.**

125. Countries address SOE dividends in various ways: (1) broad guidelines identifying factors to be taken into account when establishing dividend levels; (2) an explicit percentage of net income; or (3) the level of dividends required to maintain an optimal capital structure for the SOE. Some countries do not use guidelines but annually negotiate dividends with SOEs on a case by case basis.

126. A dividend policy is included in the financial plan of the SOE's corporate plan<sup>29</sup>. The policy is driven by the desired capital structure, the profitability of the SOE and the level of agreed capital expenditure of the SOE. The target optimal capital structure (combination of financial liabilities and equity used to fund the assets of the SOE) is agreed annually between the directors and the shareholder in the corporate plan consultation process.

### Areas for improvement and reform

#### ***Area for Improvement 9. While financial assistance to SOEs seems to be relatively transparent, the overall framework for financial oversight could be improved.***

127. Within the Budget Review 2019 (National Treasury RoSA), overall government guarantee exposures to the SOEs under DPE are listed, as are borrowing requirements of selected-state owned companies. This suggests that financial assistance to SOEs seems to be relatively transparent.
128. However, two of the three strategic SOEs under scope for this report are loss-making (the exception is Transnet), with the government providing operating subsidies or state guarantees of their loans. This suggests that a robust environment of financial oversight is required in order to control and minimize the State's outlays or exposure.
129. Nevertheless, while the DPE has an organised interface with SOEs, that of the National Treasury is more ad hoc (though intensive on important issues). At the same time, there is no direct Treasury input into the budget of SOEs (though the Treasury does provide input on the strategic plan and the compacts, which govern the budgets).
130. It is established best practice for the state to have a "hands-off" approach allowing SOE boards a degree of autonomy for commercial operations. This is partly the reasoning why the Treasury in South Africa has no representative on SOE boards, though this would be a common practice in some countries. Nevertheless, the resulting financial oversight seems weak, despite regular monitoring of liquidity positions and cash management of certain SOEs by Treasury. As argued in previous sections, the creation of an ownership entity such as a holding company with a central role for the Treasury on its Board could be a way to remedy this ad hoc, "trees, not forest" approach which might have been partly to blame for the loss of financial discipline in the first place. Even however in the case where the current DPE-centred arrangement remains, the government needs to strengthen the overall financial oversight of SOES (see Rec. 7 below).

#### ***Area for Improvement 10. The link between PSO-related payments to SOEs and SOE requirements to fulfil PSOs could be strengthened.***

131. The OECD suggests that most national governments either base SOE financing decisions on broad guidelines on capital structure efficiency or come up with financial performance targets for at least some aspects of SOE operations. About 60% of surveyed countries in

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<sup>29</sup> Treasury Regulations, 2001.

an OECD study<sup>30</sup> require SOEs to separate the accounts of commercial and non-commercial activities to facilitate transparency around cost allocation. Furthermore, in most countries, direct state support for SOEs is generally provided in compensation for PSOs assigned to SOEs. Ensuring that this compensation is calibrated to the cost of requiring SOEs to fulfil public policy objectives is a challenge in practice.

132. In light of the state support provided to the SOEs under scope, it would seem opportune for the SA Government to give a broad direction and guidelines for SOEs to more clearly distinguish between commercial and non-commercial costs, for example through restructuring to establish separate cost centres by activity. Even outside restructuring, cost centers and business lines can be distinguished and this is not always happening e.g. in the case of Eskom, specific business lines targeted for the unbundling, generation, transmission and distribution. The elaboration of cost centres as a general principle could be part of the state ownership policy to be developed.
133. SOEs such as those under scope in this report face a financing challenge given the backlog in infrastructure and other essential services. They are saddled with a legacy of debt and remain insufficiently capitalised to invest in infrastructure to increase capacity or just to maintain existing capacity. They continue to depend on Government for financial support in the form of explicit guarantees to back up debt funding and/or subsidies.
134. It is recognised that South Africa's self-imposed limit on a debt/equity ratio of no more than 40 percent constrains the extent to which the Government can support SOEs<sup>31</sup>. According to industry experts, some SOEs have succeeded in obtaining tariff increases but these do not come close to being sufficient to meet the financing needs, and in some cases will never be able to do so. Moreover, there is strong opposition to adopting the "user pay principle" for economic infrastructure where most people have limited means.
135. SOEs are increasingly operating in a context where large infrastructure needs are combined with weak balance sheets and investment positions. To bridge the financing gaps, they have attempted partnerships with the private sector. Public-private partnerships can be beneficial and there is evidence and international best practices on how SOEs can leverage private capital in joint ventures for pursuing the public interest.
136. In this environment, recommendations (including in the PRC Review) to enhance the financing capacity of SOEs to meet infrastructure financing needs include: rationalisation of State holdings; effective oversight for commercial SOEs; greater mix of debt and equity finance; a clear policy for the treatment of non-commercial objectives; and strategic partnerships with the private sector<sup>32</sup>.
137. Regarding public-private partnerships however, the World Bank notes that such attempts of SA SOEs have been problematic; SOEs are often not inclined to undertake such public-

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<sup>30</sup> OECD (2018). Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

<sup>31</sup> Kikeri, Sunita (2018). Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English). Washington, D.C.: World Bank Group.

<sup>32</sup> Kikeri, Sunita (2018). Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English). Washington, D.C.: World Bank Group.



private partnerships (PPPs) on “good” assets as they prefer instead to retain the ability to cross-subsidize loss-making activities by more profitable ones. Nevertheless, international experience suggests that across a wide range of type of projects, well-designed and executed PPPs can deliver infrastructure assets and related services faster and at lower cost than traditional public procurement.

138. This suggests the need to elaborate a balanced public-private partnership policy with broad public acceptance that would enable the State to access capital for long term infrastructure projects. In this context also, the State could provide SOEs with clear uniform rules for such partnerships, developed in the context of an entity entrusted to design rules and procedure for the wide use of such practices and backed up by appropriate PPP demonstration projects.

#### Proposal and recommendation – statement

- Rec. 7.** The Government should consider strengthening the overall financial oversight of SOES, while assisting them in achieving PSOs. In this context:
- a. The reporting framework for companies that receive financial assistance by the Treasury should be clarified and strengthened.
  - b. There should be an established Treasury veto in the approval of compacts until remedial action is taken by the board of SOEs receiving financial assistance.
  - c. The State should provide SOEs with clear uniform rules for public-private partnerships aimed at leveraging private capital to fulfil public infrastructure needs.

## B. SOE board leadership

### B. 1. The State's approach to the SOE board composition and nomination process

#### Background and best practice

139. SOEs need to be sustainable over time like any other business, addressing the needs of their owners and stakeholders. Their boards need to take full responsibility for the company direction and control, including the stewardship of its assets. Conversely, in acting as an informed and active owner, the State should rely on SOE boards to ensure the implementation of agreed commercial and non-commercial objectives by SOEs.

140. The OECD Guidelines stipulate a number of elements in this respect:

*"The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise's performance. [...] The board should be fully accountable to the owners. [...] SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government.*

*SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications.*

*Independent board members [...] should be free of any material interests or relationships with the enterprise [...] and the ownership entity.*

**OECD Guidelines, 2015**

141. In addition, the OECD SOE Guidelines for Southern Africa<sup>33</sup> focus on the need for nomination and appointments to emulate best practices, including those applicable to private enterprises. This implies that to the extent feasible, the appointment (and removal) of board members, even in wholly owned SOEs, should be the responsibility of the annual shareholders meeting. Nominations should be based on a transparent, contestable and merit-based appointment process where candidates can put their names forward and have their qualifications evaluated.

142. In terms of composition, countries surveyed for the OECD report<sup>34</sup> generally have a mix of state representatives and "independent" directors on their SOE boards. Good practice calls for SOE boards to be composed primarily of members from the private sector, with

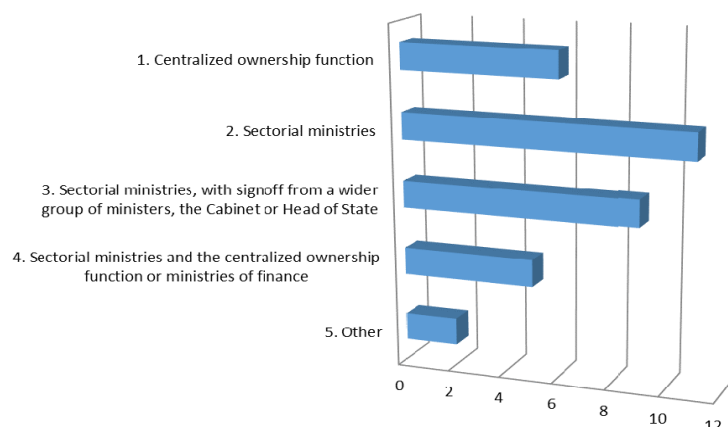
<sup>33</sup> See OECD (2014), Guidelines on the Governance of SOEs for Southern Africa (<https://www.oecd.org/daf/ca/SOE-Guidelines-Southern-Africa.pdf>).

<sup>34</sup> OECD (2018). Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

business, professional and other relevant backgrounds. Increasingly, countries have none or only a small number of civil servants on SOE boards.

143. Where an SOE has public policy obligations, some state representation on the SOE board may be justified. The general view is that ministers, state secretaries, or other direct representatives of, or parties closely related to, the executive power should not be represented on SOE boards. To avoid unwarranted state influence, some jurisdictions employ measures to limit the number of state officials on SOE boards. Such measures might include quotas for public officials (like in Finland), although explicit exceptions may be in place for the inclusion of representatives of the state enterprise ownership entity on the board (e.g. Australia and Sweden).
144. The eventual board composition in SOEs depends largely on the nomination process in place. Boards are important instruments for guiding SOE performance and monitoring delivery against objectives; hence the board nomination process is crucial to ensure effective SOE leadership, permitting continuity and balancing organisational memory. While many countries adopt specific procedures and follow general principles in this respect, the actual responsibility across government for nominating members of SOE boards varies widely (see Exhibit below).

*Exhibit 7: Who is responsible for nominating members to SOE boards?*<sup>35</sup>



Countries include Austria, Belgium, Brazil, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Israel, Italy, Korea, Latvia, Lithuania, Malaysia, Mexico, New Zealand, Norway, Pakistan, Poland, Portugal, Slovenia, Sweden, Switzerland, Turkey and United Kingdom.

## Strengths

**Strength 8. The State has taken steps to restructure the composition of the SOE boards, particularly for Eskom and Transnet.**

<sup>35</sup> OECD (2018) Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

*“There is a skill matrix. The DPE has a discussion on the skills of the whole board. There is evaluation of skills matrix and performance strength / weaknesses of the board to understand what is missing at the board level.”*

*“The DPE primarily makes board appointments out of a database – the candidates for the ad go into the database. If no appropriate skill mix is found in the database, the minister can expand to industry / organisations, but only then.”*

145. Following irregularities, corrupt practices and weak company performance, new boards have been appointed at Eskom and Transnet. The current boards appear to consist of professional individuals from the private sector. At Eskom, a large majority (80%) are independent directors and there are no state officials, although many have had past experience working in the DoE or the energy regulator NERSA. The board appointed in January 2018 is almost entirely new, with greater diversity as well (for example, 40% female participation).
146. A large majority of directors on Transnet’s board are also non-executive, whereas in PRASA the board composition reflects its oversight structure: its statutes mandate that officers of the DoT, the Department of Finance and the Department of State Expenditure are members of its Board of Control.

#### Area for improvement and reform

**Area for Improvement 11. *The State’s approach to board nomination could be more transparent and rigorous, less ad-hoc and politicised, more merit-based and better structured.***

*“The boards have been the weakest links in driving the state agenda.”*

*“The SOE board nomination process is a mess.”*

*“We should be stricter on who gets into the board. There is looseness around that. People bring in their friends.”*

*“There is a lot of patronage associated with the nomination and appointment of directors.”*

147. In practice, the board nomination process in SA suffers from a number of shortcomings, as both the Government and external analysts have recognised: it is non-transparent and only partially structured, representing a mix of technocratic and political. Ultimately, political decisions have prevailed in the selection of top management and the board in SOEs. In principle, attention is supposed to be paid to the required skill-set for the board; in practice, it is hard to know whether boards reflect and especially avail of the expertise required in such a skill-set.

148. The DPE issued in 2018 a “Handbook for Appointment of Persons to Boards of State-Controlled Institutions”<sup>36</sup>; this is not however followed by all government departments. There is no overall nominee director framework; the existing legal framework for board appointments is scattered across various documents with no single legislation or policy in place. Instead, a “black box” process of board appointments tends to dominate. There is also no consistency on how different government departments are represented on boards; in general, the DPE is not, but this is not the case for the DoT and Treasury (e.g. PRASA).
149. Following the state capture saga in a number of SA SOEs including Eskom and Transnet, the overarching aim of appointing board members should be their capacity to resist undue interference in their duty as stewards of the SOE business. They need to bring independence of mind, competence (sectoral, financial or broader governance) and reputational weight which ensures they will not be pushed around. The State Ownership Policy (discussed below in Section C) needs to set the basic principle of a structured process to select, vet, nominate and appoint them. The ownership entity will need to further elaborate the main principles in the Policy with a fit-for purpose Nomination Policy and process for the SOEs in scope – like most private company boards would.
150. In the new institutional model proposed in the report with an ownership entity at its core (holding company or an alternative equivalent arrangement), the responsibility for board nominations should in the end rest with the entity and represent a combination of professional search (possibly backed up with open advertising to build up Director pools) and vetting based on the board’s needs (conducted by the ownership entity with the help of external expertise) with a wide and transparent political consensus underpinning appointments. Such a process will address issues of competence but also of corruption that have plagued the SOEs under scope in this report.
151. In addition to this process for board nominations, the ownership entity could appoint one or two of its own senior staff as shareholder representatives in key SOEs. This will allow for a more direct “conveyor belt” on strategy and will facilitate meeting shareholder expectations. In the early days of the system, it will also help the emergence of a uniform governance culture of SOEs in scope, while enhancing responsibility among ownership entity management who would be exposed to the vagaries of the “front line”.
152. Key to all this is professionalising the process of board nominations, making it rules- and process-oriented, with both those rules and processes elaborated in a nominee director framework included in the State Ownership Policy and subsequently executed by the ownership entity. This would involve the professional staff of the ownership entity, assisted by outside experts, proposing appropriate individuals for SOE boards, with approval by the board of the ownership entity (rather than the DPE Minister playing the primary role as is currently the case) based on the rules established in the State Ownership Policy.
153. For significant SOEs in SA, full Cabinet approval of board appointments may be required, usually with the President’s validation. Particularly, the President’s approval is sought by

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<sup>36</sup> Kikeri, Sunita (2018). Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English). Washington, D.C.: World Bank Group.

Cabinet for the appointment of most Schedule 2 boards (e.g. Eskom and Transnet). This may be understandable given the importance of Eskom to the budget. The proposed direct involvement of senior representatives of several line ministers and the NT on the board of the ownership entity (or the PSEC, in options 2 and, especially option 3) combined with the assistance of professional management, which will do the footwork, may streamline and professionalise the nomination process while maintaining political consensus (not one-person ministerial power) as the basis of appointment. The President might still be called to validate the more significant appointments.

154. This proposed nominee director framework would, inter alia, include: <sup>37</sup>
  - 154.1. Properly defined selection criteria, such as a minimum educational requirements and sector specific experience; proven integrity and probity; and additional proficiency and suitability requirements for large and complex businesses;
  - 154.2. Requirements for the number of and mix of independent directors;
  - 154.3. Provisions for the use of open advertising and hiring of professional selection firms to short-list candidates;
  - 154.4. Delegation of the process to the centralized ownership entity or to a specialized independent body;
  - 154.5. As well as tools used extensively by state ownership entities across countries such as the development of a directors' pool of pre-qualified board members.
155. SOE boards and their Chairpersons should be expected to be consulted by the State on the relevant skills required in appointments (at the moment, interviewees suggested that such consultation is ad-hoc and not strictly required). While the SOE board nomination process will be driven by the state ownership entity, SOE boards should be responsible for the maintenance of skills matrices that will constitute inputs to that process.
156. In elaborating this director nominee framework, methods used in other countries can be examined and utilised:
  - 156.1. **Director pools:** In some countries, a "directors' pool" is maintained from which new external directors for SOEs are drawn. In France, this pool is managed by the ownership entity; in Malaysia, candidate pools are managed by the Institute of Directors. In Thailand, vacancies are widely advertised, and outsiders are invited to apply; a nomination committee is set up to select qualified candidates from a directors' pool based on a board skill matrix (which is subject to consensus among the board, the line ministry, and SEPO).
  - 156.2. **Use of external recruitment agencies:** Another option is using recruitment professionals, where their role is to identify and pre-screen candidates for SOE boards. This practice is adopted also in emerging countries like Chile, where head-

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<sup>37</sup> Kikeri, Sunita (2018). Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English). Washington, D.C.: World Bank Group.

hunters are commonly used to fill chair roles in large SOEs. In Finland, the ownership entity outsources the development and maintenance of a database of pre-qualified candidates to recruitment management consultants.

156.3. **Board input:** The incumbent SOE board can also play a vital role in nominations, by identifying missing skills or competencies on the board. For instance, in Finland, the ownership unit consults with the chair on the board's performance and the skills and attributes required, well in advance of the AGM when board appointments are to be made. In Estonia, there are informal discussions with SOE board chairs to choose the best possible candidate. In Norway, board evaluations explicitly inform the nomination process. In the UK, the SOE board is formally involved at certain stages in the recruitment and selection process.

156.4. **Board profiles matrices:** The Canadian government requires SOE boards to establish and maintain a board skills matrix. When a vacancy arises, the responsible Minister for nominating a candidate is guided by the SOE board profile developed by the SOE board to identify potential directors for appointment.

156.5. **Nomination committees:** Another mechanism is the establishment of nomination committees on the boards of SOEs. In some jurisdictions, some large SOEs establish external nomination committees attached to their annual general meeting of shareholders (AGM) (typically in Nordic countries where this is a common practice). In Norway, nominations to the boards of listed SOEs are made via nomination committees made up of representatives from the state and non-state shareholders.

157. Various countries use a mix of the above approaches. In China, external non-executive directors in central SOEs are directly nominated and appointed by the ownership agency, SASAC, in consultation with line ministries, the SOEs and industrial associations. They are recruited either through direct appointment or through an open selection process. The SASAC has also established an external directors pool subject to a qualification review on a regular basis. Whenever there is a board vacancy, the SASAC can select a director from the pool according to the specific needs of the board. SOE boards can make suggestions to the SASAC on the selection of external directors.

**Area for Improvement 12. *There is too much turnover on SOE boards undermining accountability.***

158. Maintaining a decent level of tenure on SOE boards does not appear to be a prime consideration for the board nomination process as it currently stands. PRASA has had four Boards of Control since 2015 (as well as three Ministers and seven interim CEOs). In some cases, it seems the board did not meet the quorum to take key decisions. In fact, in December 2019, the DoT Minister dismissed the PRASA Board and CEO, with a sole administrator, who reports only to the DoT Minister, appointed to assume the role of both the board and executive for next 12 months<sup>38</sup>. In TRANSNET, all independent NEDs have served for 0-3 years; none has served longer. Following the "capture" of previous boards,

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<sup>38</sup> <https://www.dailymaverick.co.za/article/2019-12-10-mbalula-fires-prasa-board-and-ceo-but-he-may-have-broken-the-law/>.



such “churning” was to be expected – to an extent. Moving forward however, a director nominee framework would need to incorporate the issue of tenure in balancing the competing needs of renewal and organisational memory, and in addition specify the conditions required for removal.

159. Most importantly, short tenure over long periods weakens managerial accountability. Executives do not consider themselves accountable to the board—the boards are expected to be replaced before they cause any serious trouble. This “wait and it will blow over” approach is a common ailment in politicised SOEs that lowers accountability and reduces management responsibility.

### Proposal and recommendation – statement

**Rec. 8.** An SOE Board nomination and appointment process should be elaborated that is less political, and more professional, uniform and transparent. In this context:

- a. A director nominee framework should provide general guidelines on board nomination, requirements for the State to respect board skills matrices, diversity, tenure, and achieve appropriate balance of independent directors, ownership entity, state representatives.
- b. The ownership entity (or the PSEC in Option 3 and—partly – 2) should retain the formal authority for appointments to SOE boards, possibly validated by the Cabinet and/or the President.

## B. 2. State’s approach to SOE board leadership: chair versus CEO

### Background and best practice

*“The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison for communications with the state ownership entity. Good practice calls for the Chair to be separate from the CEO.”*

*“[SOE boards] should have the power to appoint and remove the CEO. They should set executive remuneration levels that are in the long-term interest of the enterprise.”*

**OECD Guidelines, 2015**

160. The OECD Guidelines recommend a clear role distinction between the Chair of the board and the company CEO. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison with the ownership entity. Good practice calls for the Chair to be separate from the CEO, with the latter having sole responsibility over the leadership of company management.
161. The OECD SOE Guidelines for Southern Africa further suggest that the appointment and removal of the CEO should be a key role for an SOE board. The logic is that If CEOs feel they “owe their jobs” to government, it will be difficult for SOE boards to exercise their monitoring function and assume full responsibility for corporate performance. At the

same time, it is understood that governments will want to exercise a degree of control over who manages the country's largest SOEs. This implies that some form of joint-decision making process may have to be established, which could involve consultative mechanisms between the board (or the Chair) and the ownership entity.

### Exhibit 8: Do the SOE boards appoint the CEO? <sup>39</sup>

| Board appoints CEO  | Government appoints CEO   |
|---|---|
| <ul style="list-style-type: none"> <li>• Australia</li> <li>• Austria</li> <li>• Denmark</li> <li>• Finland</li> <li>• Greece</li> <li>• Japan*</li> <li>• New Zealand</li> <li>• Norway</li> </ul> | <ul style="list-style-type: none"> <li>• Belgium</li> <li>• Canada</li> <li>• Korea</li> <li>• Slovak Republic</li> <li>• United Kingdom</li> </ul> |

\* With government approval

162. International experience on CEO appointments in SOEs is mixed (see Exhibit above). In general, boards involve the state in the appointment of CEOs in the following ways: a) the board's decision can be subject to a veto from the state owner, b) candidates for CEO positions are subject to a vetting procedure hosted by the ownership function; or c) a candidate is selected from a shortlist proposed by the ownership function.

### Strengths

#### **Strength 9. The role of the CEO and Chair are separate for the three SOEs under scope.**

163. The role of the chair is separated from that of the CEO for the three companies<sup>40</sup> considered. The DPE Protocol covers the role of the chair. However, there are indications that the role of the chair as the link between the board, company and the shareholder could be further developed.

### Areas for improvement and reform

<sup>39</sup> Adapted from OECD (2018) Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

<sup>40</sup> This was as at November 2019 DoT has just appointed a sole administrator for Prasa.

***Area for Improvement 13. The process for the appointment of SOE CEOs could be made more transparent and consistent.***

164. There seems to be no consistent and uniform process for CEO selection, and the ad-hoc process in place lacks in transparency. Several SA ministers delegate the recruitment process to the board, supported by the Human Resources and Nominations Committee (which is a good practice that reinforces CEO accountability to the Board). For significant SOEs, the process may be outsourced to a recruitment agency by the Committee. A shortlist of 3-5 candidates is sent to the Committee, which selects the preferred candidate and recommends her/him to the Minister and to the Cabinet for approval.
165. For SOEs under the DPE, the DPE Protocol indicates that the board proposes the CEO's appointment to the DPE. The interviews confirmed this general practice whereby the companies are responsible for the process for the appointment of CEO and CFO (two executive directors at the board). The SOE boards conduct the recruitment process and make recommendations to the ministries which then need to provide approval. The CEO must be approved by the Ministry and Cabinet.
166. For Eskom, the shareholder's CEO decision binds the company to the "exclusion of the Board"; also for Eskom, the CFO is validated by the Shareholder. Moreover, the board should consult with the shareholder about its preferred candidate for the position of Chief Executive Officer and provide sufficient time for the shareholder to consider the candidate and respond prior to an appointment being made.
167. For PRASA (in the context of a DoT-owned SOE), according to one interviewee, the Board is responsible for the appointment of the CEO (currently PRASA does not have a permanent CEO). This includes setting out the specifications, advertising, holding the interviews and making the selection. The DoT's role is supposed to be to provide concurrence to the decision by the PRASA board.
168. The World Bank does criticise the fact that a contract with the CEO is drafted and signed by the Minister, and not by the board as per good practice—leaving the CEO beholden to the Minister and not to the board. The weakness of the system is that it is ultimately political, driven by the interests of the nominating minister. A new institutional arrangement with an ownership entity at its centre would embody a different philosophy, with Board and CEO ultimately responsible and accountable to the ownership entity.

**Proposal and recommendation – statement**

**Rec. 9.** There should be transparent guidance on the process for the appointment of SOE CEOs, which should include the following characteristics:

- a. SOE boards rather than Government should be playing the leading role and maintaining the nomination initiative.
- b. The roles, responsibilities and coordination of the SOE board, the state ownership entity and eventually others in the process should be clearly outlined.
- c. In situations where final approval is outside the SOE, this should rest with the ownership entity rather than the government.

- d. CEO contracts should be signed by SOE boards.

### B. 3. Role, responsibilities and authorities of SOE board (vis-à-vis State)

#### Background and best practice

*“SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government. They should have the power to appoint and remove the CEO. They should set executive remuneration levels that are in the long term interest of the enterprise.”*

OECD Guidelines, 2015

169. The board role, responsibilities and authorities of SOE boards are outlined in OECD best practice recommendations. In the context of responsibilities articulated in legislation, regulations, the government ownership policy and the corporate charters, SOE boards should actively (i) formulate or approve, monitor and review corporate strategy, within the framework of the overall corporate objectives; (ii) establish appropriate performance indicators and identify key risks; (iii) develop and oversee effective risk management policies and procedures with respect to financial and operational risks, but also with respect to human rights, labour, environmental and tax-related issues; (iv) monitor disclosure and communication processes, ensuring that financial statements present the affairs of the SOE fairly and reflect the risks incurred; (v) assess and monitor management performance; and (vi) decide on CEO remuneration and develop effective succession plans for key executives.

#### Strengths

#### **Strength 10. The SOE Board appears on paper to exercise significant authority with respect to SOEs.**

170. As defined in the legislation of the Companies Act, the board has ultimate responsibility for SOE performance in South Africa and the board guides the development of strategy for the SOE. The board is involved in the CEO evaluation and appointment process, while it sets the remuneration of executives and senior staff in line with State guidelines. The actual operational role of the board is also anchored in legislation (PFMA).
171. In terms of remuneration, the SOE Remuneration Guidelines (2007), published by DPE give indications as to the remuneration level setting for chairpersons & non-executive directors and for executive directors. In line with international trends, the PRC Review supports the approach of pegging SOE salaries to the market to attract suitable candidates

and providing clear guidelines and parameters within which the board may have discretion, especially for large commercial SOEs operating in key sectors of the economy.<sup>41</sup>

*“The remuneration package of CEO is proposed by the board to the shareholder for approval.”*

*“There is an indirect rather than direct link between senior exec remuneration and the compact, assuming that the corporate plans are aligned with the compact.”*

*“If a bonus is to be paid, the board makes a recommendation to the shareholder as to the remuneration pool. If you agree on indicators, you must also agree on non-negotiables; if these are not met, you cannot begin talking about bonuses. In this manner, the Minister essentially tries to link the Shareholder Compact with bonuses.”*

172. In terms of oversight of risk and control environment, from various sources of disclosure, it appears that the boards are responsible for risk oversight. The three SOEs in question have established audit committees and seem to be planning to strengthen internal control frameworks. All three have an internal audit function that reports to the Board (via the Audit Committee). They also appear to have independent external auditor reviews in addition to the review by the Auditor General, although their quality and reliability has been seriously questioned.

### Areas for improvement and reform

**Area for Improvement 14. The Boards should review their internal and external audit frameworks as well as remuneration frameworks.**

**Principle 1: Leadership:** *“The governing body should lead ethically and effectively.”*

**King IV Report on Corporate Governance, 2016**

*“SOEs should develop efficient internal audit procedures and establish an internal audit function monitored by and reporting directly to the board and to the audit committee or the equivalent corporate organ.”*

**OECD Guidelines, 2015**

*“There is a greater need for compliance; we are coming out of the era where the internal controls are weakened.”*

<sup>41</sup> Kikeri, Sunita. 2018. Corporate governance in South African state-owned enterprises: background note for the South Africa systematic country diagnostic (English). Washington, D.C.: World Bank Group.

*“The Minister of DPE has included ... internal controls issues in the Shareholder Compacts of those SOEs.”*

173. According to the DPE Protocol, the board is the accounting authority. There should be a comprehensive internal audit component headed by a qualified internal auditor, who shall be independent of the external auditor. The internal auditor must have direct access to the board or other governing bodies and the internal audit function should have written terms of reference provided by and coordinated with the board.
174. Despite however the existence of both an internal audit function that reports to the Board (via the Audit Committee) and external independent auditor reviews undertaken, such audits have not managed to uncover in time financial mismanagement problems. This suggests that both processes need to be reviewed. The experience with large SOEs such as those under scope in this report suggests that over time, both internal and external audits in SOEs can become “captured”, becoming less independent, and not giving the board the necessary information (or giving misleading information). The repercussions for the company financial position, reputation and standing of such capture is enormous.
175. In this vein, it appears that the legislative framework and oversight for external company audits needs to be revamped, with an emphasis on stronger regulation and sanctions (these could for example include striking people off professional audit rosters that are a requirement to positions at SOEs). At the same time, the state ownership entity should create links between audits and the revisions of the shareholder compact, while SOEs and the oversight entities need to ensure that audit controls mechanisms are staffed by sufficiently experienced financial experts (who must have the opportunity and means to report irregularities – “whistle-blowing”). In addition, the ownership entity could develop a “control and audit” forum function where internal audit staff from key SOEs exchange experience and best practice.
176. In terms of remuneration, South Africa could benefit from the experience of countries which have developed elaborate structures for differentiating board remuneration according to SOE size and indicators of workload (for example, in Canada, Estonia, Israel, New Zealand, and Sweden). In Canada, grades are assigned to each SOE according to a ranking system (based on size, complexity, etc) and remuneration levels depend on the rankings. Furthermore, the interviews undertaken in the process of preparing this report suggested that there is often a weak link in score cards between the KPIs triggering variable remuneration and the fulfilment of the Shareholders’ Compact.

#### Proposal and recommendation – statement

- Rec. 10.** The Government should consider revamping the overall legislative framework and oversight for external company audits. The state ownership entity should encourage and assist SOE Boards in reviewing the internal and external audit processes of their companies to bolster their independence and effectiveness, while ensuring that are staffed by sufficiently experienced financial experts.
- Rec. 11.** In approving executive remuneration, SOE boards should ensure that there is adequate linkage between the KPIs triggering variable remuneration and fulfilment of the Shareholders’ Compact.

## B. 4. Functioning of the SOE board

### Background and best practice

177. It is good practice for ownership entities to set out their expectations for the functioning of SOE boards. In China, for instance, the SASAC has established “Guidelines on further improving Corporate Governance of SOEs” and the “Guidelines on Pilot Programs for Central SOE Board of Directors” to enhance the responsibility of the board of directors along with corporatisation of SOEs. In Greece, the state holding company HCAP is developing a Handbook for SOE boards in 2020 that aims to become a reference in their functioning and a benchmark as the Fund evaluates board performance in individual SOEs.

*“SOE Boards should [...] carry out an annual, well-structured evaluation to appraise their performance and efficiency.”*

OECD Guidelines, 2015

### Strengths

#### **Strength 11. The DPE protocol provides guidance on SOE board functioning.**

178. In general, SOE boards appear to actively function, with regular meetings for board and board committees, and with guidance on board functioning provided in the DPE protocol. This includes for example requirements and specifications for an audit committee with at least two independent non-executive directors, and a remuneration Committee composed of independent non-executive directors and headed by the board chairperson.
179. The guidance for board functioning also includes instances where it needs to explicitly report to the shareholder before a decision is executed. Thus for example, while SOEs are generally free to establish partly owned subsidiaries, purchase a controlling interest in other companies or enter into joint venture arrangements, the PFMA stipulates that the board is required to inform the National Treasury of the particulars of the transaction and to obtain the approval of the Executive Authority.

#### **Strength 12. Board evaluation seems to be a common practice in Eskom and Transnet, but not PRASA.**

*“[Board evaluation is] a vital tool for the ministers in terms of gaining insight into the performance of the board and functioning of the board.”*

*“DPE expect every board to have a board evaluation every year. This is particularly as the Minister reads these together with the Shareholder Compact.”*

*“It is difficult to get evaluation out on time for the Minister to be able to use to make a decision. It is backward looking.”*



180. The DPE Protocol expects board evaluations. For some of the companies in question (Eskom and Transnet), it appears that externally-facilitated board evaluations have been recently conducted. This is a usual means for reflection on how the SOE boards can improve their performance. Nevertheless, while board evaluations have indeed occurred, what is less clear is the feedback of such evaluations for director nominations and general board assessment. Some government officials have claimed that board evaluations rarely provide an input in this respect.
181. In international practice, board evaluations may take two forms. One is self-evaluation conducted by boards. Sweden, Thailand, and Vietnam formally request SOE boards to carry out annual evaluations of their performance (OECD 2018a). In Sweden, boards are mandated to carry out board evaluations according to the state ownership policy; the chair communicates the findings to the ownership entity. Internal evaluations are more common but external facilitators are often used from time to time and considered good practice. Brazil's Ministry of Planning requires SOE boards to conduct annual self-evaluations and share the results with the Ministry. Israel, in 2015, developed a structured process of board evaluation including a system for self-evaluations, focusing on the board as a group as well as individual directors. In the UK, a country with a tradition of board evaluations, SOEs under UK Investments are required to follow the UK Code's guidance of annual self-evaluation with an external one every three years.
182. Other countries undertake a top-down evaluation of individual SOE boards in an ad-hoc external fashion. In China, the SASAC annually evaluates the boards and directors of central SOEs on performance, conduct, expertise and attendance of board meetings. Boards with poor evaluation results are required to formulate improvement plans and implement the plan upon. The evaluation forms an important basis for position adjustment, tenure, training, re-appointment, and remuneration. It is also recorded into the file of the external directors (for future appointments in other SOEs). SOE boards in Switzerland are evaluated against strategic goals that are set every four years. SOE boards are assessed as a whole, and feedback is provided to the Chair.

### Proposal and recommendation – statement

**Rec. 12.** All large SOEs should regularly undertake board evaluation run by the SOE board with the help of external expertise. These should be aimed at assessing board functioning and effectiveness, serve as inputs in the process of (re)appointment of board members as well as a mechanism for the SOE board to reflect on its contribution to the achievement of the SOE's objectives.

### Areas for improvement and reform

**Area for Improvement 15.** *The state ownership entity could further support induction and training for SOE directors.*

183. OECD SOE guidelines suggest that training should be required in order to inform SOE board members of their responsibilities and liabilities. To ensure board members are trained properly, timely induction training sessions need to be in place for SOE board members. In the SOE South African context however, as evidenced by the interview

process in this report, it seems like nominee director induction, even in large strategic companies, could be strengthened vis-à-vis international practices. Such training can prove extremely valuable in being able to realise the potential of appointees for board functioning.

184. New Zealand's Commercial Operations Group, for example, organises inductions for new and recurrent directors for SOE boards. Other jurisdictions encourage on-going professional development for individual directors or on a board-wide basis. The OECD notes that these trainings focus on thematic areas where supplementary training is needed, for example on accounting standards, tax codes, or laws, regulations and other areas of relevance. Israel's Government Companies Authority (GCA) develops professional trainings for SOE board members: the programs consist of director inductions and training on financial statements as well as HR management.
185. In Sweden, the preferred form of induction consists of a one-on-one meeting between the director and ownership entity in addition to on-site visits organised by the SOE. New directors are required to meet with the ownership entity and discuss its view on the SOE. In Korea, the Ministry of Strategy and Finance and the Korea Institute of Public Finance (KIPF) invite the newly appointed non-executive directors to a workshop that discusses the role and duties of the board of directors. These sessions also provide an overview of the public institution management system and related laws and regulations.

#### Proposal and recommendation – statement

**Rec. 13.** The state ownership entity should consider reinforcing its mechanisms for supporting the induction, training and skills development of SOE board members, in particular as regards the importance of supporting the NDP goals and ways to manage their oversight responsibilities.

## C. Transparency and accountability

### Background and best practice

186. Transparency in the context of this report takes two forms: it concerns the information disclosure and associated transparency of the SOE vis-à-vis the government and the broader public; and the existence of clear norms and rules that order the relationship between the government and the SOEs which informs all relevant stakeholders and simultaneously renders stakeholders accountable for conforming to these norms.
187. The government and its various agencies dealing with SOEs (mostly the state ownership entity) should also be transparent to the public, instilling a sense of accountability on behalf of both SOEs and the government.
188. Accountability has been discussed throughout the report but it is important to recall the cascade: CEOs need to be accountable to their boards, the boards to the ownership entity's professional management, the latter to the "political" board of the entity, and the latter to the PSEC. The whole system needs to be held to account in a broad sense by the South African Parliament in the basis of annual reporting but also when deeper dives are required. Finally, the well-respected SA judiciary will hold individuals accountable for illegal behaviour.
189. The OECD Principles are clear on the need to hold agents accountable at every level:

*"The CEO is accountable to the board."*

*"The board should be fully accountable to the owners, act in the best interest of the enterprise and treat all shareholders equitably."*

**OECD Guidelines, 2015**

190. In addressing issues of transparency, OECD best-practice guidelines note that SOEs should observe the same high quality of disclosure, compliance and auditing standards as listed companies. They should report material financial and non-financial information on the company in line with internationally recognised standards of corporate disclosure and including areas of significant concern for the State as an owner and the general public.
191. This includes in particular SOE activities that are carried out in the public interest and include: a clear statement to the public of enterprise objectives and their fulfilment; financial and operating results; the governance, ownership and voting structure of the company; the remuneration of board members and key executives; board member qualifications and selection process; any material foreseeable risk and measures taken to manage such risk; any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE; and any material transactions with the state and other related entities.
192. The more targeted OECD SOE Guidelines for Southern Africa add that the government should ensure consistent aggregate reporting on the operations of SOEs, and publish annually a report providing aggregate and company-specific information. In addition, the

institutions exercising ownership rights should be held accountable to representative bodies such as Parliament and state audit institutions.

193. These broad guidelines and directions can in turn be broken down to distinct categories: transparency and reporting to board; transparency and reporting of SOE to owner and key State agencies; and transparency and reporting of government and SOEs to the public.

### C. 1. Transparency and reporting to board

#### Strengths

##### ***Strength 13. There appears to be regular management reporting to the board***

194. The company Annual Reports outline a number of reporting items and categories which are in accordance with best practice (e.g. between the internal audit function and the relevant Audit Committee, reporting on strategy to the board etc).
195. This report however cannot judge the quality of such reporting, nor the level of detail of the decisions brought to the board, since no access to this documentation was provided. This is an especially important issue for example with respect to procurement issues: boards can easily become overwhelmed by having to take numerous procurement decisions for relatively low budget items; as a result, they often fail to adequately fulfil their oversight and fiduciary function for important procurement plans, as has been the case on a number of occasions in the SOEs under scope in this report.

### C. 2. Transparency and reporting of SOE to owner and key State agencies

#### Strengths

##### ***Strength 14. The DPE protocol covers disclosure to State***

196. The boards of wholly-owned SOEs follow a disclosure principle similar to the continuous disclosure requirements of the JSE Securities Exchange SA listing rules: once an SOE becomes aware of any information that may have a material effect on its value that information must be immediately provided to the Executive Authority.
197. Along with the other components of the annual financial statements, a report of the directors is required. (Companies Act, section 286). Each subsidiary of a SOE which is majority owned by or deemed to be controlled by that SOE must also submit a directors' report. The directors' report should be submitted to the auditors, who should provide written comments on the report, specifically commenting on any omissions to the report.
198. Boards must provide a financial statement and an annual report within five months of the end of the financial year. On a quarterly basis, SOEs should submit management accounts (unaudited Profit and Loss Statement, Balance Sheet), financial analysis, liquidity, leverage, income, expenditure, sales and inventory information. Annually, SOEs should submit audited Financial Statements, a Value-Added Statement, as well as Performance Evaluation (against benchmarks or baseline).

***Strength 15. There appears to be regular information flows to the state ownership entity and to Treasury for SOEs in distress.***

*“DPE does actually attend some board meetings depending on the issues and lead AGM to have a closer insight into the functioning. This happens for Transnet and others.”*  
*“Treasury does not have instrumental knowledge into the board functioning.”*

199. The accounting authority for a public entity must submit financial statements to the relevant treasury (if under ownership control of the national or a provincial government). Furthermore, an annual report and financial statements following audit needs to be submitted to the executive authority responsible for that public entity (and to the Auditor-General if they did not perform the audit of financial statements)<sup>42</sup>.
200. It was suggested in interviews that the DPE also has periodic meetings with the chairs of the various SOEs under its supervision. At the same time, there is regular information sharing with the National Treasury in cases of SOEs in financial distress.

**Areas for improvement and reform**

***Area for Improvement 16. The absence of a state ownership policy may contribute to lack of transparency and weaker accountability in the governance of SOEs and their stewardship by the State.***

*“The role of the shareholder needs review and formalisation – where it starts and where it ends. [Undue political] Interference can paralyse SOE boards.”*

*“There must be clarity on the government’s role as a shareholder.”*

*“The SOE bill will have things you do not want to change, while a state ownership policy is something you can update regularly.”*

201. Multiple interlocutors highlighted that to increase transparency, coherence and accountability in SOE policy, there is a need for greater formalisation of the role of the State as a shareholder, including the limits of state interference in the functioning of SOE boards. A contributing factor to the absence of clarity is the lack of a universally agreed state-ownership policy among government departments – such policy is a standard recommended by the OECD.

*“The government should develop an ownership policy. The policy should inter alia define the overall rationales for state ownership, the state’s role in the governance of SOEs, how*

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<sup>42</sup> PFMA 1999

*the state will implement its ownership policy, and the respective roles and responsibilities of those government offices involved in its implementation.”*

**OECD Guidelines 2015**

202. The international best practice consists in the explicit formulation of ownership rationale, state stewardship and SOE governance design. For this purpose, many countries adopt a state ownership policy (the “Policy”) that orders the whole “cascade”. The Policy can have varying regulatory underpinnings: a government decision, resolution, or decree (as in Chile, Finland, Norway and Switzerland); government policy statements (Ireland and the Netherlands); or some combination of the two (the Czech Republic, Hungary, Israel and Portugal). It typically covers the following aspects:
- 202.1. *Purpose of state ownership:* This Policy typically describes the rationale and general objectives for state ownership. Objectives typically include supporting national economic and strategic interests; supplying public goods or services; performing business operations in a “natural” monopoly situation; or maintaining a state-owned monopoly where market discipline (or regulation) is deemed insufficient<sup>43</sup>.
- 202.2. *Scope of and criteria for enterprises covered by the Policy:* The Policy might or might not include all SOEs within its scope. In most (but not all) countries the SOEs in scope will have a primarily commercial character.
- 202.3. *Roles, responsibilities, profile and nomination of key governance instances:* The Policy provides clarity on the role, governance and organisation of the ownership entity including the approach to the ownership entity board and management structure of the ownership entity. It also orders (in a flexible manner) the profile, nomination process and responsibilities of the individual SOEs within its scope.
- 202.4. *Requirements for transparency and public disclosures:* This section covers the relevant reporting of SOEs to the State and the general public, but also that of the ownership entity to ensure it is accountable to the public.
203. In South Africa, an explicit written state ownership policy may provide clarity to SOEs on which the government plans to focus on (as in section A2) and provide a high level means for the new Government to steer (and adjust as required) the overall philosophy for SOE ownership and oversight, communicating clear expectations to all arms of government (including various Ministries) and stakeholders, providing transparency and adding to accountability. It also provides a frame of reference for state actions taken with respect to the ownership function, addressing the current fragmentation and often ad hoc coordination between ownership entity and line ministries. It may also provide clearer guidance on which SOEs are to be put under the oversight of a new state ownership entity – the rationale for the SOEs under DPE oversight currently appears ad-hoc and not transparent enough (as per the case of PRASA).

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<sup>43</sup> OECD (2018) Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

204. More broadly, the elaboration of a state ownership policy is also an opportunity for the government to provide clarity on the extent to which certain SOEs need to remain under state ownership or instead undergo partial or full privatisation.
205. In 2012, the PRC acknowledged the absence of this overarching framework and did recommend “an appropriate shareholder ownership model and an overarching shareholder policy” which DPE was assigned the responsibility to develop for Cabinet’s approval. Interviewees in the context of preparing the report mentioned plans at the DPE to develop a shareholder management strategy. There has also been a parallel discussion on legislating provisions in an SOE bill. Interviewees identified some key areas of focus for this proposed SOE bill (see Exhibit).

#### Exhibit 9: SOE bill areas of focus<sup>44</sup>

- i. **SOE appointment process:** The process is expected to be clarified within the bill.
- ii. **Privatisation mandate in law:** There should be a mandate that comes from the legislation on privatisation. There is a need for proper parliamentary oversight over the process, where parliament should have oversight over pricing in SOEs.
- iii. **Procurement:** The regulation of procurement is strongly based on the constitution and is not a transparent process; there appears to be a need for check and balance process.
- iv. **SOE strategic planning process**
- v. **Hybrid state ownership model:** Resolving the hybrid approach between the centralised and decentralised model.

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<sup>44</sup> This information was provided by interviewees.

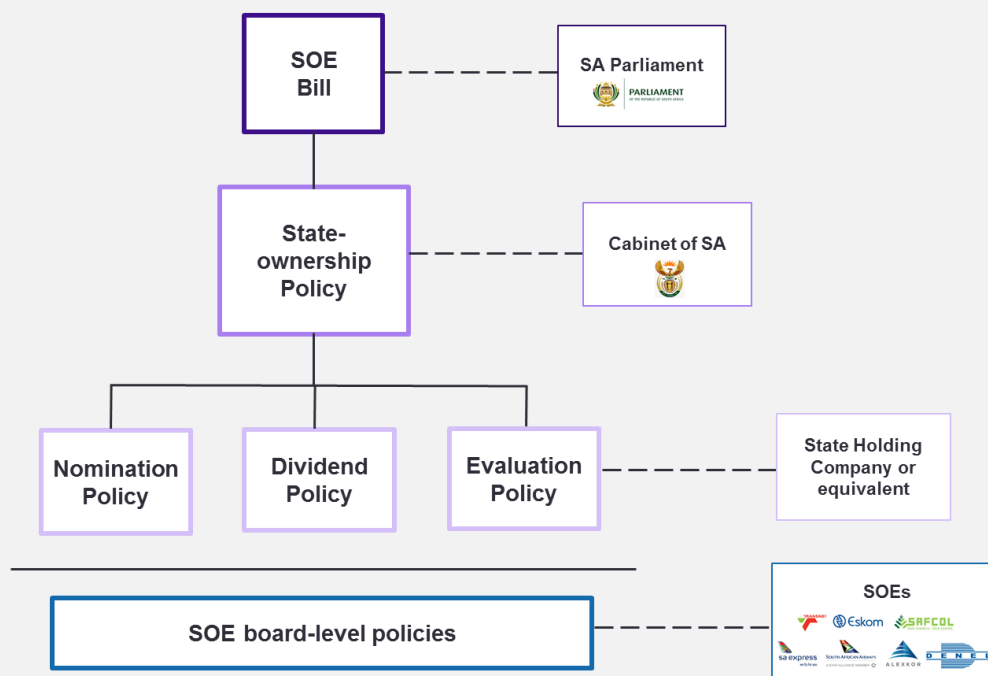


*Exhibit 10: Main elements for a State Ownership Policy in South Africa  
(Example based on option 1 of a “comprehensive HoldCo)*

|  |   |
|--|---|
| <b>I. Introduction</b>   | <b>III. Governance of SOEs in scope</b>   |
| <b>A. The purpose of the state as an owner</b><br><b>B. The purpose of the Policy</b><br><b>C. Policy approval and review</b><br><b>D. The scope of the Policy</b>   | <b>The Board</b><br><i>Including information on board structure.</i><br><b>Composition of SOE Boards</b><br><i>Including information on size; members; skillset and expertise.</i><br><b>Role and responsibilities of the SOE Board</b><br><i>Responsibilities regarding strategy; performance; appointments; risk and other matters.</i><br><b>SOE Board committees</b><br><i>Expectations with regards to committees; including formation of executive / audit committee.</i> |
| <b>II. Exercise of the Ownership Function by the State</b>   | <b>IV. Objective setting and strategic planning</b>   |
| <b>A. Creation and mission of HoldCo</b><br><b>B. Role, governance and organisation of ownership entity</b> <ul style="list-style-type: none"> <li><b>Role of HoldCo</b><br/><i>Expectations of HoldCo exercising ownership activities. This includes nomination activities; strategy approval etc.</i></li> <li><b>Governance of the HoldCo</b><br/><i>Responsibilities of the HoldCo Board.</i></li> <li><b>Composition of HoldCo Board</b><br/><i>Including relevant state entities.</i></li> <li><b>HoldCo Board Appointment Process</b><br/><i>Including appointment identification, nomination and appointment authority.</i></li> <li><b>Functioning of HoldCo Board</b><br/><i>Including information pertaining to voting rights.</i></li> <li><b>Organisation of the HoldCo</b><br/><i>Including role, responsibilities and structure of the management.</i></li> </ul> | <i>Information on how the HoldCo sets objectives for SOEs under consideration.</i><br><b>V. Transparency and reporting</b><br><b>Reporting to HoldCo by SOEs in scope</b><br><b>Public disclosures expectations for SOEs</b><br><b>Reporting by the HoldCo to the government and the public</b>   |

206. Care needs to be taken in differentiating which matters are addressed by the SOE bill and the ones that are addressed by the state ownership policy. The former would provide a useful legal underpinning while the latter could provide for a complete blueprint, communicate a clear approach to all stakeholders within the State and to the public, while retaining flexibility to transparently adjust as the situation develops without going back to Parliament. Developing a state ownership policy can serve as an important signalling device for the broader changes in the governance framework suggested in this report.
207. Issues to be covered in the elaboration of the State ownership policy would *inter alia* include: guiding principles about how the government defines its shareholder role; how it would exercise its voting rights; the government rationale for having SOEs; dividend policy (which could also be covered in the SOE bill); funding policy and how government should be funding non-commercial activities; the policy on strategic partners and private-SOE partnerships; remuneration guidelines. The main elements for such a state ownership policy (assuming the holding company option is retained) are outlined in the Exhibit above. An indication of a possible policy cascade is also provided below:

Exhibit 11: Institutional governance policy cascade – a transparent view



### Proposal and recommendation – statement

**Rec. 14.** In the interest of transparency, coherence and accountability in SOE policy, the Government should consider adopting a state ownership policy (“the Policy”) that lays out the State’s objectives, approach and governance framework for the stewardship of SOEs; this should be separate from the planned SOE bill. The Policy should provide general principles and a unified approach for SOE governance:

- It should clearly outline the expected division of roles and responsibilities of key ministries and government agencies (e.g. ownership entity, DPE, National Treasury, line ministries, NPC, Auditor General, Cabinet etc) with respect to engaging with SOEs;
- Complement the DPE protocol, outlining general expectations for the SOE board nomination, composition and remuneration processes;
- Cover transparency and accountability requirements for SOEs beyond the scope of other legal requirements;
- Provide a clear process for the periodic review of the rationale for the State’s ownership of and participation in SOEs and examine options for asset divestment and privatisations.

**Area for Improvement 17.** *Process for assessing Information flows may need to be unified and improved.*

208. Disclosure to the State is provided for in official documents and as a result there is a regular information flow, often driven by Treasury requirements for information. But what is less clear is the assessment of those information flows in the process of evaluating policy, reformulating the shareholder compact, assessing business plans and financial results etc. A more standardised framework with specific roles for the different state entities (and the state shareholding entity central to this) may be warranted.
209. In addition, consideration could be given to increasing the visibility and transparency of Shareholder Compacts (there has been a discussion with Parliament to this effect). As these SOEs are commercial entities, the DPE believes the Compact itself includes competition-sensitive issues and its confidentiality should be retained. While however the Compacts themselves cannot be made public, their main annual objectives should be more systematically disclosed to the public, to facilitate public scrutiny and broader SOE accountability. This includes the disclosure of any assessment made over the achievement of these objectives.

#### Proposal and recommendation – statement

**Rec. 15.** Consideration should be given to enhance transparency by SOEs on the fulfilment of public policy objective implementation and costs:

- a. Main annual objectives from Shareholders Compact should be more systematically disclosed to the public, to facilitate public scrutiny and broader SOE accountability.
- b. An assessment of the achievement of these annual objectives should also be disclosed.

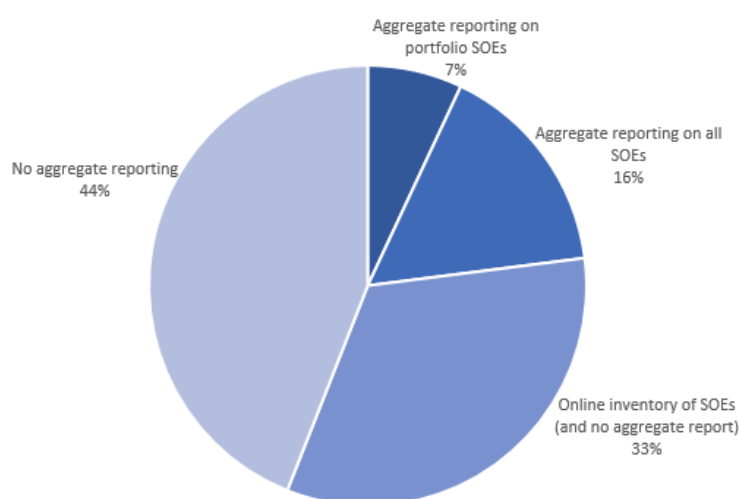
### C. 3. Transparency and reporting of government and SOEs to public

#### Strengths

***Strength 16. There are a number of reports prepared by the State aggregating SOE performance.***

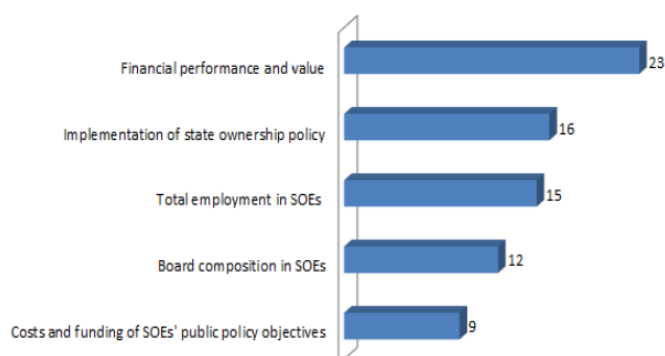
210. Within 30 days after the end of each month, the National Treasury must publish in the national Government Gazette a statement of actual revenue and expenditure with regard to the National Revenue. There is also the DPE's annual report and DoT's annual report; both of which cover the respective SOEs under them.
211. The Auditor General prepares a report on SOEs.
212. Internationally several countries produce a sort of report on SOEs. This is done by way of aggregate reporting on portfolio of SOEs, aggregate reporting on all SOEs or an online inventory of SOEs, as can be seen in the following exhibit:

Exhibit 12: Aggregate reporting on SOEs <sup>45</sup>



Countries include: Up to 50 countries surveyed by the OECD as part of their study.

Exhibit 13: What is included in aggregate reports? <sup>46</sup>



Countries include: Up to 50 countries surveyed by the OECD as part of their study.

213. In terms of content, most aggregate reports report on the financial performance and value of SOEs; in addition, on the implementation of the state ownership policy and the total employment in SOEs. Some countries also report on the board composition in SOEs, as well as costs and funding of SOEs' public policy objectives.

<sup>45</sup> Adapted from OECD (2018) Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices.

<sup>46</sup> OECD (2018) *ibid.*

### Area for improvement and reform

**Area for Improvement 18.** *There is no clear public reporting on the performance of SOEs against objectives (even if individual objectives are not disclosed) including public service obligations.*

*“The document [i.e. Shareholder Compact] itself is not public but the targets should be public and are shared with parliament on quarterly basis.”*

214. SOEs have various levels of disclosure in their individual finances and public documents; but disclosure regarding PSOs and performance could improve. This may also provide public pressure on SOE leadership to deliver on objectives.
215. PRASA does disclose its contribution to the NDP. It includes: increasing investment in public transport and resolving existing public-transport policy issues; providing incentives for public transport use; renewing the commuter train fleet; property development & corridor densification (including NDP imperatives of housing, employment, environment and skill development and training).
216. Disclosure of performance against objectives is an important element of SOEs across countries. Once mandates are agreed, ownership entities typically develop a framework for communicating the government’s expectations for SOE performance to each SOE and to the public. In many countries, the performance agreement or mandate is made public and presented to parliament to establish the links in accountability. Multiple countries have also moved to disclose more on their performance management systems. The WBG recommends that while specific targets do not have to be disclosed, social objectives and the target areas for measuring performance can and should be<sup>47</sup>.
217. Reports from ownership entities also usually provide an overview of the mandate of the state holding company/ownership entity and how this fits into the broader context of the state’s ownership or privatisation policy. With respect to public policy objectives, four countries that produce aggregate reports (Lithuania, Norway, Sweden, and Turkey) attempt to produce distinct reporting on the costs related to SOEs’ public policy objectives, and the related funding provided from the state budget. There are also usually aggregate figures on diversity in boards and the remuneration of individual board members. For Sweden, the aggregate report also includes reporting on financial and non-financial targets on an individual SOE basis; this includes information on whether individual SOEs have reached their targets.

**Area for Improvement 19.** *Disclosures on SOE websites on corporate governance could be further enhanced.*

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<sup>47</sup> World Bank Group (2014) Corporate Governance of State-Owned Enterprises: A Toolkit.

218. The DPE Protocol does cover SOE disclosures. Corporate governance policies, board charters and board committee terms of references are however frequently not disclosed on SOE websites. Increasing public disclosure of this type would contribute to transparency and accountability towards the public.

#### Proposal and recommendation – statement

**Rec. 16.** Corporate governance policies, board charters, and board committee terms of reference should be publicly disclosed to enhance transparency on governance practices.

#### ***Area for Improvement 20. Multiple stakeholders could be involved in evaluating SOE performance and service delivery.***

219. The operation of large SOEs in strategic sectors such as energy and transport impacts directly or indirectly on the lives of millions of South Africans. Yet these SOEs (especially in the case of natural monopolies) are not typically geared up to their performance and service delivery being evaluated by consumers or other parts of the economy which depend on the quality and price for their services.
220. Parliamentary scrutiny is one way to review such performance and exercise the scrutiny that is expected from elected representatives of the people. The various parliamentary committees do this by receiving and debating annual reports, in a process which is made more transparent and useful when it is accompanied by audits of SOE leadership.
221. In addition, the government could expand this process to involve other stakeholders, from industry, consumers and civil society representatives to labour, creditors and affected communities, in fulfilling a shareholder task carried out in an independent fashion. This would be particularly important in evaluating the fulfilment of PSOs as well as the SOE contribution to wider societal goals as these are expressed in the NDP.

#### Proposal and recommendation – statement

**Rec. 17.** The government should consider involving multiple stakeholders beyond the executive and the legislative (from industry, consumers and civil society representatives to labour, creditors and affected communities) in evaluating SOE performance and service delivery in the context of a stakeholder forum, especially for large utilities.

## Appendix I: Key sources of information

### A. General information sources

| No | Name  | Year |
|----|---|------|
| 1  | PFMA Updated 2010   | 1999 |
| 2  | PFMA Institution Schedule as of 29 March 2018   | 2018 |
| 3  | Treasury Regulations for departments, constitutional institutions and public entities | 2001 |
| 4  | DPE Protocol on Corporate Governance in the Public Sector                             | 2002 |
| 5  | National Development Plan 2030  | 2012 |
| 6  | Department of Public Enterprises Annual Performance Plan 2019/20                      | 2019 |
| 7  | Auditor General's General Report 2016-17  | 2016 |
| 8  | PFMA Consolidated General Report 2017-18  | 2017 |
| 9  | Treasury Publication on SOE Governance  | 2005 |
| 10 | South African Government Website  | 2019 |
| 11 | DPE Website   | 2019 |
| 12 | Department of Energy Strategic Plan 2015-2020   | 2015 |
| 13 | Department of Energy Integrated Resource Plan   | 2018 |
| 14 | National Rail Policy Draft White Paper  | 2017 |
| 15 | Economic Regulation of Transport Bill   | 2018 |
| 16 | National Railway Safety Regulator Act   | 2002 |
| 17 | Department of Transport Annual Report 2017/18   | 2017 |
| 18 | DoT Website   | 2019 |
| 19 | Report of the Presidential Review Committee on State-Owned Entities                   | 2013 |



## B. Eskom disclosures

| No | Name of document                   | Year |
|----|------------------------------------|------|
| 1  | Eskom Memorandum of Incorporation  |      |
| 2  | Eskom 2013 Shareholder's compact   | 2013 |
| 3  | Eskom Integrated Report March 2018 | 2018 |
| 4  | Eskom Website                      | 2019 |

## C. Transnet disclosures

| No | Name                            | Year |
|----|---------------------------------|------|
| 1  | Transnet Integrated Report 2018 | 2018 |
| 2  | Transnet Governance Report 2018 | 2018 |
| 3  | Transnet Website                | 2019 |

## D. PRASA disclosures

| No | Name                           | Year |
|----|--------------------------------|------|
| 1  | PRASA Corporate Plan 2020-2022 | 2020 |
| 2  | PRASA Annual Report 2017/18    | 2017 |
| 3  | PRASA Website                  | 2019 |

## Appendix II: Consolidated gap analysis versus OECD Guidelines

### The State's role as owner – summary of gap analysis

| <i>Gap analysis versus OECD Guidelines: The State's role as owner</i>   |  |  |
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| Is the exercising of ownership rights centralised into a single ownership entity, or carried out by a co-ordinating body? |  | This is the case for Eskom / Transnet. But ownership rights are decentralised for PRASA.   |
| Does this ownership entity have the capacity and competencies to effectively carry out its duties?                        |  | DPE appears to be well structured to execute the ownership function on paper, though in practice it may lack some of the commercially oriented competences required. We were unable to assess the competencies of the DoT. |
| Is the state represented at the general shareholders' meetings, effectively exercising voting rights?                     |  | PRASA: DoT is the sole shareholder.<br><br>Eskom and Transnet: The Government is the sole shareholder as represented by the Minister of Public Enterprises.  |
| Is the exercising of ownership rights clearly identified and defined within the state administration?                     |  | This is clearly defined for the 3 SOEs: DPE for Eskom / Transnet and DoT for PRASA.  |

### The State's role as policy maker – summary of gap analysis

| <i>Gap analysis versus OECD Guidelines: The State's role as policy maker</i>   |  |  |
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| Does the state set and monitor broad mandates for the SOE?   |  | Each year, in consultation with the shareholder, SOEs agree on performance objectives, measures and indicators, as well as annual targets in the Shareholder's Compact. This is mandated by the Public Finance Management Act (1999).  |
| Are the activities of the SOE divided into activities which are for commercial or resale and activities which fulfil a governmental purpose? |  | In general, the appearance is that this could be strengthened. For example, in the case of PRASA, it is not clear if PRASA's projects for network expansion, done in collaboration with local government, is for a commercial or governmental purpose. It is interesting to note that PRASA's bus business has recently cut non-profitable routes in light of the company's financial situation. |

### The State's role as regulator and overseer – summary of gap analysis

| <i>Gap analysis versus OECD Guidelines: The State's role as regulator and overseer of SOEs</i>  |  |   |
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| Is there a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regards to market regulation? |  | PRASA: The DoT is currently also the regulator.<br><br>Eskom and Transnet: The regulator is separate from the ownership entity. |

### The State's approach to funding decisions – summary of gap analysis

#### Gap analysis versus OECD Guidelines: The State's approach to funding decisions for SOEs

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| Is the funding and fulfilment of public policy objectives monitored and evaluated through the overall performance monitoring system?   | Some processes in place but no full and separate costing of PSOs. |
| Do SOEs report and disclose any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships? | Guarantees are disclosed.   |

### The State's approach to the SOE board composition and nomination process – summary of gap analysis

#### Gap analysis versus OECD Guidelines: The State's approach to the SOE board composition and nomination process

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| Does the SOE Board composition allow for objective and independent judgement, with all board members nominated based on qualifications with equivalent legal responsibilities?  | PRASA: There is a binding requirement for one member to be from DoT and other state agencies. There appear to be only a few independent directors.<br>Eskom & Transnet: There is a majority of independent directors.  |
| Has the state established a well-structured, merit-based and transparent board nomination process?  | Eskom: All directors are appointed at the discretion of the shareholder. The shareholder takes into consideration diversity across race, gender, age, independence and skills when appointing Board members<br>Transnet: The Corporate Governance and Nominations Committee provides recommendations to the Shareholder minister based on related skills requirements and skills matrix.<br>PRASA: PRASA doesn't follow the same process. Board members are appointed and dismissed by the Minister. |
| Are all independent Board members free of any material interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardise their objective judgement? | Eskom: 80% of directors appear to be independent non-executives.<br>Transnet: In accordance with the King IV Code, the Board is satisfied that the non-executive directors of the Company are independent.   |

### State's approach to SOE board leadership – summary of gap analysis

#### Gap analysis versus OECD Guidelines: The State's approach to SOE board leadership - Chair versus CEO

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| Is the Chair responsible for boardroom efficiency, co-ordination between board members, and acting as liaison for communications with the state ownership entity? | Transnet: The Chairperson is an independent non-executive director and is responsible for leading the Board and ensuring its effectiveness.  |
| Is the Chair separate from the CEO?   | PRASA: Chairperson was separate from Group CEO.<br>Eskom: Currently chair is interim Group Chief Executive, but this is temporary following CEO resignation.<br>Transnet: Separate Chairperson and Group Chief Executive |

## Institutional Governance Review

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Does the Board have the power to appoint and remove the CEO?

Eskom: It appears that the Board makes recommendations.

Transnet: The Board has the power to make recommendations to the Shareholder Minister on the appointment of the Chief Group Executive.

PRASA: Board decides for final concurrence by DoT.

## Role, responsibilities and authorities of SOE board – summary of gap analysis

### Gap analysis versus OECD Guidelines: Role, responsibilities and authorities of SOE board (vis-à-vis State)

Is the role of the SOE's Board clearly defined in legislation?

Eskom and Transnet: Major responsibilities of boards are defined in the PFMA, the primary legislation governing SOEs.

PRASA: The PFMA imposes fiduciary duties to the board, including a duty of care in managing the financial affairs.

Does the state establish a clear remuneration policy for the Board which can attract motivated and qualified professionals, and fosters long and medium-term interests of the SOE?

Eskom: State issues Guidelines for the Remuneration and Incentives for State-Owned Companies DPE 2018).

Transnet: Transnet aims to align guaranteed remuneration with the market median. 2018 Annual Report 2018 report outlines remuneration philosophy. This includes variable pay.

PRASA: Practice unclear here.

## Board functioning – summary of gap analysis

### Gap analysis versus OECD Guidelines: Board functioning

Does the Board, under the Chair's oversight, conduct an annual appraisal of their performance and efficiency?

Eskom: Board evaluation to be conducted annually by an independent party; outcome considered by board. Not performed annually (Eskom report 2018 p.21).

Transnet: Board evaluates its performance and that of its committees, Chairperson and NEDs through annual independent evaluation, provides support for improvement. Process facilitated by an independent service provider. 2018 evaluation was conducted by PwC.

PRASA: does not conduct these

Has the SOE established Board committees composed of independent and qualified members to support the board in performing its functions and improve boardroom efficiency?

Eskom: Audit and Risk; Investment and Finance; People and Governance; Social, Ethics and Sustainability Committees.

Transnet: Audit; Acquisitions and Disposals; Remuneration, Social and Ethics; Risk; CG and Nominations Committee.

PRASA: Board of Control; Governance and Performance; Audit, Risk Committee (ARC); Finance, Capital, Investment and Procurement; Human Capital and Remuneration; Safety, Health, Environment and Quality.

### Transparency and reporting of SOE to owner and key State agencies – summary of gap analysis

#### Gap analysis versus OECD Guidelines: Transparency and reporting of SOE to owner and key State agencies

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| Does the government have an adequate and transparent state ownership policy?  |  | There is no state ownership policy; but there have been discussions to prepare something in this respect.   |
| Does the SOE, even if unlisted, adhere to national corporate governance codes, where practical?   |  | All 3 SOEs indicate that they adhere to King IV Code  |
| Does the SOE disclose the remuneration of its Board Members and key Executives? (Including CEO)   |  | Eskom & Transnet: Some information available online / within Integrated Report.<br><br>PRASA: Not disclosed |
| Does the SOE provide a Director's Report, outlining significant events and relations with stakeholders, as well as commenting on organisation, financial performance and material risk factors for the SOE? |  | SOEs provide this in annual report.   |

### Transparency and disclosures – a summary of gap analysis

#### Gap analysis versus OECD Guidelines: Transparency and disclosures

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| Does the SOE provide non-state shareholders with adequate information when the SOE pursues public policy objectives?<br>Does the SOE disclose a clear statement of policy objectives and their fulfilment? |  | Eskom: Eskom only discloses a general mandate.<br><br>Transnet: There is an overall mandate disclosed.<br><br>PRASA: The SOE discloses its objectives, some of which are policy-related. It does not explicitly identify which ones are directly related to policy. |
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### Appendix III: Report outline – strengths, areas for improvement and recommendations

|  | Strengths   | Areas for improvement and reform  | Consolidated list of recommendations (without prioritisation colour coding in the Report)   | Brief note on linkages and similarities with NDP proposals  |
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|  | <b>A. The institutional and ownership framework</b>   |   |   |   |
|  | <p><b>A1. The State's Role as Owner</b></p> <p><i>There is a centralised government agency, separate from sectoral policy-making line ministries, which is clearly responsible for the ownership function with respect to Eskom and Transnet.</i></p> <p><i>The DPE has assumed several responsibilities expected from a state ownership entity as per best international practice.</i></p> | <p><i>The current institutional framework may not be providing for the integrated oversight structure and required professionalisation to shield the process from politicisation and capture and to fulfil effectively the State's role as owner/shareholder.</i></p> | <p><b>Rec. 1.</b> The Government should consider overhauling the institutional framework for state ownership, with the creation of a separate "ownership entity" to exercise stewardship for State participations in SOEs. Three options are proposed:</p> <p>a. Option 1: Creation of a comprehensive "holding company" where the State would transfer the rights to the shares it currently owns in strategic SOEs, including Eskom, Transnet and PRASA. This entity would take over many of the functions undertaken by the DPE (such as the elaboration of shareholder compacts, review of SOE corporate &amp; business plans and quarterly reports); it would appoint and dismiss SOE boards, and ensure professionalism and the right skill-set in SOE board appointments. Its operation would rely on a team of professional staff, drawn from government departments and recruited externally. The HoldCo board would be composed of senior representatives of the main ministries (including</p> | <p>Action 100 of the NDP highlights the general need to improve "coordination" between the policy ministries and state ownership entity. Options 1-3 are options for enhancing this coordination.</p> |

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|  | <p><b><u>A2. The State's Role as Policy Maker</u></b></p> <p><i>South Africa has a system of shareholder compacts to set, cascade and monitor performance and policy objectives for each SOE.</i></p> | <p><i>SOEs may face multiple policy objectives (not all cohesive/coordinated) whose prioritisation and translation into</i></p> | <p>the Treasury in a leading role) and a minority of INEDs from the private sector. The DPE would become a smaller department with responsibility of developing and owning the SOE ownership policy for Government approval — with the PSEC having an overall consultative role, including on INED appointments.</p> <p>b. Option 2: The DPE's remit would remain as is for the large bulk of the companies but a "pilot" HoldCo would be assigned stewardship of a few strategic companies with a primarily commercial perspective (or in dire need of financial discipline due to previous capture issues) including Eskom, Transnet, and possibly PRASA. Its main governance characteristics would be the same as in option 1, but the DPE would play a leading role on its board.</p> <p>c. Option 3 (closer to the current institutional arrangements): The DPE would retain ownership oversight over its current portfolio but under the coordination and oversight of the PSEC. It would assign some of its current functions related to board appointments and evaluation to a subsidiary staffed with highly skilled professionals</p> <p><b><u>Rec. 2.</u></b> In order to better prioritise objectives for SOEs and improve coordination, the Government should ensure all key objectives including financial discipline and developmental goals are prioritised and aligned with the specific financial and operational objectives in SOE</p> | <p>The NDP notes that "By 2030, South Africa needs to be served by a set of efficient, financially sound and well-governed SOEs that address the country's developmental objectives..."</p> |
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|  |  | <p><i>specific operational objectives is not always successful.</i></p> <p><i>There is a need for more effective coordination among different government stakeholders and in setting objectives.</i></p> <p><i>The appropriate balance between commercial and development objectives for SOEs requires review. A clearer process on the treatment and costing of PSOs is also necessary.</i></p> <p><i>The process and indicators used for monitoring and evaluating SOE performance could be strengthened.</i></p> | <p>shareholder compacts. This could be made operational through:</p> <ul style="list-style-type: none"> <li>a. Mandating that the acceptance of shareholder compacts is contingent on the inclusion of clear financial implications involved in meeting specific developmental and other goals.</li> <li>b. Establishing a regular forum among senior policy makers from different government stakeholders to achieve this—for example the board of the HoldCo or the PSEC.</li> <li>c. Ensuring that individual SOEs have an opportunity to present and discuss their perspective in the mix and prioritisation of objectives.</li> </ul> <p><b>Rec. 3</b> The Government should consider reviewing the overall PSO framework to provide SOEs with the appropriate balance between commercial and development objectives and involve a clearer process on the costing of PSOs. In this direction:</p> <ul style="list-style-type: none"> <li>a. Line ministries and the ministry of finance should agree on the clear definition and costing of SOE-specific PSO obligations.</li> <li>b. Such SOE-specific PSO obligations should become part of the holding company compact development and agreement.</li> </ul> | <p>(NDP pg 438). Regarding specific measures, the NDP also notes that the policy ministries and the state ownership function need to work together to “frame the objectives and performance measures embedded in the shareholder or performance compact”.</p> <p>Action 100 of the NDP discusses the need to “develop public interest mandates for SOEs”. Further, the NDP notes that “each SOE needs a well-defined and transparent mandate that sets out its role and how its activities serve the public interest” (NDP pg 439.) This recommendation to ensure a clearer overall PSO framework builds on this.</p> |
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| <p><b>A3. The State's Role as Regulator and overseer of SOEs</b></p> <p><i>The State regulatory function is separate from the ownership function for Transnet and Eskom. There are parliamentary bodies which provide another layer of oversight over SOEs on behalf of the public.</i></p> | <p><i>The consequences of significant SOE deviation from performance against policy objectives are unclear, and so is relevant remedial action.</i></p> <p><i>The framework for SOE procurement practices needs to be reviewed and strengthened.</i></p> | <p>c. The commercial activities of the SOE and the developmental activities should be ring-fenced into separate accounting systems.</p> <p><b>Rec. 4.</b> The government should consider reviewing the process and indicators used for monitoring and evaluating SOE performance. This would involve:</p> <ul style="list-style-type: none"> <li>a. Developing more granular performance indicators for specific SOEs through a dialogue of the ownership entity, also using external expertise.</li> <li>b. Including indicators linking performance to remuneration in an explicit and transparent fashion.</li> <li>c. Making clear and binding the consequences for SOE leadership and ownership entity management for deviation from performance against objectives set in Shareholder Compacts and in the NDP.</li> </ul> <p><b>Rec. 5.</b> The framework for SOE procurement needs to be overhauled so that procurement practices are competitive, non-discriminatory and transparent. In this context:</p> <ul style="list-style-type: none"> <li>a. SOEs should be provided with explicit uniform guidelines on procurement organisation and controls</li> <li>b. Regular audits of procurement practices should be put in place based on such guidelines.</li> </ul> | <p>The NDP notes that the SOE mandate is an “important mechanism to hold individual SOEs accountable for how they use public resources”. This recommendation elaborates on a possible mechanism.</p> <p>Not specifically covered in NDP.</p> |
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| <p><b>A4. The State's approach to funding decisions for SOEs</b></p> <p><i>The National Treasury provides financial oversight of SOEs.</i></p> <p><i>There appears to be a relatively clear approach on SOE dividend policy.</i></p> | <p><i>The combination of regulatory and ownership functions for PRASA needs to be reviewed.</i></p> <p><i>While financial assistance to SOEs seems to be relatively transparent, the overall framework for financial oversight could be improved.</i></p> <p><i>The link between PSO-related payments to SOEs and SOE requirements to fulfil PSOs could be strengthened.</i></p> | <p>c. Transparency requirements should include a system for a review of complaints.</p> <p><b>Rec. 6.</b> In the case of PRASA, ensure a clear division of ownership/ regulatory roles through the effective and timely establishment of an independent regulator for transport, covering both economic and safety regulation.</p> <p><b>Rec. 7.</b> The Government should consider strengthening the overall financial oversight of SOEs, while assisting them in achieving PSOs. In this context:</p> <ul style="list-style-type: none"> <li>a. The reporting framework for companies that receive financial assistance by the Treasury should be clarified and strengthened.</li> <li>b. There should be an established Treasury veto in the approval of compacts until remedial action is taken by the board of SOEs receiving financial assistance.</li> <li>c. The State should provide SOEs with clear uniform rules for public-private partnerships aimed at leveraging private capital to fulfil public infrastructure needs.</li> </ul> | <p>Not specifically covered in NDP.</p> <p>Not specifically covered in NDP.</p> |
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| B. SOE board leadership  |  |   |   |
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| <p><b><u>B1. State's approach to SOE board composition and nomination process</u></b></p> <p><i>The State has taken steps to restructure the composition of the SOE boards, particularly for Eskom and Transnet.</i></p> | <p><i>The State's approach to board nomination could be more transparent and rigorous, less ad-hoc and politicised, more merit-based and better structured.</i></p> <p><i>There is too much turnover on SOE boards undermining accountability.</i></p> | <p><b><u>Rec. 8</u></b> An SOE Board nomination and appointment process should be elaborated that is less political, and more professional, uniform and transparent. In this context:</p> <p>a. A director nominee framework should provide general guidelines on board nomination, requirements for the State to respect board skills matrices, diversity, tenure, and achieve appropriate balance of independent directors, ownership entity, state representatives.</p> <p>b. The ownership entity (or the PSEC in Option 3 and—partly-- 2) should retain the formal authority for appointments to SOE boards, possibly validated by the Cabinet and/or the President.</p> | <p>Action 100 of the NDP notes that the Government should ensure that there is greater stability in board appointments. The development of the proposed framework creates the conditions for greater stability.</p> <p>Action 100 of the NDP notes that the policy and shareholder ministries should be jointly responsible for appointing the board.</p> |
| <p><b><u>B2. State's approach to SOE board leadership: chair versus CEO</u></b></p> <p><i>The role of the CEO and Chair are separate for the three SOEs under scope.</i></p>   | <p><i>The process for the appointment of SOE CEOs could be made more transparent and consistent</i></p>  | <p><b><u>Rec. 9</u></b> There should be transparent guidance on the process for the appointment of SOE CEOs, which should include the following characteristics:</p> <p>a. SOE boards rather than Government should be playing playing the leading role and maintaining the nomination initiative.</p> <p>b. The roles, responsibilities and coordination of the SOE board, the state ownership entity and eventually others in the process should be clearly outlined.</p>   | <p>The NDP notes that boards should "appoint their chief executives" as this enables a "clear line of accountability [...] between the board and the chief executive" (NDP pg 441)</p>  |

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| <p><b><u>B3. Role, responsibilities and authorities of SOE board (vis-à-vis State)</u></b></p> <p><i>The SOE Board appears on paper to exercise significant authority with respect to SOEs.</i></p> <p><b><u>B4. Functioning of the SOE board</u></b></p> <p><i>The DPE protocol provides guidance on SOE board functioning.</i></p> <p><i>Board evaluation seems to be a common practice in ESKOM and Transnet, but not PRASA.</i></p> | <p><i>The Boards should review their internal and external audit frameworks as well as remuneration frameworks.</i></p> | <p>c. In situations where final approval is outside the SOE, this should rest with the ownership entity rather than the government.</p> <p>d. CEO contracts should be signed by SOE boards</p> <p><b><u>Rec. 10.</u></b> The Government should consider revamping the overall legislative framework and oversight for external company audits. The state ownership entity should encourage and assist SOE Boards in reviewing the internal and external audit processes of their companies to bolster their independence and effectiveness, while ensuring that are staffed by sufficiently experienced financial experts.</p> <p><b><u>Rec. 11.</u></b> In approving executive remuneration, SOE boards should ensure that there is adequate linkage between the KPIs triggering variable remuneration and fulfilment of the Shareholders' Compact.</p> <p><b><u>Rec. 12.</u></b> All large SOEs should regularly undertake board evaluation exercises run by the SOE board with the help of external expertise. These should be aimed at assessing board functioning and effectiveness, serve as inputs in the process of (re)appointment of board members as well as a mechanism for the SOE board to reflect on its contribution to the SOE achieving its objectives.</p> | <p>Not specifically covered in NDP.</p> <p>Not specifically covered in NDP.</p> <p>Not specifically covered in NDP.</p> |
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|  | <i>The state ownership entity could further support induction and training for SOE directors.</i>   | <b>Rec. 13.</b> The state ownership entity should consider reinforcing its mechanisms for supporting the induction, training and skills development of SOE board members, in particular as regards the importance of supporting the NDP goals and ways to manage their oversight responsibilities.   | Not specifically covered in NDP. |
| <b>C. Information flows, transparency, reporting of the SOE</b>  |   |  |                                  |
| <b><u>C1. Transparency and reporting to board</u></b><br><br><i>There appears to be regular management reporting to the board.</i><br><br><b><u>C2. Transparency and reporting of SOE to owner and key State agencies</u></b><br><br><i>The DPE protocol covers disclosure to State.</i><br><br><i>There appears to be regular information flows to the state ownership entity and to Treasury for SOEs in distress.</i> | <i>The absence of a state ownership policy may contribute to lack of transparency and weaker accountability in the governance of SOEs and their stewardship by the State.</i> | <b>Rec. 14.</b> In the interest of transparency, coherence and accountability in SOE policy, the Government should consider adopting a state ownership policy ("the Policy") that lays out the State's objectives, approach and governance framework for the stewardship of SOEs; this should be separate from the planned SOE bill. The Policy should provide general principles and a unified approach for SOE governance:<br><br>a. It should clearly outline the expected division of roles and responsibilities of key ministries and government agencies (e.g. ownership entity, DPE, National Treasury, line ministries, NPC, Auditor | Not specifically covered in NDP. |

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|  | <p><b><u>C3. Transparency and reporting of government and SOEs to the public</u></b></p> <p><i>There are a number of reports prepared by the State aggregating SOE performance.</i></p> | <p><i>Process for assessing Information flows may need to be unified and improved.</i></p> <p><i>There is no clear public reporting against objectives in the shareholders' compact (which themselves are not public) or public service obligations.</i></p> <p><i>Disclosures on SOE websites on corporate governance could be further enhanced.</i></p> | <p>General, Cabinet etc) with respect to engaging with SOEs;</p> <p>b. Complement the DPE protocol, outlining general expectations for the SOE board nomination, composition and remuneration processes;</p> <p>c. Cover transparency and accountability requirements for SOEs beyond the scope of other legal requirements;</p> <p>d. Provide a clear process for the periodic review of the rationale for the State's ownership of and participation in SOEs and examine options for asset divestment and privatisations.</p> <p><b><u>Rec. 15.</u></b> Consideration should be given to enhance transparency by SOEs on the fulfilment of public policy objective implementation and costs:</p> <p>a. Main annual objectives from Shareholders Compact should be more systematically disclosed to the public, to facilitate public scrutiny and broader SOE accountability.</p> <p>b. An assessment of the achievement of these annual objectives should also be disclosed.</p> <p><b><u>Rec. 16.</u></b> Corporate governance policies, board charters, and board committee terms of reference should be</p> | <p>The NDP notes that SOE mandates and performance contracts should be publicly available online (NDP pg 439-pg 440).</p> <p>The NDP highlights the need for comprehensive annual reports and financial statements. However, the</p> |
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|  |  | <p>publicly disclosed to enhance transparency on governance practices.</p> <p><b>Rec. 17.</b> The government should consider involving multiple stakeholders beyond the executive and the legislative (from industry, consumers and civil society representatives to labour, creditors and affected communities) in evaluating SOE performance and service delivery in the context of a stakeholder forum, especially for large utilities.</p> | <p>Report recommendation goes further towards international best practice for governance disclosures.</p> <p>Not specifically covered in NDP.</p> |
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