

**A
SUMMARY
of the
Policy Framework for an
Accelerated Agenda for the
Restructuring of
State-owned Enterprises**



Ministry of Public Enterprises
Republic of South Africa
August 2000

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This document is a summary of the Policy Framework for an accelerated agenda for the restructuring of State Owned Enterprises. The full Policy Framework is available for the reader who wishes to understand the rationale behind the policy.

To obtain additional copies of this document, please contact:

The Librarian
Department of Public Enterprises
Private Bag x15
HATFIELD
0028
South Africa
Tel: +27 12 342 7111
Fax: +27 12 342 7224

Enquiries: lipmanv@ope.pwv.gov.za

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Foreword by Jeff Radebe, MP Minister of Public Enterprises



There are many challenges facing South Africa. At the top of the list is the eradication of the crushing poverty that holds back the development of our country and region. We have adopted the view that the real conditions of every day life require a strong democratic developmental state. Only by adopting this perspective will we be able to rise above the challenges of the day and establish the conditions in which all our people are able to enjoy a better life for all.

Part and parcel of the developmental state are the State Owned Enterprises, or SOEs, that are described in some detail in the *Policy Framework*. Our SOEs do not operate in a vacuum – they engage in economic activity and provide essential services that traverse even our borders. We have found that, in many instances, their traditional methods of operation and business management, human resource development, and even their targeted constituency base were inappropriate in a democracy. Furthermore, they command large procurement budgets, social and human resources and some of them dominate the economic sectors in which they operate. Since the emergence of democracy, South Africa has begun to integrate itself into the global environment as a worthy member of the international community. In particular, our country has become an important agent towards the realisation of the African Renaissance. In this context, the accelerated restructuring of SOEs to meet these combined challenges has become a matter of urgency.

Recognising this need, Government, at a Lekgotla¹ on the 29th November 1999, directed that a detailed and coherent policy framework be prepared to guide the restructuring process into the 21st Century. The *Policy Framework* will enable Government to co-ordinate thinking on the restructuring of State Owned Enterprises. As such, it goes beyond being merely the integration and consolidation of policy arising from the experiences of Government since 1995 when the initial framework for restructuring was agreed by Cabinet.

¹ Lekgotla is a South African word describing a type of workshop where decisions are taken.

In summary, Government's policy with regard to State Owned Enterprises is more properly referred to as a restructuring programme, and not in the more simplistic terms of privatisation. The programme was and remains designed around a multiple array of strategies, or mixes of options, that are designed to ensure the maximisation of shareholder interests defined in economic, social and development terms. Thus restructuring refers to the matrix of options that include the redesign of business management principles within enterprises, the attraction of strategic equity partnerships, the divestment of equity either in whole or in part where appropriate, and the employment of various immediate, turnaround initiatives.

At the enterprise and sector level, restructuring involves improving the efficiency and effectiveness of the entity, accessing globally competitive technologies where appropriate, mobilising private sector capital and expertise, and assisting the creation of effective market structures in sectors currently dominated by the SOEs. At the broader, macroeconomic level, restructuring initiatives aim to attract foreign direct investment, to contribute to the reduction in the public borrowing requirement, and to assist the development of an economic context that promotes industrial competitiveness and finances growth. Social imperatives include the need to ensure growth in employment, particularly in new areas of endeavour, and to rationalise or develop new skills within the labour force and their deployment throughout the economy.

Obviously, the time lapse between initiating an economic or social programme and the realisation of objectives cannot be defined with any accuracy in terms of months or even in many instances, years. However, initial results indicate that substantial sums of money have already accrued to the state since 1996. Furthermore, the recent financial results of the major SOEs, in particular Transnet, including SAA and Spoornet, Denel, Eskom, and Telkom have revealed that internal reorganisation has resulted in very promising turnaround successes since the restructuring programme was initiated.

The past five years have represented a steep learning curve for the Government, and, although not all initiatives have been trouble-free, we can justly claim that we have established a solid foundation for the accelerated restructuring agenda that is reflected in the *Policy Framework*.

The *Policy Framework* describes a dynamic process that will require careful monitoring and constant evaluation. As implementation unfolds, I am sure that there will be areas that may require revisiting. We do not wish to cast in stone timetables and procedures that are proved inappropriate later through the experience of action on the ground. At the same time we believe that this framework provides satisfaction,

security, and will form the basis for further confidence for employees, managers, boards and investors alike. Government, as the primary shareholder in many instances, will ensure that the restructured SOEs will continue to play a responsible, proactive role in the development agenda. This document has been presented in a format that by providing the discussion around issues ensures that the readers understand the rationale behind the policy.

I am confident that the *Policy Framework* provides sufficient consensus for all stakeholders to remain part of the team who will ultimately be responsible for the success of the restructuring initiative. Indeed, it remains our intention to seek the views of all stakeholders affected by the restructuring process it unfolds to deal with any unforeseen problems that may arise. To this end we will use the institutional mechanisms afforded to us by the Constitution, Parliament and Nedlac, as well as other less formal channels to ensure that the views of all affected stakeholders are heard.

I wish to thank all those, both inside and outside of Government, who have contributed to the development of the *Policy Framework*.

A handwritten signature in black ink, appearing to read "J. Radtke". The signature is written in a cursive, flowing style.

August 2000

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ABBREVIATIONS

ACSA	Airports Company of South Africa
GDP	Gross domestic product
IPO	Initial public offering
SOE	State-owned enterprise
SEP	Strategic equity partner

Government's vision for restructuring

Government confirmed its strategic vision for the restructuring of state-owned enterprises (SOEs) in November 1999. This vision sets out the role of the state in the in the restructuring of SOEs, in view of the development needs of the country and of recent international SOE restructuring. Several policy interventions since 1994 facilitated ongoing policy discussion about the role of the state. It is generally accepted that South Africa needs both the state and the market in a mixed economy to address the legacies of apartheid. The state's role is dynamic, shifting emphasis to meet the changing development needs of society. The Constitution requires the state to take proactive action to ensure that the injustices of the past are overcome in fairness and equity; SOEs clearly have a role to play in this process. Government's key policy statements both explicitly and implicitly address the state's relationship to the SOEs, as discussed below.

The *Reconstruction and Development Programme*² argues that Government should decide, on "the balance of evidence", whether the public sector should be expanded in strategic areas through "nationalisation, purchasing a shareholding in companies, establishing new public corporations or joint ventures with the private sector". Alternatively, it could reduce the public sector in a manner that will "enhance efficiency, advance affirmative action and empower the historically disadvantaged, while ensuring the protection of both consumers and the rights and employment of workers" (clause 4.2.5).

Similarly, the *Growth, Employment and Redistribution (GEAR) strategy*³ notes that restructuring "may involve the total sale of the asset, a partial sale to strategic equity partners or the sale of the asset with Government retaining a strategic interest". It also proposes a phased process of restructuring to maximise value and to ensure that adequate regulatory frameworks are put in place. GEAR argues for "decisive leadership by Government". This entails a protocol on corporate governance indicating the objectives and performance appraisal norms for all SOEs, a programme of asset restructuring, and fair pricing policies to ensure full cost recovery while "also promoting competition or protecting consumers against monopolistic practices" (s.7.2).

² ANC/Alliance (1994), *Reconstruction and Development Programme*, Johannesburg, Umanyano Publications.

³ Department of Finance (1996), *Growth, Employment and Redistribution: A Macroeconomic Strategy*, Pretoria.

Meeting in November 1999, the key Ministries involved in SOE restructuring discussed the objectives of this process. It was evident that Government has benefited from its experience of restructuring over the past five years. Progress with the restructuring of some major SOEs has been considerable, but negative experiences with some smaller SOEs indicated that Government's approach to restructuring needed to be refined. This is particularly important now that the South African economy is reorientating itself towards the regional and international markets, and the major public corporations (energy, telecommunications, transport and defence-related industries) must increasingly support this global positioning.

The peculiar circumstances around the establishment of SOEs in apartheid South Africa created the conditions for skewed development aims, and irregular infrastructure and service delivery. Combined with their many structural shortcomings, these problems restrict the SOEs' ability to adjust to new requirements and new policies. Some corporations are struggling to overcome a legacy of unsustainable debt burdens, underinvestment in key infrastructure and technology, and unmanageable corporate structures. The state, therefore, currently not only risks failing in its broader policy objectives but could also see the value of these assets severely depreciate as the market discounts them due to their current difficulties. This may prevent it from ensuring rigorous and directed interventions to secure socio-economic development in disadvantaged areas, as well as for the development of the new economy.

Despite their difficulties, the major SOEs represent massive financial, investment, labour, technology and infrastructure resources, and dominate sub-Saharan Africa's transport, communication, power and defence-related technology sectors. Government's restructuring strategy aims at maximising the contribution that its assets can make to development both in South Africa and on the continent. The restructured SOEs can lead the way in promoting the African Renaissance in their respective sectors, providing world-class expertise, resources, services and infrastructure to a developing continent, often in partnership with enterprises in other African countries.

Development cannot be measured only by financial criteria, and restructuring is not a means of improving government finances and enterprise efficiency at the expense of the poor. Rather, the success of restructuring will be measured by its contribution to improving the standard of living of the majority of the population. The goal of restructuring must therefore be the creation of sustainable economic and social benefits. Government's strategy on restructuring aims at benefiting all South Africans by expanding infrastructure services that are competitively priced and accessible, and that provide an opportunity for economic participation. Private capital and expertise, within an appropriate framework to encourage delivery, will expand the potential for providing such services and infrastructure beyond that which the state alone can

deliver. The state will manage the economy through both direct and indirect mechanisms to ensure that this expanded potential translates into large-scale improvements in service delivery. Restructuring will be accompanied by regulatory reforms to ensure that consumer interests are protected, that services and public participation in service delivery are extended and that environmental and other public policy concerns are addressed.

Restructuring or privatisation programmes may be interpreted as a withdrawal of state power, authority and responsibility from the provision of services, employment and investment. However, as a result of the high levels of debt that some SOEs find themselves, public ownership is, for all intents and purposes, nominal, as the control and power over the SOEs rests with international financiers. In addition, many SOEs have not aligned their operations with the broader objectives of Government, their shareholder, beyond vague references to social responsibility. The restructuring programme aims at *returning* SOEs to the ambit of citizens' concerns, using performance contracts, shareholder compacts, and regulatory instruments designed to ensure that they fulfil their responsibilities while being economically efficient.

Equity partnerships, management contractors and other participants from the private sector will likewise be guided by a common commitment to the broader aims of Government's reconstruction and development programme. In short, non-state institutions will be participating in the organisation, financing and management of SOEs. Thus, rather than alienating state assets, the role of private, national, international and community-based capital resources is being increased. This includes trade union investment funds, employee share plans, public offerings and other forms of participation.

The Government's vision is based on recent development thinking, which provides important clarifications on the role of the state in the development of the economy. The range of ideological shifts in developmental economics in the second half of the 20th century include import substitution in the 1970s, macroeconomic stabilisation in the 1980s, and overcoming financial instability in the late 1990s. Yet, the economies that have grown and have best weathered the global economic integration are those with institutional frameworks well suited to managing the balance of external shocks and of internal development. Development is more likely to occur where appropriate, often pre-existing, institutions have adapted to the social and economic pressures arising from changes in the international economy. In these mixed economies, which are responsive to market incentives within a framework of socially integrative institutional mechanisms, development is generally more sustainable. The *Policy Framework*, published separately, identifies the institutional mechanisms required to ensure the development of the South African economy in the global arena.

The restructuring of SOEs has a better chance of success when it can exploit the potential of a mixed economy. This policy framework, however, is primarily about restructuring these SOEs, and although this occurs within, and to some extent as a result of, the overall restructuring of the economy, this document cannot cover all the related social, political and economic issues. It instead aligns itself with the primary developmental thinking in Government and outside, while focusing primarily on issues around the restructuring of SOEs.

Government can use various approaches to achieve the objectives noted above. These approaches can be classified into three interrelated categories: those internal to the industry or sector to which the enterprise belongs, those that relate more broadly to the economy, and those that relate to the achievement of social goals. The approaches Government adopts are related to its overwhelming electoral mandate and are defined by the dynamic relationship between its responsibilities to all South Africans and to the region as a whole.

Within each industry or sector, Government aims at enhancing the efficiency and effectiveness of SOEs to secure services and infrastructure delivery at optimal cost and service levels. This requires access to globally competitive technology for the provision of the best available and affordable services. Appropriate market structures will be created within the sectors currently dominated by SOEs to encourage greater effectiveness and efficiency. Private sector capital and expertise will be mobilised and structured to ensure that Government's aims are achieved.

SOE borrowing represents a significant portion of debt in the broader economy. Government wants to lower the public sector borrowing requirement, primarily to release interest commitments for other social uses. The public sector borrowing requirement includes SOE borrowing. Many SOEs are highly geared – their level of borrowing is high relative to other financial measures, such as their earnings before interest and taxation. The SOEs need to attract foreign direct investment to provide access to markets and technology, and finance growth and the requirements for industrial competitiveness.

Government also aims at promoting wider ownership and participation in the economy, improving service delivery in terms of cost, quality and access, and promoting human resource development, including the development of management skills for SOEs. Comparative assessments of restructuring and privatisation initiatives show short-term job losses in some sectors, either from existing overemployment or from new challenges facing these enterprises. South Africa's economy is changing rapidly, particularly in the secondary or manufacturing sectors, with the emergence of

small, medium- and micro-enterprises. Furthermore, tourism as a new industry, linked to the recreation and environmental sector, has also emerged as a new role player in job creation. All of these affect the organisation of the secondary sector, the labour market and the type of job opportunities being created. Government has noted these new contexts, and aims at mitigating negative short-term impacts through a conscious and viable social plan programme. This programme promotes the creation of sustainable employment either directly or indirectly through improvements in the economy, as well as through immediate alleviation programmes to ensure that short-term losses do not become longer-term realities. Expanding the scope for employment in general and in new areas in particular remains a key objective of government policy.

The *Policy Framework* provides Government, SOEs and stakeholders with a common frame of reference on restructuring. As such, it integrates and reconciles the various objectives of the different stakeholders concerned with SOEs. Most broadly, the objectives of restructuring are to enhance the business efficiency and effectiveness of the enterprises, attend to macroeconomic needs to promote investment and/or reduce public sector debt, and address social concerns such as employment losses and improving service delivery.

The *Policy Framework* describes a dynamic process that will require careful monitoring and constant evaluation. As Government learns from experience during the implementation process, it will be open to reviewing the *Policy Framework* and will hold discussions with stakeholders when necessary.

Principles of the restructuring programme

To put the accelerated restructuring programme in context, Government reviewed both local and international restructuring experience. This review enabled Government to formulate the principles to assist it, SOEs, investors and other stakeholders in developing a consensus around the primary objectives of restructuring. Although not every restructuring initiative can achieve all the objectives in equal measure, they should be met in the overall programme. Where restructuring proposals will deviate from the principles, the reasons for this deviation should be spelt out. The key principles of restructuring are as follows:

- Competition and competitive markets should be promoted, within an appropriate regulatory framework, to ensure that the benefits of restructuring (such as efficiency gains) translate into lower prices, higher quality goods and services, and/or wider coverage. In addition, where the competitive market does not address social needs, Government will need to intervene.
- Although the scope for promoting competition has increased with globalisation and technological change, it remains impractical in industries with residual natural monopolies, such as network industries (e.g. power transmission). The nature of the business of these industries makes it unfeasible to establish more than one firm. A regulatory framework needs to be in place when restructuring initiatives occur to ensure that the residual monopolies do not distort the development of competitive markets in the non-regulated sectors of the industry. The regulatory framework must be consistent, manageable, appropriate and not bureaucratic.
- Government should clearly spell out its intentions and envisaged relationship with the restructured SOEs in individual shareholder compacts, in the corporate governance framework for all SOEs, and in a clear policy framework and programme for restructuring. This will make the performance of individual SOEs easier to assess, enabling the state (as shareholder) and investors alike to make more appropriate investment decisions.
- Government should explore options to enhance productivity, profitability, investment and innovation. This will often entail equity sales (full or partial privatisation) in order to access additional funding, technology or markets. Where this is not required, approaches such as corporatisation, joint ventures, employee participation schemes and community partnerships may be more beneficial. In

instances of partial privatisation, other partnership arrangements may also be appropriate.

- Government should maximise the optimal return to the shareholder (fiscus), whether through equity sales, dividends and/or tax returns. Its long-term returns on its shareholding can be maximised by trading off short-term gains from equity sales in depreciated assets for medium- to longer-term gains (dividends, taxes, deferred equity sales) from successfully restructured SOEs.
- Restructuring proposals should assess the SOEs impact on overall social welfare. It should address the costs and benefits to society, both direct (e.g. immediate impact on pricing or employment) and indirect (e.g. social costs from non-delivery of certain essential services or the impact of unemployment on specific communities). Apartheid concentrated people, but not infrastructure and services, in the former Bantustans. Consequently, the Northern Province, KwaZulu-Natal and the Eastern Cape are most affected by structural poverty. The proposals should consider such regional variations, as well as the impact of the restructuring process on, for example, rail and road transport networks, and electricity and communications roll-out.
- Government should be transparent in addressing its social objectives (social plans, employment creation, price subsidies, optimisation of public goods, empowerment, etc.), allowing stakeholders to reach agreement on the logic and methods of the restructuring process. Transparency will enable stakeholders to hold both Government and the SOEs accountable for their individual actions towards meeting their objectives, and will ensure that poor performance can be both identified and remedied. Government will still monitor and evaluate the implementation of applicable laws, in particular on transparency and on the management of public finances.

These principles acknowledge the underdevelopment legacy of the apartheid past. In the early 1980, the then government switched resources from investment in infrastructure to consumerist priorities in a deliberate strategy to purchase the short-term submission of the majority. The failure of that policy led to the current problems – first, an investment environment must be strengthened, and second, with the introduction of democracy in 1994 the state's responsibilities to its people have increased massively. This is placing significant pressure on its resources. Its immediate actions will be to stimulate investment, create mechanisms to direct market-orientated strategies to ensure that growth does not negatively affect people's welfare, make infrastructure a platform for development rather than a burden, and ultimately release capital for social development.

1. Stimulating investment

Mobilising public and private sector capital and expertise

The current structure and form of SOEs are the outcome of the long period of isolated development in which narrow “strategic” interests took precedence over broader economic and social development. Investment decisions that were not always efficient or in line with development needs contributed to poor SOE performance and infrastructure backlogs. Some SOEs could not access global technology and skills, becoming uncompetitive in a rapidly changing world economy. Given their key role in providing economic infrastructure for other sectors of the South African economy, this is hindering South Africa’s integration into the global market. Many SOEs also have high levels of borrowings. These raise the public sector borrowing requirement and translate into high interest payments that affect SOEs’ profitability and ability to expand development opportunities.

As the state lacks the immediate resources to address these backlogs, it needs new financing through different domestic and foreign partnerships to provide equity capital and technology. Although it considers a range of restructuring methods, as noted above, the context of infrastructure backlogs and limited resources will often require some equity sales to provide capital, technology and/or access to markets for infrastructure expansion. Further infrastructure investment can only be achieved through an accelerated programme of restructuring SOEs and through more extensive use of public-private partnerships to increase local and foreign direct investment.

Attracting foreign direct investment

Foreign direct investment improves access to international expertise, technology and new markets. It also benefits credit standing and the ability to finance investment, leading to infrastructure expansion, the development of related industries and the prospect of higher growth. Foreign direct investment inflows to South Africa have, in recent years, averaged roughly 1 per cent of gross domestic product (GDP) a year. This is low relative both to other investment into South Africa and to the recent experience of other emerging economies. Inflows related to restructuring in the form of equity investment and infrastructure expansion may even double the average level of foreign direct investment over the next five years.

Easing constraints on growth

Restructuring should generate more capital inflows through both foreign direct investment and portfolio investment. Although Government recognises the pitfalls of an overreliance on portfolio investment, if properly managed, such flows can be positively correlated with higher growth prospects, initial public offerings of utility

companies, notably Telkom, and subsequent secondary markets in these stocks. Capital inflows reduce the constraint that the balance of payments can place on economic growth, improve investor confidence and reduce risk premiums, further supporting higher levels of investment. At the same time, regulation, corporate governance, transparent subsidies for achieving social goals and similar measures should ensure that the services provided by SOEs support broader government objectives.

2. Comprehensive Regulatory Context

Regulation is not only the creation of mechanisms to prevent unscrupulous business activity when competition is being introduced. It also incorporates measures to align the activities of the restructured SOEs with interests and well-being of the public, both as consumers and as shareholders.

Economic regulation

A regulatory framework must be implemented when competition is imperfect or not feasible, such as in residual natural monopolies. Price regulation will prevent excess profits and be an incentive for the SOE to pass on efficiency gains to the consumer through lower prices. The regulator should also address service costs and quality, and can assist Government in monitoring environmental and other public policy concerns. Appropriate corporate governance measures for SOEs will protect consumers by ensuring adequate disclosure of information, and greater transparency and accountability.

Restructuring may lead to some short-term price realignment that will have to be regulated. In the longer term, prices will be administered in a way that encourages efficiency improvements and complies with Government's inflation objectives.

Increasing competition and ensuring that returns are not excessive are key to enhancing the efficiency of infrastructure delivery. International experience shows that the failure to establish competitive market conditions will, at best, reduce the microeconomic benefits and, at worst, encourage serious abuses of monopoly power. Some early attempts at restructuring preserved the monopoly status of SOEs in an attempt to make them more globally competitive and/or to increase their value. However, any positive impact of such a strategy was probably outweighed by the negative consequences of inadequate competition. Technological advances in many sectors, especially telecommunications and energy, have made competition possible in sectors previously regarded as natural monopolies.

Corporate governance

Corporate governance regulates the relationship between the state and the SOEs, and can circumvent pitfalls traditionally associated with state ownership, such as differential access to information and contractual ambiguities. The 1997 Protocol on Corporate Governance for the governance of SOEs was based on the King Report, and covers most aspects frequently found in international corporate governance frameworks. Although it is an acceptable basis for corporate governance of SOEs in the medium term, it will have to be refined in future to remain in line with international best practice.

In the interim, the four largest SOEs (Eskom, Transnet, Telkom and Denel) will have to adopt the 1997 Protocol. Government has also developed shareholder compacts with each of these SOEs to define their relationship and address any limitations in the 1997 Protocol. These compacts will include the critical assumptions about the operating environment, economic conditions and political relationships, as well as any specific obligations to deliver services.

Ethics and probity

Poorly managed restructuring may create opportunities for corruption, fraud and/or bribery. Government will not tolerate any form of corruption, including the improper paying or receiving of benefits. It is committed to a transparent and accountable restructuring process. Although the current legislative and institutional framework against corruption is adequate, SOEs should be particularly vigilant against unethical business practices.

The management and boards of the SOEs must uphold appropriate standards of ethics and probity, as approved and monitored by Government. Many have already established codes of conduct, which Government will enforce through performance monitoring. The ethics and probity management programmes should include the following measures for boards and management:

- Code of ethics
- Code of conduct
- Ethical training programmes
- Process of probity investigation and procedures for actions to be taken
- A system of adequate and appropriate disciplinary procedures and sanctions.

The SOEs will periodically have to review and update these ethics and probity management programmes in line with international best practice. Those who manage the restructuring process will also be subject to appropriate probity investigation, and

any evidence of misconduct will be fully investigated and prosecuted where applicable. Government's focus on ethics and probity will constrain corruption and self-serving behaviour, and by enforcing international ethical standards, will assure potential foreign investors that financial and other corporate misbehaviour will not be tolerated. Government's commitment to world-class standards of probity is demonstrated by its emphasis on transparent and accountable management of the restructuring process. Investors and stakeholders will be able to monitor the process, holding Government accountable for deviations from the published process and programme.

Ultimately, corruption and fraud, in any manifestation, are theft and criminality against the people of South Africa. In the context of continuing poverty and inequality, these practices can deprive people of homes, livelihoods and sustenance, and will not be tolerated.

Improving regulatory regimes

A sector-specific regulatory regime will be established within the broader framework of current competition policy, based on the type of industry and the potential for competition, as well as the competence of the regulator in question. In the interim, Section 3(1)(d) of the Competition Act should be removed and concurrent jurisdiction should prevail in all regulated industries. Both authorities should approve mergers, and abuses of dominance should be met by a sector-specific approach. In the longer term, regulators could concede jurisdiction on competition matters to competition authorities, and consult these authorities on other regulatory decisions.

Improving the regulatory environment in the key SOE-dominated sectors (energy, telecommunications and transport) should benefit all. South Africa's globalising economy will benefit from lower prices and/or improved service outputs, becoming more competitive and creating more employment and investment opportunities. All people, but especially unemployed and poor people, will benefit from increased job opportunities and more affordable and available services, while greater certainty will stimulate investment.

3. Community and consumer protection

Creating effective market structures in sectors currently dominated by SOEs

Consumer protection is a vital institutional precondition for successful restructuring, and requires either regulation or the creation of competition. In the absence of competition, private, unregulated monopolies generally charge higher prices, as demonstrated internationally. Adequate regulation of both private and public sector

monopolies is therefore essential. A major aim of restructuring is to improve access to quality, reliable services and/or lower prices. Where possible, this should be achieved through competition, which drives down prices by enabling consumer choice and by encouraging further investment and innovation. Sector-specific frameworks will be developed, based on the intended future market structure of the sector and on regulatory capacity.

During restructuring, communities who do not have access to resources should not be further disadvantaged. Where services are to be extended to underserved communities, Government should provide transparent subsidies or stipulate other agreements as a clear condition of the licensing or sale of the SOE.

4. Infrastructure delivery

Enhancing the efficiency and effectiveness of state enterprises

Effective infrastructure delivery depends, first, on more and better services and, second, on ensuring equitable access to these services. The first step involves improving the efficiency of SOEs, whether by changing the structure of the organisation, its form of management, its processes, or its ownership. Corporatisation, the introduction of business and market principles, brings efficiency by setting effective individual and organisational incentives, shifting towards hard budget constraints and promoting self-financing. Where Government wants the enterprise to incur expenditure to meet social goals (which will not cover costs), Government will need to finance these expenditures. Other ownership arrangements that involve performance measures and incentives can be valid alternatives to privatisation. In the context of infrastructure backlogs and an overreliance on debt finance, however, some level of equity transfer will provide capital and expertise not only to improve the efficiency of existing capacity but also to create new capacity for service delivery.

Dynamic impact of increased efficiency

As the South African economy positions itself in the regional and international markets, the major public corporations (energy, telecommunications, transport and defence-related industries) play a critical role. Improving their efficiency will result in lower prices and/or improved service outputs, which will enable the South African economy to become more competitive and create more employment and investment opportunities.

Equitable access

Improved efficiency in service delivery does not necessarily ensure broad-based development. Services must be accessible to a broader section of the population,

including poor people who are otherwise excluded from the market. The inability of poor people to pay market rates for services and the apartheid legacy of social inequities will necessitate ongoing government intervention.

The equitable provision of infrastructure will be funded directly through subsidies that are fully accounted for in the Budget. Alternatively, when the regulatory approach explicitly sets a price for an SOE's product for other social purposes, this will be made clear within published price or tariff schedules. Social objectives will be transparent and explicitly included in the shareholder compacts negotiated with each SOE. Government will demand performance improvements (reflected in tax receipts or dividends) from SOEs, but grant explicit subsidies for addressing social requirements.

5. Increased government resources for social spending

Restructuring will benefit basic living standards not only through more effective infrastructure delivery, but also by freeing up funds for more spending on other essential social services. Where restructuring involves a sale of equity, the proceeds to the fiscus will allow an accelerated reduction of state debt and, therefore, of future interest costs. Lower debt service costs free more resources for spending on social services and infrastructure or allow Government to lower revenue targets, leaving the public with more money for discretionary spending. Lower SOE debt will also significantly reduce interest expenses, enabling these enterprises to increase their investment in the maintenance and development of infrastructure.

Institutional and procedural requirements for restructuring

This section describes the key processes in Government's approach to restructuring, and emphasises certain preconditions for successful restructuring. Government needs to refine its views on competition and regulation, its proposals on expanding economic participation to historically disadvantaged sectors, and its approach to improving corporate governance in the SOE sector.

1. Encouraging appropriate competitive and regulatory frameworks

The policy on restructuring is in line with the general competition policy of the Department of Trade and Industry. Sector-specific regulatory regimes may be necessary to deal with technical issues, but will still operate in the broader framework of current competition policy. Government adopted a position requiring concurrent jurisdiction between the sector-specific regulator and the Competitions Commission to eliminate existing and potential conflicts of authority. Ideally, the Competitions Commission will address all issues related to anti-competitive behaviour (including mergers and acquisitions), and the sector-specific regulators will deal with technical issues. In practice, some overlap is likely since technical decisions often affect the competitive structure of the markets concerned.

Government will not create many new sector-specific regulators, preferring to use existing institutions with complementary competencies. It will consider the type of industry, the potential for competition and the competence of the regulator before establishing a new one. A framework for regulating the regulators will be developed; this will affirm Government's prerogative to set policy and will define the jurisdiction and operations of regulating authorities. Regulatory bodies will work within the framework of government and sector policies, and will not set their own policies.

A better regulatory environment in the key SOE-dominated sectors (energy, telecommunications and transport) will benefit the whole economy. Better service, higher outputs and lower prices will positively affect South Africa's growing economy, enabling it to become more globally competitive, increasing both employment levels and investment opportunities, and leading to more affordable and available services.

2. Encouraging empowerment

Restructuring strategies that include broadened ownership, training, procurement and management opportunities for previously disadvantaged groups will spread the benefits of restructuring more widely. Participation will be broadened through training and involvement in SOE management, and through indirect approaches such as procurement reform and increased ownership opportunities. No single approach will optimise empowerment – a combination approach will probably be best.

Several empowerment mechanisms involve some level of equity transfer or sale, while others concentrate primarily on changing operational responsibilities to ensure greater participation by employees and client communities. The following approaches are envisaged:

- Share ownership can be broadened through the National Empowerment Fund and other individual and collective ownership mechanisms focusing on previously disadvantaged groups. This process should avoid the problems of existing empowerment schemes, but draw on international experience of collective investment vehicles to provide a range of equity schemes for those previously excluded from mainstream economic participation.
- Operational empowerment strategies, such as procurement, training and employee participation in management, can be improved to ensure meaningful access to state-regulated activities through entrepreneurial opportunities for outsourcing, expanded partnerships and easier access to financing.
- Employee share ownership plans and community trusts should be actively promoted to stimulate enterprise self-management and community involvement.

3. Improving the restructuring process

Government mapped the main processes involved in a restructuring initiative, i.e. strategic analysis; planning for enterprise restructuring; transaction management; and post-restructuring management. These processes are set out below.

1. Strategic analysis

This involves the development of high-level restructuring plans for individual SOEs (informed by sectoral industrial strategies), as well as maintaining a list of restructuring priorities for Government as a whole. The process starts with an analysis of the SOE to identify possible restructuring opportunities. These are further refined after consideration of macroeconomic, sectoral and legislative and regulatory trends. In line with the functional differentiation of roles in Government, the policy departments will

define the broader sectoral, regulatory and legislative policy environments in which enterprise-specific restructuring will occur.

Once a set of restructuring priorities has been defined, the Department of Public Enterprises will take primary responsibility for drawing up appropriate restructuring plans that address stakeholder concerns. Once an acceptable plan has been developed after stakeholder consultation, the Department of Public Enterprises will seek Cabinet approval for the high-level restructuring plan.

2. Planning for enterprise restructuring

After Cabinet approval of the high-level restructuring plan, the Department of Public Enterprises will appoint advisers, where appropriate, to prepare a detailed enterprise restructuring plan. This will involve the identification of appropriate restructuring mechanisms (public offerings, equity partners, etc.), with due stakeholder involvement. Following Cabinet approval of the detailed plan, due diligence and a valuation will be performed and the relevant prospectuses prepared, when required.

3. Transaction management

After Cabinet approval of the detailed restructuring plan, the Department of Public Enterprises will work with the relevant policy and line departments to develop a detailed work plan. During the subsequent transaction management phase, the Department will project manage the transaction process. Cabinet will approve the portfolio of potential bidders and of potential buyers, and the selected purchasers.

The transaction process will involve a bidding phase where indicative bids will be evaluated and preferred bidder(s) shortlisted. After negotiations with the preferred bidder(s), contractual documents describing the agreement of sale will be prepared and signed off by the contracting parties. When the deal is concluded, any proceeds will be paid to the Treasury.

4. Post-restructuring management

The SOE portfolio will be managed by the relevant executive authority⁴. It will develop shareholder compacts and performance agreements, monitor SOE performance in terms of these compacts and the Public Finance Management Act, and evaluate the impact of restructuring. The Department of Public Enterprises will support the other executive authorities in carrying out these functions.

⁴ Different departments have been given responsibility to act as executive authority for different SOEs.

Roles and responsibilities

Government confirmed that the Department of Public Enterprises will be responsible for coordinating and leading the restructuring process, and that the Minister will report to Cabinet on restructuring initiatives. Policy departments⁵ such as Communications, Minerals and Energy, Transport, Defence, and Water Affairs and Forestry will still define the sectoral and regulatory strategies for enterprise-specific restructuring. As most SOEs dominate the sectors in which they operate, the restructuring and sectoral strategies will often overlap, necessitating intensive coordination. To ensure that every restructuring is considered within a sectoral and macroeconomic context, other critical line departments, such as Finance, Labour, and Trade and Industry, will also participate in the restructuring process.

The Department of Public Enterprises will coordinate the restructuring process, and its programme officers for specific sectors will work with the primary policy departments. However, policy, regulation and shareholder functions are intertwined and integration is needed on key issues. To eliminate the current ambiguities and bottlenecks, the roles and responsibilities of Government and of the boards and management of SOEs must be clarified in the proposed shareholders' compact, and in the Protocol on Corporate Governance and Restructuring Process.

Increased stakeholder involvement will be arranged through the Labour Relations Act, through the social plan framework negotiated at the 1998 Job Summit, and through the National Framework Agreement to address high-level political engagement. Government is committed to the National Framework Agreement as a vehicle for discussions with labour on strategic issues relating to the restructuring of SOEs. The National Framework Agreement will emphasise the sectoral level, facilitating the alignment of specific enterprise restructuring initiatives with the broader sectoral policy. These proposals will benefit the relationship between Government and affected stakeholders, such as employees and consumers. Government will also communicate with other stakeholders and investors through a quarterly bulletin and a web site. Its approach to and progress with restructuring will remain subject to public scrutiny, as transparency and accountability will improve stakeholder and investor confidence in the process.

⁵ This is only a partial list of departments involved in restructuring. Other policy departments may also get involved as their own restructuring initiatives develop.

In addition, the process within Government has been revised to improve communication and decision-making. The new two-stream decision-making structure in Government (which distinguishes between day-to-day transactional decisions and those that require a strategic or policy input) should expedite decisions. Periodic strategic workshops and the circulation of short sectoral strategies should improve the overall strategic understanding of restructuring priorities in Government, and between Government and the SOEs.

Impact of restructuring

Restructuring can potentially benefit the economy while providing significant social gains. These will be discussed in turn.

1. Potential economic benefits

Many of the benefits of restructuring arise from improved corporate governance and market discipline in the SOE environment. Transparent and accountable corporate governance promotes service delivery and efficiency, clarifies SOEs' objectives and enables stakeholders to measure their performance against these objectives⁶. When SOE performance diverges from these objectives, problems can be identified early on, and remedied. In particular, investment decisions have to follow explicit principles. Putting in place appropriate performance incentives and penalties ensures greater management accountability.

The introduction of market discipline also increases the transparency of performance, as competitors provide a clear comparison. In competitive markets, SOEs have to provide an attractive product at competitive prices or lose market share. They therefore have to focus on improved efficiency and service. However, competition can also undermine SOEs' sustainability unless they are enabled to compete effectively. Because Government has limited resources, SOEs often rely on debt finance. This can prove expensive when the degree of leverage increases. Many SOEs also face substantial technological advances and increasing global competition in their sectors. Private equity can provide the finance, expertise, technology and/or market access they need for a competitive edge. Private equity also brings more incentives for improved internal and dynamic efficiency, as shareholders focus on return on equity.

The potential macroeconomic growth and employment benefits from restructuring are both direct and indirect. Direct benefits flow from improved efficiency, increased investment, higher capital inflows and lower public sector debt. Indirectly, restructuring also brings important dynamic benefits through improved competitiveness.

While the efficiency levels of SOEs vary widely, the sector as a whole lags significantly behind the private sector in terms of efficiency improvements. Better corporate

⁶ The Department is finalising an SOE database that will provide basic data on all entities. Where possible, this information will be made public, but sensitive market information will be restricted. To date, the data for almost 300 SOEs have been captured.

governance and competition may increase efficiency to private sector levels and increase the sustainable growth potential of their output.

Internationally, during periods of active privatisation in developing countries, gross privatisation proceeds averaged 1,5 per cent of GDP a year, and net privatisation proceeds accruing to the budget averaged 0,75 per cent. In South Africa, this translates into gross proceeds of approximately R12 billion per year at 1999 prices, with net proceeds to the fiscus of around R6 billion a year.

For every R1 billion of reduced debt, state debt costs fall by approximately R125 million at the prevailing funding cost of approximately 12,5 per cent. This does not include potential further dynamic savings from lower interest rates (resulting from a lower public sector borrowing requirement and higher capital inflows). Therefore, restructuring may result in a potential increase in discretionary spending on social services and infrastructure of over R1 billion a year.

Restructuring is also likely to lead to a substantial inflow of capital related to equity sales and of private investment into infrastructure expansion. Portfolio capital inflows will also increase in response to better growth prospects and increased stock market capitalisation. Higher capital inflows lessen the constraint that the balance of payments places on economic growth, and reduce lower interest rates through lower risk premiums, which further support investment.

As noted, several of the dynamic benefits of restructuring flow from increased competitiveness. The services provided by public utilities are important inputs into all sectors of the economy and, if inefficient, they effectively constitute a tax on economic growth. If competition improves efficiency, with resulting lower prices and better service, this will improve domestic and international competitiveness.

The combined impact of microeconomic efficiency improvements, expanded infrastructure delivery, increased investment, reduced balance of payments constraints and improved competitiveness will increase sustainable GDP growth. In addition, more efficient and effective operation of these enterprises, combined with improved government financing, should promote investment in infrastructure and services. This will benefit the standard of living of all South Africans.

Where enhanced competitiveness and additional investment accompany restructuring, employment creation through higher economic growth may offset any initial employment losses. Where restructuring procures significant efficiency improvements and new technology and capital, it often stimulates new niche industries, which can absorb retrenchments in other areas. Nevertheless, there are many delays in the

process. Even though restructuring may increase long-term sectoral or total employment, some enterprises, depending on their sectors, will experience transitional job losses. Government will mitigate the social impact of restructuring through a social plan that will include retrenchment packages, unemployment insurance and job reskilling.

In short, Government's restructuring strategy will affect employment. There will be some direct job losses in the short to medium term, but these should be offset by new employment opportunities in the medium to longer term, resulting from additional investment and growth in other sectors. The expansion of certain key sectors, such as telecommunications, will create additional employment opportunities in new niche markets. The dynamic growth implications of higher investment and improved competitiveness will lead to even greater employment creation over the longer term.

2. Potential social benefits

The introduction of market-orientated pricing and product development, combined with transparent regulation of access to public goods, will significantly improve infrastructure delivery. Market-orientated pricing reduces the incidence of monopoly pricing and ensures that efficiency gains are passed on to consumers in the form of lower prices and better services. Market-orientated product development reduces prices over the longer term through innovation. Product variety further reduces the effective price of services by allowing consumers to tailor their consumption to their individual needs. Internationally, technological advances and innovation have markedly reduced the price of SOE services, notably in the telecommunications and electricity sectors.

Separating regulatory from service provision responsibilities will free SOEs to compete effectively, while meeting the development goals of Government transparently and effectively. Separating business decisions from development decisions allows for clearer performance evaluation and a coordinated development policy. Development programmes can be explicitly costed and funded, reducing the degree to which operational inefficiencies, anti-competitive cross-subsidisation and excessive vertical or horizontal integration can be obscured behind public good commitments. The transparent allocation of subsidies for the provision of social services and/or infrastructure makes it possible to evaluate the performance of individual SOEs in terms of efficiency and public good targets. SOEs will be expected to maximise efficiency and conform to hard budget constraints, while meeting definite and transparently priced delivery targets. Separating service regulation from production responsibilities enables Government to maximise the level of service delivery with a

given pool of funds and to transparently debate the provision of social services/infrastructure within an overarching development framework.

CONCLUSION

The current stage of development of the South African economy necessitates a mixed economy, with both the state and the market playing key roles; this sets the context for the restructuring of SOEs. The restructuring programme will evaluate a variety of approaches to restructuring, choosing an approach that may best meet the overall objectives of the programme. While it draws on international best practice and experience, the approach is primarily in response to the internal and external factors affecting the South African economy.

This document outlines the policy framework that guides the restructuring of SOEs. Restructuring plans for individual enterprises will be in line with this framework, but will consider the individual attributes of each enterprise.

Government will use this framework to achieve its social and economic objectives. Although any specific restructuring may not achieve all of these objectives, the overall programme should enable Government to achieve its aims.

Government is committed to accelerating the restructuring process, and has benefited from the steep learning curve of the past five years. Having established a solid foundation, it can now set the framework for the accelerated restructuring agenda, as reflected in this document.

ANNEXURE: Programme of Restructuring

The Department of Public Enterprises oversees six SOEs, with asset values exceeding several billion rand. Once the Department's database on Government's SOEs portfolio is complete, it will estimate the total value and output of the whole portfolio more accurately. The value of the portfolio will change, of course, depending on investor perception when each asset, or part of it, is put on the market.

The most significant SOEs are Eskom, Transnet, Telkom and Denel. They comprise approximately 91 per cent of estimated total assets, provide 86 per cent of turnover and generate 94 per cent of net income, while employing 77 per cent of employees in the top 30 SOEs⁷. By focusing primarily on these SOEs, without neglecting the non-core assets, Government can maximise the impact of its restructuring programme. Subject to Cabinet approval, a programme for restructuring the major SOEs has been put in place, signalling the political intent of Government. It is envisaged that most restructuring activities will be completed by 2004.

A summary of the specific actions for the significant SOEs is presented below.

1. Transnet/ACSA

- Transnet debt restructuring is being addressed, and progress on the pension fund debt has been significant.
- Spoornet will be corporatised, and its different business units will become separate corporate entities.
- Coallink, Orex, Luxrail and Linkrail will be concessioned.
- Spoornet's General Freight Business will be commercialised before either an initial public offering (IPO) or a strategic equity partnership (SEP) is negotiated.
- A new ports policy and a ports regulatory framework are being drafted. Portnet will be corporatised to form a port authority entity and a port operations entity; the latter will then be privatised.
- Subject to shareholder approval, an IPO for SAA will be initiated.
- Petronet will be corporatised, its synergies with other pipeline projects assessed and restructuring options developed.
- The disposal of non-core units will be addressed on an ongoing basis.

⁷ Financial Mail Special Survey Top Companies June 25 1999

- The airports regulatory framework is being revised. On its completion, and subject to shareholder approval, an IPO will be processed for ACSA.

2. Telkom

- Work on the proposed IPO for Telkom is proceeding.
- A policy and a process to determine the second national operator (SNO) are quite advanced.
- Given the possible involvement of other SOEs in the SNO, the Department of Public Enterprises will oversee a full investigation of the costs and benefits, and of the possible synergies.

3. Eskom

- Eskom will be corporatised, with Transmission, Distribution and Generation each forming a separate corporate entity.
- The Department of Public Enterprises is evaluating the different models for restructuring Eskom.
- Different generating companies will be formed to promote internal competition before the introduction of private sector participation in Generation.
- The Department of Minerals and Energy is coordinating the design and implementation of the Regional Electricity Distributors.
- SEPs will be introduced into different Eskom Enterprises business units.
- Private sector participation will be introduced specifically into the generation and transmission entities, through either SEPs or IPOs.

4. Denel

- Denel will be corporatised; an initial SEP is expected at the business unit level of Denel Ordnance.
- The local ordnance industry may need to be consolidated; this will be followed by a search for international equity partners at the corporate level.
- The consolidation of aircraft maintenance synergies between SAA and Denel is being investigated.
- The Department of Trade and Industry is coordinating a study into the consolidation of the aerospace industry.
- SEPs are being sought for Denel Aerospace.

5. Other restructuring initiatives

- *Safcol*: The sale of three packages is being concluded; the remainder will be consolidated and re-offered.

- *Information technology*: Options for the consolidation of the information technology capabilities of Datavia, Ariel Technology and Eskom are being assessed.
 - *Alexkor*: A turnaround strategy is being effected with a strategic management partner.
 - *Aventura*: A turnaround strategy is being effected with a strategic management partner; this will be followed by the sale of the entity.
 - *Post Office*: A turnaround strategy is being effected with a strategic management partner.
 - *Sentech Signal Distribution*: The Department of Communications is investigating a restructuring strategy for the entity.
 - *SOE property portfolio*: The property portfolios of Denel, Eskom and Propnet will be analysed to identify restructuring options.
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