



**ADDRESS BY MINISTER OF FINANCE: NHLANHLA NENE TO THE
NATIONAL COUNCIL OF PROVINCES, 21 AUGUST 2018:
DEBATE ON ADDRESSING GOVERNANCE CHALLENGES IN
STATE OWNED ENTERPRISES**

Honourable Chairperson;
Members of the NCOP; and
Distinguished Guests

State-Owned Companies play a critical role in the development of social and economic infrastructure and therefore give practical effect to the National Development Plan of the country. In recent years their ability to perform this critical function has been hampered by what has become known as “state-capture”, which in simple English would be referred to as fraud and corruption. So, today’s debate is opportune because of the various government initiatives currently underway that are aimed at rebuilding the capacity of state-owned companies to live up to their mandates.

But in the rebuilding of state-owned companies, there is a great risk that we will lean more towards measures that focus on individuals rather than institutions. We do run the risk of focusing more on heroes and their heroic deeds. Jean Monet, one of the architects of European Unity, warns of this trap. Monet once wrote: “Nothing is possible without men, but nothing lasts without institutions.”

Given the dire situation in which some of these state-owned companies are, we do need capable and morally upright women and men that we can parachute into state-owned companies to stabilise them. But we should not search for heroes we can drop behind enemy lines without applying our minds to the institutional frameworks that will help secure the long-term future of state-owned companies.

In this regard, we have done a lot of preparatory work, drawing in large part from the recommendations of the Presidential Review Committee on State-owned Companies. The committee concluded that the key challenges that led to the poor performance by SOCs included:

- policy and mandate misalignments;
- inefficient operations, and failure to keep pace with changes in the industry;
- governance failings;
- weak balance sheets and poor financial performance;
- inability of SOCs to refinance the existing debt which led to liquidity risk, and
- inadequate mechanisms to enforce accountability.

In my input today, I will therefore focus on three measures which seek to address these challenges. These measures are:

- The Private Sector Participation Framework;
- Costing the developmental mandates of SOCs;
- The framework for the appointment of members to Boards of SOCs and remuneration of Executives of SOCs.

Let me take each of these measures and deal with them in detail.

Private Sector Participation Framework (PSP Framework)

The framework which was approved by government in 2016 provides for alternative financing strategies to enable infrastructure investment and highlights considerations for SOCs to partner with private sector companies in order to enable a faster, more efficient delivery of goods, services and economic infrastructure to support the country's higher economic growth aspirations and economic transformation goals.

The PSP framework is therefore aimed at accelerating the delivery of infrastructure projects that are key for enabling economic growth through leveraged financing from the private sector.

The PSP framework proposes the key principles for determining where PSP projects should be undertaken. These are:

- i) the possible PSP structures that could be employed depending on the nature of the infrastructure project; and
- ii) a governance framework for government to oversee the implementation of PSPs.

The proposed PSP projects must be a by-product of the filtering process based on sector performance and market structure analysis with a key focus on economic development. Key principles of the framework include consideration that:

- PSP project is feasible and demonstrates that it will yield socio-economic benefits for the country;

- PSP project delivers value for money versus the equivalent public sector comparator;
- Financial viability; and
- There is appropriate risk allocation between the parties.

In crafting the PSP framework consultations were held with key departments (the departments of Economic Development, Public Enterprises, Transport, Energy, Water and Sanitation, and Telecommunications and Postal Services) and their comments were integrated into the framework.

Currently, all SOCs are required to give effect to the implementation of the PSP framework in their respective Corporate Plans.

To give effect to this framework, government is currently working towards the following objectives:

- Higher levels of investment in economic infrastructure in both the public and the private sectors for South Africa to achieve its economic growth rate aspiration of 5 per cent as outlined in the National Development Plan (NDP).
- To enable State Owned Companies (SOCs) to be key players in the delivery of this economic infrastructure, requiring them to strengthen their financial positions and in-house capacity to package and procure projects.
- Crowding-in the private sector will accelerate investment in the form of funding, as well as realise other benefits such as greater innovation, efficiency and expertise.

Costing Developmental Mandates

Government has also committed to a mechanism for the costing of the developmental mandates of SOCs, with the financial implications set out more clearly in Shareholder Compacts.

The proposed mechanism includes:

- Identifying existing and future developmental activities; and
- Quantifying the net cost of the activity using a corporate finance approach to measure the net present value and quantify the value add.

Once costs have been quantified a funding mechanism then needs to be decided upon.

SOCs contribute to the development of the country through their commercial and non-commercial (developmental) activities. Many poorly performing SOCs claim that non-commercial (developmental) activities have contributed to their poor financial performance.

In this regard, it has become important that the costs associated with the developmental activities be clearly specified and that these generate external benefits without compromising the financial sustainability of the entity.

State Owned Companies are required to identify activities, quantify the net costs of the activity and calculate the Net Present Value using a specified rate of return. Where activities have a negative Net Present Value, and they are strategic and developmental, fiscal support may be considered.

Other critical objectives include the following:

- (i) reviewing the commercial models of certain SOCs;
- (ii) developing a national strategy to reposition and sustain SOCs;
- (iii) centralising procurement by SOCs with a view to achieving economies of scale;
- (iv) strengthening the current public accounting and oversight role of Government in relation to SOCs;
- (v) the realisation of transformation targets in relation to skills development and economic empowerment with clear time-lines;
- (vi) strengthening the governance relationship between Government and SOCs; and
- (vii) differentiating SOC sectors (water, agriculture, transport, etc)

The commercial and developmental mandates of SOCs is also being aligned to Government's objectives and being strengthened with a view to ensuring that services are delivered cost effectively and taking market conditions into consideration.

Framework for the appointment of members to the Boards of SOCs and the Remuneration of SOC Executives

Under the guidance of the Minister for Public Service and Administration, government has developed a framework for the appointment of members to SOC Boards and the SOC Executives. It comprises the following key elements:

- i) A review of the requirements of minimum qualifications for potential candidates;
- ii) A review of the methodology for processing of board appointments and their submission to Cabinet;
- iii) A review of the number of boards each person may serve on at any given time, especially in view of the importance of growing the knowledge base and enhancing transformation;
- iv) The appointment of Executive Authorities (EAs) to strategic boards; and
- v) The developing guidelines regarding the level of security clearances for board appointees.

It is also important that the Framework for the appointment of members to the Boards of SOCs should be aligned to the remunerations Framework (both guaranteed packages and short-term incentives) for the boards and executive management in order to standardise the determination of

compensation and also close the huge gaps between compensation of boards and executive management of the different SOCs.

In conclusion, Honourable Members, successful implementation of these measures requires close co-ordination within government and effective collaboration with the private sector. In addition, the Inquiry into State Capture will be closely monitored and any recommendations aimed at addressing governance-related challenges, strengthening the financial position of SOCs and improving service delivery to the public through optimal procurement practices, will be considered favourably by government.

Thank you.