8

Financial position of public-sector institutions

In brief

- The financial performance of several large state-owned companies continued to deteriorate sharply over the past year, leading to an increasing drain on public resources.
- The Public Finance Management Act (1999) requires major state-owned companies to generate sufficient financial resources from their operations to meet their obligations to employees, the public and debt holders. Few are meeting these requirements: liabilities are growing faster than assets, with a consequent decline in aggregate net asset value of 5.6 per cent in 2018/19.
- The combined net asset value of the three large development finance institutions – the Development Bank of Southern Africa (DBSA), the Industrial Development Corporation (IDC) and the Land Bank – increased to R139.4 billion in 2018/19.
- The social security funds will pay out R211 billion in benefits and collect R238 billion in contributions over the medium term. Large surpluses in the Unemployment Insurance Fund and the Compensation Fund, however, are more than offset by Road Accident Fund liabilities, which are expected to reach R605 billion by 2022/23.
- In 2018/19, the Government Employees Pension Fund paid out R102.5 billion in benefits funded by investment income of R84.2 billion and contributions of R75.6 billion.

Overview

Public-sector institutions need to be well governed, operationally sound and financially sustainable

This chapter discusses the financial position of state-owned companies, development finance institutions and social security funds. Their mandates include building and operating infrastructure, financing social and economic development, and augmenting the country's social security system. To meet their objectives, these institutions need to be well governed, operationally sound and financially sustainable.

The 2019 *Budget Review* outlined a set of urgent reforms for Eskom, acknowledging that it was the largest state-owned company in need of significant restructuring – but not the only one. Since then, there has been some progress. The Department of Public Enterprises has published a roadmap for Eskom's reform, outlining the utility's role as part of a reformed electricity supply industry, and will report on progress at key milestones. South African Airways (SAA) has been placed in voluntary business rescue. The business rescue practitioners are expected to publish their plan within a matter of weeks.

Apart from Road Accident Fund, financial position of social security funds remains sound

With the exception of the Road Accident Fund, the financial positions of the social security funds are sound. They are able to meet their long-term obligations, as is the Government Employees Pension Fund. Over the past year, government has taken steps to strengthen governance and transparency at the Public Investment Corporation.

State-owned companies

Unlike their private counterparts, most state-owned companies hold developmental rather than profit-driven mandates. Nonetheless, these entities need to be financially self-sustaining. In recent years, a pattern of mismanagement and poor governance at major state-owned companies has led to operational failures, financial distress and increased demands for taxpayer support through the national budget. This problem is compounded by broad, sometimes unfunded mandates and, in some cases, outdated business models.

Average return on equity at state-owned companies has fallen sharply

The financial performance of state-owned companies continues to deteriorate. Liability growth has outpaced that of assets, with a consequent decline in net asset value, eroding the ability of these entities to meet their financial obligations and deliver on their mandates. Average return on equity, a measure of how effectively net assets are used to create value, fell sharply in 2018/19 – the most recent year for which data is available. This decline is largely the result of weak revenue growth, high compensation costs and rapidly growing debt-service costs.

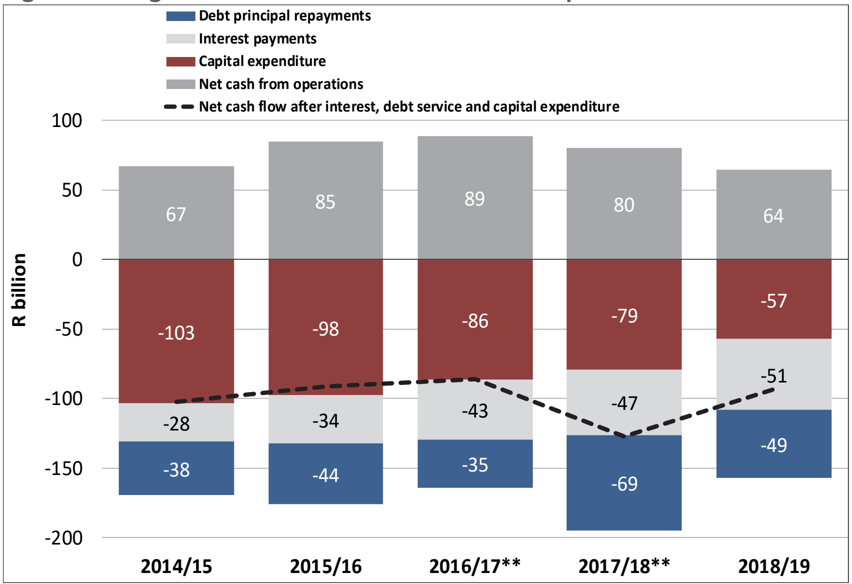
Table 8.1 Combined balance sheets of state-owned companies[1]

R billion/per cent growth	2014/15	2015/16	2016/17[2]	2017/18[2]	2018/19
Total assets	1 037.5	1 178.6	1 224.3	1 263.2	1 269.0
	13.9%	*13.6%*	*3.9%*	*3.2%*	*0.5%*
Total liabilities	739.2	818.2	870.3	901.1	927.0
	16.2%	*10.7%*	*6.4%*	*3.5%*	*2.9%*
Net asset value	298.3	360.4	354.0	362.1	342.0
	8.6%	*20.8%*	*-1.8%*	*2.3%*	*-5.6%*
Return on equity (average)	*-2.5%*	*0.6%*	*0.7%*	*-0.8%*	*-8.2%*

1. State-owned companies listed in schedule 2 of the PFMA, excluding development finance institutions
2. Numbers may differ from earlier publications due to restatement or error
Source: National Treasury

As the scale of financial challenges in state-owned companies has become apparent, many have struggled to access capital markets. In combination with weak cash flows (Figure 8.1), this has reduced their capital spending, resulting in delayed delivery of much-needed social and economic infrastructure. It has also affected their ability to meet debt commitments. The Public Finance Management Act requires state-owned companies listed in schedule 2 to generate sufficient financial resources from their operations to meet obligations to employees, the public, creditors and debt holders. Increasingly, however, these entities rely on external funding, government-guaranteed debt and bailouts to sustain operations.

Figure 8.1 Negative cash flows at state-owned companies*



**Companies listed in schedule 2 of the PFMA, excluding development finance institutions*
***Numbers may differ from earlier publications due to restatement or error*
Source: National Treasury

Over the past 12 years, government has allocated R162 billion to the financially distressed state-owned companies shown in Table 8.2. These allocations generally provide short-term support, but cannot substitute for the far-reaching structural reforms needed to return them to operational and financial stability. Of the total allocations, Eskom accounts for 82 per cent. In 2019/20, government allocated R49 billion to Eskom and committed R112 billion in medium-term funding.

Eskom accounts for 82 per cent of fiscal support to state-owned companies over past 12 years

Table 8.2 Summary of recapitalisations and bailouts of state-owned companies

R billion	Eskom	South African Airways	Denel	South African Express	South African Broadcasting Corporation	Total
2008/09	10.0	–	–	0.4	–	10.4
2009/10	30.0	1.5	–	–	–	31.5
2010/11	20.0	–	–	–	–	20.0
2011/12	–	–	–	–	–	–
2012/13	0.7	–	0.4	–	–	1.1
2013/14	–	–	–	–	–	–
2014/15	–	–	–	–	–	–
2015/16	23.0	–	–	–	–	23.0
2016/17	–	–	–	–	–	–
2017/18	–	10.0	–	–	–	10.0
2018/19	–	5.0	–	1.2	–	6.2
2019/20	49.0	5.5	1.8	0.3	3.2	59.8
2008/09-2019/20 (history)	**132.7**	**22.0**	**2.2**	**1.9**	**3.2**	**162.0**
2020/21	56.0	10.3	0.6	0.2	–	67.1
2021/22	33.0	4.3	–	–	–	37.3
2022/23	23.0	1.8	–	–	–	24.8
2020/21-2022/23 (MTEF)	**112.0**	**16.4**	**0.6**	**0.2**	**–**	**129.2**
Total	**244.7**	**38.4**	**2.8**	**2.1**	**3.2**	**291.2**

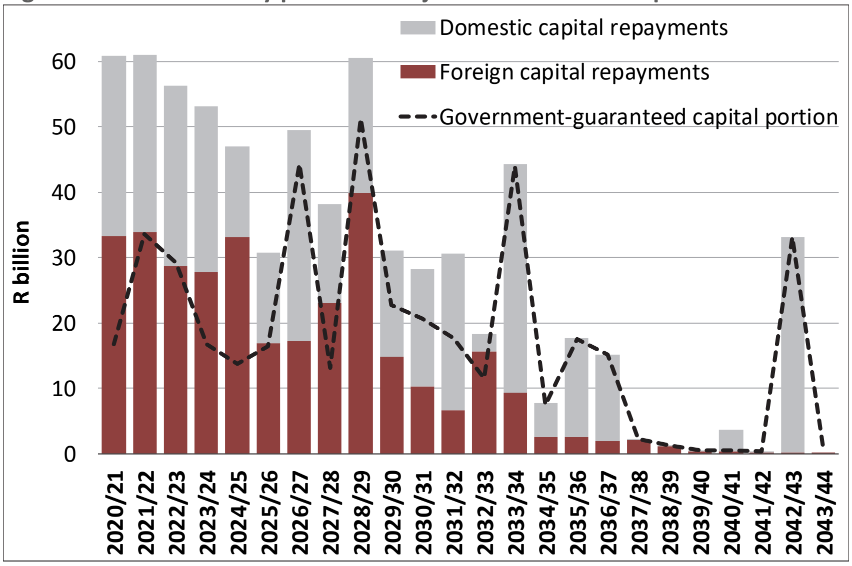
Source: National Treasury

Debt obligations

Debt repayments over next three years total R178.1 billion, of which Eskom holds R103.5 billion

Figure 8.2 shows the long-term debt maturity profile for the seven largest borrowers. Total debt amounts to R759.9 billion, of which 62 per cent is guaranteed by government. Over the next three years, debt repayments total R178.1 billion, of which R103.5 billion is held by Eskom.

Figure 8.2 Debt maturity profile of major state-owned companies*

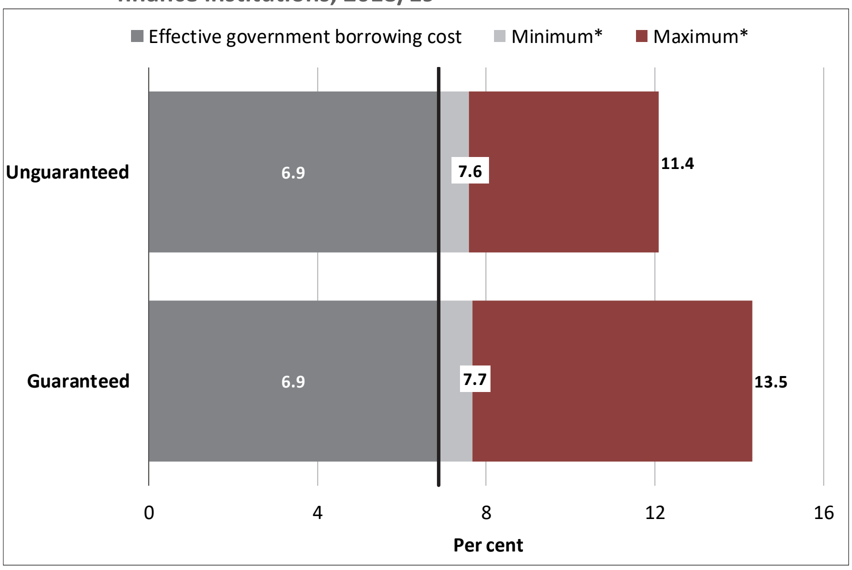


**Airports Company South Africa, Denel, Eskom, South African National Roads Agency Limited, SAA, Transnet and Trans-Caledon Tunnel Authority*
Source: National Treasury

Rising interest costs reflect market doubts about state-owned companies' ability to repay debt

In recent years, the ability of state-owned companies to access funding and generate sufficient cash flows to repay maturing debt has declined. Rising interest costs reflect market doubts about their ability to repay debt. Increasingly, these entities require state guarantees to borrow. Furthermore, much of the debt that has been raised is in short-term instruments, and is used for refinancing and operations rather than capital investment.

Figure 8.3 Borrowing costs for state-owned companies and development finance institutions, 2018/19



**Effective cost of debt for the 10 largest borrowers*
Source: National Treasury

State-owned companies borrow at higher rates than government

Figure 8.3 shows the difference between borrowing costs for government and state-owned companies, indicating the level of risk that the market attaches to the latter. Government's average effective borrowing cost is 6.9 per cent. State-owned companies are paying substantially more to borrow – and the highest cost is for guaranteed debt. SAA's borrowing incurs nearly twice the interest rate of government.

Table 8.3 shows that in 2018/19, as in the previous year, state-owned companies could only raise 75.4 per cent of planned borrowing. The decline in borrowing plans has reduced or delayed capital expenditure. In 2018/19, in contrast to previous years, about 70 per cent of state-owned companies' domestic borrowing was in long-term instruments. Nonetheless, this debt continued to be used for refinancing maturing debt.

Table 8.3 Borrowing requirement of selected state-owned companies[1]

	2017/18		2018/19		2019/20	2020/21	2021/22	2022/23[2]
R billion	**Budget**	**Outcome**	**Budget**	**Outcome**	**Revised**	**Medium-term estimates**		
Domestic loans (gross)	**70.1**	**54.4**	**61.8**	**46.1**	**46.6**	**51.2**	**32.3**	**27.1**
Short-term	17.9	29.4	20.1	13.9	13.2	14.2	10.6	7.0
Long-term	52.2	25.0	41.7	32.2	33.4	37.0	21.7	20.1
Foreign loans (gross)	**65.0**	**48.8**	**52.0**	**39.7**	**37.7**	**37.4**	**38.6**	**39.9**
Long-term	65.0	48.8	52.0	39.7	37.7	37.4	38.6	39.9
Total	**135.1**	**103.2**	**113.8**	**85.8**	**84.3**	**88.6**	**70.9**	**67.0**
Percentage of total:								
Domestic loans	*51.9%*	*52.7%*	*54.3%*	*53.7%*	*55.3%*	*57.8%*	*45.6%*	*40.4%*
Foreign loans	*48.1%*	*47.3%*	*45.7%*	*46.3%*	*44.7%*	*42.2%*	*54.4%*	*59.6%*

1. Airports Company South Africa, Eskom, SANRAL, SAA, Transnet and Trans-Caledon Tunnel Authority
2. ACSA and TCTA not included, as no forecast was provided
Source: National Treasury

Overall, these trends reflect the deteriorating financial state of major state-owned companies. Without effective structural reforms, this cycle of lower funding access and higher reliance on government is set to continue.

Eskom

Eskom, which does not generate sufficient cash to cover debt and finance costs, is reliant on state support

Eskom relies on state support to operate. The utility reported a net profit of R1.3 billion at 30 September 2019, but it is not generating enough cash to cover debt and finance costs. This is partly a result of non-payment by municipalities and other consumers. Government is working with municipalities to strengthen governance and financial management. Eskom's immediate priority is to stabilise its operational and financial position, as discussed in Annexure C of the 2019 *Medium Term Budget Policy Statement*.

Government has provided significant financial support to Eskom since 2008. This includes R105 billion in 2019/20 and 2020/21, which is conditional, to improve accountability and address inefficiencies. The conditions include reducing primary energy costs, containing other costs and making progress on restructuring. Eskom provides regular updates on these conditions, and government reviews its cash flows on a daily basis. Eskom has begun the process of separating its three operating activities – generation, transmission and distribution – each of which will soon have its own board and management structure.

Transnet

Transnet borrows on the strength of its own balance sheet

Transnet operates South Africa's port, freight rail and pipeline infrastructure. The group's net profit increased from R4.9 billion in 2017/18 to R6 billion in 2018/19, supported by fair-value adjustments on leased investment properties. Transnet, which borrows on the strength of its own balance sheet, raised R6.7 billion through commercial paper, bank loans and development finance institutions in 2018/19. It invested R14.7 billion to maintain rail and port capacity, and R3.2 billion to expand infrastructure and equipment.

Rating agencies downgraded Transnet's credit rating, citing increased liquidity risk as a result of loan covenants triggered by an audit qualification on the 2018/19 annual financial statements.

South African Airways

R16.4 billion set aside over medium term for SAA to repay guaranteed debt and cover debt-service costs

SAA's board placed the airline into voluntary business rescue in December 2019 as a result of its inability to meet financial obligations. Since 2008/09, SAA has incurred net losses of over R32 billion. Government has set aside R16.4 billion over the medium term for SAA to repay its guaranteed debt, and cover debt-service costs. Government anticipates that additional funding will be required to cover restructuring costs in line with the business rescue plan.

South African Express

Government needs to assess its appetite for continued ownership of SA Express

SA Express, illiquid and insolvent, is unable to settle either short- or long-term obligations as they become due. Cumulative losses amount to R1.2 billion over the past 10 years. The airline was recently placed under involuntary business rescue, which it intends to appeal. Government will need to assess its appetite for continued ownership of the carrier, given that it has a limited role in the local aviation market.

Denel

Denel's role in a modern defence industry needs to be defined

Denel, the state-owned military and aerospace equipment manufacturer, faces serious liquidity problems. In response, government provided Denel with R1.8 billion in 2019/20. State guarantees granted to the entity amount to R6.9 billion. Additional funding of R576 million is allocated for 2020/21. This support is allocated with conditions that emphasise the need for Denel to speedily implement its turnaround plan. The plan includes exploring private-sector participation, optimising its property and plant, and developing an appropriate funding model. It is critical for government to define Denel's role in a modern defence industry.

South African Broadcasting Corporation

Government allocated R3.2 billion to SABC in 2019/20 to enable it to pay its bills

Government allocated R3.2 billion to the SABC in 2019/20, of which R2.1 billion has been transferred, to enable the broadcaster to pay its bills. The conditions included reviewing broadcasting sector policies to respond to advances in technology, costing the developmental mandate and evaluating opportunities for private-sector participation. The remaining R1.1 billion is expected to be transferred to the SABC by 31 March 2020.

Development finance institutions

To support government in achieving inclusive growth and the objectives of the National Development Plan, development finance institutions require supportive governance structures, financial sustainability and developmental impact. They also require strong capacity.

The net asset value of the three largest development finance institutions – the DBSA, IDC and Land Bank – increased by 4.7 per cent in 2018/19 to R139.4 billion. The institutions transitioned to the International Financial Reporting Standard 9 during the period, which resulted in higher impairments, causing a slight decrease in net loan books.

Combined net asset value of DBSA, IDC and Land Bank increased by 4.7 per cent in 2018/19

Table 8.4 Financial position of selected development finance institutions

R billion	2016/17	2017/18	2018/19
IDC			
Total assets	**129.8**	**137.0**	**144.6**
Loan book	26.7	30.7	25.9
Equity and other investments	103.1	106.3	118.7
Total liabilities	**41.5**	**44.9**	**49.3**
Net asset value	**88.3**	**92.1**	**95.3**
DBSA			
Total assets	**83.7**	**89.2**	**89.5**
Loan book	76.6	75.0	75.8
Equity and other investments	7.1	14.2	13.7
Total liabilities	**51.6**	**54.9**	**52.3**
Net asset value	**32.1**	**34.3**	**37.2**
Land Bank			
Total assets	**45.4**	**49.5**	**52.4**
Loan book	41.0	43.4	44.5
Equity and other investments	4.4	6.1	7.9
Total liabilities	**39.0**	**42.8**	**45.5**
Net asset value	**6.4**	**6.7**	**6.9**

Source: National Treasury

Land Bank

The Land Bank supports development and transformation of the agricultural sector. In 2018/19, it disbursed R5.1 billion of developmental and transformational loans, significantly up from R1.6 billion in 2017/18. The bank is refocusing on the development of smallholder farmers and aims to adopt financially and economically sustainable practices. During 2018/19, the Land Bank used R377.4 million of the R400 million joint Land Bank/IDC drought relief fund to provide low-interest loans to affected areas. In addition, it agreed with the Jobs Fund to provide concessional credit and support to small- and medium-scale emerging farmers.

Industrial Development Corporation

The IDC finances industrial development across Africa. Over the medium term, it will focus on financing and facilitating the adoption of emerging technologies and creating new industries. In 2018/19, the IDC approved funds totalling R13.1 billion, compared with R16.7 billion in 2017/18, and disbursed funds of R11.8 billion, compared with R15.4 billion in 2017/18. The corporation's profits decreased by 78 per cent from R3.2 billion in

IDC approved R13.1 billion in financing in 2018/19, down from R16.7 billion a year earlier

2017/18 to R720 million in 2018/19, mainly due to higher once-off capital gains recorded in 2017/18.

In 2015/16, the IDC set a five-year target to approve R23 billion for black industrialists; by 2018/19, it had approved R21.4 billion for such projects. This programme is expected to create about 22 600 jobs.

Development Bank of Southern Africa

DBSA's developmental loan book rose marginally to R75.8 billion

The DBSA finances infrastructure projects in water, sanitation, communication, energy and school infrastructure across southern Africa. It also assists with project preparation and implementation. The DBSA's profit increased from R2.3 billion in 2017/18 to R3.1 billion in 2018/19, mainly due to interest income, and gains from foreign exchange and financial instruments. During the year, its developmental loan book rose marginally from R75 billion to R75.8 billion.

Development finance borrowing requirement

Development finance borrowing rose significantly in 2018/19, largely as result of Land Bank lending

In 2018/19, the three development finance institutions borrowed R56.3 billion, significantly more than the budgeted R45.4 billion. The difference is attributable to a steep increase in borrowing by the Land Bank, which was used to support its lending activities. The Land Bank and the DBSA account for 82.4 per cent of development finance borrowing. Over the medium term, borrowing plans total R90.7 billion. In 2018/19, nearly 90 per cent of borrowing was in domestic debt.

Table 8.5 Borrowing requirement for development finance institutions[1]

	2017/18		2018/19		2019/20	2020/21	2021/22	2022/23[2]
R billion	**Budget**	**Outcome**	**Budget**	**Outcome**	**Revised**	**Medium-term estimates**		
Domestic loans (gross)	**51.1**	**54.0**	**36.2**	**50.6**	**39.8**	**26.8**	**31.1**	**6.0**
Short-term	36.2	39.0	23.9	23.1	20.3	20.9	20.8	1.0
Long-term	14.9	15.0	12.3	27.5	19.5	5.9	10.3	5.0
Foreign loans (gross)	**9.3**	**5.6**	**9.2**	**5.7**	**18.0**	**14.4**	**9.6**	**2.8**
Long-term	9.3	5.6	9.2	5.7	18.0	14.4	9.6	2.8
Total	**60.4**	**59.6**	**45.4**	**56.3**	**57.8**	**41.2**	**40.7**	**8.8**
Percentage of total:								
Domestic loans	*84.6%*	*90.6%*	*79.7%*	*89.9%*	*68.9%*	*65.0%*	*76.4%*	*68.2%*
Foreign loans	*15.4%*	*9.4%*	*20.3%*	*10.1%*	*31.1%*	*35.0%*	*23.6%*	*31.8%*

1. Land Bank, DBSA and IDC
2. Land Bank and DBSA not included, as no forecast was provided
Source: National Treasury

Social security funds

Social security funds, financed through levies and taxes, provide insurance for unemployed workers and those injured in road or workplace accidents. Over the medium term, these funds expect to collect R238 billion in contributions and pay R211 billion in benefits. The scale of Road Accident Fund (RAF) liabilities, however, means that the combined financial position of the social security funds is deeply negative.

Combined R3.3 billion cash deficit over medium term is a result of RAF liabilities

In 2018/19, the funds had a combined cash surplus of R6.8 billion. Over the medium term, however, the funds will have an average combined cash deficit of R3.3 billion, as benefits paid out by the Unemployment Insurance Fund (UIF) increase following legislative amendments.

Table 8.6 Financial position of social security funds

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
R billion		Outcome		Estimate		Medium-term estimates	
Unemployment Insurance Fund							
Total assets	139.5	159.3	165.5	174.1	182.8	191.5	200.7
Total liabilities	6.4	13.4	21.2	22.3	23.4	24.5	25.7
Net asset value	133.1	145.9	144.3	151.8	159.4	167.0	175.0
Compensation Fund[1]							
Total assets	66.4	72.0	75.4	79.1	82.8	87.0	91.1
Total liabilities	18.5	38.5	47.8	49.8	51.8	54.2	56.6
Net asset value	47.9	33.5	27.6	29.3	31.0	32.8	34.5
Road Accident Fund							
Total assets	9.2	9.8	11.2	11.5	11.7	11.8	11.9
Total liabilities	189.2	216.1	273.3	341.1	413.1	500.4	604.9
Net asset value	-180.0	-206.3	-262.1	-329.6	-401.4	-488.6	-593.0

1. Compensation Commissioner for Occupational Diseases in Mines and Works
Source: National Treasury

Unemployment Insurance Fund

UIF maintains surplus, but higher benefits will see it run cash deficit over medium term

The UIF pays benefits to those who are out of work due to retrenchment, illness or maternity leave. Benefit payments are expected to grow from R11 billion in 2018/19 to R22 billion in 2022/23. Over this period, the fund will run an average surplus of R3.6 billion on an accrual basis and a cash deficit. The latter is the result of retrospective payments to claimants who were assessed and paid at a rate based on the old legislation, when they were meant to be paid based on higher rates in the amended act. The additional benefits are expected to cost R12.7 billion. The fund plans to finalise these claims by 2020/21. The UIF's net asset value is set to increase from R144.3 billion in 2018/19 to R175 billion in 2022/23.

Road Accident Fund

Figure 8.4 RAF liabilities

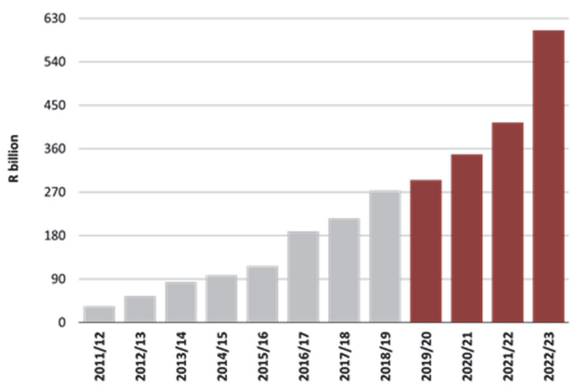
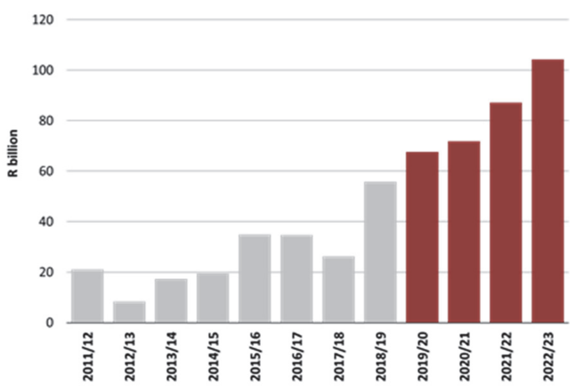


Figure 8.5 RAF annual deficit



Source: National Treasury

The RAF provides compensation for the loss of earnings, along with general damages, and medical and funeral costs to victims of road accidents. Claims against the fund are expected to increase from R96.4 billion in 2018/19 to R145.6 billion in 2022/23. The RAF's revenues are insufficient to meet its liabilities. Consequently, the accumulated deficit is forecast to increase from R262.1 billion in 2018/19 to R593 billion in 2022/23. Over the past 20 years, increases in the RAF levy have typically exceeded inflation, yet the liabilities of the fund have grown at a faster pace. The RAF fuel levy increases by 9c/litre on 1 April 2020.

Compensation Fund

The Compensation Fund provides compensation for disability, illness and death resulting from occupational injuries and diseases. In 2018/19, the fund paid out R3.9 billion in benefits and ran a surplus of R1.7 billion. Over the medium term, the surplus is expected to average R2.5 billion due to higher returns on investments. This will increase the fund's net asset value.

Government Employees Pension Fund

In 2018/19, the GEPF provided retirement security to about 1.3 million employees and 460 000 beneficiaries. Active membership has declined slightly, reflecting government's efforts to stabilise headcounts, while the number of pensioners has remained relatively constant. The fund paid out benefits totalling R103 billion in 2018/19. Contributions received increased from R70.4 billion in 2017/18 to R75.6 billion in 2018/19, largely due to members' annual salary increases. The cash revenue that the fund received from its investments grew by 17 per cent in 2018/19 to R84.2 billion.

Table 8.7 Selected income and expenditure of GEPF

R billion	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Revenue							
Employer contributions	30.8	33.5	36.1	38.6	42.1	45.3	48.7
Employee contributions	17.1	18.7	20.3	21.7	23.4	25.1	26.9
Investment income[1]	49.9	54.0	68.5	69.0	69.5	72.0	84.2
Expenditure							
Benefits paid	43.2	57.9	85.8	83.1	88.3	94.9	102.5

1. Dividends on listed equities, interest on bonds and money market instruments and income from unlisted properties and unlisted investments excludes adjustments for value of financial assets
Source: Government Pensions Administration Agency

The Public Investment Corporation invests the excess funds accumulated by the GEPF and the social security funds. At end-March 2019, it had R2.13 trillion in assets under management. A commission of inquiry was appointed to investigate allegations of impropriety in 2018. The commission has submitted its final report to the President. In the interim, the Minister of Finance has reconstituted the corporation's board.

Table 8.8 Breakdown of assets under management by PIC, 2018/19

R billion	Government Employees Pension Fund	Unemployment Insurance Fund	Compensation Fund[1]	Other	Total
Asset class					
Equity	1 032.4	40.0	16.2	–	1 088.7
Bonds	574.9	89.5	41.5	13.1	719.1
Money market	75.1	18.4	8.5	34.0	136.0
Property	95.4	4.8	0.1	1.4	101.6
Unlisted investments	70.9	13.6	1.9	–	86.4
Total	**1 848.7**	**166.3**	**68.2**	**48.5**	**2 131.7**

1. Includes the Compensation Pension Fund
Source: Public Investment Corporation and National Treasury