



***State Owned Enterprises: A Policy Analysis of South African Airways (SAA)***

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## ***Declaration***

I, Andrew Chilenga, declare that:

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*DEDICATION*

My late mother, Pamela Chunga

Always in my heart

Fondly remembered

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## Abstract

It is said that the establishment of SOEs is a governance approach adopted by governments to promote economic growth, in order to increase government's ability to delivery public services, as well as to help develop the state. Of late however, major State Owned Enterprises (SOEs) in South Africa have come under scrutiny, with the media accentuating their shortcomings. Malfeasance, inept leadership and mismanagement have often been cited as some of the issues that the South African State Owned Enterprises are faced with. There exists an extensive set of frameworks that guides the operations of SOEs, this is in order to make them efficient and effective. Of particular pertinence is the New Public Management approach as well as Good Corporate Governance which suggests that the commercialization of state owned enterprises will lead to making them profitable and essentially promote effectiveness and efficiency. The fact that some of South Africa's major SOEs still fall short of fulfilling their mandate begs the questions and calls for a need for an examination of how the management of SOEs can be improved.

Given the above context, this study will adopt a two-pronged approach to examine some of the challenges facing SOEs in South Africa. Using the South African Airways as its case study, mainly because for too long SAA has been a drain on South African taxpayers. Furthermore SAA, has been struggling to keep its fleet in the skies with a crippling debt of \$1.5 billion and has had to receive a couple of state sponsored bailouts, including a recent 6.5 billion rands (\$560 million) guarantee to keep liquidators off its back. The study will begin by conceptualizing SOEs, then move on to examining the different legislative acts and frameworks put in place to ensure the efficient and effective management of the SAA. The study will maintain that one of the major challenges faced by SAA is a problem of governance. Accordingly, the study will proceed to demonstrate how the different frameworks that exist could be implemented in order to ensure the efficient and effectiveness of SOEs in South Africa.

## ACRONYMS AND ABBREVIATIONS

ANC African National Congress

ARMSCOR (the Armaments Corporation of South Africa)

BEE Black Economic Empowerment

DA Democratic Alliance

DFI Development Finance Institution

DPE Department of Public Enterprises

GEAR Growth, Employment and Redistribution

HACCP Hazard Analysis of Critical Control Points

HSRC Human Sciences Research Council

IATA International Air Transport Association

IEnvA IATA Environmental Assessment program

IoDSA the Institute of Directors in Southern Africa

King III the King Code of Governance for South Africa, 2009

MFMA Municipal Finance Management Act

MRO Maintenance, repair, and operations

NDA National Developmental Agenda

NGP New Growth Path

NPM New Public Management

OECD Organization for Economic Co-operation and Development

PFMA Public Finance Management Act

PRC Presidential Review Commission



PwC PricewaterhouseCoopers

RDP Reconstruction and Development Programme

SAA South African Airways

SAAIA South African Airways Internal Audit

SAAT SAA Technical

SABC South African Broadcasting Corporation

SARHA South African Railways and Harbors Administration

SATC South African Travel Centre

SOC State Owned Company

SOE State Owned Enterprise

# Chapter 1: Introduction

## 1.1: Background to the Study

Large State Owned Enterprises in South Africa have been under scrutiny recently, with the media shedding some light on their shortcomings. Many newspapers are publishing articles on how most of the state's major SOEs are running at a loss which is forcing government to come to their rescue and bail them out of the financial crisis they are in (McGregor, 2012).

SOEs can also be referred to as state owned entities or companies, which according to Balton (2010) are legal entities that tend to carry out business activities on behalf of the state. The South African government, in its National Development Plan 2030 has identified SOEs as a major driving force for service delivery and structural development. However with some of the SOEs running at a loss this is under threat as stated in the President's 2016 State of the Nation address.

SOEs in South Africa are legally defined by the Public Finance Management Act (Act of 1999) (PFMA). Section (1) of the PFMA of 1999 (updated in 2008, pp8-10) refers to SOEs as *“National Government Business Enterprise” to be “an entity which: (a) is a juristic person under the ownership control of the national executive (b) has been assigned financial and operational authority to carry on a business activity (c) as its principal business, provides goods and services in accordance with ordinary business principles (d) is financed fully or substantially from sources other than the National Revenue Fund or by way of a tax, levy or statutory money”* (PFMA, 1999).

## 1.2: Objectives and Research Questions of the Study

The objective of this study is to examine the governance issues they face with, with specific reference to the South African Airways (SAA) SOE. SAA is the leading carrier in Africa serving 20 destinations across the continent, as well as major destinations within South Africa, from its hub, Johannesburg. SAA was made a division of Transnet (the South African government's holding company for transportation enterprises) on April 1<sup>st</sup>, 1990. (referenceforbusiness, no date). According to different reports, the national carrier, SAA has suffered massive losses and is in serious debt. Its Annual Report showed a loss of R2.6 billion in 2014, which was more than double the loss of R1.2bn in the previous financial year (Mkhwanazi, 2015). The City Press at the end of 2015 claimed that SAA's losses for the year reached a staggering R4.7 billion. Besides its financial woes, SAA is also accused of corrupt or improper management. A headline by Carine Smith in

Fin23 news states “Report shows improper deals behind huge SAA losses”, hinting at corruption at the SOE. Another headline reads “SAA ignored procedure in R14.6 billion contract – report” just another clear example that some legal frameworks are being ignored. This therefore leads one to question the governance of this SOE.

This mini-dissertation is organized around a number of research questions. The broad questions informing this study are:

- Where do State-Owned Enterprises originated from?
- What is the rationale for the establishment of State-Owned Enterprises?
- What are the benefits/advantages of State-Owned Enterprises?
- What are the critiques leveled at SOEs?
- What governance strategies have been used to manage SOEs?
- What is the background of State-Owned Enterprises in South Africa?
- What is the legislative policy framework for SOEs in South Africa?

More specific questions that relate to SAA are:

- What was the rationale for the creation of SAA?
- What have been some of the governance challenges facing SAA?
- What is the legislative policy framework for SAA?
- What have been the problems facing SAA’s?

### 1.3: The Significance of the Study

The study aims to investigate issues plaguing SAA as an SOE in more detail. This is a timeous study because SAA has been running at a loss for the last couple of years, and because in this year’s State of the Nation Address (2016), the President stated that the government intends on doing away with failing SOEs. This study wants to undertake an objective policy analysis of SOEs in general, as well as in South Africa. In order to ascertain the issues of governance in the South African context.

### 1.4: Research Methodology and Methods

This is a qualitative desktop study. This research consists of mainly of two parts. Firstly, a thorough literature review of the concept of State Owned Enterprises (SOE); and secondly, a case study of the South African Airways (SAA) SOE.

This study, in part, uses a case study approach in order to generate an in-depth, multi-faceted understanding of a complex issue in its real-life context. It is an established research design that is used extensively in a wide variety of disciplines, particularly in the social sciences (Crowe, 2011). The research design of this study draws from case study approaches and stresses the importance of contextual detail and deep description, the function of multiple sources of data, and exploratory explanation-building (Crowe, 2011). Case studies are widely used in organizational studies and across the social sciences, and there is some suggestion that the case study method is increasingly being used and with a growing confidence in the case study as a rigorous research strategy in its own right (Kohlbacher, 2006). This is a relevant approach mainly because this study seeks to explore and give a descriptive analysis of SAA's governance and corporate issues.

The purpose of the research is exploratory and descriptive, meaning it aims to establish a background on SOEs in South Africa, and analyze the policy framework relating to SOEs. According to Babbie and Mouton (2001) exploratory studies aim to supply reasonably new information as well as describe events or situations while explanatory aims to provide explanations as to why certain things are occurring.

Legislation and policy documents were gathered, read and analyzed to help establish the legal framework of SOEs in South Africa. Newspaper articles, blogs, and journal articles were used to assist in providing insight into discussions, opinions and debates around the challenges facing SOEs, such as SAA.

Primary sources include newspapers, various reports by government departments (such as the Treasury, the national Department of Transport, and the national Department of Public Enterprises), press releases and theses from academic institutions. While secondary sources used are published books and journal articles.

For data analysis, a thematic analysis approach was used. A thematic analysis approach is a method for: 'identifying, analyzing and reporting patterns (themes) within data. It minimally organizes and describes your data set in (rich) detail. However, frequently it goes further than this, and interprets various aspects of the research topic.' (Braun and Clarke, 2006: 79).

## 1.5: Structure of the Dissertation

This dissertation has six chapters. This chapter (Chapter 1) present the introduction of the study. It describes the rational for the study, research methodology and the structure of the thesis. The chapter also identifies the research questions guiding the study.

Chapter 2 presents the conceptual framework of the study. The chapter is a literature review on SOEs in both developed and developing countries. It provides definitions of SOEs, its premises, benefits and challenges of SOEs. It also examines related concepts such as governance and corporate governance in order to establish a conceptual framework for analyzing SOEs.

Chapter 3 presents a descriptive summary of SOEs in South Africa before and after 1994.

Chapter 4 constitutes the case study of this research. The chapter discusses SAA. It identifies and analyses the legislative and policy framework in which it operates and identifies governance issues.

Chapter 5 presents the overall findings and analysis of the study. It provides a reflection on SAA as a SOE and to what extent it meets its legislative mandate and the governance expectations of SOEs. The chapter also provides recommendations.

## Chapter 2: Conceptualizing SOEs

### 2.1: Introduction

This chapter provides the conceptual frameworks of this study. It provides a summary of key definitions on SOEs. This chapter explains the origins and rational of SOEs and the way in which they have transformed over the years. It looks at the legal and regulatory framework that guide SOEs. It also underscores the purposes of SOEs in both developed and developing states, as well as presents information on its strengths and weaknesses. In conceptualizing SOEs this chapter discusses the concept of new public management (NPM) and governance focusing on corporate governance in the process.

### 2.2: State Owned Enterprises

Before defining what SOEs are it is vital to note that they differ from place to place and that there is no one single definition. When one is defining SOEs one has to differentiate between commercial SOEs and non-commercial SOES. SOEs can sometimes be referred to as state-owned companies, state- owned entities, or state owned enterprises. They all are government owned business entities or publicly owned companies created by government to undertake commercial actions on the behalf of government (Shabalala, 2011).

A non-commercial SOE is a company created and solely owned by government to carry out particular functions on behalf of the government with the main aim of providing goods and services to its citizens (OECD, 2005). In most cases these are agencies of government created to pursue objectives that are not financially driven.

Various scholars suggest that not all SOEs are the same. They are configured differently, hence the expectations are different. It depends on:

- the way in which it was established,
- its listing on the stock market or not,
- the purpose of the enterprise,
- state enabled rather than state owned, status of the entity if it is in the public administrative set-up,
- as well as governments shareholdings via tools such as government pension funds,
- restructuring company and development lenders and asset management

(Kowalski, P. et al, 2013).

Kowalski argues that the issue of transparency arises with SOEs when government imposes ownership policies which make government as owner have the flexibility to run the entity (Kowalski, P. et al, 2013). Shapiro and Globerman (2012) uses the table below to compare different governance features of other corporate forms in relation to SOEs. They break it down even further using the table to show how corporate governance can be understood.

The table below shows how entities can be managed and governed depending on ownership. Namely whether SOEs are family-owned, private equity owned, state-owned or widely-held. The table further gives various characteristics or principles that SOEs can or should follow. The various characteristics it talks about are: (i) Ownership structures/Principles, (ii) Goals of principles, as well as governance structures which are divided into; (i) monitoring by principles, (ii) financial stakeholders, (iii) boards, (iv) take-overs, (v) bankruptcy and (vi) transparency (Shapiro and Globerman, 2012).

Table 2.1: governing types of entities

	Family-Owned or Privately Held		Private Equity	State-Owned		Widely-Held
<b>Ownership Structure (Principals)</b>	Single or dominant ownership by individual or family		Owned by a small number of private and institutional investors	Owned by a state agency in whole or in part on behalf of society		Many dispersed shareholders, including institutional investors
<b>Traded</b>	No	Yes	Rarely	No	Yes	Yes
<b>Goals of Principals</b>	Family or individual interests	Family or individual interests	Return to Investors	Mixed goals including social benefits, commercial benefits	Mixed goals including social benefits, commercial benefits	Shareholder interests
<b>Principal/Agent Problem</b>	Hired managers may not share family goals	Hired managers may not share family goals; minority shareholders not protected	Supposedly aligned	Managers may not share or understand social goals; political goals may compromise social goals; conflict between social and commercial goals	Managers may not share or understand social goals; political goals may compromise social goals; conflict between social and commercial goals; minority shareholders not protected	Managers may take advantage of dispersed holdings to pursue individual goals (size, perks)
<b>Governance Structure</b>						
<b>Monitoring by Principals</b>	Strong incentives	Strong incentives	Strong incentives	Delegated, incentives ambiguous	Delegated, incentives ambiguous	Weak incentives
<b>Financial Stakeholders</b>	Debt holders	Investors	Debt holders	State banks/institutions	State and other institutions	Institutional investors
<b>Boards</b>	Limited outsiders	Some outsiders	Internal Board	Internal and political	Internal and political	Strong outsiders
<b>Take-overs</b>	Limited	Limited	Not relevant	Not relevant	Somewhat relevant	Highly relevant
<b>Bankruptcy</b>	Relevant	Relevant	Relevant	Not relevant	Somewhat relevant	Highly relevant
<b>Transparency</b>	Limited	Required	Limited	Limited	Required	Required

Source: Shapiro and Globerman, 2012, pp 42

According to Bantug (2013) SOEs exist in two main categories, depending largely on the activities they offer and engage in. Category one SOEs deliver the essential public infrastructural services, such as: sanitation and water; postal services; power; telecommunication; airports; and broadcasting (Bantug, 2013). Category one SOEs can either engage in commercial or non-commercial activities. With the non-commercial activities being basic services that are rendered to the population or services that can cut down cost to sectors of the public (Bantug, 2013).

Category two SOEs consist of SOEs that are purely commercial. For example entities like banks, air transport, real estate development, shipping and retailing. Both these categories of SOEs are



key actors in the economy with the main objective of generating profits (Bantug, 2013). It is also crucial to note that even though commercial SOEs are focused on economic development, they are theoretically tasked at bettering service delivery (OECD, 2005).

### 2.2.1: History, Rational and Purpose of state-owned enterprises

When looking at the origins of SOEs it is important to note that SOEs are not a recent phenomenon as in developing countries the origins can be traced back to colonialism. But SOEs were long in existence in developed countries (before colonialism). They were created for the purpose of economic development (Turner and Hulme, 1997). According to a 2013 report done by The Organization for Economic Co-operation and Development (OECD), SOEs are seen as vital actors in the development of infrastructure. Turner and Hulme (1997) state that SOEs in developing countries were created by their colonial masters for the main purpose to speeding up economic growth. For example, the United Kingdom established SOEs in their colonies in order to get resources from their colonies back home so as to advance their own economy. This entailed the building of infrastructure in colonies. By 1840 about 80% of railway tracks across the world were private owned, come around 1910 the states owned just under 60% of most of the large railway track networks that were in operation (Stern, 2016).

Even after most of the colonised countries gained independence, the number of SOEs continued to increase mainly because the states needed to develop their infrastructures. When India gained its independence in 1947, their SOEs were actually more than that of Britain, its colonial master (Gang, 2013).

State ownership of most of the utilities rapidly increased in most of Europe during the first decades of the 20<sup>th</sup> century. Fourie (2011) argues that at the time government was seen as the only sector able to develop the state. This explained why there was an increase in the number of SOEs in most developing countries, including African states. During this time, most private entities were nationalized and controlled by government or state.

Even though China was not colonized, they too have benefited from SOEs. China has made extensive use of SOEs in the last decade. For example according to Zhong (2014) by 2003, China had about 34,280 SOEs and state-holding entities that brought about \$658 million gross industrial output. Gang (2013) goes on to state the main SOEs in China not only play a vital part in the country but also at an international level especially in strategic industries and sectors.

Montes argues that during the development process in the early 20<sup>th</sup> century SOEs were seen critical due to three important grounds which are:

1. The scale of long-term capital required in new economic activities, many of which are critical foundations for other new activities, requires state involvement/leadership
2. The size of the risk of new ventures is too high for private entities to undertake for reasons of technology and absence of critical complementary economic activities
3. Private appropriation of benefits from certain new economic activities prevents more widespread access by other private sector parties and requires higher cost than if undertaken by a state enterprise with lower profit requirements and longer-term investment horizons. (Montes, 2014: 51).

SOEs were set-up to aid in the provision of services by the government. They were expected to ensure that the state provides effective and efficient goods and services to the citizens while also providing the state with revenue for further capital investment. SOEs have been created worldwide each with their own public policy agendas, such as the building of basic physical infrastructure in order to provide services like water, electricity. However, this was to be done in a manner that would generate income for the treasury (World Bank Group, 2014). While SOEs have contributed to the economy, it became evident that from the 1970s through the 1980s many SOEs had performed below expectation. SOEs did not generate revenue/profits necessary for capital investment. Compared to private sector operations, SOEs were financially not viable. However, the World Bank pointed out that SOEs (unlike the private sector) serves a multitude of policy aims and goals, many which are not profitable (World Bank Group, 2014).

OECD and World Bank have identified a range of reasons behind the establishment of SOEs, namely to:

- Provide public goods (e.g. national defence and public parks) and merit goods (e.g. public health and education), both of which benefit all individuals within a society and where collective payment through tax may be preferred to users paying individually.
- Improve labour relations, particularly in ‘strategic’ sectors.
- Limit private and foreign control in the domestic economy.

- Generate public funds. For instance, the state could invest in certain sectors and control entry in order to impose monopoly prices and then use the resulting SOE revenues as income.
- Increase access to public services. The state could enforce SOEs to sell certain goods and services at reduced prices to targeted groups as a means of making certain services more affordable for the public good through cross-subsidisation.
- Encourage economic development and industrialisation through:
  - Sustaining sectors of special interest for the economy, and in particular to preserve employment.
  - Launching new and emerging industries by channelling capital into SOEs which are, or can become, large enough to achieve economies of scale in sectors where the start-up costs are otherwise significant. This might be seen as an alternative to regulation, especially where there are natural monopolies and oligopolies (e.g. electricity, gas and railways).
  - Controlling the decline of sunset industries, with the state receiving ownership stakes as part of enterprise restructuring.

(World Bank Group, 2014)

State owned enterprises are considered to be a vital element of development in most economies (Buge et al, 2013). SOEs are tasked with providing strategic services and goods to a country's people (PwC and IoDSA, 2011: 2). Furthermore, according to Fourie (2001: 206), SOEs can contribute by improving the living conditions of the citizens. Balbuena (2014: 6) argues that SOEs mainly focus on the fiscal development of utilities and infrastructure. Other academics go on to write that with SOEs focusing on economic development, they are then seen as relevant entities in rising economies, SOEs have a responsibility to provide strategic facilities that are seen as national interests (Aproskie, et al 2014: 2).

SOEs are significant vehicles for job creation and employment because of the extent of the work they undertake. They provide the citizens with employment opportunities since these are entities they have to employ people to work in these companies (Chavez and Torres, 2014).

SOEs further aid in the provision of vital services to the citizens at a rather affordable and cheaper rate, also they protect consumers which are the citizens from being exploited by private companies (Chavez and Torres, 2014). SOEs are often established to ensure that government is in control of the strategic sectors of the country's economy, in order to avoid the abuse of private industries monopolizing these sectors at the expense of citizens (Buge et al, 2013).

SOEs are often established to remove foreign and private control over the domestic economy. As much as it aims to ensure that revenue generated in the local economy does not leave the country (Chavez and Torres, 2014). SOEs can also help to generate revenue. For example the state might invest in particular sectors and ensure that they have control over entry so as to impose monopolization of prices, this then can result in the state using the revenue acquired as income (Chavez and Torres, 2014). Moreover by establishing new sectors by funnelling money into state entities that are developing so that they can be sustainable.

### 2.3: Legal and Regulatory Framework for State-Owned Enterprises

The literature on SOEs emphasizes the importance of having a legal and regulatory framework for SOEs in place. In order for key expectations to be communicated there has to be a well-defined regulatory and legal framework that can guide the obligations of SOEs (World Bank Group, 2014). The primary purpose of regulatory and legal frameworks is to ensure that everyone is clear about the policy direction of the state. The boundaries of, and the relationship between government shareholders the Board of Directors of SOEs need legal reference. The roles and responsibilities of SOE Boards and SOE managers need government oversight and control so as to enforce SOE accountability (World Bank Group, 2014). There cannot be one legal framework for SOEs since they vary in objective and composition. Some SOEs are created as statutory companies having their own legislative Act or other unique legal foundation, while others can be non-corporate enterprises appearing like an SOE or a government sector which at times would fall under public enterprise law (OECD, 2011). Corporatized SOE tend to fall under the jurisdiction of company law. The legal and regulatory frameworks of SOEs are important in ensuring the governance of SOEs (OECD, 2011).

Since there are different types of SOEs, the legal and regulatory framework may at times overlap. Legal framework can range from either a full-sized application of private law to public law framework or a mixture of both. While, in a few instances SOEs have to comply with constitutional

and supranational/ international law (OECD, 2014). When SOEs are listed on the stock exchange, they are subject to listing needs of the exchange as well as other security laws. SOEs that are established by the Act of government as statutory companies, are governed by its own unique statute giving it autonomy such as fiscal authority to acquire specific fees (OECD, 2014). In many states, SOEs are obliged to comply with standard company legislation. This includes codes of corporate governance (OECD, 2011).

However, there is a general critique that legal and regulatory frameworks are outdated because they were established when SOEs were operational as vertically integrated entities with limited competition in the industry. This has caused overlap, at times incompatibility resulting in conflict. This has led to undermining the accountability of the state, management and other stakeholders of the SOEs (OECD, 2014).

Most legal frameworks were put in place to ensure that there is a regulatory framework that stipulate the extent/limitations of SOEs autonomy in or to pursue commercial activities. However, they have brought about unwanted effects such as; limiting the means to change the capital structures of state enterprises or delay decision making by having long approval procedures for investment and budgets (OECD, 2011). Also they consist of weak corporate governance requirements in areas such as preferred rights, disclosure and boards, they also carry out restrictions that limit the functional freedom of SOEs in vital areas like investments, budgeting, human resources and pricing (OECD, 2014). Other effects could be that they want SOEs to produce profits while tending to social objectives without provisions of funds to meet those objectives, and lastly they do not state how the state should act as a major shareholder as well as they at times overrule general company laws (OECD, 2014).

For an effective legal and regulatory framework for SOEs, the OECD (2014) has identified five recommendations states should follow, which are:

1. An effective legal and regulatory framework must be enforceable and implementable. Any additional good practices should be consistent with existing legal and regulatory frameworks.
2. There should be a clear separation between the state's ownership function and other state functions that may influence the operating conditions for SOEs, particularly with regards to legal enforcement and market regulation.

3. Governments should strive to simplify, streamline and harmonise the legal form under which SOEs operate. Unless there are strong reasons to the contrary, SOEs should be incorporated subject to ordinary company law.
4. Any obligations and responsibilities that a SOE is required to undertake beyond its normal commercial functions should be clearly mandated, disclosed to the public and their costs covered in a transparent manner.
5. Where SOEs and Private enterprises compete (or might compete) in the market place, a level playing field should be ensured and reconciled with economic development objectives. No entity should have a competitive advantage, or disadvantage, purely in consequence of its ownership (OECD, 2014: 6).

When looking at SOEs in developing countries, it is important to note their specific socio-economic and political context. SOEs were adopted in developing countries for different reasons such as ideology, political and economic (Smith and Trebilcock, 2001). Countries tended to form SOEs to help support them in developing their economies as well as have a huge influence on the public, so the larger the SOE the more the influence the government has over the people (Smith and Trebilcock, 2001). SOEs were also used as a tool of income redistribution where by dropping the price of goods which are principally consumed by the poor, mainly in less developed countries from which income redeployment cannot nearly be achieved through the more common income tax (Smith and Trebilcock, 2001).

The main motivation economically for SOEs was capital investment increase, as well as investment in infrastructure. However, this is not the only purpose of SOEs in developing countries. Other purposes include: controlling inflation; protecting developed countries' economy from external shocks, the effective limitation of industries prone to natural monopolies so that citizens are not forced to pay for prices that are inadequately high as well as ensuring for a more consistent provision of needed good and services (Smith and Trebilcock, 2001).

SOEs are used by government to execute commercial actions for profit as well as important governmental tasks in developing countries where investment isn't suitable for private sector involvement (Bantug, 2013). Governments in developing countries provide needed goods and services to the people as well as participation in the running of public utilities, money services and other undertakings that are profit oriented using SOEs (Bantug, 2013).

In developing countries it is clear that this was hard to keep up. Between 1986 and 1991, SOE saving- investment (S-I) recorded a loss of an average of 1.7 percent of its GDP, meaning they were not able to come up with the required resources to pay for their expansions, operations and maintenance of their debts (Smith and Trebilcock, 2001). The continuous underperformance of SOEs brought about serious issues. Firstly, SOEs obtained an uneven amount of domestic funding, considerably gathering the cost of capital of less developed countries private entities (Smith and Trebilcock, 2001). Also, ineffective levels of production within SOEs led to the removal of assets from economic areas which might have been used wisely elsewhere (Smith and Trebilcock, 2001). In developing countries, SOEs in Africa tend to produce in the region of 15 percent of the regional gross domestic product (GDP), 6 percent in Latin America and about 8 percent in Asia. SOEs account for about 20-50 percent of the economic value in the North and Middle East of Africa as well as up to 30 percent of the total employment according to OECD (2012), while Kikeri and Kolo (2006) identified that more than 50 percent of the GDP is due to SOEs in some places in Central Asia. This shows how SOEs are vital contributors of GDP in the developing countries.

Ennsner-Jedenastik (2014) identified some issues regarding SOEs in developing countries. Patronage, such as when staff of an SOE are solely appointed because of their loyalty to the ruling elite as opposed to being employed based on merit. Scholars such as Kopecky and Scherlis (cited in Ennsner-Jedenastik) explain that party patronage is prevalent in developing countries. In such cases, the dominant political party assigns people into key positions in SOEs which enables the political party to influence the actions of that SOE (2014).

## 2.4: Advantages and Disadvantages of SOEs

Various scholars and academics have written about the strength and weaknesses of SOEs, for example Tuan (2015) identifies that SOEs are there to make sure the socialist alignment of the economy as well as reserve the economic goals of the nation. Bishnoi (2015) identifies a number of advantages of SOEs. Firstly since most SOEs are controlled and owned by the state basic services and goods are made affordable. Secondly, commercial SOEs, tend to enjoy fiscal freedom since they only rely on government for the primary investment, thereafter they can pursue their mandate responsibilities in the manner they see fit. Thirdly, non-commercial SOEs can supply citizens with much needed services at an affordable and cheaper rates, since such SOEs are not primarily focused on making profits (HOSBEG, no date).

HOSBEG (no date) also identifies a number of advantages. SOEs protect citizens from being taken advantage of by private companies, by providing better and cheaper alternatives. SOEs assist the government to take control over some strategic industries of the economy. This is done mainly because if these sectors are not controlled and monitored properly they stand a chance to have major risks to the citizens of the state (HOSBEG, no date). Scholars such as, Bantug, (2013), Kowalski, Buge and Sztajerowska, (2013) and Wong (2004) argue that SOEs have the ability to create jobs for its citizens in the roll-out of goods and services.

Another advantage of SOEs is that they are protected from bankruptcy and takeovers, because the state is the main shareholder (Shapiro and Globerman, 2012). However, this can also be a disadvantage in the sense that the incentive for financial viability is weak since the state guarantees its financial survival through bail-outs and loans.

As much as there are strengths or advantages of SOEs, some scholars such as Ennsner-Jedenastik (2014) argue that there are more disadvantages in the SOE system. Agesa (2000) states that SOEs are susceptible to corruption. Besides patronage and nepotism, it is relatively easy for SOEs to procure services and goods without using proper tender channels (Zvavahera and Ndoda, 2014). In addition, the incentive for procuring value-for-money goods and services is lessened because SOEs know they can rely on government bail-outs.

SOEs are criticized for their poor performance compared with the private sectors. This results in the majority of the population who can afford private sector services and goods to choose them over the SOEs (Kim and Chung, 2007).

Kim and Chung (2007) argue that SOE managers tend to be more interested in trying to maximize their own prestige, resources under their control as well as power. The prevalence of patronage and nepotism and management levels can result in low staff morale. This leads to workers not motivated to work, hence low performance. This is often due to the fact that they are not in control or there are no incentive measures in place to try and combat this weakness (Kim and Chung, 2007). As a result, the call for reform in the public sector, includes SOEs became prevalent.

## 2.5: Reforms of SOEs

Different types of reforms have been proposed and implemented in SOEs worldwide. Privatization was initially the most popular public sector reform approach. According to Goodman and



Lovemen (1991), in the 1980s and 1990s most government in the developed countries decided to sell some or parts of their entities to generate revenue and also free themselves from losses gathered by failing entities (World Bank Group, 2014). This new shift in reforms was worldwide, private sectors procuring anything from prisons, educational utilities, railroads and anything being privatized, in 1990 alone worldwide, government was able to generate over \$25 billion from selling state entities to private companies (Goodman and Lovemen, 1991). Developing countries were not far behind in this reform as they too also began selling off state entities either because they followed political and economic ideologies, while others sold them to build their revenue (Goodman and Lovemen, 1991). This reform did improve the performance of the firms in competitive sectors as well as the infrastructural and financial sector respectively (World Bank Group, 2014).

However, Nellis and Birdsall (2005) point out that *ad hoc* privatization brought about service delivery failure. In some instances it led to the creation of uncompetitive monopolies in the market (Pettinger, 2011). Once the private sector was able to create a monopoly, it had the power to increase user fees charges (Pettinger, 2011). For example, the privatization of health services in developing countries led to an increase in user fees charges, which made health services unaffordable for the majority of the population (Pettinger, 2011). In order to make more profits, private companies often downsized staff resulting in unemployment.

The privatization of successful SOEs resulted in a loss of government revenue because government was no longer entitled to profits and dividends of the entity (Pettinger, 2011). Furthermore, in some cases privatization led to the fragmentation of industries whereby one large entity breaks up into smaller companies which may weaken overall accountability issues (Pettinger, 2011). Privatization also resulted in increased foreign ownership, resulting in profits and dividends being earned by foreigners which was not reinvested in the local economy. Not only did user fees become more expensive, but profits generated left the country (World Bank Group, 2014). All these factors as well as the global financial crisis of the 2007-2008 brought about economic turmoil within the capital markets thus reducing investor confidence (World Bank Group, 2014). This in turn pushed governments around the world to focus on rather improving the performance of SOEs as opposed to outright privatization (World Bank Group, 2014).

## 2.6: New Public Management

This critique of privatization brought to the fore the philosophy of New Public Management (NPM). SOEs were once again acknowledged as vital tools to provide public goods and services and generate revenue for government.

NPM challenges the old traditional bureaucratic style of public administration typical of the Weberian state (Andrews and Van de Walle, 2013). The traditional bureaucratic approach tended to emphasize the process of governing, submission to hierarchy and adherence to rules rather than focusing on outputs (Haque, 2004). The Weberian approach to governance was criticized for being ineffective, unresponsive and too slow (Andrew and Van de Walle, 2013).

Hood has been identified as the scholar who coined the NPM concept in 1989. (Lynn Jr, 2013: 107). Hood (1991) states that NPM became popular towards the late 1980s and emphasized the importance of management in the delivery of services in the public sector. The NPM paradigm proposed the adoption of managerial practices common in the private sector. Scholars such as Wainwright (2004) regard NPM as a collection of systematic managerial changes adopted in the public sector. Others refer to it as a toolbox, a menu or a shopping list consisting of various public management approaches (Uwizenyinama, 2009: 11).

NPM refers to reforms in the administration of public management, showing a move towards measurable performance (Lynn Jr, 2003: 107). Haynes (2003:10) explains that NPM is about implementing private sector managing and organizing approaches in the public sector. Uwizenyinama concurs and mentions that advocates for NPM argue that the public sector should apply principles and techniques of private sector management, and market organization in order for them to be efficient, effective in their provision of public goods and services (2010:10). NPM can thus be viewed as a body of thought in which private sector approaches are implemented in the public sector in an attempt to provide more effective public services.

NPM introduces the practice of performance evaluation. This, it is argued, will make public servants more accountable for their actions or lack thereof. NPM tasks the public sector to formulate indicators of performance and measure outputs. Better performance is likely to be guaranteed when public sectors move to meet objectives rather than focusing on rules (Haque, 2004).

NPM emphasizes the need for outcomes and aims to make the public sector more output driven. The emphasis is on results instead of bureaucratic processes. Parsons (1995:473) believes that NPM came about because there was a need for the public sector to become more business-like in the way government managed their matters. Parson (1995: 473) coined this as the managerialist approach to governance. He referred to the managerialist approach as the shift in which public sectors adopt private sector approaches including reward systems, like performance related pay as well as less rigid working practices (Parsons, 1995: 473).

## 2.7: Governance

Weiss (2000) contends that governance as a concept needs to be distinguished from government. Vagliasindi (2008) defines government as the system by which a state is controlled by a collective group of individuals or people using their power within that state, while governance to him is the way in which power and policies are managed. Weiss (2000) associates governance with the national administration system. Graham, Amos and Plumtre (2003: 1), define governance as, “how governments and other social organizations interact, how they relate to citizens, and how decisions are taken in a complex world”. The World Bank states governance as “the manner in which power is exercised in the management of a country's economic and social resources for development" (Santiso, 2001: 3).

Furthermore as much as governance is important, good governance is considered to be better. Abdellatif (2003: 2) quotes Kofi Annan (then Secretary General of the United Nations) when he claimed that: “good governance is perhaps the single most important factor in eradicating poverty and promoting development”. Camerer (1997:1) states that good governance entails elements such as transparency, accountability, and the rule of law. Government should be open and predictable in the way it governs the state. . Other scholars add the need for public participation, equity, responsiveness, consensus orientation as well as effectiveness and efficiency as key elements of good governance (Abdellatif, 2003:5). However even after all these elements the citizens still depends on how the citizens perceives the government’s legitimacy, this is shown by the way government provides and caters to its citizens as well as how government runs its democracy (Camerer, 1997:1).

Abdellatif (2003) identifies nine core characteristics of good governance. First, the rule of law in which government respects and abides the law so they do not overstep on the rights of the people.

Secondly, public participation where government seeks to include citizens in decision-making processes. Thirdly, transparency which refers to the responsibility of government to make information available and accessible to its citizens. Information such as how state resources are used. Fourthly, closely linked to transparency is, accountability. Government officials should be held accountable for their (lack of) performance. Fifthly, governance must be to the needs of the citizens. It refers to the time and way government deals with issues or tasks (Abdellatif, 2003:25). He mentions other characteristic such as equity, strategic vision and consensus orientation (Abdellatif, 2003:25). She further identifies need for governance to promote equity. Governance needs to be guided by, strategic visions and lastly, policymaking should be consensus orientation (Abdellatif, 2003:25). Taken together, these principles, it is argued, will ensure that policy-making and policy-implementation is in the interest of socio-economic development of all the citizens in a country.

The principles of good governance apply to the public sector as a whole. However, besides the public sector, good governance is equally important in the private sector. The concept corporate governance refers to the principles guiding governance in the private sector.

### 2.7.1: Corporate Governance (CG)

Throughout the world many SOEs have performed poorly mainly due to poor corporate governance (Wong, 2004). The ASXCG Council (2010:3) defines corporate governance the framework of regulations, systems, relationships and procedures inside a corporation and on which power is practiced and controlled in the corporation. Furthermore it goes on to state that corporate governance tends to encompass the fundamental tools by which enterprises, and those in charge are held accountable (ASXCG Council, 2010:3). Corporate governance focuses on how companies determine their objectives and assess their accomplishments. It also considers how companies assess and monitor their risks. The premise is that good corporate governance will improve overall corporate performance ASXCG Council, 2010:3).

Corporate governance has several objectives which are to mitigate or eliminate conflicts of interest between stakeholders, especially between shareholders and managers. It also aims to ensure that a company's assets are used productively and efficiently, in the interest of its investors and stakeholders (Clayman, Fridson and Troughton, 2010). Clayman *et al* (2010) argues that if a company fails to establish an effective and operational corporate governance system, it can present

a huge operational risk for the company and their investors, and for one to understand the possible risk of an investment in a company, it is vital to know the corporate governance system quality of that company (Clayman, Fridson and Troughton, 2010).

Just like good governance, corporate governance has some core attributes, Clayman *et al* (2010) have identified five attributes. Firstly, the rights of shareholders and core stakeholders need to be delineated. Second, the responsibilities of managers and directors to the company's shareholders and stakeholders must be stipulated (Clayman, Fridson and Troughton, 2010). Thirdly, there has to be recognizable and quantifiable measures for accountability when it comes to the performance of responsibility within an entity. Fourthly, fairness and reasonable treatment when it comes to all dealings between directors, shareholders and managers (Clayman, Fridson and Troughton, 2010). Lastly full transparency and accuracy when it comes to the disclosures concerning performance, financial position, risk and operations (Clayman, Fridson and Troughton, 2010).

Corporate governance ought to provide suitable incentives in order to encourage for management and the board to pursue goals that serve the best interest of shareholders and stakeholders alike (Jesover and Kirkpatrick, 2005). An effective corporate governance system helps give a certain level of confidence required for the proper operation of a market (Jesover and Kirkpatrick, 2005). However, it is important to note that corporate governance is not an end, but rather it serves as a means to establish confidence within markets and ensure integrity in businesses which is vital for companies that require admission to equity resources for long term investment (OECD, 2015).

The OECD came up with principles to help provide direction for policymakers, market participants and regulators when it comes to improving the regulatory, legal and institutional framework that underpin corporate governance, focusing on SOEs (Jesover and Kirkpatrick, 2005: 128). These principle have been put into six main areas, which are;

- I. ensuring the basis for an effective corporate governance framework;
- II. the rights of shareholders and key ownership functions;
- III. the equitable treatment of shareholders;
- IV. the role of shareholders in corporate governance;
- V. disclosure and transparency;
- VI. responsibilities of the board (Jesover and Kirkpatrick, 2005:130).

Corporate governance is also a method of monitoring company performance (Wong, 2004). Corporate governance can lead to higher levels of accountability and higher profit margins. It can also encourage further and future growth since investors will be more likely to invest in the company (Hemphill and Cullari, 2014). When looking at the benefits to shareholders and stakeholders, corporate governance provides favorable reasons for management and the board to pursue objectives that are in the interest of its shareholders and stakeholders (Wong, 2004).

Corporate governance, if implemented accordingly, will not only benefit the company's shareholders and stakeholders but in return the national economy (Hemphill and Cullari, 2014). For example when a company complies with the principles of corporate governance, it can benefit by bettering their access to resources such as capital as well as financial markets. Offering a get out policy as well as ensuring less chances of conflict of interest (Sokol, 2009).

## 2.8: State-Owned Enterprises and Corporate Governance

Emphasis in reforms of SOEs is on identifying the state as a majority shareholder, and civil society as stakeholders. Just like a company, establish a board in SOE that represents the shareholder and stakeholders' interests. In doing so this ensures that there is even representation of interests, there is accountability, as well as transparency in decision-making. The state as an owner should allow the SOE boards to be independent as well as allow them to execute their responsibilities without interfering (OECD, 2014).

## 2.9: Conclusion

This chapter has looked at SOE as a concept. It has shown us that SOEs are government entities that are owned by the state, can either be commercial or non-commercial. It showed that SOEs is not a new concept but that it has been there for a long time. With the main purpose of developing a state so that its population can benefit from the development SOEs bring. It further identified key rationales behind the establishment of SOEs like; provide public goods, improve labour relations and limit private and foreign control. SOEs have their own advantages and disadvantages. Some advantages for SOEs stating they have a positive impact on the economy, and the social development of a state. While some disadvantages regarding SOEs such as ethnicity and nepotism. When SOEs do not perform to their best abilities SOEs need to undergo reforms. Privatization has severe shortcomings, hence the call for NPM as opposed to outright full privatization. However before such extreme measure can be taken NPM has to be put in place, this way government can

reform their SOEs without having to privatize them as they contribute so much to the economy. And to ensure that SOEs are being effective governance and good governance practices have to be put in place to support the legal and regulatory frameworks put in place. Corporate governance is also crucial as SOEs are corporate entities that are being functioned by the state, so to address key issues of ownership and how the objective are done corporate governance then becomes a key tool.

## Chapter 3: SOEs in South Africa before and after 1994

### 3.1: Introduction

State Owned Enterprises (SOEs) are present in all states worldwide, South Africa is no exception. This chapter presents a summary of SOEs in South Africa. It first presents a brief history of SOEs in South Africa, focusing on SOEs before, during and post-apartheid. The chapter also presents the legislative framework of SOEs in South Africa, focusing on the policies that guide the operations of SOEs as well as their functions in ensuring SOEs in South Africa function properly. Lastly it describes some of the main SOEs in South Africa, looking at what they do and how they function and the policies that govern them.

### 3.2: Brief South African History of SOEs

South Africa, has for some time adopted the use of SOEs as key tools for socio-economic expansion (Fourie, 2001: 205). According to the National Treasury (2013:2) they are twenty one major public entities listed on the PFMA Schedule 2. The existence of SOEs and their primary purpose being to contribute to the South Africa socio-economic development agenda is not something new according to Fourie (2014: 32). He explains that the first SOE in South Africa was created by the Dutch East India Company and was responsible for expanding postal services, which was opened on the 2<sup>nd</sup> of March 1792 in Cape Town by the then acting governor of the Cape, Johan Isaac Rhenius (Fourie, 2014: 32).

However, other academics contend that the first official SOE in South Africa was the South African Railway, which was established in 1880 (Fourie, 2001). Fourie (2014) cites Jerome and Rangata stating that from the early 1920s, the South African economy was shaped by SOEs. SOEs, were firstly created to improve the import-substitution industries while they functioned as elite franchises. Most SOEs that were created in the 1920s were geared towards strategic industrialization as well as job creation during a period where there were high levels of unemployment according to the Presidential Review Commission (PRC, 2013). From 1948 when apartheid was made official by the National Party, the government made extensive use of SOEs to improve the living conditions of the few in the society and economy (PRC, 2013). However by the 1960s, the apartheid regime became internationally isolated through sanctions which forced the government to adopt economic policies which would make the government self-sufficient. During this period SOEs were aimed at uplifting the socio-economic living conditions of the white



minority, by fostering self-sufficiency and develop strategic industries (PRC, 2013). Some of the SOEs that were established during this time were Aventura, South African Broadcasting Corporation (SABC), the Land Bank and the Sasol Science Council (PRC, 2013). The apartheid era (1948 and 1994), was a time of great economic boom for the Afrikaner society in South Africa. Mostert (2002) states that, the state during apartheid had massive control when it came to the economy. He goes on to further state that, the big state-owned entities established during this period, gave the apartheid state the power to have a huge influence over the economy (Mostert, 2002). SOEs, they were able to provide the minority Afrikaner population with job opportunities and help them develop in the country's economy allowing them to be able to afford proper schools which were far more advanced than that of the education received by the black majority. The apartheid government establish SOEs in order to consolidate their power, especially over the economy. So SOEs became large monopolies, dominating the economy. The revenue generated by these SOEs were then purely directed at the socio-economic development of the apartheid government's electorate. From the 1976 till mid 80s the political environment became hostile and community protests such as the Soweto uprisings, and the conflict going on in Angola brought about the impetus for the establishment of a stronger State security system (PRC, 2013). One outcome was the establishment of ARMSCOR (the Armaments Corporation of South Africa) (PRC, 2013).

Fourie (2014: 33) shows that towards the late 1980s, a number of SOEs underwent public sector reforms, mainly due to the fact that they had become financially unsustainable, and were being funded from very limited state resource. Some SOEs were outright privatized due to the fact that they were inefficient to the point that they got unwanted criticism against the government by other entities (Fourie, 2014). With a change in regime becoming certain, government looked to use SOEs as instruments to gain new voters, so they worked around already established structures of government (PRC, 2013). A summary of the history of SOEs in South Africa is given in Table 2.1 below.

Table 2.1: History of SOEs in South Africa

Political environment	Rationale	Examples
<b>1880 – 1910</b> Period of economic self sufficiency. Monopoly concessions were granted to private citizens.	Sovereignty and economic self-sufficiency of the Afrikaner	South African Railways
<b>1910 – 1940s</b> Period of high unemployment. Saw the establishment of a number of key State-owned corporations.	Strategic industries Job creation	Eskom, Iscor and IDC (also SAR, Post Office)
<b>1948 – 1970s</b> The Government used State instruments to improve the living standards of a few in the economy and society. After 1960, with growing isolation, there was an emphasis on self-sufficiency.	Upliftment Strategic industries Self-sufficiency	Aventura, SABC, Sasol Science Council, Land Bank
<b>1976 – mid-1980s</b> The Soweto Uprising and conflict in Angola gave impetus to the development of the State security establishment. Also the Government created entities to circumvent sanctions. In the mid-1980s the Government followed a trend of fostering the private sector and privatising some key State industries.	Avoid Parliamentary scrutiny Busting sanctions Privatisation	Central Energy Fund, Denel, Armscor, Mossgas, SBDC (Iscor and Sasol)
<b>Late 1980s – early 1990s</b> Political change became inevitable. Government sought to use the instruments of State to "win the hearts and minds" of the new voters.	Working around the existing structure of Government	IDT (also used Eskom and Telkom)
<b>1994 – the present</b> New Government focused on poverty alleviation, developing a competitive economy, and improving the functioning of Government. Strong emphasis on creating independent bodies to carry out new functions. Also a tendency to move functions out of Government so as to "create something new" or effect "transformation".	Regulatory functions autonomous of Government Running away from Government Continued privatisation	NER, Nuclear Regulator, Competition Commission, SA National Parks, Museums, Water boards, Theatres, etc.

Source: presidential review committee on state-owned entities volume 2. pp.37

With the advent of democracy in 1994, the ANC-led government was faced with the huge issue of dealing with the high levels of poverty, inequality, high levels of illiteracy, unemployment and

other legacies left behind by apartheid and the colonial regimes (PRC, 2013). The features left behind by the apartheid bureaucracy more particular to SOEs were:

- Poor and outdated management practices,
- Old and aging infrastructural structures,
- Duplication, waste and fragmentation,
- Absence of outlining state assets and financially sincere balance sheets,
- Demotivated staff and conflict in labor relations,
- Absence of control systems, accountability and transparency,

(PRC, 2013)

When it came into power in 1994, the ANC-led government of SA implemented its Reconstruction and Development Programme (RDP). The objective of the RDP was to help develop and rebuild the country, to ensure that it meets basic needs, increase human resources, democratize the society as well as the state, and build the economy (Fourie, 2001). The Macroeconomic Strategy which is concerned with the growth, employment and redistribution (GEAR) supported the RDP, since GEAR aimed to help improve government efforts to accomplish the goals and objectives of RDP by transformation of the economy and state structures according to the Department of Public Enterprises (DPE) of 1999 cited by Fourie (2001).

There was a need to reform SOEs since they were underperforming, and even though privatization was seen as a solution, the state still needed to have control over some of the industries in the country (Fourie, 2001). The process of reform tended to focus on a lot of aspects when it came to political, social and economic lives of the community. Since it had the underlying mandate of ensuring that it did abide by the constitutional rule of providing the citizens with fair and equal rights as well as being just, to make sure that the injustice brought about by the former regime was abolished (Fourie, 2001). While in terms of the economy the reform tended to focus on the facilitation of economic increase by growing competition and trying to prevent situations that promote monopoly (Fourie, 2001). This therefore leads to a huge ownership in the country's economy, to help reduce state debt, assemble private entity capital, as well as promote the competitiveness and capital of SOEs (Fourie, 2001).

The government wanted SOEs to be able to contribute to the development and improvement when it came to the living standards of the citizens by bringing about social benefits and sustainable economy (Fourie, 2001). Since the old apartheid regime left some challenges in terms of SOEs as mentioned above. Government had to tackle the immediate issue of infrastructure as well as services which needed to be supplied at higher qualities but lower costs, while services had to be accessible to even the previously disadvantaged groups in society according to the 2000 DPE cited by Fourie (2001). And since Telkom, Eskom, Transnet and Denel were the largest SOEs which had control of 91% of the assets and a turn of 86%, 94% of net income gathered, as well as they employ about 77% of workers when looking at the top 30 SOEs nationwide (Fourie, 2001; PRC, 2013), government thought they should concentrate in trying to reform these four SOEs first. Since the democratization of South Africa in 1994, there have been a lot of policies that have been put up and have had an impact on SOEs, the table below represents an overview of the different macro-policies that are significant and related to SOEs, and the rationale behind these policies.

Since 1994 a number of policies have been brought about to address the economic and developmental growth objectives as well as general strategies, which have knock-on effects particularly on SOEs. It is vital to have an understanding and clarity of South African economic and development policies when looking at the short, medium as well as their long term and how they have an effect on SOEs. The RDP was one of the policies brought about post-1994, it had an impact or an input on SOEs in the sense that one of its objectives was to enhance the capacity and competitiveness of all SOEs. The Growth, Employment and Redistribution (GEAR) framework was introduced by government in 1996. However unlike RDP, the GEAR policy was underpinned by privatization as a tactical imperative trying to strengthen the rather weak economy that came about from the apartheid era.

Table 2.2: Summary of post- 1994 policies affecting SOEs

Policy environment	Rationale
<p><b>1994: RDP</b> The Government committed itself to reforming the country. The ANC-led Government focused on social issues that were neglected during the apartheid era such as unemployment, housing and crime.</p>	<p>The establishment of SOEs in apartheid South Africa created the conditions for skewed development aims, irregular infrastructure and service delivery, and a host of structural problems. Since 1994, these have limited the ability of SOEs to adjust to new requirements and new policies.</p>
<p><b>1995: GEAR</b> The Mandela administration began to re-introduce South Africa into the global economy by implementing a market oriented economic plan.</p>	<p>Speeding up the restructuring of State assets to optimise investment resources. The implementation of the public sector asset restructuring programme, including guidelines for the governance, regulation and financing of public corporations, and leading off with the sale of non-strategic assets and the creation of Public-Private Partnerships in transport and telecommunications.</p>
<p><b>2004: AsoISA</b> AsoISA originated from a commitment made by the ANC in its 2004 election manifesto to halve unemployment and poverty by 2014. To this end and with other stakeholder inputs, Government developed a focused set of initiatives to accelerate shared growth.</p>	<p>The policy was meant primarily to address the scourge of poverty. The policy intended to mandate the Government to halve poverty and unemployment by 2014. Steady improvement in the economy's performance and job creation capacity at the time convinced SA policy makers that these objectives were feasible and achievable.</p>
<p><b>2010: ANC National General Council</b> Re-affirmed the commitment of the ANC to the Developmental State.</p>	<p>The ANC defined its understanding and vision of the key attributes of the South African Developmental State for the first time in 2007.</p>
<p><b>2010: New Growth Path (NGP)</b> Re-affirmed the commitment of the ANC to a Developmental State.</p>	<p>The policy is meant to create decent work, reduce inequality and defeat poverty. The realisation is that this can only happen through a new growth path founded on a restructuring of the South African economy to improve its performance in terms of labour absorption as well as the composition and rate of growth.</p>
<p><b>2011: IPAP2</b> A plan to guide trade and industry in the country.</p>	<p>To enable the Department of Trade to continue with its efforts to build on its industrial development which, inter alia, will align to the NGP.</p>
<p><b>2011: NPC</b> Located in the National Planning Department in the Presidency.</p>	<p>The purpose of the NPC is to develop the country's long term vision and national strategic plan as well as producing a development plan of how this vision will be achieved.</p>

Source: presidential review committee on state-owned entities volume 2, pp.40

However by 2010, it is said that the number of SOEs had increased from just over 300 in 2001 to over just over 700 by 2012 (Fourie, 2001; Mbo and Adjasi, 2013), creating jobs over 150,000 jobs. In total, SOEs had a combined value of R175 billion in assets (PRC, 2013).

### 3.3: The Structure and Classification of SOEs

In South Africa, SOEs are grouped into different schedules (Schedule Two and Schedule Three) based on their level of autonomy and nature.

#### 3.3.1: Schedule 2 public entities

Schedule two entities are what the state classifies as major public entities. These entities are there to declare dividends as well as the creation of profits. Since the schedule two entities function in the competitive market as well as operate in accordance with business principles generally they tend to be given the more autonomy than other public entities in the state. These entities have been given the ability to lend money through their accounting authorities according to the provisions made by the PFMA section 66 (3) a, meaning that they can have far-reaching borrowing powers. Since these entities have been given the power to borrow money, they must then submit annually a report to the Minister of Finance with a detailed description of a borrowing plan for the year according to section 66 (7) (a) and (b) of the PFMA, this section applies fully to entities that are fully government owned. Furthermore according to the PFMA these entities are not allowed to borrow foreign currency money above a certain limit in their borrowing plan, unless the entity is not wholly state owned.

#### 3.3.2: Schedule 3 public entities

Schedule Three SOEs are divided into three categories: 3A, 3B and 3D. Schedule 3A and 3B are regarded as agencies of government departments with a mandate of ensuring the fulfilment of a particular social or economic responsibility of government. These entities depend on government for funding through statutory money transfers from the Revenue Fund. These SOEs have the least autonomy of all SOEs. Schedule 3B SOEs are also known as provincial public entities, which include entities at provincial levels from all the nine provinces in South Africa.

The other entities that do not fall under the above mentioned schedules fall under Schedule 3D entities. These are known as government business entities. These enterprises create revenue, however they are either substantially government funded or substantially self-funded which makes it hard for them to have substantial autonomy. This means that they do not have the amount of autonomy like those in schedule two, even though they operate along the lines of the general

business principles. These entities can also be known as provincial government businesses, however they only operate in seven provinces (all provinces excluding Gauteng and North West). It is also important to note that these entities have limited borrowing powers.

### 3.4: Legislative and Regulatory Framework

SOEs in South Africa function within a wide policy framework, that is in line with and that complements government's intention of strategic, social, economic and developmental objectives.

According to (Bronstein and Olivier, 2011) SOEs need to be aligned to certain aspects like:

- South African circumstances and strategic priorities;
- Political imperatives;
- Social impact (job creation, critical skill development, pricing, quality and access of services, facilitation and economic empowerment);
- Economic impact (formation of new industries, facilitating value creation by Government, and effective utilization of state resource in driving economic growth); and
- Increasingly, environmental imperatives that have gained momentum through the Kyoto protocol.

The regulatory framework for SOEs in South Africa is complex. There are a number of Acts that have implications for the operations of SOEs, such as the Companies Act, the Public Finance Management Act (PFMA), and the Municipal Finance Management Act (MFMA) (Bronstein and Olivier, 2011). In addition, SOEs are further regulated by their sector's own regulatory framework. Regulation also takes on a diversity of forms, from safety and environmental regulation, economic regulation to regulation of standards (Bronstein and Olivier, 2011). Regulations pertaining to SOEs can also found in the Protocol on Corporate Governance in the Public Sector, Policy Frameworks for SOEs Shareholder Compacts (Bronstein and Olivier, 2011). In short, the regulatory framework of SOEs is to some point determined by the type of entity. Below is a discussion of the legislation which applies to all SOEs, regardless of sector.

#### 3.4.1: Companies Act (Act 71 of 2008)

The Companies Act (Act 71 of 2008), as revised by the Companies Amendment Act 3 of 2011, and the Companies Regulations 2011, was brought into effect on 1 May 2011. The Act replaced the 1973 Companies Act. Some of the provisions in the 1973 Companies Act continue to apply. For example the winding-up of insolvent companies. Also any investigation by the Minister or the

Registrar of Companies under the 1973 Companies Act may be continued. However it must be noted that the Act comprises new provisions which apply to SOEs (STBB, 2011). There are certain exemptions set out in Schedule 5 which focus on transitional measures to facilitate the transition from the 1973 Companies Act to the Companies Act (STBB, 2011), such as the continuation of pre-existing companies, pending matters, memorandum of incorporation and rules, pre-incorporation contracts and par value of shares, treasury shares, capital accounts and share certificates. Even though the Companies Act applies to all SOEs, section 3(3) of the PFMA allows for the prevailing of the PFMA when conflict arises between the PFMA and another Act. Section 5(4) of the Companies Act determines that if there is a conflict between any section of this Act and a section of any other national legislation then:

- the section of both Acts apply alongside, to the degree that it is likely to apply and comply with one of the varying sections without breaching the second; and
- to the degree that it is hard to apply or comply with one of the inconsistent sections without breaching the second.

### 3.4.2: The Public Financial Management Act (Act 1 of 1999) (PFMA)

The Public Financial Management Act (or PFMA) refers to the term ‘national government business enterprise’ which is defined in section 1 as an entity which:

- is a juristic person under the ownership control of the national executive;
- has been assigned financial and operational authority to carry on a business activity;
- as its principal business, provides goods or services in accordance with ordinary business principles; and
- is financed fully or substantially from sources other than the National Revenue Fund; or
- by way of tax, levy or other statutory money.

The PFMA regulates the management of finances at national and provincial government levels. It sets the procedures for efficient and effective management of all the revenue, expenses, resources and liabilities (Treasury, 2010). It creates the duties and responsibilities of government officials who are in charge of public finances. The Act seeks to secure accountability, transparency and



sound financial management in government and public institutions (Treasury, 2010). Section 49 of the PFMA establishes the accountability of the board of the SOEs. The Act itself points out the laws in relation to the Treasury at a national and provincial level, also the Revenue Funds at the national and provincial level as well as the national budget. The Act seeks to further govern the way government departments manage the finances of SOEs constitutional institutes, parliament and the provincial legislatures (Fourie, 2014).

All public entities listed in Schedule 2 and Schedule 3, (which are subject to change by the Minister of the DPE who is tasked with overseeing the performance of SOEs), must assign a person or group who will be held responsible for the purposes of this Act (Treasury, 2010). The accounting authority needs to protect the properties and records of the SOE and needs to do everything possible to avoid negative impacts to the financial interests of the State (Treasury, 2010). Accounting authorities who represent Schedule 2 public entities must provide an annual budget and corporate plan to the accounting officer (Treasury, 2010). These need to show a projection of expected income and costs as well as any other activity plans for the following three years (HSRC, 2011). Accounting officers who represent Schedule 3 public entities that are not government business entities and are non-commercial SOEs must provide a budget of estimated income and expenses to the executive authority.

Public entities must get the needed approval from the relevant treasury (be it national or provincial) before doing any of the following:

- setting up a company or starting or ending an important business activity,
- participating in an important partnership, joint venture or trust or changing the nature of an existing interest in a partnership or trust,
- acquiring or doing away with a significant shareholding in a company or a significant asset.

(HSRC, 2011)

The public entity's accounting authority must keep full and correct financial records of the affairs of the company and should submit statements for auditing, either to the Auditor-General or a registered external auditor (HSRC, 2011). An annual report, representing the state of affairs of the entity needs to also be submitted to the executive authority which is the Minister of Finance.

Section 3(3) of the PFMA regulates that if any clashes exists between the PFMA and another act, the PFMA prevails (PFMA, Act 1 of 1999, section 3 (3)).

### 3.4.3: Municipal Finance Management Act (Act 56 of 2003)

The Municipal Finance Management Act (Act 56 of 2003) or MFMA seeks to modernize financial plans and fiscal management practices within the municipalities so as to maximize the ability of the municipalities to deliver effective services to all of their customers, users and residents. Furthermore it gives rise to the norms of transparency as mentioned by sections 215 and 216 of the Constitution.

Section 215 of the constitution states that: *“(1) National, provincial and municipal budgets and budgetary processes must promote transparency, accountability and the effective financial management of the economy, debt and the public sector. (2) National legislation must prescribe— (a) the form of national, provincial and municipal budgets; (b) when national and provincial budgets must be tabled; and (c) that budgets in each sphere of government must show the sources of revenue and the way in which proposed expenditure will comply with national legislation. (3) Budgets in each sphere of government must contain— (a) estimates of revenue and expenditure, differentiating between capital and current expenditure; (b) proposals for financing any anticipated deficit for the period to which they apply; and (c) an indication of intentions regarding borrowing and other forms of public liability that will increase public debt during the ensuing year.”*

Section 216 of the Constitution states that: *“National legislation must establish a national treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government, national treasury must enforce compliance with the measures established in terms of subsection (1), and may stop the transfer of funds to an organ of state if that organ of state commits a serious or persistent material breach of those measures. A decision to stop the transfer of funds due to a province in terms of section 214(1) (b) may be taken only in the circumstances mentioned in subsection; Parliament may renew a decision to stop the transfer of funds for no more than 120 days at a time, following the process established in terms of subsection (3). Before Parliament may approve or renew a decision to stop the transfer of funds to a province.”*

The Constitution, however needs to be read together with three other important Acts namely, the Municipal Systems Act (Act 32 of 2000), the Property Rates Act (Act 6 of 2004) and the Municipal

Structures Act (Act 117 of 1998). These four Acts have been structured to give effect to the 1998 White Paper on Local Government, which seeks to alter municipalities so as to become more transparent, accountable and participatory in their financial management obligations.

The MFMA consists of five underlying principles that help it try and achieve the aims and goals it was created to fulfil, since it tries to promote a better, stronger, well managed and accountable local government. One which is well suited to meet the demands and challenges being encountered by various communities. The five principles underlying this Act are:

- Promoting sound financial governance by clarifying roles

The MFMA and the Municipal Systems Act are crucial to developing the governance framework within a municipality, specifying and splitting the roles of mayors, officials and councilors, as well as the system of accountability and oversight (Treasury, 2004).

- A more strategic approach to budgeting and financial management

By implementing three-year budgets associated to longer-term IDPs, municipalities can embrace more forward-looking and better-informed methods and make proper rulings about the future main concerns for capital development and delivery of services in their communities (Treasury, 2004).

- Modernization of financial management

The MFMA notices that fiscal management structures, procedures and policies in local government needs be updated to help reinforce the municipality's ability to perform effectively (Treasury, 2004).

- Promoting co-operative government

The MFMA nurtures a greater level of co-operation across as well as within the various spheres of government, based on structures of common support, information distribution and communication as well as coordination of activities, each seeking to add value to the others' constitutional tasks with a view to improving production for all (Treasury, 2004).

- Promoting sustainability

Sustainable local government is assembled on the foundation of balanced budgets, as unfunded insufficiencies are not permitted. Municipalities must take full accountability for their actions and should not rely on national or provincial government to bail out poorly managed municipalities. The level of service delivery should be prioritized as well as ensuring costs that are reasonable to ratepayers and the continuation of routine upkeep will assure the sustainability of the service offered by the municipality. (Treasury, 2004)

#### 3.4.4: The King Code of Governance for South Africa, 2009

The King Code of Governance for South Africa, 2009 (or King III) is the key policy document for on corporate governance in South Africa. King III consists of codes of principles as well as practices that are not based on legislation (Engelbrecht, 2009). King III applies to all enterprises irrespective of the way and form of incorporation or formation and whether in the public, private or non-profit sectors. Principles are structured on the basis that, if they are adhered to, enterprises would have practiced good corporate governance.

King III has widened the scope of corporate governance in South Africa with its core issues revolving around sustainability, leadership and corporate citizenship.

These key principles are given prominence:

- Good corporate governance is fundamentally about effective leadership. Leaders should define strategy, supply direction and create the values and ethics that will impact and monitor practices and behavior when it to sustainability performance.
- Sustainability is the key moral and economic imperative and it is one of the most essential sources when it comes to both openings and risks for businesses. Society, nature and business are interrelated in various ways that ought to be understood by decision makers. Apart from incremental alterations towards sustainability one also needs a major shift in the way companies and directors perform and organize themselves.
- Innovation, collaboration and fairness are crucial pieces of any shift to sustainability – advancement offers new ways of doing things, as well as gainful responses to sustainability. Fairness is important since social injustice is unsustainable and collaboration is usually a requirement for large-scale change.

- Social change and redress is key and a requirement to be combined within the wider evolution to sustainability. Mixing sustainability and social transformation in a strategic and rational manner will give rise to greater benefits, efficiencies, and opportunities, for both company and society.
- King III required companies to put in place sustainability reporting as an essential aspect of corporate governance. Ever since 2002, sustainability reporting has now become a commonly accepted practice and South Africa is an upcoming market leader in this practice. Nevertheless, sustainability reporting needs to be renewed in order to respond to:
  - The persistent trust shortfall among civil society of the purposes and practices of big business
  - Worries between business decision makers that sustainability reporting is not satisfying their expectations in a cost-effective way.

It is suggested that all enterprises should show which principles and or practices they are choosing or choosing not to implement. This level of openness will permit stakeholders to comment on existing practices, as well as challenge the Board to adapt the governance within the entity if stakeholders deem this necessary (Engelbrecht, 2009). Since there are various categories of SOEs, the extent of King III tends to differ among enterprises. In other words, King III is not a one size fits all corporate governance yardstick. Unless SOEs can motivate why they should be exempt from it (Engelbrecht, 2009).

### 3.5: Key SOEs in South Africa

There are over 700 SOEs in South Africa, some large some very small belonging to various agencies of government. Eskom and Transnet are regarded as two of its largest SOEs. They account for 5% of the country's economic output (Mbo and Adjasi, 2013)

#### 3.5.1: Eskom

Eskom is the largest electricity producer in South Africa, making it a monopoly in the power sector of South Africa (Mbo and Adjasi, 2013). It produces 95% of South Africa's electricity and about 45% of Africa's electricity. Eskom was established in 1923 in South Africa. In 2002 it was turned into a fully government owned, public, limited liability entity, (Fourie, 2014). It is regarded as one of the top twenty power utilities in the world. The generation of electricity is the main function of

Eskom. However Eskom also is involved with the supply chain of electricity, which involves transmission and distribution of the produced electricity to residential and commercial consumers, mines and other industrial facilities (Fourie, 2014). Eskom provides social and economic benefits to its citizens by, for example, providing jobs to more than 46,000 people developing skills, and training facilities through building programs and academic learning (BusinessTech, 2015 and Eskom, 2011).

Among others, Eskom has to comply with the following Acts: the Companies Act, the Competition Act, the National Environmental Management Act, the Public Finance Management Act, the Promotion of Administrative Justice Act, and the Promotion to Access to Information Act (Eskom, 2011).

Eskom is further regulated by the National Energy Regulator of South Africa (NERSA) in tandem with the Electricity Regulation Act (4 of 2006). The NERSA has key monitoring and oversight powers and is responsible for:

- Issuing licenses for the operation of generation, distribution and transmission facilities.
- Regulating imports, exports and the trading of electricity.
- Determining and approving electricity prices and tariffs and the conditions under which electricity may be sold. (Fourie, 2014).

The Electricity Regulation Act (Act 4 Of 2006) identifies 7 key functions of Eskom. It is to provide:

- 1) Sustainable, efficient, effective and orderly development and process of electricity supply infrastructure in South Africa.
- 2) Long-term sustainability of the industry.
- 3) Investment in the industry.
- 4) Universal access to electricity.
- 5) Diverse energy sources and energy efficiency.
- 6) Competitiveness and customer choice.
- 7) Fair balance between the interests of customers and end users, licensees, investors and the public.

The functions identified above must be met following corporate governance principles, such as those stipulated in King III and the Protocol on Corporate Governance in the Public Sector (Eskom, 2011). Eskom claims (on its website) that its structures and processes are frequently reviewed to guarantee that compliance is observed in this regard.

Eskom has a number of commercial subsidiaries:

- Eskom Holdings SOC Limited
- Eskom Enterprises SOC Limited
- Escap SOC Limited
- Eskom Finance Company SOC Limited

Eskom also has a non-commercial/nonprofit subsidiary, namely the Eskom Development Foundation

Eskom claims that it adheres to the principles of corporate governance. According to Eskom (2011), it created its own Companies Act Task Team and the King III Task Team in 2009 in order to identify, evaluate and plan how Eskom would adhere to these corporate governance requirements. McGregor (2014) identified, however, contradictory performance. For example:

- Profits were down from R12.8bn to R12.6bn between March and September 2014, while revenue was up by 14.7%
- In 2013, Eskom was nominated as the worst company in the world in terms of social responsibility. Particularly regarding its bid to exempt two-thirds of its coal-fired power stations from air pollution, despite exceeding official levels. It also had to apologize for spying on environmental bodies at Medupi Power Station.
- Above inflation revenue requirements (greater than R1trillion), with ongoing calls for a 16% p.a. price increase.
- Its electricity and gas remains among the most expensive in world.

Even though Eskom had a R5 billion profit before tax in 2014/15, their debt is set to exceed R350mil over the course of the next five years (DA, 2016). Such indicators point to a SOE that is not sustainable as a business enterprise. It relies on national government funding and despite being South Africa's largest SOE, it does not contribute to its revenue base.

### 3.5.2: Transnet

Transnet is a fully government owned entity, operating as a united freight transport company, that was established around five core complementary units, consisting of freight rail, national ports authority, port terminals and pipelines plus rail engineering which are supported by different but interrelated projects (Transnet, 2011). Transnet helps to deliver over thousands of tons of goods per day all around South Africa (Transnet, 2011). The main goal of the entity is to dedicated freight transport entity, delivering goods safely, efficiently, reliably, at a cost-effective way to bring about economic growth to the nation (Transnet, 2011).

Principles of NPM are evident in Transnet. It has redefined its strategic intent so that it reflects an improved focus on the needs of their customers and clients. This aims to be more outcomes and output driven. Greater customer and client revenue reduces overall business cost, enabling the SOE to build more capacity, aid in safe operations as well as improve effectiveness and efficiency (Fourie, 2014). Transnet has also committed itself to the development of skills among its workforce, creating an organizational culture that emphasizes customer service. The adoption of NPM principles at Transnet:

- Facilitate trade development by increasing South Africa's competitiveness
- Development of skills
- Enable economic growth through expanding its infrastructure.
- Reduce business cost by transferring traffic load from road to rail.

According to Fourie (2014), Transnet's vision for growth is highly dependent on them maximizing the rail corridors working together with their customers and clients.

Transnet as an SOE, has to comply with the Companies Act and the PFMA, the Promotion of Administrative Justice Act and the Promotion to Access to Information Act. In addition, each of Transnet's subsidiaries is equally obliged to comply with national legislation as well as with sectoral regulations.

Transnet is implementing the guiding principles of corporate governance. The PFMA outlines the tasks and duties of the Transnet Board of Directors which serves as the SOE's accounting authority. For example, it conducts regular assessment of risk and submits its annual budget, as well as the annual conclusion of their Shareholder's Compact. The SOE also follows all processes



for quarterly reporting to the Executive Authority (the national Department of Public Enterprises) and the requirements for the composition and appointment of the Audit Committee.

Transnet appears to be heading in the right direction. It continues to implement reforms to improve outputs. For example, in 2003 Transnet designed a Four-point Turnaround strategy to achieve financial stability (Department of Public Enterprises, 2003). This turnaround strategy focused on reigniting investment, strengthening governance, disposing of non-core assets and Quantum Leap strategy to achieve operational stability

#### 3.5.4: General Overview of Performance of SA SOEs

It is usually argued that large SOEs tend to face lots of scrutiny and are pressured into providing better results mainly because of their level of strategic importance (Mbo and Adjasi, 2013). Kim and Chung (cited by Mbo and Adjasi, 2013) state that government pressure alone guide SOE performance in the positive direction (Mbo and Adjasi, 2013). When looking at the general status of SOEs in South Africa, the impression is that SOEs are not performing up to standard. In recent months, the South African government has been urged to sell some of the country's SOEs to improve the weak economy (EWN, 2016). Many of the country's commercial SOEs are dependent on government funding (EWN, 2016).

The influence of SOEs on socio economic development and poverty relief is mixed. Eskom made rapid progress with electrification in the 1990s, but that program has slackened. A third of South Africans still have no access to electricity. The national policy of 50 free kilowatt of electricity per month to indigent household is not fully implemented. In the telecommunications sector, Telkom has made little progress in expanding telephone and data services to rural and poor households, even though there is a dedicated Universal Service Fund (Eberhard, 2012). While on the other hand, private telecommunication providers have almost flooded the market (Eberhard, 2012). Even though Telkom and Transnet are making profits, these come from monopoly rents, which largely add to the cost of doing business in South Africa (Eberhard, 2012).

The Democratic Alliance (DA) political party identifies three problems of SOEs in South Africa: (i) the composition of their Boards; (ii) their non-commercialization; (iii) and widespread conflict of interest. The DA (2016) argues that the government shareholders on different SOE Boards are not comprised of members based on skills but based on political affiliation. The DA (2016)

contends that many SOE Boards have been captured by “political rent-seekers”. As a result, government shareholders on SOE Boards do not have the expertise to manage SOEs as commercial entities. Political appointees in SOE Boards consolidates a system of patronage across the operations of SOEs. Patronage is conducive to corruption. It was recently revealed that the Eskom Board awarded a R4billion tender to Areva, who according to the Supreme Court of Appeal (SCA) did not merit the tender, so it was revoked (DA, 2016). When government is the majority shareholder of SOEs, decisions taken are meant to be in the interest of the nation. However, patronage brings about a conflict of interest. When SOEs are nothing but structures of patronage, any proposed restructuring of SOE bears financial consequences for its patrons.

### 3.6: Conclusion

This chapter has shown that SOEs have been and can be important drivers for economic development in South Africa. The growth of SOEs in South Africa since 1994, was primarily motivated by the NDP mandate for state-led infrastructure investment and development. This chapter showed that the legislative and regulatory framework for SOEs in South Africa is broad and complex. SOEs in South Africa have adopted principles espoused by New Public Management and the principles of corporate governance are, at least in theory, prevalent in SOEs. However, adherence to these principles are questionable.

## CHAPTER 4: SOUTH AFRICAN AIRWAYS (SAA)

### 4.1: Introduction

This chapter presents an analysis of South African Airways (SAA). SAA is considered to be a large SOE in South Africa. It provides employment for over ten thousand people and is the leading airline on the African continent. However, SAA has faced ongoing critique as evident in numerous media reports. This chapter aims to identify and analyse these critiques. The chapter commences by providing a brief history of SAA, determining when the SOE was established. A brief analysis of SAA during the apartheid regime is presented in order to determine what, if any, consequences apartheid rule has had on the national airline.

The chapter presents a detailed discussion on the role and responsibilities of SAA as an SOE, and identifies the outcomes to date. In order to do this, this Chapter presents the legislative and regulatory framework of SAA. It identifies the applicability and relevance of the corporate governance. This Chapter also identifies the various governance structures of SAA and identifies the challenges of governance at SAA.

### 4.2: History of South African Airways

SAA, as the largest airline on the continent, is a vital SOE in South Africa. It is the leading carrier in Africa serving 20 destinations across the continent, as well as major destinations within South Africa, from its hub, Johannesburg. According to flySAA, it has identified its mission as: *delivering commercially sustainable world class air passenger and aviation services in South Africa, the African continent and to our tourism and trading partners* (FlySAA, no date).

SAA has identified five objectives. These are to:

1. Support South Africa's national developmental agenda.
2. Achieve and maintain commercial sustainability.
3. Provide excellent customer service.
4. Achieve consistent, efficient and effective operations.
5. Foster performance excellence. (SAA annual report, 2014)

#### 4.2.1: SAA Before Apartheid

Very little has been written on the history of SAA. Of interest is that SAA was not always a state-owned enterprise. In fact, SAA used to be privately owned by the Union Airways which was founded in 1929 in Port Elizabeth. The government granted Union Airways a license to fly airmail between Cape Town and other major centers within the country (saamuseum, 2001). Union Airways was nationalized by the South African government on the 1<sup>st</sup> of February 1934 and named South African Airways. It was managed by the then state-owned enterprise, the South African Railways and Harbors Administration (SARHA) (saamuseum, 2001). In the following year, the SARHA acquired South West African Airways, which provided weekly air-mail services from Windhoek (Namibia) and Kimberley. The airline moved their base of operations to the Rand Airport in Johannesburg, since this city was seen to become the country's hub for aviation (Spinner, 2016). Between 1940 and 1944 all commercial services were suspended as SAA became part of the military wing (www.southafrica.to). This was due to the upcoming World War II On the 24<sup>th</sup> of May 1940, SAA seized all their commercial operations and was used by the SA Airforce to supply reliable maritime patrol services as a part of war efforts (Spinner, 2016). The SA Airforce used all of SAA's 29 passenger aircrafts (Spinner, 2016).

#### 4.2.2: SAA During Apartheid

Since apartheid affected many parts in South Africa, it is important to discuss the history of SAA during this period (1946-1994). Pirie (1992) argues that aviation during the apartheid era was subjected to increasing political pressure due to the many apartheid protests occurring both locally and internationally. SAA was dealt a huge blow when most African states denied SAA the right to fly over their countries (Griffiths, 1989). African states were not the only countries that stopped SAA from landing in their states, during the 1980s, America and Australia also revoked SAA's landing rights. In addition, foreign countries refused their own airlines from traveling to South Africa (Pirie, 1992). Carriers such as Air Canada decided to close their representative offices in South Africa due to the sanctions being imposed upon South Africa. Griffiths identifies four basic airways sanctions that were put upon South Africa during apartheid which had an impact on SAA, these four basic sanctions stated that a state "may:

1. Refuse over-flying rights to any South African-based aircraft.
2. Refuse landing rights to any South African-based aircraft.

3. Prohibit its own airlines flying to and from South Africa.
4. Refuse landing and/or over-flying rights to any aircraft flying to and from South Africa” (Griffiths, 1989: 250).

The first two sanctions are said to have been covered in the UN’s Resolution 1771 of 1972, which stipulated that states that are members of the UN must deny passenger amenities and landing to any aircraft that belongs to the South African government as well as entities that are registered under the laws of South Africa (Lipton cited by Griffiths, 1989). While the third sanction was enforced by the Comprehensive Anti-Apartheid Act of 1986 by the United States, with the fourth not being endorsed by any state or international group, meaning that no one was adhering to it (Griffiths, 1989).

According to Griffiths (1989: 258) the sanctions applied by the European states had the most impact. Mainly because they had cut SAA off from traveling to and from Europe, resulting in a loss of revenue, including a decline in tourism. While the bans from other African states did not have as much of an impact as SAA, sanctions implemented by African states meant that SAA could not fly internationally because aircraft did not have the ability to fly direct, they had to stopover in African states to refuel. However, many of the Southern African states were afraid to impose sanctions mainly due to their reliance on South Africa for goods and services (Griffiths, 1989). Griffith further contends these sanctions did not have any direct impact on black South Africans but rather they had a greater impact on the white business community members who needed to travel internationally (Griffiths, 1989), since business owners could no longer travel easily. These sanctions did not have a negative bearing on the European countries. In fact, they benefitted from these sanctions as they became the primary international carriers (Griffiths, 1989).

#### 4.2.3: SAA Post- Apartheid

With the ending of apartheid in the early 1990s, sanctions were removed and SAA could fly worldwide again. However, the impacts of sanctions brought a number of challenges to the fore. SAA re-entered a global environment where new carriers had entered the market, as international aviation was revolutionized due to economic and political pressure in the economic world (Pirie, 1992). Pirie (1992) contents it became obvious that the aviation context had changed. The principle players in aviation had changed, mainly because of aggressive competition in the aviation

industry, resulting in an oligopolistic market as a result of the airline deregulations in Europe and America (Pirie, 1992).

SAA had to adapt. SAA brought about various shifts in its civil air transport patterns. For example, SAA's route network was extensively increased as more destinations were being created (Pirie, 1992). By 1991, SAA was travelling to eleven cities within Africa, as well as a further four islands in the Indian Ocean. SAA also had a number of African airlines flying to South Africa, such as Air Zaire, EgyptAir and Kenya Airways (Pirie, 1992). One must also note that apart from SAA increasing their destinations on the African continent, the abolishment of apartheid and the end of their sanctions allowed SAA to restart its economic activities across the globe. (Pirie, 1992). America allowed SAA to resume its trans-Atlantic schedule again to New York in November 1991, and in early January 1992 following a decision made after the Common Wealth meeting in Harare to drop the sanctions on SAA, they were finally allowed to commence their flight services on Australia (Pirie, 1992).

All this also rejuvenated tourism in South Africa. South African sports teams, which were also banned from playing worldwide were once again able to compete internationally. In November 1991, one of SAA's planes landed on Indian soil for the first time, carrying South Africa's national cricket team (Pirie, 1992). And apart from that just a few days' later South African performers were legally chartered to Moscow (Russia) to perform in the Moscow circus (Pirie, 1992). In other words, SAA once again enabled South African politicians, sportsmen and entertainers to travel freely.

In 1990, SAA became a subsidiary of Transnet which is 100% state-owned commercial enterprise. Transnet is in charge of all transportation entities within the state. In line with the NPM paradigm of the time, Transnet underwent extensive public sector reforms which included, for example, the outsourcing of certain functions. SAA, for example, entered into partnerships with privately owned SA Express and SA Airlink. These private companies helped train some of SAA's pilots (southafrica.to, 2016). There was talk of privatizing SAA, however this process was halted once the ANC replaced apartheid rule. (southafrica.to, 2016). The ANC was anti-privatization and its RDP called for the nationalization of all SOEs. It was against any form of privatization. In fact, its distrust of the private sector made it resistant to any of the public sector reforms proposed by the NPM principles.

However, SAA soon faced financial challenges. In its 1996-97 financial year, SAA incurred its first major loss of about R323million. This was ascribed to a spike in the fuel price and a devaluation of the Rand by 35%. Other factors contributing to this significant loss were accredited to a shortage of long haul aircraft as well as corruption (Andrews, 1998). Transnet had found itself in debt of R4million in 1998 largely because of SAA.

### 4.3: South African Airways as an SOE

Having discussed the background of SAA, it is vital to determine the rationale or reasoning behind SAA being established as an SOE in South Africa. SOEs in South Africa and in other states, are established for various reasons. A Report published by the Presidential Review committee on State-Owned Entities in 2012, identified four main types of SOEs which are: (i) commercial, (ii) developmental finance institutions, (iii) statutory corporations and (iv) non-commercial SOEs.

SAA is classified a commercial SOEs. As such it must be able to command market-related revenues plus able to sustain their bankable balance sheets. It must be able to create profits as well as replenish and maintain capacity at a market level while having freedom from unnecessary government intervention. As such, SAA is meant to enable people to fly people between major cities in South Africa as well as abroad. However, it should not result in the monopolization of the aviation industry at the cost of private entities. The danger of monopolization is that it removes competition. Competition results in lower prices as entities (public and private alike) search for customers. As an SOE, SAA should be able to provide cheaper alternatives for its citizens when it comes to flying, while providing exceptional services to its customers.

As per NPM, SOEs should be financially viable and customer-oriented. In this respect, SAA states in its mission that it aims to provide “*commercially sustainable world-class air passenger and aviation services in South Africa (flysaa, no date)*”. It claims to be customer focused insofar as it aims to meet the customers’ various needs by designing their interactions to best suit the customer’s needs (flysaa). It also claims to value accountability. It is committed to take responsibility for their actions, results and decisions of their teams and individuals bringing about clear goals and plans which are measured against the airlines performance objectives (flysaa, no date). SAA also identifies integrity as another vital value and claim to pursue this by ensuring practices remain at high standards in terms of ethical behavior in everything they do, “*as well as keeping up their high levels of credibility by making sure their words are matched by their actions*”

(flysaa, no date). Another core value identified by SAA is safety, where they seek to provide proper training to their staff in risk management and work practice to ensure a zero safety incidence by them going according to safety regulations always (flysaa, no date). SAA further claims to pursue excellence in performance. Accordingly, its goals are set at high standards to reinforce their reputation of keeping its performance of quality high as well as attaining high levels by ensuring that best practices are observed (flysaa, no date). Another vital core value of SAA is valuing their people, this is done, it claims, by making sure that their people are treated with dignity, fairness and respect, so as to ensure their development, well-being and satisfaction. (SAA website).

When it comes to their service vision, SAA identified two: (i) to become the most awarded airline when it comes to excellence in customer services out of Africa to the world and from the world to Africa (flysaa, no date); and (ii) to show the world the warmest African hospitality, every time and in every department.

According to SAAs 2014 Annual Report its objectives are: to deliver commercially sustainable world-class air passenger and aviation services in South Africa, the African Continent and South Africa's tourism and trading partners (SAA annual report, 2014).

#### 4.3.1: Subsidiaries of SAA

SAA has a number of subsidiaries. These are (i) Mango, (ii) SAA Technical, (iii) Air Chefs and (iv) SATC.

##### 4.3.1.1: *Mango*

Mango was launched in 2006 and is meant to run as an independent low-cost airline. Its Board comprises two executive members representing the SAA board and other non-executive members from independent organizations (SAA Annual Report, 2014). Only the SAA board members are entitled to make executive decisions. Mango also has to report to the Department of Public Enterprises.

Mango's mandate to: strategic dual-brand intent (Meaning that two different brands which are similar that compete are combined by the same company) within a highly competitive marketplace. Also the socio-commercial role that is required from a state-owned company (SAA Annual Report, 2014). Another of its mandates is to provide price-sensitive passenger and cargo service in trunk and high-density routes for local and international flights across Africa (SAA Annual Report, 2014).



Unlike SAA, Mango recorded profits in the 2014 calendar year, this was due to the results of focusing on yield management. It had an average yield rising from R712 to R823 (SAA Annual Report, 2014). Private airlines, such as Kulula and OneTime claim that the Mango airline is able to provide unprofitable prices because it is a state-owned entity. OneTime filed for bankruptcy in 2012. If more private airlines collapse, it will mean that SAA will become a monopoly and will have no incentive to keep its prices low.

#### *4.3.1.2: SAA Technical (SAAT)*

South African Airways Technical SOC Limited (SAAT) is the largest full-service Maintenance, repair, and operations (MRO) organization in Africa. It services a number of local and international airlines. Its Board is (like Mango) comprised of Executive Members representing the SAA Board, and other non-executive board members representing the various subsidiaries. (SAA Annual Report, 2014). SAAT employs over 3,000 employees. SAAT provides maintenance and support for SAA's fleet of aircraft as well as other airlines in Africa like Air Namibia, Air France and Air Mauritius. These customers provide SAAT with 15% of its revenue (SAA Annual Report, 2014).

SAAT outsources some of its activities (such as engine and component overhauls) while important day-to-day airline operations (like line and minor maintenance) are done by SAAT themselves. SAAT's strategic objective is to grow third party businesses exponentially from its current base of 85:15 percent split in favour of SAA as against other sources to a more balanced ratio of 65:35% (SAA Annual Report, 2014).

#### *4.3.1.3: Air Chefs*

Air Chefs (like Mango and SAAT) is fully owned by SAA. The main purpose of Air Chef is to produce and supply food and drinks to SAA and other airlines. It operates by preparing and cooking food, and providing drinks. It also is responsible for cleaning thereof, after the airlines return the equipment is taken, the trolleys and utensils are washed and prepared for the next flights (SAA Annual Report, 2014).

They have to abide by the ISO 22000 standards which are environmental international standards, while the food quality is controlled by the Hazard Analysis of Critical Control Points (HACCP).

#### *4.3.1.4: South African Travel Centre (SATC)*

The South African Travel Centre (SATC) is wholly owned by SAA. It is independently managed and operates travel management companies and agencies with a nationwide presence in South

Africa as well as in Botswana, Lesotho, Mozambique, Swaziland and Ghana. It has over 80 agency franchises, which are independently run, but accountable to the SATC Board (SAA Annual Report, 2014).

The SATC Board too has of Executive Members representing the SAA Board, and other non-executive board members representing the various subsidiaries, and two non-executive franchisee. This, claims SAA, enables industry-wide participation in decision-making. (SAA Annual Report, 2014).

What is clear from the above discussion on SAA's four main subsidiaries, is that executive authority reside ultimately resides with the SAA Board. While this is sound in principle, if there are any doubts about the integrity of the SAA Board, then this has ramifications for executive decisions taken at subsidiary level.

#### 4.4: SAA's Legislative Framework and Corporate Governance

##### 4.4.1: SAA's legislative and regulatory framework

SAA has to abide by a series of Acts. Some of these Acts pertain to the public sector in general (such as the Public Financial Management Act, Act 1 of 1999); and some Acts are sector specific (such as the Airports Company Act, Act 44 of 1993; the Air Services and Licensing Act, Act 115 of 1990; the Air Traffic and Navigation Services Company Act, Act 45 of 1993; the Carriage by Air Act, Act 17 of 1946; the Civil Aviation Act, Act 13 of 2007; the Convention on International Interests in Mobile Equipment Act, Act 4 of 2007; the International Air Services Act, Act 60 of 1993; the Shipping and Civil Aviation Laws Rationalisation Act, Act 28 of 1994; the South African Airways Act, Act 5 of 2007; the South African Civil Aviation Authority Act, Act 41 of 1998; the South African Maritime and Aeronautical Search and Rescue Act, Act 44 of 2002; and the Transport Advisory Council Abolition Act, Act 9 of 1996. Below is a summary of some of the main Acts which apply to SAA.

##### *4.4.1.1: The Public Finance Management Act, Act 1 of 1999*

The PFMA regulates the financial management of the public sector (including national, provincial and local government). The objective is to ensure that all the revenue, expenditure, assets and liabilities of government are managed efficiently and effectively. According to section 55 of the PFMA, the entity must: (i) keep full and proper records of the financial affairs of the public entity

and; (ii) must submit those financial statements within two months after the end of the financial year. This must be submitted to the auditors of the public entity for auditing and to the relevant treasury (Public Finance Management Act, 1999).

#### *4.4.1.2: The South African Airways Act, Act 5 of 2007*

The preamble of the Act states that:

- the Republic's rapidly developing economy requires reliable and extensive air transport capacity;
- the State desires to promote air links with the Republic's main business, trading and tourism markets within the African continent and internationally; and
- it is the national carrier and a strategic asset

As a state-owned enterprise, SAA must enable the State to preserve its ability to contribute to key domestic, intra-regional and international air linkages.

The Act facilitates key aspects of SAA, namely:

- the transfer of SAA shares and SAA interests from Transnet to the State;
- the conversion of South African Airways (Pty.) Ltd. into a public company with share capital; and
- the listing of SAA as a major public entity in Schedule 2 to the PFMA.

#### *4.4.1.1: The Companies Act, Act 71 of 2008*

According to Section 2, the purpose of the Companies Act is:

- *to provide for the incorporation, registration, organization and management of companies, the capitalization of profit companies, and the registration of offices of foreign companies carrying on business within the Republic;*
- *to define the relationships between companies and their respective shareholders or members and directors; to provide for equitable and efficient amalgamations, mergers and takeovers of companies; to provide for efficient rescue of financially distressed companies;*
- *to provide appropriate legal redress for investors and third parties with respect to companies; to establish a Companies and Intellectual Property Commission and a Takeover Regulation Panel to administer the requirements of the Act with respect to*

*companies, to establish a Companies Tribunal to facilitate alternative dispute resolution and to review decisions of the Commission;*

- *to establish a Financial Reporting Standards Council to advise on requirements for financial record-keeping and reporting by companies.*

Furthermore section 7 of the Act identifies the following purposes of a company:

- *to promote innovation and investment in the South African markets; promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law;*
- *to promote the development of the South African economy;*
- *to promote innovation and investment in the South African markets; and*
- *to continue to provide for the creation and use of companies, in a manner that enhances the economic welfare of South Africa as a partner within the global economy.*

Section 1 of the Act shows that the concept of the company is a means of achieving economic and social benefits. Such as; create optimum conditions for the aggregation of capital for productive purposes, and for the investment of that capital in enterprises and the spreading of economic risk; encourage the efficient and responsible management of companies. In addition, it provides a predictable and effective environment for the efficient regulation of companies; promotes the development of companies within all sectors of the economy, and encourages active participation in economic organisation, management and productivity; lastly provides for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders (The Companies Act, Act 71 of 2008).

Since SAA is a Schedule Two SOE, it has to abide by the objectives of the PFMA which is to secure transparency, accountability, and sound management of its revenue, expenditure, assets and liabilities. (Public Finance Management Act, 1999)

#### *4.4.1.4: The Airports Company Act, Act 44 of 1993*

This Act was put in place to provide for the transfer of certain assets and functions of the State to a public company to be established and for matters connected therewith (Airports Company Act, 1993). It ensure that companies know their objectives which are: the acquisition, establishment, development, provision, maintenance, management, control or operation of any airport, any part

of any airport or any facility or service at any airport normally related to the functioning of an airport (Airports Company Act, 1993).

*4.4.1.5: The Air Services and Licensing Act, Act 115 of 1990*

The Air Service and Licensing Act provides for the establishment of an Air Service Licensing Council; for the licensing and control of domestic air services; and for matters connected therewith (Air Services and Licensing Act, 1990). This Act applies only to the operation of a domestic air service. Subject to the provisions of this Act, no person shall operate an air service, unless it is operated under and in accordance with the terms and subject to the conditions of an air service licence issued to that person in terms of this Act (Air Services and Licensing Act, 1990). The Act states that the Licensing Council shall issue a licence in respect of the prescribed class of air service (Air Services and Licensing Act, 1990). According to Section 16 of the Act all representations, information, evidence and other documents relating to such application and at the disposal of the Council will then only be a licence to operate an aircraft be issued.

*4.4.1.6: The Air Traffic and Navigation Services Company Act, Act 45 of 1993*

This Act seeks to provide for the transfer of certain assets and functions of the State to a public company to be established and for matters connected therewith (Air Traffic and Navigation Services Company Act, 1993). The objects of the company according to the Act are the acquisition, establishment, development, provision, maintenance, management, control or operation of air navigation infrastructures, air traffic services or air navigation services (Air Traffic and Navigation Services Company Act, 1993). This Act regulates the transfer of functions and assets of a State to a company; the sale of expropriated land; the sale or closure of air navigation infrastructure or curtailment of air traffic service or air navigation service. The establishment of a public company will not happen without the signature of the Shareholding Minister of the entity which is the Minister of Treasury.

*4.4.1.7: The Carriage by Air Act, Act 17 of 1946*

The Carriage by Air Act gives effect to the Convention (Convention' means the Convention for the Unification of certain rules for International Camage by Air), for the unification of certain rules relating to international carriage by air. It also makes provision for applying the rules contained in the said Convention, subject to exceptions, adaptations and modifications by the airline which according to the Convention is not international carriage; and for matters incidental thereto (Carriage by Air Act, 1946). This Act states that the Governor-General may make regulations

prescribing the procedure to be followed by a carrier in connection with the payment, before action has been brought, of claims under Article seventeen of the Schedule to this Act, in respect of the death of any passenger, and all other matters which he considers necessary or expedient to prescribe in order that the purposes of this Act may be achieved (Carriage by Air Act, 1946). This Act according to Schedule 1 regulates the following:

- (i) Liability of the carrier and extent of compensation for damage
- (ii) Combined carriage
- (iii) Carriage by air performed by a person other than the contracting carrier
- (iv) Other provisions such as: (a) mandatory application, (b) insurance, (c) Carriage performed in extraordinary circumstances, and (d) definition of days.

#### *4.4.1.8: The Civil Aviation Act, Act 13 of 2007*

This Act was created to repeal, consolidate and amend the aviation laws giving effect to certain International Aviation Conventions:

- (i) to provide for the control and regulation of aviation within the Republic;
- (ii) to provide for the establishment of a South African Civil Aviation Authority with safety and security oversight functions, to provide for the establishment of an independent Aviation Safety Investigation Board in compliance with Annex 13 of the Chicago Convention, to give effect to certain provisions of the Convention on Offences and Certain other Acts Committed on Board Aircraft;
- (iii) to give effect to the Convention for the Suppression of Unlawful Seizure of Aircraft and the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation;
- (iv) to provide for the National Aviation Security Program;
- (v) to provide for additional measures directed at more effective control of the safety and security of aircraft, airports and the like; and
- (vi) to provide for matters connected thereto.

#### *4.4.1.9: The Convention on International Interests in Mobile Equipment Act, Act 4 of 2007*

This Act gives effect to the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment. It provides for the constitution and effects of an international interest in

certain categories of mobile equipment and associated rights. This Convention applies when, at the time of the conclusion of the agreement creating or providing for the international interest, the debtor is situated in a Contracting State (Convention on International Interests in Mobile Equipment Act, 2007). These protocols and conventions are made clear in schedule one and two in the Act.

#### *4.4.1.10: The International Air Services Act, Act 60 of 1993*

Since SAA does international flights, it must comply with international regulations such as the International Air Services Act. This Act provides for the establishment of an international air services council; for the regulation and control of international air services. The Act ensures there is a promotion of trade with, and tourism to and from, the Republic. It also promotes competition between persons who operate international air services. The Act must also ensure the promotion of high standards of safety in the operation of international air services as well as promote the development and interests of the local international air services industry, including promoting the interests and needs of users or potential users of air services with the Republic.

#### 4.4.2: The Governance of SAA

As an SOE, SAA needs to abide by the legislative framework as identified above, and must comply with the expectations of governance in a democratic South Africa. This includes principles of good governance and corporate governance.

##### *4.4.2.1: SAA and Corporate Governance*

According to SAAs 2014 Annual Report, SAA's Board consists of nine non-executive directors and two executive directors. The non-executive directors and the chairperson of the board, are all appointed by SAA shareholders which is the State (SAA annual report, 2014). The composition of the board should reflect a diversity of public interests, each with the necessary experience and expertise (SAA annual report, 2014). SAA 2014 Annual Report shows that management, shareholders, the Board as well as other stakeholders need to co-operate in order for SAA to have effective corporate governance.

The King III Report on Corporate Governance for South Africa expects SAA to establish and ensure:

- ethical leadership and corporate citizenship;
- Boards and directors;
- audit committees;

- the governance of risk;
- the governance of information technology;
- compliance with laws, rules, codes and standards;
- internal audits;
- governing stakeholder relationships; and
- integrated reporting and disclosure.

The 2014 SAA Annual Report states that the Board is responsible to ensure compliance with SAA's Company's Memorandum of Incorporation; the Board Charter as well as all of the other Acts which regulate the operations of SAA. The Board is also responsible for the approval and review of the annual budget, the corporate plan and the strategic direction of SAA and each of its subsidiaries. The Board are tasked with the dispensing of all major fiscal expenditure, approving detailed budgets and tracking the performance of the SAA and its subsidiaries against SAA's fiscal objectives. Furthermore, the SAA Board is tasked with ensuring that SAA complies with the policy requirements stipulated by the National Treasury as they emerge.

#### 4.5: Analysis of SAA

The previous discussion presented the theoretical expectations and obligations of SAA as a SOE, and SAA's Board as the custodian of good and corporate governance. This study recognises that there are some extenuating factors that can hinder the ability of SAA to meet its expectation such as the fluctuating value of the Rand, often being weak against other foreign currencies. This impacts on their operational costs such as, for example, the increasing costs of petrol. SAA operates in a highly competitive field in aviation. Nevertheless, that is the environment in which SOEs operate. SAA must develop a well-defined long-term strategy in order to help curb these issues. One such strategy is its Long Term Turnaround Strategy.

There are five strategic pillars which forms the foundation for assessing SAA's performance. These pillars are:

1. to achieve and maintain commercial sustainability;
2. to support South Africa's National Developmental Agenda (NDA);
3. to achieve consistent, efficient and effective operations;
4. to foster performance excellence; and
5. to provide excellent customer service.



The extent to which it is meeting these is questionable.

One has to note that despite its contextual challenges, SAA has achieved in certain areas. SAA won the “Best Airline Based in Africa” award three times (in 2008, 2013 and again in 2014) (SouthAfrica.to, 2016). Furthermore they have achieved other awards such as in 2012, SAA won the best airline award in Africa. In 2013, SAA was awarded a 4-star rating and was voted the 11<sup>th</sup> best airline in the world, and won the award for being on time in the Middle East and Africa (SouthAfrica.to, 2016). It was also awarded the Best African Long-Haul Airline; best African short-haul airline; best business class and best business class lounge (SouthAfrica.to, 2016). In 2015, SAA it was one of two airlines in the world to get Stage 2 of the IATA Environmental Assessment program (IEnvA) (SouthAfrica.to, 2016). One can conclude that SAA is able to meet the last two pillars of its strategic plan, namely: to foster performance excellence; and to provide excellent customer services. However, it is failing the first two of its strategic pillars, namely: to achieve and maintain commercial sustainability; and to support South Africa’s National Developmental Agenda (NDA);

SAA is clearly in trouble when it comes to their commercial sustainability. SAA’s losses for the 2014/15 financial year were R5.6-billion, which was a R1-billion more than anticipated. (Mail and Guardian, 2016). In September 2016, the Daily Maverick claimed that financial losses have become an every year occurrence for SAA.

1990, SAA was part of Transnet (a 100% state-owned SOE) (southafrica.to, 2016). This was seen by many as a possible move for a way for SAA to later be privatized at some point. But due to the change in political system this failed as the then new government, brought about new policies and strategies which was thought could have helped SAA, reach its potential. However this was not the case as in the 1996-97 year SAA incurred its first major loss of about R 323 million (Hilka and Srodes, 1998).

On the 31<sup>st</sup> of March 2006, Transnet had reached an agreement to sale its share of SAA to the Department of Public Enterprises. This was in a bid to make Transnet financially sustainable. SAA was categorised as a Schedule 2 public entity in accordance with the Public Finance Management Act. At the end of 2014, because of the dire state of many of South Africa’s SOEs, the administrative powers of SOEs such as SAA were changed from the Minister of Public Enterprises to the Minister of Finance. (Ministry of Finance, 2014). However, since then SAA has

yet to produce an annual report. Its financial losses incurred in the 2015-2016 financial year were only reported in mid-September 2016. One could argue that the SAA Board has neglected its corporate governance requirements.

SOEs were criticised for their underperformance in the President's 2016 State of the Nation Address. SAA has been at the forefront of criticism.

In 2010 SAA shareholders called for an investigation of the regarding various allegations levered at the SOEs former Chief Executive, Dr K Ngqula. The findings revealed corruption within SAA (southafrica.to, 2010). The investigation identified a lack of transparency. Camerer (2007) contends that corruption thrives when the principles of good and corporate governance are neglected.

SAA has not kept up with developments in the area of aviation, resulting in the inefficient and infective use of state resources. According to the then acting SAA CEO, Musa Zwane (Enca, 2015), one of the main reason the fuel price is such a problem for SAA is that many of its aircraft are old and fuel-inefficient. Osborne and Gaebler (1993) and contend that SOEs need to keep up with development in their sector. The NPM paradigm calls for SOEs to be more pro-active, like their private sector counterparts and be more innovative. (Osborne and Gaebler, 1993). Given the weak value of the Rand, issues such as an ageing fleet, an uncoordinated state approach, legacy transactions and high funding costs become even more difficult to redress. SAA has limited resources so the pressure to use them efficiently is even higher.

When it comes to the actions of the SAA's Board, the extent to which it is able to manage the five strategic pillar in line with corporate governance principles, is limited. The SOE should have the skills to leverage strategic planning process. It should focus on the sustainability of its business; and it should minimize negative impacts. However, the SAA Board has been unable to improve its financial crisis. It is commercially unsustainable and relies primarily on government bailouts.

Furthermore it is evident that their strategic planning process could be flawed in either the process or implementation stage. Also this principle focuses on four values of good governance being responsibilities, accountability, fairness and transparency, which all appear to be lacking, firstly when looking at responsibility, rather than board members of SAA taking responsibility for the crisis, they are blaming each other to the point where by some of the members were either fired,

or decided to resign their posts. Accountability and transparency go hand in hand, this aspect is also lacking when looking at SAA, and this is evident with the fact that no one is being held accountable for the current financial crisis, and with transparency, as stated earlier on, SAA has not taken or produced an annual report since 2014.

Members of the SAA Board have been accused of pursuing their own personal business interest at the cost of the SOE. There has also been limited disclosure, transparency and accountability of decisions made. This is evident in the case of its previous CEO, Coleman Andrews, who earned more than R22million for the 20 months he was at SAA. The justification was that the SOE made a profit of R350 million during his tenure (Vermeulen and Williams, 2001). It was later revealed that this figure was misguided because the profit was not due to its general operations but because of SAA's once off sale of aircrafts (Vermeulen and Williams, 2001).

The establishment of audit committees is a key corporate governance in the King III Report. It requires that every company must have an audit committee which has the duty of overseeing the financial process, integrated reporting, internal and external audit, ensuring combined assurance model is applied, risk management goes accordingly, that board and shareholders get the required information on time, review financial information as well as think about the needed technology to be used to better audit coverage (King III Report, 2009). According to SAA's 2014 Annual Report, SAA does appear to comply. It has an in-house internal audit function committee known as the South African Airways Internal Audit (SAAIA). It must report on SAA's internal controls, efficiencies, governance, effectiveness as well as performance in line with the SOE's strategic objectives. Furthermore this Auditing Committee is tasked with developing internal information technology and audit skills capacity. It must increase the audit focus on the SOE's strategic risks, and analyse cross-cutting root causes so that it can present valid findings.

The governance of risk has been identified as a key principle of the King III Report. It requires that the SOE has a risk management framework in place in order to guide its risk strategy, risk policy, risk plan, risk management processes as well as risk management systems. SAA's 2014 Annual Report states: "SAA recognises that risk in commercial aviation is complex and diverse, with many parts of the organisation working toward managing the risk exposures" (SAA annual report, 2014: 40). However, this is not the case as seen in a newspaper article written by Skiti and Hofstatter (2016) which quotes "Hong Kong threat to block broke SAA", this shows that they

clearly do not have an adequate risk management system that can come into places without SAA having to always fall back on government bailing them out. Furthermore MacDonald shows that SAA has suffered from strong international and domestic competition which has had a significant impact on its financial position. As mentioned earlier, the granting of excessive bonuses to management points to the contrary. Its lack of innovative decision-making also makes the SOE less competitive and commercial viable compared to other airlines.

#### 4.6: Conclusion

Chapter four provided a description of SAA as an SOE and identified some of its core responsibilities. It also identified some of the governance challenges. In order to contextualise the challenges, a brief description was provided on the SAA's background from before apartheid to post-apartheid. This chapter has identified that SAA was created as an SOE mainly to try and stop the monopolization of other airlines within the country as well as to make flights within the country more affordable to its citizens. This chapter argues that corporate governance is important and that the Board at SAA is ultimately responsible for complying with corporate governance principles. The chapter has also shown that the SOE is not a viable commercial SOE given that it relies predominantly on government bailouts to fund its day-to-day operations.

## Chapter 5: FINAL ANALYSIS AND CONCLUDING REMARKS

### 5.1: Introduction

This chapter returns to the theoretical discussion on SOEs. The objective is to consider how SAA compares to the literature on SOEs. This chapter revisits Table 2.1, which set out some of the defining characteristics of the different types of SOEs. This study will draw up its own Table (Table 5.1) in order to summarize some of this study's key findings.

### 5.2: Analysis of Findings

Table 5.1: different types of SOEs

	Family-Owned or Privately Held		Private Equity	State-Owned		Widely-Held
<b>Ownership Structure (Principals)</b>	Single or dominant ownership by individual or family		Owned by a small number of private and institutional investors	Owned by a state agency in whole or in part on behalf of society		Many dispersed shareholders, including institutional investors
<b>Traded</b>	No	Yes	Rarely	No	Yes	Yes
<b>Goals of Principals</b>	Family or individual interests	Family or individual interests	Return to Investors	Mixed goals including social benefits, commercial benefits	Mixed goals including social benefits, commercial benefits	Shareholder interests
<b>Principal/Agent Problem</b>	Hired managers may not share family goals	Hired managers may not share family goals; minority shareholders not protected	Supposedly aligned	Managers may not share or understand social goals; political goals may compromise social goals; conflict between social and commercial goals	Managers may not share or understand social goals; political goals may compromise social goals; conflict between social and commercial goals; minority shareholders not protected	Managers may take advantage of dispersed holdings to pursue individual goals (size, perks)
<b>Governance Structure</b>						
<b>Monitoring by Principals</b>	Strong incentives	Strong incentives	Strong incentives	Delegated, incentives ambiguous	Delegated, incentives ambiguous	Weak incentives
<b>Financial Stakeholders</b>	Debt holders	Investors	Debt holders	State banks/ institutions	State and other institutions	Institutional investors
<b>Boards</b>	Limited outsiders	Some outsiders	Internal Board	Internal and political	Internal, external and political	Strong outsiders
<b>Take-overs</b>	Limited	Limited	Not relevant	Not relevant	Somewhat relevant	Highly relevant
<b>Bankruptcy</b>	Relevant	Relevant	Relevant	Not relevant	Somewhat relevant	Highly relevant
<b>Transparency</b>	Limited	Required	Limited	Limited	Required	Required

*Table 5.2: SAA as a State-Owned Enterprise*

	State-Owned		SAA
<b>I. Ownership structure (Principals)</b>	Owned by a state agency in whole or part on behalf of the society		100% state owned
<b>II. Traded</b>	No	Yes	No
<b>III. Goals of principals</b>	Mixed goals including: social benefits, commercial benefits	Mixed goals including: social benefits, commercial benefits	Mixed goals including: Social and economic
<b>IV. Principals/ agent problem</b>	Managers may not share or understand social goals; political goals; political goals may compromise social goals; conflict between social and commercial goals	Managers may not share or understand social goals; political goals may compromise social goals; conflict between social and commercial goals; minority shareholders not protected	Managers may take advantage of dispersed holdings to pursue individual goals
<b>V. Governance structure</b>			
<b>Monitoring by principals</b>	Delegated incentives ambiguous	Delegated incentives ambiguous	Weak incentives
<b>Financial stakeholders</b>	State banks/institutions	State and other institutions	State and other institutions
<b>Boards/corporate</b>	Internal and political	Internal, external and political	Nine Non-executive directors, two executive directors
<b>Take-overs</b>	Not relevant	Somewhat relevant	Not relevant
<b>Bankruptcy</b>	Not relevant	Somewhat relevant	Somewhat relevant
<b>Transparency/ good governance</b>	Limited	Required	Limited

The table above gives an indication of theory vs practical in the case of SAA. When one looks at the goals of principals which can be also known as the purposes both theory and SAA, share similar purposes as they both focus on social benefits which is job creation and affordable flights. Not only that because since SAA is a commercial entity is also seeks to gain profits, however when looking at the Annual Report of 2014 and newspaper articles it is clear that SAA, has been running at a loss.

Table 5.2 above identifies SAA as a state-owned enterprise based on some of the key characteristic identified in this study. The section below provides a fuller description of these characteristics.

- **Ownership and Structure**

This study found that the state is the sole owner of SAA. When a commercial SOE is wholly owned by the State like in the case of SAA, the appointment of Board members is the outcome of political power. In the case of SAA, outside stakeholders do not have any executive powers, meaning that they cannot make any executive decisions, their influence is therefore negligent.

The DA (2016) contends that the SAA board has had a history of what they called “merry-go-round enactment” whereby executive members of its Board serve political agendas and not the SOE’s commercial and social obligation. The DA questions her independence because of her rumored personal relationship with President Zuma, as well as her position as Head of the Jacob Zuma Foundation (DA, 2016).

- **Traded**

SAA is not listed on the stock exchange so it is not affected by trading.

- **Goals of Principals**

The Table above gives an indication of theory vs practice with specific reference to SAA. When one looks at the goals of principals (which refers to the objectives of SAA) these are both social and economic. The Annual Report of SAA is clear about its social and commercial goals. It reflects that it has to contribute to the NDP as well as being a commercially viable SOE. When looking at its social goals, one of SAA’s policy requirements is to contribute to Black Economic Empowerment (BEE). This study has found that BEE has been forthcoming through SAAs

various subsidiaries. Preference is given to qualified black suppliers as well as black-owned SMME suppliers. This was an attempt of SAA to get private funding from banks by saying 51% or more, it would make the bank look good for BEE. However, the Treasury does not want SAA to get private loans. Mainly because if they default on their loans, it becomes Treasury's problem because Treasury is ultimately responsible for SAA's debts.

- **Principal/Agent Problem**

The literature on commercial SOEs explains that a common problem among state principals/agents is that there is confusion between the SOEs social, political and economic goals. An SOE may meet its social/political goals (like being a substantial employer), but may be oblivious that it serves an economic purpose (in other words, it needs to generate revenue). Managers at SOEs may not share this view. The case of SAA is similar. It prides itself in having been awarded as best airline on the continent, and its ability to provide customer satisfaction. However, it does not seem to dedicate itself to become commercially viable.

- **Governance Structure**

Based on Table 5.1 above structures of governance relates to: how principals are monitored; the role of its financial stakeholders (whether these stakeholders are public and/or private); the composition of the Boards; the risk of takeover; the danger of bankruptcy; and the extent of transparency. This study found that there was little evidence of how principals are monitored. There is scant provision in SAA's Annual Report on the different functions of principals but not how they are being monitored. SAA only has public financial stakeholders. This means that financial efficiency is only motivated by pressure exerted by government. This chapter has already pointed out the dangers/consequences of the current composition of SAA's Board. However, it is worth reiterating that this is a serious governance problem. When the Board's chairperson and executive directors are appointed by the political executive, the governance of the SOE can get compromised. SAA's Board is appointed by the Minister of Finance, as the Executive Authority for SAA, in consultation with Cabinet, whereby a list is handed to cabinet by the Minister of Finance to a sitting of cabinet which is chaired by the President. However it is crucial to note that even though the Minister of Finance comes up with a list of possible board members, that list has



to get approved by the President. According to the principles of good and corporate governance, the Chairperson of the Board is responsible for the governance of the SOE. However, such an individual may become susceptible to political influences. Accountability, in such circumstances, are directed to the individual who appointed the chairperson. In the case of SAA, the media has been highly critical of its existing Chairperson (Myeni), accusing her of making executive decisions that are beneficial to the political elite at the costs of SAA's financial viability.

This study argues that since SAA is a fully-owned SOE, the risk of takeover and the danger of bankruptcy was not seen as being relevant to the Board of SAA. However, this study has found that SAA's failure to present its financial statements is indicative of its failure to be transparent.

### 5.3: CONCLUSION AND RECOMMENDATIONS

In the conceptual framework of this mini-dissertation, it was noted that SOEs were set-up to aid in the provision of services by the government. Also SOEs are meant to provide effective and efficient goods and services, while also generating revenue so that it can reinvest this capital in the SOE enabling it to develop its infrastructure. SAA has failed to submit financial statements to the National Treasury for the last three years. The latest figures are in Table 6.1 below. The Table shows the ever-increasing debt incurred by SAA. R2.5 billion by 2014

Table 5.2: SAA Revenue 2003-2014.

SAA (in millions)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>Revenue</b>	17342	16339	17402	19264	20652	22511	26829	22462	22608	23 861	27098	30266
<b>Energy</b>	3255	2820	3257	4933	5740	6685	8601	5148	6086	8302	9579	11108
<b>Energy Cost as a % of Operating Cost</b>	19%	18%	20%	26%	27%	28%	35%	25%	28%	33%	35%	36%
<b>Employment Costs</b>	2888	3084	3459	3282	3382	3298	3582	4095	4417	4711	4848	5257
<b>Employee Cost as a % of Operating Cost</b>	17%	19%	21%	18%	16%	14%	15%	20%	20%	19%	18%	17%
<b>Net Profit/Loss</b>	-5977	-8610	966	65	-883	-1085	398	581	779	-843	-1170	-2538

Sources: Clipped Wings - The case for the sale of SAA

A commercial SOE is a public entity that has the following characteristics:

- 1) Commands market-related revenues;
- 2) Has a balance sheet capability;
- 3) Has ability to post surplus or profit;

4) Maintains and replenishes market capitalization autonomously from the State.

However, this study concludes that SAA does not share such characteristics. It is not able to command market related revenues, neither has it been able to prepare a balance sheet in the last two years. As Table 5.2 above shows, it has not been able to generate profits. On the contrary, the Treasury has, to date, bailed them out to the value of R4.7billion. SAA has not generated any revenue in the last couple of years making it impossible for it to invest autonomously from the State.

### 5.3.1: Recommendations

This study proposes a number of recommendations relevant to SAA based on some of the findings of this study as well as the Report of the Presidential Review Commission.

As proposed by the PRC (2013):

The Government should develop an overarching, long-term strategy for SOEs. This should be aligned to the objectives of the NDP. This study identified the need for a consolidated legislative framework.

The government should enact a single overarching law (such as a ‘State Owned Entities Act’) governing all State Owned Entities. The act should supersede all current legislation governing SOEs, reduce the current burden of compliance with multiple laws and regulations; and include all subsidiaries of SOEs.

As recommended by the PRC, government should develop a framework for the appointment of Board members and the SOE’s CEO. The PRC argued that appointments should be done by the relevant Minister in concurrence with Cabinet, at the recommendation of the Board. This study proposes that the appointment process needs to be even more public and transparent. It could follow the same vetting as is the case in the appointment of the Public Protector.

The PRC recommends that government should undertake a process of identifying policy inconsistencies and policy conflicts; clarify the role of economic regulators; and develop a blueprint to guide regulatory designs. This study has shown the relevance of this recommendation based on the extensive legislative framework that regulates SAA.

In line with New Public Management thinking, government should develop a common performance management system, which will serve as a benchmark of how SOEs need to perform in terms of their rationale. In addition, a lack of performance should result in accountability.

This study supports the call for sanctions for corrupt activities as well as fronting and that this should be supplemented by a register of delinquent individuals and companies that are involved in corruption practices. The common register should be made available to all SOEs.

Government should develop a consolidated funding model for commercial SOEs and DFIs.

As recommended by the OECD in line with governance, government should develop and issue an ownership policy that defines the overall objectives and rationale for state ownership and the state's role in the governance of SOEs, the policy should be backed by credible implementation mechanisms.

Since SAA is a commercial enterprise, according to OECD'S recommendation on commercial SOEs, SAA should operate according to objectives that are, to the largest feasible, consistent with private sector best practices.

OECD recommends that government should not be involved in the day-to-day management of SOEs. It should allow companies (SAA) full autonomy to achieve their defined objectives. However the state should exercise its ownership rights according to the legal structure, including:

Being involved in board nomination processes, while ensuring that board objectives and independence are maintained.

Where the state owner has specific objectives for SOEs, these should be transparently communicated to the entire board via appropriate channels.

Establishing adequate procedures for monitoring and assessing SOE performance.

### 5.3.2: Conclusion

This study has explored SOEs in depth. It has provided an introductory chapter that gave a background to the study, highlighting the objectives and research questions. The objective of this study was to examine the governance issues facing SAA as the leading carrier in Africa. The study before going deep into SAA had to establish the conceptual framework which it was going to be underpinned by. These being New Public Management, good governance and corporate

governance. After examining these concepts the study went on to focus on SOEs in South Africa, showing the two schedules that SOEs fall under.

SAA, in theory can seem to be abiding by the principals of good governance and King III principals. However when going deeper it was noticeable that this was not the case. SAA according to the study has failed to live up to its mandate as a commercial SOE, as it keeps landing itself into financial debt. However this report with the use of other readings has provided recommendations that can assist it when it comes to the issues it faces with governance and corporate governance as discussed in this chapter.

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