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Anton Eberhard and Grové Steyn: Public enterprises

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SA's major infrastructure industries in electricity, transport and telecommunications are dominated by state-owned enterprises. Few would express satisfaction with the prices, reliability and quality of these infrastructure services. What can be done to improve performance and to position these sectors to contribute more effectively to economic growth and development?

Electricity prices will double in three years and the risk of further blackouts in the medium term is real. Improvements in rail and port costs and efficiencies are urgently required to boost trade and improve macroeconomic indicators. And the costs and limitations of information and communication technologies such as broadband frustrate businesses and households alike.

Much of the focus in recent months has been on the contest around leadership and management of state-owned enterprises. These are billion-rand industries and large employers; it is not surprising to find contestation around political patronage, procurement practices and economic empowerment. However, there are more fundamental challenges, to do with how these enterprises are governed and how they can be positioned to serve their customers and the South African economy more effectively.

Some have suggested Eskom and Transnet should no longer function as corporate companies with independent boards, but should be folded back into their line ministries with more direct control by ministers and their senior bureaucrats.

There is little international evidence such an approach would reap benefits. The opposite is more likely: nontransparent interventions in staffing and procurement practices will be easier, political pressures will result in noneconomic price levels, rates of return will fall below the cost of capital, assets will not be able to be maintained or refurbished, and there will be inadequate investment resources for system expansion with the inevitable consequence of a deterioration in infrastructure services. These circumstances are unlikely to attract the top-notch executives needed to run these organisations.

There are good reasons state-owned enterprises such as Eskom and Transnet are corporatised entities and report to the Department of Public Enterprises rather than energy or transport.

The respective roles of these two government departments gives rise to a healthy tension: promoting financial sustainability of utilities while protecting consumers. Confusing these roles, or sublimating either, is potentially disastrous. When state-owned infrastructure companies fall within one sector ministry, the likelihood of running down assets to meet short-term political pressures becomes dangerously more likely.

What this discussion points to is the need for a deeper understanding of, and consensus on, how roles and responsibilities should be clarified, delegated and co-ordinated. The roles of the government as shareholder, policy maker and regulator need to be clearly distinguished.

In managing its role as shareholder, corporatisation is an obvious choice. The government as owner appoints a board that oversees the management of the utility and the hiring and firing of executives. As Public Enterprises Minister Barbara Hogan affirmed in her recent budget speech, the government should not interfere directly in the management of state-owned enterprises. Its focus is rather on desired outcomes, specified in general sector policy statements (legislation and white papers) and performance contracts with specific financial and technical criteria.

Hogan's deputy, Enoch Godongwana, argues, rightly in our view, that the overall governance framework for state-owned enterprises in SA is broadly acceptable. The Public Finance Management Act provides for a number of checks and balances. Utilities are subject to the Companies Act, and international reporting and accounting standards apply. Performance contracts are in place. Commercial imperatives for managers are mostly not confused with social objectives, as funding for the latter generally takes the form of separate and transparent fiscal flows.

However, the application of this general governance framework is less than perfect. The appointment of CEOs (and sometimes even senior executives) is often still subject to political approval and boards are not exercising sufficient leadership in dealing with ineffective managers. Performance contracts are often poorly drafted, incomplete and not effectively monitored. A classic case was that of Eskom, where short-term financial performance measures trumped the requirement to keep the lights on, while longer-term sustainability indicators were ignored.

Performance contracts have inherent difficulties. There are the classic principal- agent, information asymmetry and moral hazard problems. Managers enjoy an information advantage over owners and can negotiate targets that are hard for outsiders to evaluate or easy for utilities to achieve. Incentives and penalties may not be credible or sufficient. And political owners may not always be committed to financial viability or improved efficiencies when faced with short- term constituency demands, especially when elections are pending.

This is not to say performance contracts are useless; but we do need to build on international experience in designing them more effectively. Governments and regulators need to deal purposefully with the challenges of information asymmetry, smart incentives and credible commitments. Effective supervisory and monitoring units in the ministry, and empowered regulators, can strengthen the government's oversight of utilities.

Clarification of roles and responsibilities is clearly important but further governance reforms are needed. Harvard academic Jose Gomez-Ibanez refers to these as changing the political economy of state-owned utilities, meaning permanently altering the political forces around utilities by strengthening the role of stakeholders with an interest in improved performance.

An obvious first step is to empower stakeholders by improving information and transparency. Timely publication of comprehensive annual reports and financial statements is an obvious requirement. The government should also make available performance contracts and actual measures achieved. Benchmarking and customer surveys should be published so consumers are better able to hold service providers to account.

But better information alone will not guarantee action to improve performance; there are often obstacles to effective collective action. An additional intervention is the promotion of mixed-capital enterprises.

The state may still choose to hold a controlling shareholding, but it could encourage state-owned enterprises to sell debt to private investors. Bondholders typically insist on debt covenants and, supported by credit rating agencies, keep a close watch on the performance of utilities. SA's large infrastructure state-owned enterprises already make extensive use of private capital markets.

The governance of SA's state-owned enterprises is being reviewed. Key areas that will need attention are clarifying roles and responsibilities, smarter performance contracts, more effective monitoring and regulation, more transparent and relevant information, and fostering mixed-capital enterprises in a way that strengthens stakeholders with an interest in improved performance.

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