DEPARTMENT OF PUBLIC ENTERPRISES STRATEGIC PLAN

2015/16 – 2018/19

public enterprises
Department:
Public Enterprises
REPUBLIC OF SOUTH AFRICA

DPE

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Foreword by the Minister

Ms Lynne Brown, MP

Five-year plans are all about giving players in the economy certainty about how Government intends to act. This allows them to anticipate and take advantage of opportunity and to develop or adjust their plans to benefit from a predictable Government environment.

South Africa's National Development Plan [NDP] is the comprehensive foundation upon which all Government planning is based.

The Medium-Term Strategic Framework [MTSF] is the immediate all-Government 5-year plan through which each successive Administration gives practical effect to bite-sized building blocks of the larger 15-year NDP.

All Government Departments and public entities are assigned roles within the MTSF. This plan, therefore, translates the policies, strategies and programmatic activities contained in the NDP and the MTSF of this Fifth Democratic Administration into the work of the Department and, in this way, into the plans and achievements of Eskom, Transnet, Denel, South African Express, Alexkor and SAFCOL, the six State owned Companies [SOCs] in the Public Enterprises Portfolio.

Through this plan, the Department will support me, as the designated Shareholder Representative, to effect custodial oversight over these SOCs.

Given the diversity of the SOCs in the Public Enterprises Portfolio, this is not a simple mandate and it is becoming more complex given that the performance of the SOCs has been uneven and, in some cases, below expectation.
Among the huge challenges facing SOCs which this plan sets out to address are financial sustainability, commercial viability and the need to accelerate the delivery of capital projects.

Expressed in different terms, this plan seeks to assist the SOCs to become drivers of radical economic transformation by being highly effective delivery instruments of the national industrial strategy.

In this light, through this plan, the Department is expressing its confidence that after five years it will have assisted the SOCs to:

- Accelerate economic growth along an inclusive and sustainable path;
- Ensure higher levels of employment creation and decent work;
- Reduce inequality substantially; and
- Ensure meaningful black participation in the ownership, control and management of the economy.

I am confident that the Department has understood the challenge and has produced a 5-year Strategic Plan, which will shift the trajectory of the SOCs significantly in a positive direction.

Ms Lynne Brown, MP

Minister

Report by the Acting Director-General

Ms Matsietsi Mokholo

The South African economy has been on the back foot since 2008. Economic growth over the past five years (2009 – 2014) has been significantly lower when compared to the preceding five years (2004 – 2008). This has largely been as a result of the slow recovery in the global economy. While the economy experienced positive annual growth since 2009, this has been substantially lower than the targeted 5 percent.

The current projections shows that the economy will be growing below 3 percent during the first 3 years of the current medium term strategic framework period and will only reach 3 percent by 2017. The current economic performance indicates that the structural challenges identified in the National Development Plan such as infrastructure deficit, skills development, regulatory uncertainty are likely to remain unless extra-ordinary interventions are implemented to significantly change the current economic outlook. Therefore, great emphasis on the delivery of the build programme is essential.

It is clear that the Medium Term Strategic Framework (MTSF) 2014 – 2019 will be implemented in a significantly constrained economic environment. This will make the achievement of the objectives defined in the MTSF even more difficult. This will require the strengthening of the execution capacity within the Department and in government in general. New execution arrangements are necessary as the resource constraints are likely to remain during the current MTSF period.

The new Strategy of the Department is intended to ensure that the current state owned companies' performance is significantly improved to ensure that they contribute to the critical developmental outcomes. This will require the Department to

implement initiatives that will ensure the financial sustainability of the SOCs and eventually eliminate huge dependency in the fiscus. The repositioning of the state owned companies and improving the current state owned companies' architecture is central to the successful execution of the strategy.

New funding arrangements that will unlock private sector investments to augment the capacity of the SOCs, without diminishing the realisation of the developmental outcomes, will be explored. Increasing the current investment levels to 25 percent of the GDP cannot be carried by wholly the balance sheet of the SOC and/or the fiscus and thus necessitates a partnership between the SOCs and the private sector to drive the current investment programme.

This is crucial to:

- Firstly, increase the capacity of the economy to grow and address the current infrastructure deficit;
- Secondly, create the demand in the short term for the supplier industries; and
- Thirdly, develop new industrial capabilities that will support the competitiveness of the industrial or productive sectors linked to the delivery of infrastructure projects.

The new Strategy will also require a significant re-organisation of the Department. This re-organisation of the Department will be focused on building the delivery capacity within the current legislative framework. This will include forming strategic partnerships with learning and the business sector to boost the current capacity of the Department.

Ms Matsietsi Mokholo

Acting Director General

Executive Summary

Ms Matsietsi Mokholo

South Africa is regarded as a developmental state and needs to place emphasis on key areas within the economy to ensure that it progresses towards a developed state. These can be broadly described within three major areas: Investment in the economy, stable economic growth and the acquisition of a positive trade balance.

Past trends across these areas have indicated sluggishness and have hampered South Africa's ability to grow in line with expectations.

The State's involvement within a developmental state is critical due to its ability to influence change and place the economy onto a new growth trajectory. It can do this through emphasis being placed onto three primary levers: Strategy development, financial intervention and technological capacity creation.

It uses State Owned Companies (SOCs) as crucial implementing agents to ensure delivery across each of the levers mentioned above. SOCs are the primary tools available to the State, given the scale and complexity within which they operate. This being said, the current position (financially and operationally) of the major SOCs within the country is sub-optimal, thereby reducing the State's ability to achieve desired results. The recovery of these SOCs will play a vital role in the execution of the overarching goals.

The State's other important functions, such as the planning, capital provision, shareholding, policy making and regulation are also required to work synergistically towards achievement of national strategy.

The DPE as the shareholder or "owner" plays a vital role within the institutional model. It is positioned strategically within the model to translate and drive national policy through the use of its SOCs, whilst aligning with the upper levels of State, and collaborating with its peer Governmental Departments.

In the current administrative period, focus is required to be placed onto the execution of the Medium-Term Strategic Framework (MTSF), a derivative of the National Development Plan (NDP). The primary focus of the MTSF, in relation to the DPE's span of control surrounds investment into enabling infrastructure, through two organisations in particular; Eskom and Transnet.

These two SOCs are however, unable to meet current market demands and are also not able to provide returns that meet capital investments made. There are inherent risks associated to the sub-optimal performance of these SOCs as well, including losses in GDP, costs incurred through load-shedding and the constraining of exports through lower-than-expected volumes transported, to name a few.

Ensuring that challenges faced by these two organisations in particular (core challenges), as well as those persisting within the rest of the institutional model (enabling challenges), are addressed over the next five years, will be crucial to ensuring a turnaround of the economy.

The Strategy represents a DPE's response to the challenges being faced by the SOCs and the economy in general. It provides an overarching approach for the DPE over the next five years, in its attempt to achieve policy targets, whilst strengthening its function as a Shareholder and improving financial sustainability of SOCs. The Strategy can be disaggregated into three distinct phases: Stabilise, Strengthen, and Solidify – each speaking to the DPE's performance within the economy, and the impact on the economy itself.

Strategic outcomes of the strategy include the following:

- Ensuring financial stability of SOCs;
- Improving commercial viability of operations;
- Delivery of capital projects;
- Strengthening the role of the Shareholder; and
- Improving alignment and efficiency across the institutional model.

A series of projects aimed at achieving the above outcomes over the next five years is to be developed and implemented.

M.A. Mokholo

Ms Matsietsi Mokholo

Acting Director General

1. Introduction and Background

1.1 Department of Public Enterprises

1.1.1. Aim

The aim of the Department is to drive investment, productivity and transformation in the department's portfolio of State Owned Companies, their customers and suppliers to unlock growth, drive industrialisation, create jobs and develop skills.

1.1.2. Mission

To provide decisive strategic direction to the SOC, so that their businesses are aligned with the national growth strategies arising out of the NDP.

1.1.3. Values

Bold – we must dare to be brave.

Professional – we must deliver work that reflects a professional level of care and skill.

Caring – this must be expressed in how we watch over and support the Department's people.

Integrity – we must do the right thing irrespective of implications.

Fun – create an environment and culture where people look forward to coming to work.

Passion – we are out to make the South African economy competitive – this requires high passion. Batho Pele principles – guide our engagements with our clients and other stakeholders.

1.1.4. Mandate

The Department's function has evolved since its inception as the Office of Privatisation and Deregulation. Notwithstanding that, there is still no founding legislation for the Department. In the current economic context, the SOCs have emerged as key instruments for the State to drive its developmental objectives of creating jobs, enhancing equity and transformation. This evolution underpins the overarching shareholder management process aimed at providing strategic rationale for government's continued ownership in the SOCs.

In the current context, the mandate of the Department is to ensure that the SOCs within its portfolio are directed to serve Government's strategic objectives as outlined in the National Development Plan and further articulated in the New Growth Path, and the Industrial Policy Action Plan. The Department does not directly execute programmes but seeks to leverage the state ownership in the economy to support the delivery of key outcomes outlined in the National Development Plan and the MTSF.

The SOCs under the Department's portfolio form the cornerstone of the economy and their capacity must be strategically utilised to support the delivery of the outcomes of the NDP. Strengthening of oversight tools is therefore crucial to ensure that the companies supports the radical socio-economic transformation agenda as articulated in the NDP and MTSF.

1.1.5. Strategic Objectives

Over the Medium Term Strategic Framework (MTSF) period, the Department will seek to achieve the following strategic objectives and this will inform the programmes and allocation of resources going forward.

Table 4: The DPE strategic objectives

Strategic Objectives	Outputs	Impact
Ensure SOC financial sustainability	• Improved SOC balance sheets • Funding options identified and implemented	SOCs are enabled to fund build programmes and general business operations
Ensure SOCs maintain commercially viable operations	• Increased electricity reserve margin • Improve productivity at the ports • Expansion of rail capacity	• Increased productivity of SOCs • Increased shareholder value
Accelerate capital project delivery	• Increased infrastructure investments • Increased GDP • New industrial capabilities developed in key supplier industries	• Enhanced infrastructure, thus greater economic capacity • Industrialisation

Strategic Objectives	Outputs	Impact
Strong shareholder	• Reorganised shareholder model • Repositioning of the DPE through improved internal processes • Competent and capable board appointed • Knowledge sharing platforms created • Performance management system implemented	• Improved SOC management • Improved performance and consequence management
Alignment and efficiency across institutional model	• Inter-Ministerial Committees implemented • Revised shareholder model and role • Separation of functions	• Increased ability to manage SOCs • Clearly defined roles and responsibilities • Improved decision-making

1.1.6. Programmes

The Department comprises three programmes, namely:

1.1.6.1. Programme 1: Administration

Provide strategic management, direction and administrative support to the Department, which enables the Department to meet its strategic objectives.

1.1.6.2. Programme 2: Legal and Governance

Provide legal services and corporate governance systems, and facilitate the implementation of all legal aspects of transactions that are strategically important to the Department and the SOCs and ensure alignment with Government's strategic intent.

1.1.6.3. Programme 3: Portfolio Management and Strategic Partnerships

Align the corporate strategies of the SOCs with Government's strategic intent, and monitor and benchmark their financial and operational performance and capital investment plans.

1.1.7. SOCs

The DPE manages a portfolio of state owned companies. These are:

- **Alexkor**: A diamond mining company primarily operating in Alexander Bay and the greater Namaqualand.
- **Denel**: A defence company and although it is established as a private company in terms of the Companies Act of 2008, Government exercises full control over the Company.
- **Eskom**: Eskom generates, transmits and distributes electricity to industrial, mining, commercial, agriculture and residential customers and redistributors.
- **SAFCOL**: South African Forestry Company Limited is the Government's forestry company, conducting timber harvesting, timber processing and related activities both domestically and regionally.
- **SAX**: South African Express is a domestic and regional air carrier with a mandate to be an African airline.
- **Transnet**: Transnet is a freight and logistics company responsible for pipelines, ports and rail transport infrastructure operations in South Africa.

1.2. The Context for the Strategy

1.2.1. Understanding the Environment

The South African economy has struggled to recover to the growth levels prior the economic crisis and has not been able to sufficiently create the opportunities for more labour absorption. Between 2002 and 2007, the South African economic growth accelerated but was adversely affected by the global financial crisis. As seen in figure 1 below, the country has experienced weak economic growth since the 2008 global recession. The economic growth rate has failed to meet target levels of between 3% - 5%. Capital formation has itself experienced some challenges.

Gross Fixed Capital Formation (GFCF) has not been a priority leading up to 2005[1]; this has resulted in slow growth and had a negative impact on local industry and human capital. In addition, this poor investment performance has stifled the country's manufacturing capabilities[2].

[1] Standard and Poor's (2014)
[2] Global Credit Portal (2014)

In the period between 2009 and 2014 Government began to lay a foundation for accelerated investment in the economy with the creation of the Presidential Infrastructure Coordination Commission, the 20 Year Infrastructure Plan[3] and the Infrastructure Development act, 2014. However, this has not been sufficient to create an infrastructure network capacity to support the productive sectors of the economy. These are new initiatives and their success are still to be measured. Finally, the country's balance of payment has remained low over the past 10 years and this has been reflected in the weak economic environment and a depreciating currency.

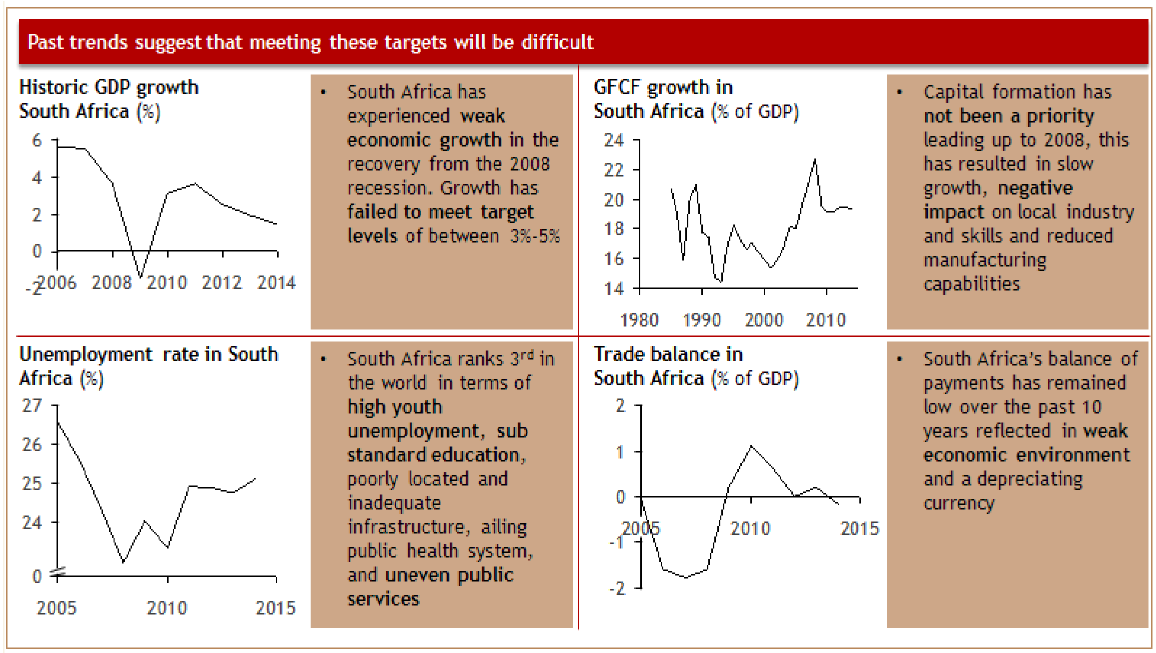

Figure 1: Economic Trends

Amidst all of this, the importance of the role of the State has been reinforced. State intervention within the context of a developmental state is crucial to economic development, particularly in light of the large scale investment required and associated risks thereof.

However, key levers must be pulled by the State in order to place the country on a positive growth trajectory that will enable the developmental state to realise outcomes defined in the National Development Plan.

[3] The 20 Year Infrastructure Plan outlines the Strategic Infrastructure Projects (SIPs)

These levers are[4]:

Strategy

- Develop national policy to steer and direct South Africa on a sustainable growth path;
- Consideration for a different stakeholder compact to unite the public sector, business, labour and civil society in a partnership geared to implement this shared programme;
- Establish clear, measurable and time bound targets for common programmes, and for monitoring their implementation; and
- Reinforce inter-governmental and integrated planning across spheres of government and between different governmental departments.

Financing

- Ensuring prudent macroeconomic policy and counter cyclical fiscal management measures; and
- Provision of guarantees to facilitate investments where required.

Technology

- Strengthen the research and development institutions to systematically enhance South Africa's existing technological capacity;
- Proactively respond rapidly to global technology developments and to partner with the private sector to access new technologies; and
- Translate broad objectives into programmes and projects and to ensure implementation.

The National Development Plan defined the structural challenges that the South African economy currrently face. To respond to these structural challenges, a series of actions have been proposed that need to be implemented within specified timeframes. These actions will require significant improvement in the capacity of the State. This also includes the further repositioning of the SOCs. The NDP indicates that for the tripple challenges of unemployment, poverty and inequality to be eradicated, the state needs to play a transformative and developmental role. This requires well and effectively coordinated institutions.

In the 2009 – 2014 Medium-Term Strategic Framework, the Government adopted a 'developmental state' approach in driving the change in the economy. Developmental states are typically characterised by significant Government intervention within the economy.

[4] DPE Study (2007)

In this system, the Government directs the course of development by identifying sectors or businesses (in the South Korean case) which it will promote to lay the foundation for further development[5]. There are a number of conceptual tools, which the Government uses to direct economic processes.

These include, but are not limited to, creating synergies between factors like human capital, innovation and making complementary investments in physical and social capital. In terms of policy, the state works with non-state actors and markets to address coordination, governance, innovation and growth related challenges.

Industrialisation and economic nationalisation[6] are key drivers of the developmental state. A crucial aspect of the industrialisation project is to grow the manufacturing sector[7] and promote foreign direct investments. Economic nationalism is about stimulating export led growth and increasing beneficiation. In the South African context, these two elements appear starkly in the focus that the government has now placed on economic development and how it enables this development through its various policy measures (e.g. the National Development Plan, New Growth Path and the National Industrial Policy Framework) which accomplish high levels of national objectives (e.g. Industrialisation)[8].

Being a developmental state and driving industrialisation as well as economic nationalism imposes a number of responsibilities on the South African government. Firstly, for South Africa to grow, its focus must be placed on the following key drivers of growth, namely: investment in the economy, creating an enabling policy framework that will support the growth of the productive sectors, facilitating private sector investments and raising exports. These have been outlined in Chapter 4 of the NDP.

In summary, these three levers (strategy, financing and technology) are required to be executed upon by the State, given the scale, complexity and associated risks of the requirement to develop the economy. Furthermore, institutional innovations across all levels of Government will be required to facilitate this growth. The NDP and other policy framework such as the New Growth Path and the Industrial Policy Framework provide the overarching framework required to change the structure of the economy.

The current MTSF recognises that the private sector demand will remains subdued and that the state need to pull levers necessary to kick start the economy. The SOC have been identified as the critical tool that can be leveraged to support growth in the short to medium term.

[5] Lim, W. (2014) “Chaebol and Industrial Policy in South Korea” *Korea’s Leading Think Tank*
[6] Identification of priority sectors that can drive export growth.
[7] Cramer, C. (1999) “Can Africa Industrialize by processing primary commodities?” The Case of Mozambican Cashew Nuts” *World Development,* 27(7)
[8] Woo-Cummings, M. (1999) *The Developmental State*

The State's utilisation of its SOCs will be crucial to facilitate the redirecting of the economy in line with the South African Government's developmental state agenda is essential. SOCs are the State's primary tool in delivery of its developmental role. These entities act as the implementing agents across the country for national level policy imperatives.

The Government invests in SOCs to provide them with the capacity required for them to provide essential services critical for the restructuring of the economy. Within this notion, the delivery of national infrastructure to enable investment in critical areas of the economy is key.

As the Government uses its SOCs to drive its objectives, the SOCs implicitly have a critical function, which they need to deliver on. SOCs enable economic growth through crucial activities. Firstly, they implement national policy by driving infrastructure expansion to meet and push economic demand. Secondly, SOCs raise the technology base of the economic industrial sectors, driving the competitiveness of the country on a local and global scale. Therefore, through its SOCs, South Africa can achieve a high level of investment and export competitiveness to ensure and enable sustainable levels of economic growth that will drive development. SOCs are also required to be good employers as well as exhibit exemplary social responsibility. The State should prioritise ensuring that SOCs are enabled to perform as required so that systemic impact can be achieved.

A period of major under-investment in South African infrastructure has however, left SOCs in a compromised situation. Figure 2 below shows how, historically, investment in infrastructure in South Africa has been relatively low. In recent years, this trend took a drastic and abrupt turn with SOCs investing heavily in infrastructure. Given the sudden nature of these large investments, and the little time for cost recovery in terms of returns on investment, SOCs now find themselves in precarious financial position. With key infrastructure projects, yet to be completed before capital costs can be recovered, South African SOCs are dealing with a major funding gap whose effect spills over to their operational inefficiencies. In order to secure future revenue, the funding gap within the SOC environment will need to be addressed. The growing budget deficit threatens the Government's ability to sustain its infrastructure investment programme. The constrained fiscal framework requires the Department to explore additional funding mechanisms to support the expansion plans of SOC.

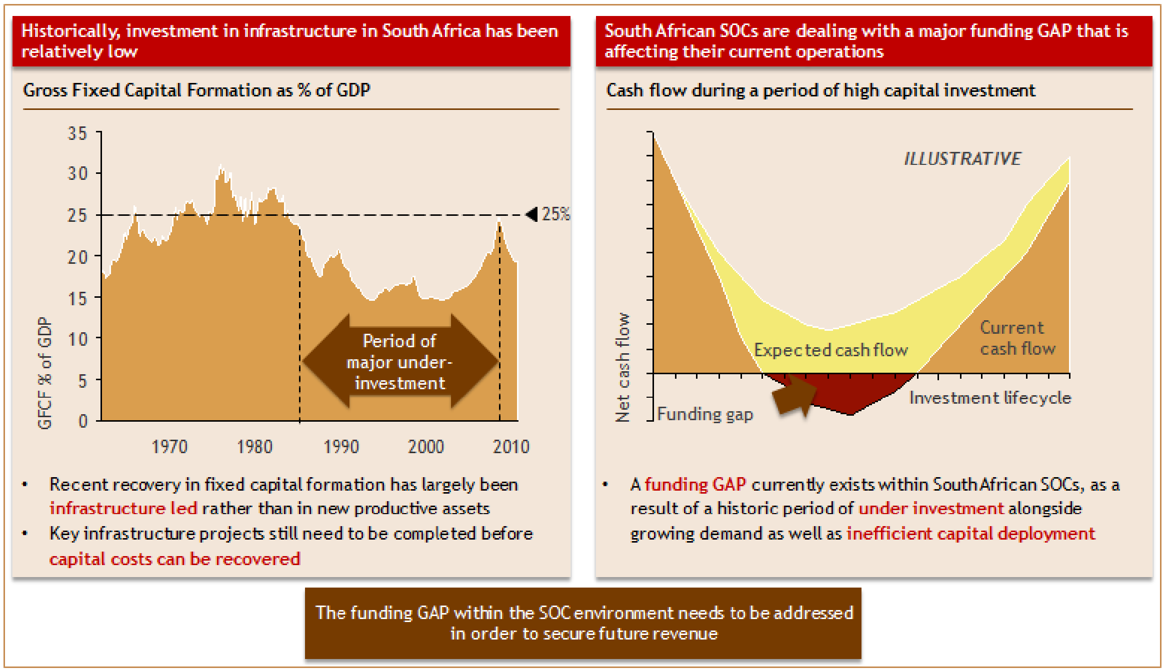

Figure 1: Major Under-investment in South African Infrastructure

In addition to this funding challenge, a recent National Treasury analysis highlighted the performance of South African SOCs, noting which ones required attention and level of focus to be provided by Government. A significant proportion of the major SOCs reviewed were said to require either close monitoring or urgent attention. This disappointing discovery was further confirmed by the weak financial performance of the top four[9] SOCs[10]. For all four SOCs, the Weighted Cost of Capital (WACC) was significantly higher than the Return on Equity (ROE). This showed that returns relative to the cost of investment were low over time and there was thus a continued dependency on the State to undertake strategic investments. Ongoing losses at these SOCs further erodes equity, resulting in a burden being placed onto the fiscus. The problem is further exacerbated as the cost of funding debt increases due to falling credit ratings, reductions in flexibility of servicing capital (debt poses an obligation to pay interest), and the inability to hedge exposures properly.

[9] The largest SOCs in South Africa (Eskom, Transnet, Airport Company of SA, and Central Energy Fund)
[10] National Treasury analysis

1.2.2. Understanding the players and their roles

The institutional model

In trying to change the poor narrative of South African SOCs and enable the government to fulfil its developmental state agenda through these companies, it is important to understand the players, which influence this narrative and their roles.

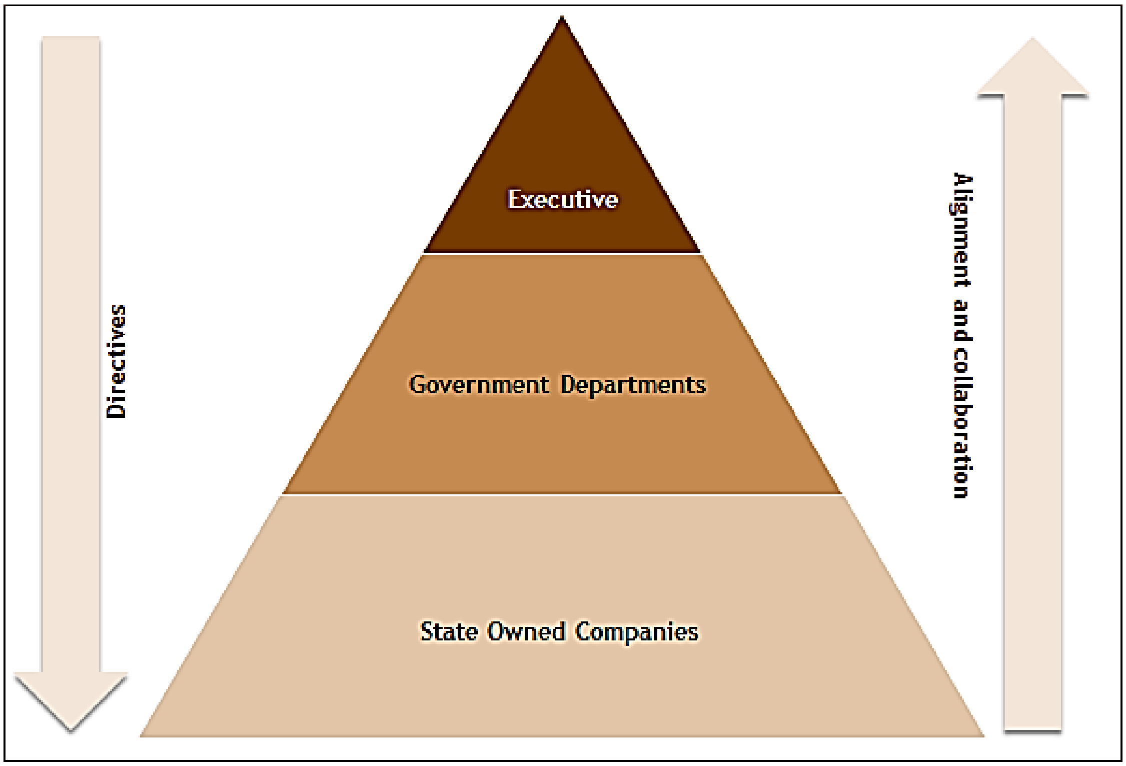

Figure 3: State Institutional model in context

The three tiers of Government (National, Provincial and Local) together with the three arms of government (Executive (Cabinet), Legislature and Judiciary) form part of an institutional model in which each plays a distinct purpose within the State. Direction and support is provided by the Executive (Cabinet) and filtered down to the SOCs. National strategic planning occurs at the executive level of this institutional model, and Government departments distil this within their various capacities as eithera funder (National Treasury), policy maker, shareholder or regulator. The SOCs are then expected to execute on national objectives while maintaining financial sustainability. In accordance with the developmental state paradigm, alignment, collaboration and coordination need to occur throughout this institutional model.

The Legislative arm (Parliament), consists of elected representatives whose key mandate is to undertake oversight over department, including SOCs in this case as well as make laws for the country. Finally, the judiciary system is the court system.

Government departments scrutinize, translate and oversee execution of the State plan. Within the context of this strategy, the following key activities at this level are worth mentioning; setting and implementing functional policies, regulating the market environment, provision of oversight to SOCs and their strategy, and monitoring the financial and operational performance of SOCs.

SOCs are created by Government and are companies in which the State may be a major or majority shareholder e.g. Telkom. They operate the State's commercial affairs, often with public policy objectives, and at their core, are required to deliver on the objectives of the State.

The interaction between these layers and players which make up this institutional model need to be in sync so as to enable the growth and economic development required by a developmental state. The right direction and support, which needs to be filtered down from the Executive to the SOCs, whilst a conducive and supportive structure guides and enables the process.

The Shareholder in context

Government as Shareholder and "owner" of the SOCs should be the essential link between stakeholders at various levels of this institutional model. The shareholder's interaction within this systemic model can be understood in terms of its unique position, which enables it to interact with the Executive and Departmental spheres as well as the SOCs. Specifically, the Shareholder has access to Cabinet (Executive) where it can ensure alignment and collaboration with national policy setting, based on SOCs capability and capacity. Within this sphere of interaction, the shareholder can also intercede and manage Cabinet expectations in respect of SOCs.

At the Government department level, the Shareholder has even easier access and ought to leverage synergies and collaborate with its peer Governmental Departments. Here too it can intercede and mediate on behalf of SOCs to the policy makers and regulators.

Furthermore, there is the role that the Shareholder plays in relation to the SOCs, which it oversees. Here the purpose of the shareholder is broadly defined as one of management, monitoring the performance of SOCs and ensuring that national policy is executed at SOC level. This specific SOC function is executed through an iterative process of to-and-from, to ensure alignment and oversight is perfectly balanced.

The primary tasks of the **Shareholder** consist of the following three functions, each of which is applicable at a certain level within the institutional model:

Alignment

- Ensure alignment with national policy based on SOC capability and capacity; and
- Intercede and manage Executive expectations in respect of SOCs.

Collaboration

- Leverage synergies and collaborate with peer Government Departments and interact with organisations outside of South Africa where applicable;
- Intercede and mediate on behalf of SOCs in respect of policy makers and regulator; and
- Facilitate collaboration among the SOC to promote efficiencies and eliminate duplication.

Oversight

- Manage and monitor performance of SOCs; and
- Translation of national policy objectives at SOCs level.

Should the Shareholder successfully performs these functions, it will be in a better position to translate national objectives to SOCs and oversee effective execution.

The DPE in context

The DPE is the State's Strategic Shareholder and plays a critical role in driving national policy. The importance of the Department cannot be understood outside of the national policy (NDP and MTSF), which it is responsible for executing upon through its SOCs. Its ideal positioning within the State institutional model, as well as the strategic importance of the SOCs within its ambit, primes the DPE as a crucial organisation in the context of the developmental state. The figure below highlights a conceptual process of how national policy is required to be translated by the DPE, prior to being executed upon by its SOCs.

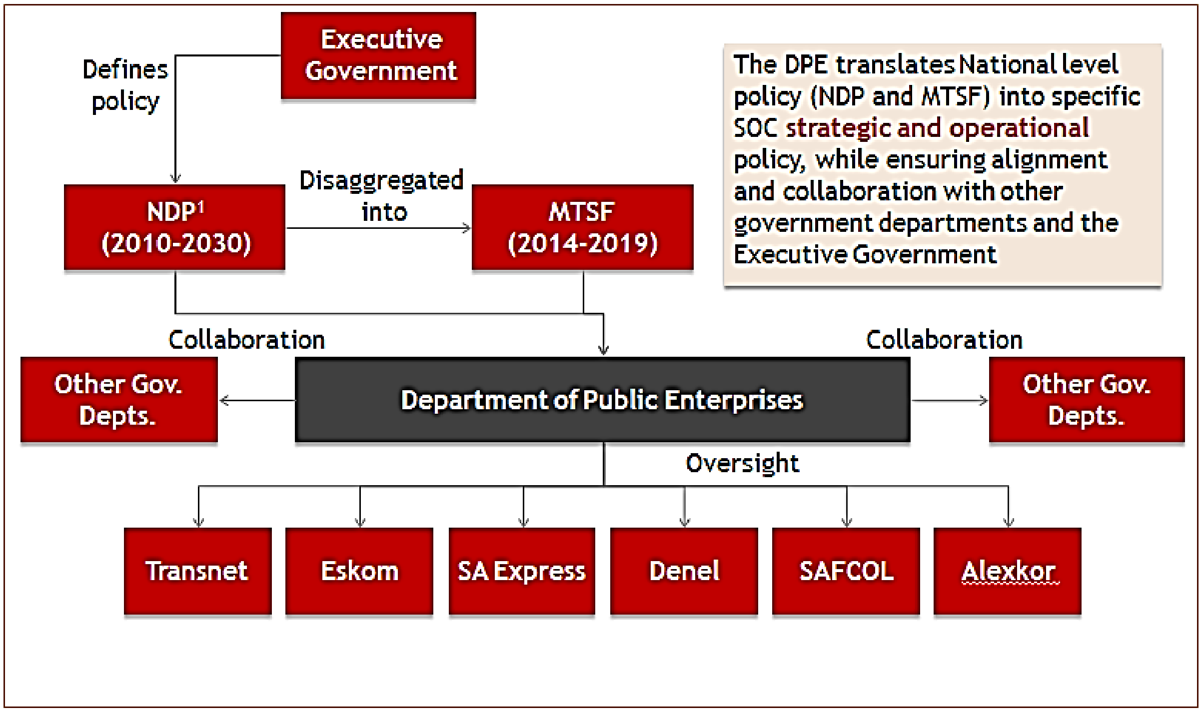

Figure 4: Conceptual model, demonstrating the translation of the NDP

National Policy guides the DPE's outlook for the next five years

The National Development Plan

The NDP is an economic policy framework for the whole country and offers long-term strategic direction. It defines our desired destination as a country and identifies the role of different sectors of society in reaching that goal. Similar to all government departments, DPE's budget allocation is shaped by the NDP.

The NDP aims to eliminate poverty and reduce inequality by 2030 and highlights the fact that improving the quality of public services is critical to achieve the radical transformation of the economy. According to the plan, South Africa can realise these goals by drawing on the energies of its people, growing an inclusive economy, building capabilities, enhancing the capacity of the State, and promoting leadership and partnerships throughout society.

The NDP will be implemented in three five-year phases. Each of these phases will have targets and will be monitored by the MTSF[11]. The section below highlights the NDP goals that would need to be supported by the DPE through alignment of SOC mandates:

- Increase employment from 13 million in 2010 to 24 million in 2030;
- Ensure that skilled, technical, professional and managerial posts better reflect the country's racial, gender and disability makeup;
- Broaden ownership of assets to historically disadvantaged groups;
- Expand capacity of our rail corridors;
  - Produce sufficient energy to support industry at competitive prices, ensuring access for poor households, while reducing carbon emissions per unit of power by about one-third;
  - Realise a developmental, capable and ethical State that treats citizens with dignity; and
  - Play a leading role in continental development, economic integration and human rights.

The Medium-Term Strategic Framework

The MTSF for the 2014/15 – 2018/19 administration periods builds on the progress made from the previous administration period. It applies to a number of Government departments and SOCs and functions as a guideline for planning. The 2014 – 2019 MTSF focuses on four key areas within the infrastructure development arena to enable downstream economic growth. As outlined in figure 5 below the MTSF (in relation to the DPE's span of control) highlights four key objectives:

- Increasing the electricity generation reserve margin from 1% to 19% in 2019;
- Increasing tonnage moved on rail from 207 to 330 Mt in 2019;
- Improving operational performance of sea ports and inland terminals from 28 to 35 average GCM/H by 2019; and
- Increasing the investment rate to 25% of GDP.

[11] National Development Plan 2030

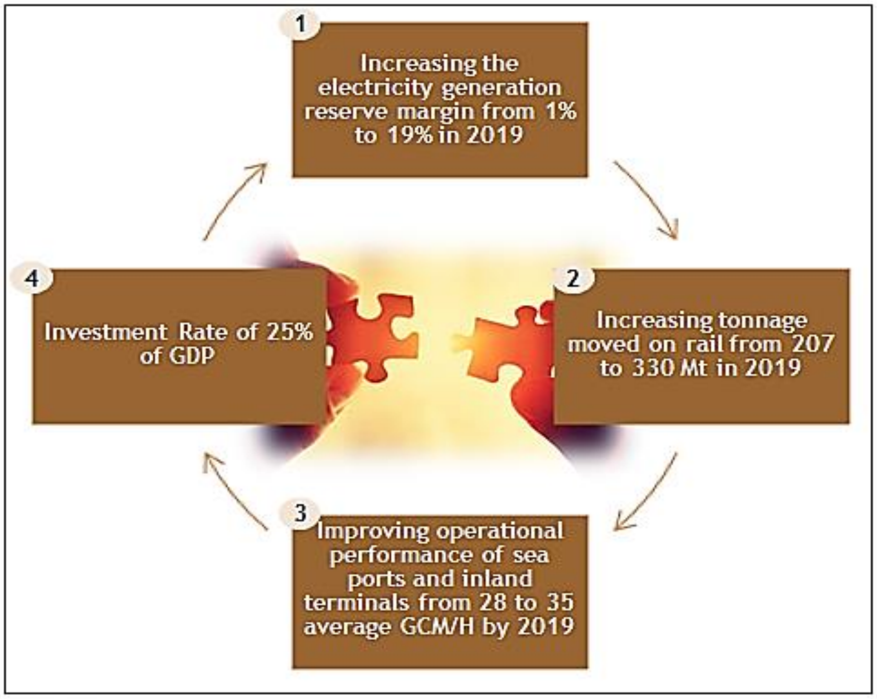

Figure 5: MTSF targets for 2019

This infrastructure expansion relies heavily on two SOCs in particular; Transnet and Eskom. In order for this infrastructure programme to be successful, all stakeholders are required to perform their role in enabling SOC service delivery[12].

Transnet and Eskom, both of which fall under the ambit of the DPE as the Shareholder, play a vital role in the successful implementation of the MTSF, particularly, in terms of infrastructure projects. The DPE is the sole Shareholder of some of the largest SOCs in the country, including Eskom, Denel and Transnet. The collective Asset Value for the DPE's SOCs is over R755bn, with Eskom and Transnet accounting for R745bn, ~98% of this value. The DPE thus plays a critical role in shaping the outcomes of the MTSF and ultimately the NDP as shown in *Figure 6.*

[12] Medium-Term Strategic Framework (2014 – 2019)

Breakdown of the SOCs overseen by the DPE
(Rbn)

public enterprises
Department:
Public Enterprises
REPUBLIC OF SOUTH AFRICA

Alexkor | BBI | Denel | Eskom | SAA | SAFCOL | SAX | Transnet

Breakdown of SOCs overseen by the DPE by Revenue, Profit and Asset Value
(Rbn)

Name	Sector	Revenue	Profit	Asset Base Value
Eskom	Energy	139.5	7.1	504.9
Transnet	Transport	56.6	5.1	240.1
SAA	Transport	30.0	-0.4	15.2
Denel	Defence	4.6	0.2	8.0
SAX	Transport	2.2	0.01	1.4
SAFCOL	Agriculture	0.9		0.1
Alexkor	Mining	0.15	0.04	0.9
BBI	Communication	0.2	-0.2	1.6
Total		**203.95**	**11.9**	**755.4**

~96% of the total revenue generated by the DPE's SOCs can be attributed to Transnet and Eskom collectively (98% profits)

These sectors contribute significantly to the economy:
Transport: 9%
Energy: 2%
Mining: 5%
Agriculture: 2%
Manufacturing: 15%

Figure 6: DPE Portfolio

These organisations are, however, not providing sufficient returns on investments made. As seen in figure 7 below, the return on equity (ROE) for the DPE's SOCs versus their estimated weighted average cost of capital is low. The companies within the DPE portfolio, in particular, are performing far below expectation and their constrained ability to recover their investment places huge strain on national investment rates. Furthermore, the sheer size of Eskom and Transnet's asset base significantly reduce the average ROE, painting a bleak investment return picture across the portfolio.

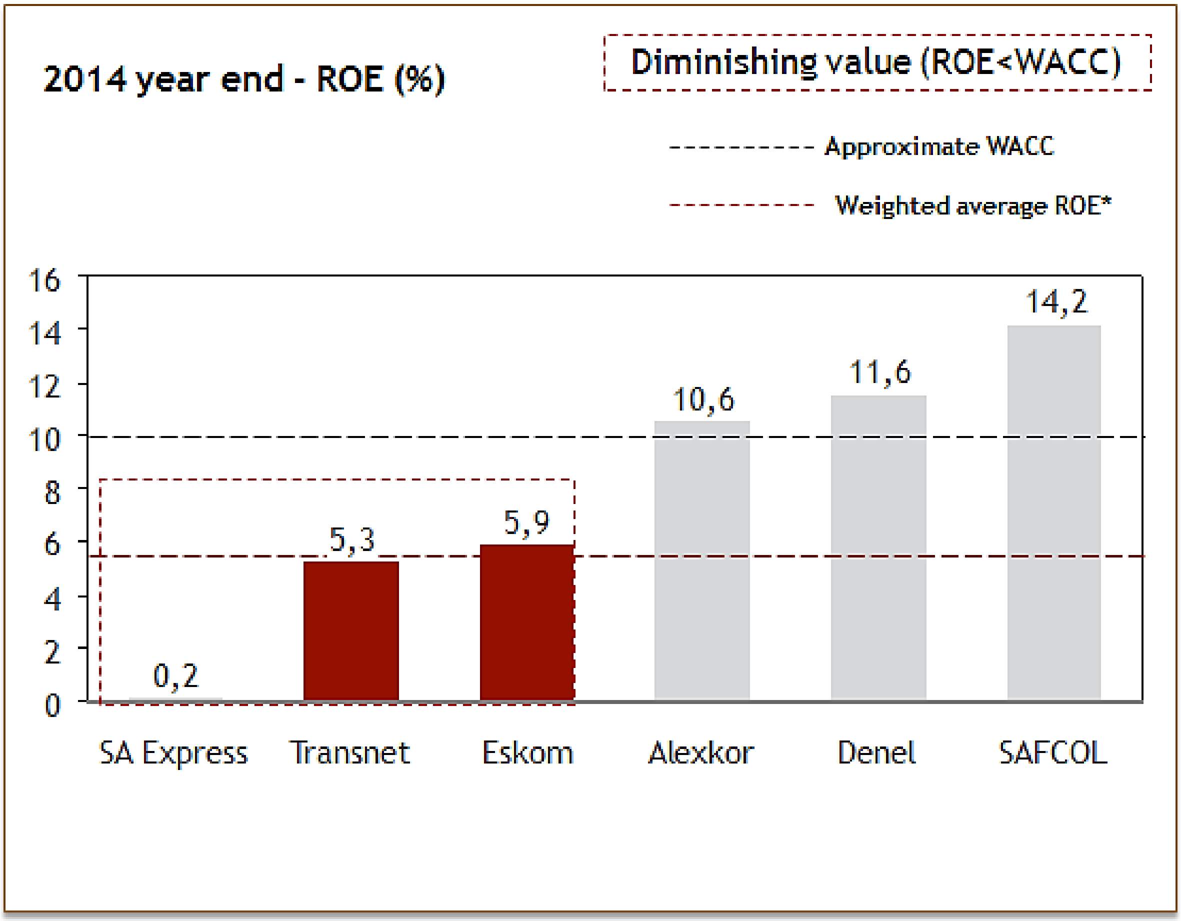

Figure 7: Average ROE relative to Weighted Average Cost of Capital (WACC) across DPE's SOCs

Eskom and Transnet, the major SOCs, are also struggling to execute on their mandates and this impacts their ability to meet their performnace targets as agreed with the Department. Eskom has insufficient power producing capacity and is thus unable to meet current demands of the South African economy. Transnet on the other hand, while in a better current position than the former, is also unable to meet the demands of the market, resulting in reduced accessibility to certain industries. These infrastructure-related challenges need to be addressed as a matter of urgency as they provide a platform for the economy to grow. However, in relation to one another and understanding the issues, faced by these entities, The Department believes that Eskom requires more urgent attention in order to resolve its sustainability issues. The attention, which Transnet requires, is of a different nature. Attention needs to be paid to the risks surrounding the current standing of Transnet as these could potentially affect its future sustainability.

The sub-optimal performance of these organisations poses a significant risk to the economy at large. From Eskom, the country is at a risk of a national blackout or continued load-shedding. With Transnet, the risks are about having continued heavy reliance on road transportation and constrained rail volumes moved.

Together, these risks have the potential to amount to dire economic consequences, which include significant loss of GDP, civil unrest and an overall economic shutdown. If these issues are not addressed, the objectives of the NDP will not be realised.

Driving investment expenditure to 25% of GDP will require a concerted effort from all SOCs within the portfolio, and will require strengthening the partnership and collaboration between SOCs and private sector. SOCs like Denel, Alexkor and SAFCOL play a critical role to invest in the productive assets and boost the output of the manufacturing sector. The strengthening of operational efficiency and capacity of all the SOCs in the portfolio is critical for the economy and boosting economic activities.

9 Action Plans Announced in February 2015 State of the Nation Address (SONA)

The 2015 SONA entailed the 9 action plans that were going to be implemented by Government to ignite the economy. This recognises that the economy has not grown fast and long enough. The 9 action plans support the implementation of the MTSF and does not represent a new plan rather outlines apex priorities. Addressing the electricity challenge and supporting the reforms in the SOCs form part of the action plans that will be directly implemented and supported by the Department.

Challenges

The challenges, which the country faces in achieving the objectives of the NDP and the MTSF, particularly in relation to SOCs, can be categorised in two themes. The first is what the Strategy refers to as the core challenges. ***Core challenges*** exist at SOC level, and predominantly affect the ability of the State to deliver on its responsibility of creating and sustaining positive economic impact. The second theme of challenges are herein referred to as the enabling challenges. ***Enabling challenges*** exist in the environment that supports the state in implementing national policy.

Core challenges are made up of two components and typically apply to the SOC environment: limited ability to meet economic demand and financial instability.

The enabling challenges are evident within the Executive (Cabinet), Government departments and in the SOCs themselves. Effectively these challenges limit the efficiency of policy implementation and execution thereof. These challenges need to be addressed in parallel to ensure SOCs are in a position to deliver on their national objectives and ensure strong economic growth, high investment in the economy and foster a competitive export market.

1.3. Core Challenges

1.3.1. Inability to meet demand

SOCs - Eskom and Transnet in particular - are unable to meet current levels of demand. This directly impacts their ability to support stable and sustainable growth in the South African economy. In particular this challenge can be further broken down into areas such as the current fleet of these organisations, execution of the new build programmes for which they are responsible, and a broader category that highlights the limited sources of supply within the country.

1.3.1.1. Operational capacity

With regards to the current operational capacity, issues around deferred maintenance are of crucial concern and are themselves outcomes of poor operational strategies or external pressures being placed onto maintenance activities. Furthermore, operational inefficiencies around ageing fleet (electricity generation and locomotives), limited skills and ineffective processes also contribute to the poor state of current fleet.

1.3.1.2. New Build

In terms of the new build programmes, SOCs face challenges around funding and operational efficiency. There are currently insufficient funds to secure required debt for new build programmes, and low credit ratings exacerbate this by increasing the cost of borrowing. There is an issue in terms of the overreliance on SOCs for specific commodities and this is seen more in Eskom than in any other SOC. There is heavy reliance on Eskom to supply electricity to the country, with only 5% of South Africa's electricity supply coming from sources outside of Eskom.

1.3.2. Financial Instability

A number of South African SOCs are in weak financial positions, particularly some of which are critical in terms of contribution to the economy. The weak financial position which some of the SOCs find themselves in has resulted in a limited ability to fund commercial and expansion activities and they are consequently unable to deliver on NDP and MTSF targets. Some of these categories of challenges as well as examples (non-exhaustive) are discussed below.

1.3.2.1. Revenue

The constrained revenues encountered by SOCs affect their financial positions significantly, as they are expected to fund their current operational, and expansion-activities through the use of their own balance sheets. Two issues come across strongly within this category, pricing and lost revenue. Eskom was, for example, not able to secure a 16% tariff increase in the Multi Year Price Determination 3 and this has strained its balance sheet partially resulted in the company receiving a government support package.

1.3.2.2. Cost

High costs erode profits and are typically indicative of weak operational efficiency. Due to operational issues, significant cost overruns have occurred due to delays in new build programmes. High substitution costs for electricity generation and breakdowns of existing power stations are issues, which have had negative impacts on costs.

1.3.2.3. Financial Planning

The capital structures of SOCs are also sub-optimal. There is high reliance on debt funding for expansion operations. Poor forecasts made have resulted in hedging losses, further eroding value within the SOC.

1.4. Enabling Challenges

A set of challenges exists within the aspects of the State institutional model, which focus on delivering support to SOCs. This text refers to these challenges as enablement challenges. There are three high level areas of enablement challenges, namely; interactions across the institutional model, oversight, and internal DPE challenges.

1.4.1. Interactions across the institutional model

These interactions are critical to the successful delivery of national policy and typically relate to activities within the institutional model limiting collaboration, alignment of the shareholder model and duplication of function. The following challenge categories exist (a non-exhaustive example is again provided).

1.4.1.1. Separation of functions

There are unclear reporting and accountability lines and overlaps exist in function, limiting effective and unbiased decision-making.

1.4.1.2. Shareholder model standardisation

There is no standardised approach to shareholding within the State.

1.4.1.3. Delegation of Authority

Processes require high levels of authorization, causing bottlenecks within the system, and turn-around times are thus negatively affected.

1.4.1.4. Limited collaboration

Collaboration across the level of Government Department and SOCs is ineffective, thereby not allowing for leveraging of particular skills, expertise and scale in the execution of similar tasks. The creation of a conducive policy framework has not been optimum and has affected the financial viability of some SOC.

1.4.2. Oversight

The DPE faces challenges in fulfilling its oversight function. These challenges include the following broad areas, with a non-exhaustive example of each being provided below:

1.4.2.1. Finance

Limited consequence management implemented for poor financial performance within the SOCs.

1.4.2.2. Governance

Weak or inexperienced Board or management, negligible board and executive fiduciary accountability for poor performance and policy/legislation gaps and misalignment.

1.4.2.3. Strategy

Poor alignment and translation of national objectives into strategy and limited upward management of stakeholders when SOCs require support.

1.4.2.4. Operations

Submissions, review and monitoring processes are lengthy between the SOC and the DPE, constraining efficient and flexible decision-making.

1.4.3. Internal DPE

The DPE is a key shareholder within the current institution and it faces the following internal challenges that lead to underperformance of its SOCs[13].

1.4.3.1. Structure

The roles and responsibilities are unclear and the current structure is not conducive to integration, therefore synergies within departments are not leveraged.

1.4.3.2. Processes

Internal processes are not coordinated effectively and Turn-around-Time is long, resulting in delays in decision- making.

1.4.3.3. Skills

Capacities and capabilities within the DPE do not enable efficient delivery at present. The Department is resource challenges to carry out its function and these impedes ability to manage SOCs effectively.

1.4.3.4. Systems

IT infrastructure within the DPE needs improvement to address significant inefficiencies in processing information.

[13] DPE Strategy Planning Session (1-3 December 2014)

2. The SOCs reporting to the DPE and DPE Programmes

2.1. The SOCs reporting to the Department

Table 1: List of all the SOCs reporting to the DPE as well as their founding legislation

Name of Entity	Founding Legislation	Nature of Business
Alexkor	Alexkor Limited Act 116 of 1992	Alexkor is a diamond mining company primarily operating in Alexander Bay and the greater Namaqualand.
Denel	None	Denel is a Defence company and although it is established as a private company in terms of the Companies Act 2008, Government exercises control over the Company.
Eskom	Eskom Conversion Act 13 of 2001	Eskom generates, transmits and distributes electricity to industrial, mining, commercial, agriculture and residential customers and redistributors.
South African Forestry Company Limited	Management of State Forests Act 128 of 1992	South African Forestry Company Limited Is the Government's forestry company, conducting timber harvesting, timber processing and related activities both domestically and internationally.
South African Express Airways	South African Express Act 34 of 2007	South African Express is a domestic and regional air carrier with a mandate to be an African airline.
Transnet	Legal Succession to the South African Transport Services Act 9 of 1989	Transnet is a freight and logistics company responsible for ports and rail transport infrastructure operations in South Africa.

2.2. The Department's Strategy

The performance of SOCs has been very mixed, while they have played a critical role in driving investments in the short term, their financial position has weakened. This places an additional strain to the shareholder to ensure that the financial sustainability of SOC has improved whilst they execute on the priorities defined in the MTSF.

The strategic plan for the Department must therefore provide a clear roadmap for improving the financial and operational sustainability of its SOCs', and ensure that all SOCs support the execution of nation policy priorities.

The DPE has firm goals and targets in place, driven by the NDP and MTSF. Systemic challenges can be overcome at each level and the DPE can play a role in driving the change that is required, which will allow the system to progress. Once optimal performance has been achieved, the DPE can promote ways and means to keep moving South Africa forward, such that the goals outlined in the NDP and MTSF are met, ensuring a better life for all South Africans. The Department has designed its strategy to ensure that the SOC fulfil their role in supporting the achievement of objectives defined in the NDP.

2.2.1. DPE Strategy: three-phased approach

The Strategy outlines the approach in improving the performance of the portfolio and strengthening of the shareholder function. The five years covered by the Strategy are to be approached in a phased manner (1-12 months, 12-36 months and 36-60 months), each phase strengthening the DPE's role and the impact that it is to influence. The figure below highlights these phases and the transition of the DPE, through a process of Stabilisation, Strengthening and Solidification.

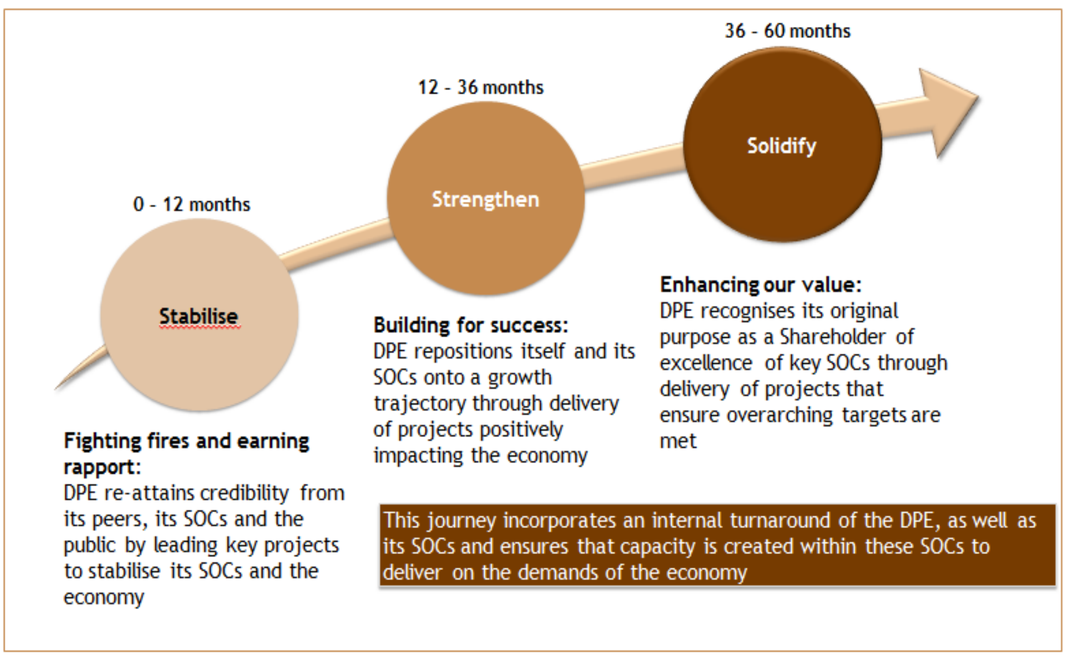

Figure 8: DPE Strategy's envisioned impact on the Department

In order to successfully implement the Strategy, the DPE needs to ensure that it addresses the current core challenges faced by its SOCs first. Developing action plans to demonstrate the DPE's role in sustaining its SOCs will ensure that the DPE re-affirms its credibility and remains relevant as a shareholder. Once complete, focus can shift towards In line with the challenges defined above; the key strategic outcomes, which the DPE must seek to realise over the MTSF period.

Key strategic outcomes for the Strategy are derived from the challenge themes to be addressed, and are discussed in detail within the Strategic Priorities section below.

Elements within the core outcomes and the enabling outcomes will be achieved at different phases within the three-phased approach, depending on the urgency requirements of the interventions developed and the interdependencies within the interventions.

Critical projects required to resolve the challenges faced can be tailored towards each particular strategic outcome desired.

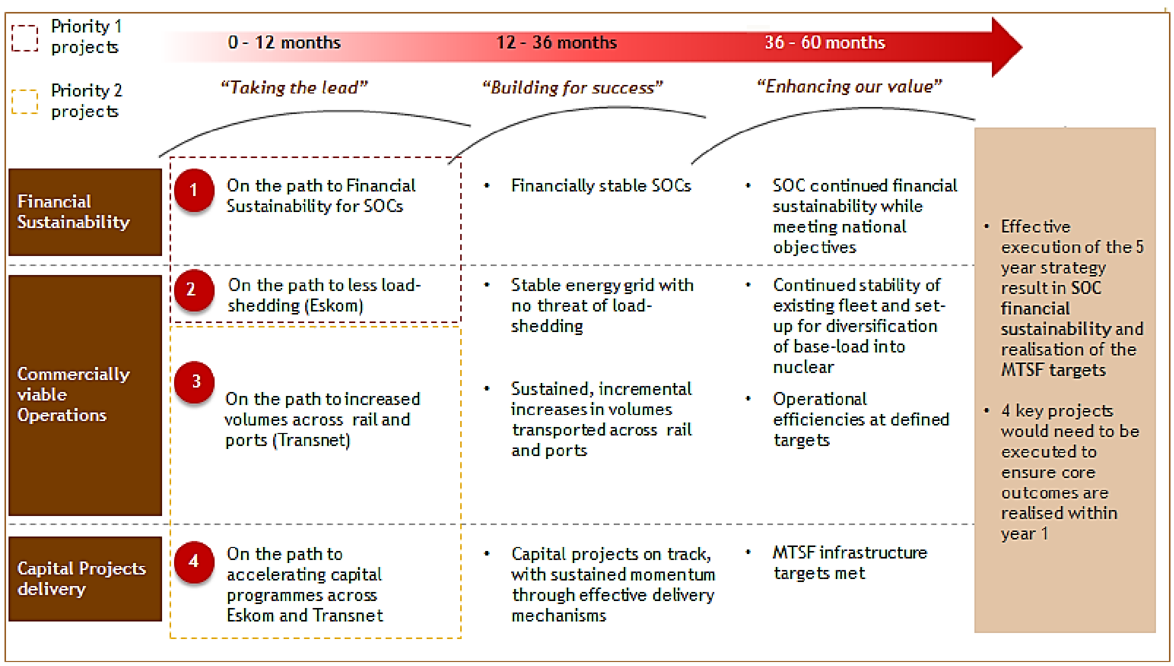

Figure 9: Core outcomes expected across the three phases

Enablement challenges will be focused on simultaneously across the three phases to ensure that adequate support is provided across the institutional environment to facilitate the delivery of required targets.

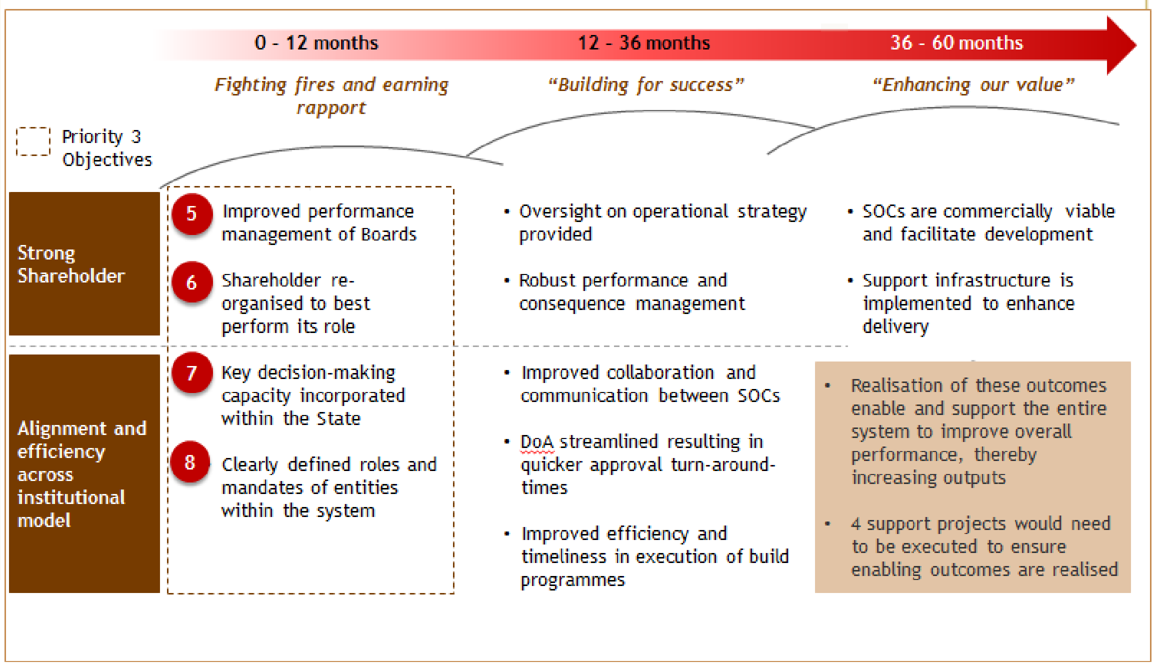

Figure 10: Enabling outcomes expected across the three phases

2.2.2. Projects to be executed upon in the first phase

This Strategy is made up of eight key projects that have been planned for execution within the next financial year (2015/16). These projects will be aimed at setting in motion the delivery of core strategic outcomes and enabling outcomes as discussed previously. A brief discussion of each of the projects can be seen below.

2.2.2.1. Financial Sustainability

2.2.2.1.1. On the path to SOC sustainability

The objective of this project is to create a framework to identify gaps in SOCs' financial position, as well as determine and execute potential funding interventions that can be leveraged by SOCs. Creating a path to financial sustainability therefore seeks to stabilise the SOCs within the DPE's span of control. By setting SOCs on a path to financial sustainability, the DPE will positively impact South Africa's economy by ensuring the delivery of key services (i.e. Eskom and Transnet), economic growth and subsequently contribute to stabilising the economy.

Financial sustainability of SOC such as Denel, Alexkor, SAX and SAFCOL remains crucial as these SOC operate within the productive sectors of the economy. Their financial and operational performance is critical for certain sectors e.g. construction for SAFCOL.

2.2.2.2. Commercially viable operations

2.2.2.2.1. Setting the economy on the path to no load-shedding (Eskom). This seeks to understand the key levers that can be pulled to augment the current capacity problem facing Eskom. A firm understanding of the possibility of load shedding and the potential mechanisms to minimise this possibility is a prime objective of this project. Emphasis will be placed on the key supply and demand interventions as well as their impact on the electricity reserve margin. This will focus on the implementation of the key actions contained in the Five Point Plan as approved by Cabinet in December 2014. This will also assess the impact of the short- to medium-term interventions targeted to stabilise the power system on the long term vision for Eskom that will be defined by the Shareholder.

2.2.2.2.2. On the path to increased volumes across rail and port (Transnet)

On the path to increased volumes across rail and port (Transnet) seeks to understand the key levers which can be pulled to augment the current capacity problems facing Transnet. Through pulling capacity and efficiency levers, Transnet will be able to improve volumes moved through the ports and on its rail network. Emphasis will be placed on increasing crane moves and increasing rail capacity to improve overall volumes transported across the rail network. The objective of this project from a DPE perspective will therefore be to create a framework to identify gaps in Transnet's rail and port operations, as well as identify and execute potential interventions that can be implemented by Transnet to improve volumes.

2.2.2.3. Capital projects delivery

2.2.2.3.1. On the path to accelerating capital programmes across Eskom and Transnet

This project involves the creation of a framework that will enable the DPE to identify any gaps in capital expansion projects and to re-steer the organisations responsible for this capital delivery onto a path re-aligned to achievement of targets within the build programmes. This will then enable the DPE to mitigate any potential risks by developing and implementing interventions where needed. The DPE will focus mainly on Eskom and Transnet during this intervention as these SOCs are in the midst of executing major expansion programmes.

2.2.2.4. Strong Shareholder

2.2.2.4.1. Improved performance management systems for SOC (Boards and executives)

The management of SOC boards is a crucial lever, which the DPE uses to ensure that SOCs achieve their targets and deliver on their mandates. The sub-par performance of some of South Africa's SOCs is partially the result of ineffective board management. This is itself an outcome of a number of factors, ranging from incomprehensive KPIs to weak corrective action in response to poor performance.

As part of the efforts to transform SOCs, the DPE needs to create and operate within a new performance management system, which will provide it with the right information, oversight power and communication tools to monitor performance and execute on its mandate of driving national objectives and ensuring sustainability in and through its SOCs.

This project's objective will be to develop and implement this performance management system as a continuation of existing efforts to improve this aspect of the DPE's role.

2.2.2.4.2. Reorganising the DPE

Another critical enabling element within this strategy and specifically in ensuring that the DPE is able to execute on it, is re-organising its internal operational model so that it supports the initiatives outlined within this strategy. DPE structure is a standard hierarchal Government structure which does not afford effective engagement and deployment of specialist service; there is also major inefficiencies and duplications due to outdated workflows and business processes implemented, In 2012, the structure was expanded and new cross cutting units established however the workflows and business processes were never reviewed and updated at a departmental level to accommodate the changes. The objective of this project is there for to reorganize the DPE so that it is structurally equipped to handle the implementation and monitoring of newly proposed interventions. In addition, this new configuration will need to be flexible enough to enable the swift and optimal implementation of any new projects going forward.

Furthermore, other internal issues impacting on the effectiveness and efficiency of execution by the DPE are to be addressed.

2.2.2.5. Alignment and efficiency across the institutional model

2.2.2.5.1. Set up a government decision making body

The Inter-Ministerial Committee (IMC) is being established to oversee the review of individual SOC mandates and performance (e.g. Centres of Excellence, Steering Committees, regular meetings, and the development of the SOC Act etc.).

The objective is to achieve a greater level of integrated business planning between Ministers put together to ensure efficient decision-making and consequent SOC service delivery.

2.2.2.5.2. Amend and develop policies – shareholder role and model.

Currently, there is limited clarity on the roles of various stakeholders, unclear reporting and accountability lines and the current oversight models lack uniformity. Oversight by the shareholder departments is at time weak and as a result, the mandate and role of the shareholder is not fully executed upon. In order for the MTSF to be realized, the State will need to separate and define functions of each shareholder.

The objective of this project is for the DPE to make recommendations to the State on policies, which need to be developed or amended in order to ensure increased alignment between SOCs, uniformity with regards to the oversight models, and uniformity when approaching and executing projects.

2.2.3. Interventions across projects

In order to successfully deliver on the projects depicted above as well as those to be envisioned within the next phases of the strategy, a number of interventions can be explored. Some of these interventions have already been deliberated across various arenas. The Department will drive implementation of the Strategy through the Annual Performance Plans that will clear outline the Key Performance Indicators as well as timeframes for different interventions.

2.2.4. Risk Management

A number of key risks have been identified that could affect the successful delivery of the Strategy. These have been broadly categorised into three distinct areas.

Table 2: The key risks for the DPE over the next 5 years

Project Risks	Risk Description	Example
Alignment and coordination	Risks that occur due to key stakeholders not aligning in terms of strategic objectives and the decision-making process related to these, resulting in ineffective strategic execution.	• Limited availability of key stakeholders • Limited standardisation in terms of monitoring and reporting • Conflict of interest, resulting in delays in the decision making process

Project Risks	Risk Description	Example
DPE internal execution risks	Risks that are internal to the DPE, hampering the DPE's ability to perform its requirements as the Shareholder of the key SOCs within the economy	• Skills gaps within the organisation that limit the potential of DPE to fulfil its role • Ineffective change management as a result of a lack of buy-in into the re-organisation strategy • Resistance to performance management system
Externalities	External risks that may occur, of which the DPE has no control over. Externalities include all factors that have a direct or indirect impact on the ability of an organization within the institutional model to execute on	• Additional unplanned SOC inefficiencies i.e. Breakdowns • Drastic changes in prices/ demands • Labour unrest • Deterioration of the credit rating, limiting the ability to obtain additional funding

2.3. SWOT Analysis

Table 3: The Strengths, Weaknesses, Opportunities and Threats for the DPE

Strengths	Weaknesses
Dedicated and passionate workforce	Operating within the fragmented shareholder model
Strategically positioned within the economy to influence change	Oversight provided to SOCs is limited, impacting on the DPE's ability to influence key decisions
Overseeing companies that are central to economic growth.	Lack of common view on shareholder oversight
Strong financial management systems and practices	Lack of clarity on roles and responsibilities and internal organisation is ineffective and inefficient
Opportunities	**Threats**
Ensure alignment of SOC performance to the requirements of the economy and enhancing shreholder oversight.	Not all enabling sector policies and legislations are in place
Stimulate economic growth through infrastructure rollout programme Drive industrialisation and localisation	Recapitalization of SOC in a constrained fiscal policy framework
SOC transformation	Slow economic growth
Oversee the delivery of the new built programme	Absence of a clear legislative framework setting out the DPE's shareholder mandate
Development of a new organizational model and functional structure in line with the strategic objectives set for the Department's new Medium Term Expenditure Framework.	
Alignment with other Government policy departments e.g. alignment with DOE on Eskom	

2.4. Organisational Structure

The DPE has adopted a programme-based organisation structure. The high-level structure is presented in the diagram below.

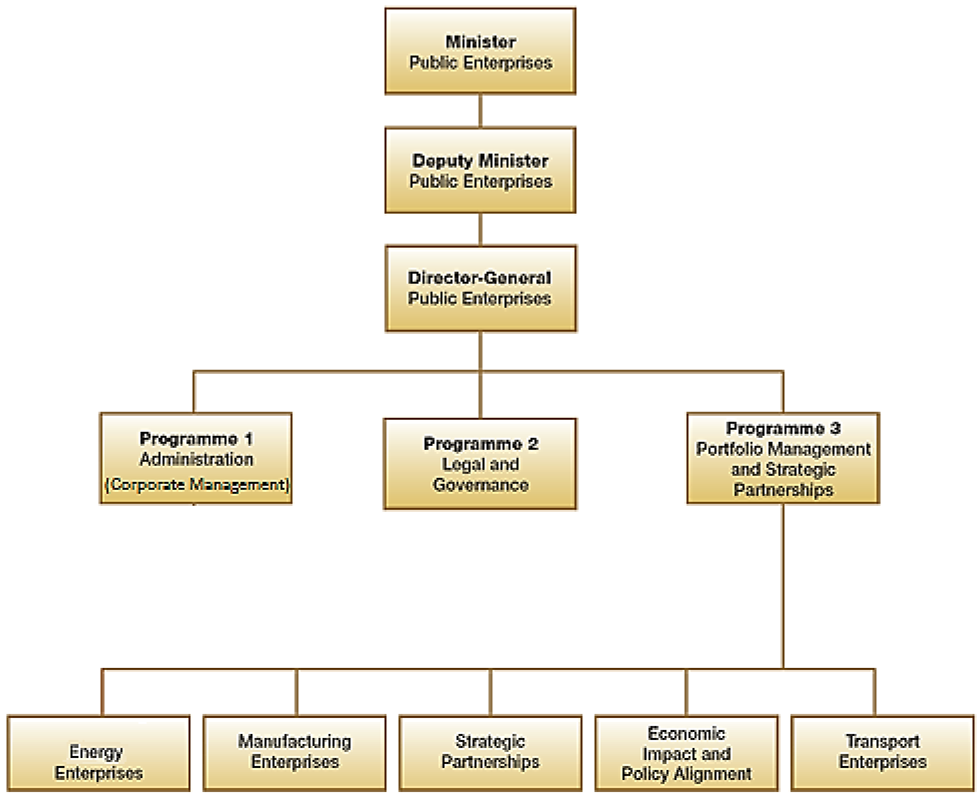

Figure 12: The DPE organisational design

The Department will adopt a matrix organisation structure. The matrix structure will promote collaboration in the delivery of the strategic objectives, reinforce and broaden technical excellence and facilitate efficient use of resources.

2.5. Shareholder Management

In April 2013, Cabinet accepted the Report and recommendations of the Presidential Review Committee (PRC) on state owned enterprises. In June 2013, the Report was presented by the Presidency to the Portfolio Committee on Public Enterprises. The Department is targeting to conclude the Bill on the management of SOC within the current MTSF period. This will codify the shareholder function to ensure effective management of SOCs across the different spheres of government.

2.6. Link to other Programmes

The work of the Department is interlinked to the work of policy departments such as Departments of Energy, Transport and Telecommunications and Post. The work of the Department through its SOC would further contribute to implementation of other programmes of government such as the Industrial Policy Action Plan and National Skills Development Strategy. Strengthening of coordination structures at the national level to ensure coherency in the delivery of programmes that are crucial to the achievement of government's economic strategy as outlined in the New Growth Path is essential.

The creation of an enabling policy, regulatory and operating environment for SOC to support the delivery of the Department's strategy is crucial. In this regard, the Department will continue to engage Departments in the energy, ICT, transport and defence sectors. This will ensure that sectorial policies create an enabling environment to support the delivery of key outcomes of inclusive growth and employment.

2.7. Risk Management

The Department continued its implementation of an integrated system of risk management in accordance with the Enterprise Risk Management (ERM) Framework. The framework enables the Department to effectively manage key risks that could prevent it from achieving its objectives. The Department's EXCO, chaired by the Director-General, fulfilled the role of the Risk Management Committee and was supported by the Audit Committee in effectively overseeing the management of key risks.

3. State Owned Companies

3.1. Alexkor

Alexkor was established in terms of the Alexkor Limited Act (1992) to mine marine and land diamonds in Alexander Bay. Alexkor is exploring opportunities in energy in line with the energy security objectives of government's 2014-2019 medium term strategic framework's, specifically outcome 6 (an efficient, competitive and responsive economic infrastructure network), through coal and limestone mining opportunities, which will require the organisation to expand its operations beyond Northern Cape. Alexkor has further commissioned a study into non-mining activities in Northern Cape that the Richtersveld community could possibly pursue from the proceeds of the pooling and sharing joint venture.

In 2007, the Government and the Richtersveld community reached a settlement for the establishment of a joint venture, whereby Alexkor and the Richtersveld Mining Company, on behalf of the community, have placed their marine and land mining rights under the control of the joint venture.

Since April 2011, all diamond sales were for the account of the pooling and sharing joint venture. Alexkor generates no other income from operations apart from its 51 per cent share in the joint venture. The company posted a profit of R29.7 million in 2013/14, compared with a loss of R14.0 million in 2012/13. Alexkor was recapitalised by R350 million in the 2012/13 medium term expenditure framework, which had a positive impact on the company's financial statements and, as a result, its profitability improved significantly. Part of the R350 million was used to invest in a diamond beneficiation plant, which assisted in creating more than 200 direct and indirect jobs. Additional economic opportunities for the community are expected as mining operations expand in the next two to three years.

Alexkor has met its financial obligations in terms of the 2007 deed of settlement obligations. The deed of settlement included amongst others the restoration of land and mineral rights, formation of Pooling and Sharing Joint Venture, environmental rehabilitation and establishment of the formal township development at Alexander bay. As a result, the town was promulgated in November 2013 and now forms part of the Richtersveld municipality. The settling of the rehabilitation liability will give rise to 200 jobs over the 15-year life of the project with 40 jobs created to date. The project intention is to ensure that that the land is environmentally safe and economically exploitable for the community.

3.2. Denel

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3.3. Eskom

Eskom's mandate is to generate, transmit and distribute electricity. The company is governed by the Eskom Conversion Act (2001).According to the national development plan, South Africa will need to meet about 29 000 Megawatts of new power demand between 2012 and 2030. As a result, more than 40 000 Megawatts of new power capacity needs to be built. In line with this vision, the focus for 2014/15 has been on finalising the response to the Multi Year Price Determination 3 (MYPD3), securing the balance of the required funding to complete the new build programme, which aims to expand the company's generation and transmission capacity to meet the country's growing demand for energy , improving the rollout of the new build programme, improving operational performance and maintenance of assets to ensure security of supply, contracting with independent power producers in line with government procurement processes, and assess the role of Eskom in the implementation of the integrated resource plan for electricity 2010.

Eskom generates 95 per cent of the electricity used in South Africa and 45 per cent of the electricity used in Africa. Eskom's reserve margin has been steadily declining since 1999 due to a lack of significant investment in generation capacity. In recent years, Eskom has had to rely on deferring maintenance of power plants to meet demand and address the constrained power system to avoid load shedding. The consequence of this has been an increase in maintenance backlogs and a decline in power plant performance.

Eskom has had to reprioritise and respond to a shortfall in revenue following the electricity price increase decision, which was 8 per cent versus 16 per cent annually over five years, which means that the borrowing plans will also, need to be revised to cover its liabilities and operational costs. The new funding gap until 2017 is now estimated at R200 -13824. Over the five year period until 2019/20, Eskom's build programme is estimated to cost R280 billion.

In December 2014, Cabinet approved the Five Point Plan targeted to address the short and medium term challenges on the supply of electricity and begin to lay a foundation critical for the creation of a sustainable electricity industry. The improvement in the energy availability factor and reducing the risk of load shedding will remain the focus over the next 3 years.

Additionally, Eskom has, since 2004, been undertaking a capacity expansion (build) programme to ensure the secure and reliable supply of electricity. Completed projects between 2005/06 and 2013/14 include the Komati, Camden and Grootvlei power stations that were once not operational but have now returned to service, and the finalisation of two open cycle gas turbines. As a result, Eskom has cumulatively installed and commissioned 6 137 Megawatts of additional generating capacity into the system, and installed 5 498km of transmission networks, increasing its transmission substation capacity by 27 565 megavolt amperes.

3.4. South African Forestry Company Limited

The South African Forestry Company Limited's mandate is to ensure management of sustainable forests and to play a catalytic role in the realisation of the state's afforestation, rural development and transformation goals.

The company's operating performance over the past three financial years has been worsening as a result of a slow recovery in its primary market, the residential construction sector, as well as rigid business structures. Despite this, the company's profit increased from R74 million in 2012/13 to R510 million in 2013/14 as a result of fair value adjustments. Cash generation from operations has been under strain due to increasing logistical and labour costs and an inelastic pricing environment. The performance has constrained the business in investing in downstream operations, which is critical in sustaining the forestry operations and reducing dependence on saw-log customers.

The company's solvency, however, remains solid to ensure that it continues trading as a going concern. This will be critical when it commences with its capital investment programme, in line with the envisaged future role by the department, which sees increased investment in value adding activities.

The company has expanded its rural development contribution in line with the national development plan's vision, and is implementing the social compacts agreed with rural communities within its operations. These compacts will ensure that communities are involved in the company's operations through enterprise and skills development opportunities. Additional corporate social investment programmes concentrate on education, recreational centres, and health care through donation of timber framed structures.

3.5. South African Express Airways

South African Express Airways is a regional carrier operating domestic and regional flights established in 1994, serving secondary routes in South Africa and the continent, which include regional routes to Botswana, Namibia, the Democratic Republic of the Congo, Zimbabwe and Zambia. It also provides feeder air services that connect with South African Airways' network.

The airline has experienced challenges with regards to operational and financial performance, as well as maintaining proper systems of internal control. As a result, the 2010/11 annual financial statements were withdrawn in November 2011 due to an overstatement of assets on the balance sheet. The financial statements were restated in August 2012, resulting in a reduction of the airline's equity position from R1.2 billion to R0.4 billion.

Following the restatement of the 2010/11 annual financial statements, the airline received a qualified opinion for the 2011/12 financial statements and another qualified audit opinion for the 2012/13 annual financial statements. The impact of weak internal controls and the losses in recent years have affected the airline's ability to raise funds without government support. To address the weak performance as well as to address the breach of covenants that resulted from the reduction of equity from R1.2 billion to R0.4 billion, a guarantee of R539 million was granted in March 2013.

The focus over the medium term will be to expand operations in the African market and to partner with South African Airways to establish other hubs in Africa and thereby increase inter-regional trade in line with the objectives of the national development plan. Furthermore, South African Express Airways intends to strengthen its balance sheet to restore confidence in its financial position and performance over the MTEF period and beyond through the implementation of the airline's long term turnaround strategy.

South African Express Airways has acknowledged the need to address its poor performance and reliance on government for financial support, and in 2013 developed a long term turnaround strategy called the 20:20 Vision. The main focus of the 20:20 Vision is to assess, review and define a new business model that will improve the sustainability of the organisation going into the next 20 years. The cornerstone of the 20:20 Vision is South African Airways' long term turnaround strategy. The objective is to ensure alignment of the strategic direction of these two state owned airlines so as to derive maximum value for government as the shareholder. This will be achieved through collaboration, cooperation and coordination between the airlines.

The implementation of the 20:20 Vision has been slow, and as a result has not yet yielded the expected outcomes of a positive turnaround. Due to the deteriorating position of South African Express Airways, the airline has had to develop a recovery plan to address the cash drain and to put the airline back on the path to recovery. The department, through the shareholder compact, will ensure the initiatives outlined in the 20:20 Vision and the recovery plan are agreed upon, and performance against these targets will be monitored on a monthly and quarterly basis. The three main issues the airline plans to address with the 20:20 Vision are the relationship with South African Airways, the feeder model conflict, and the business growth to maximise economies of scale.

3.6. Transnet

Transnet's mandate is to assist in lowering the cost of doing business in South Africa, enabling economic growth, and ensuring security of supply through providing appropriate port, rail and pipeline infrastructure in a cost effective and efficient manner within acceptable benchmarks, in line with outcome 6: an efficient, competitive and responsive infrastructure network, of government's 2014-2019 medium term strategic framework.

In March 2014, Transnet announced its largest ever procurement transaction when it signed a R50 billion contract with four original equipment manufacturers to acquire 1 064 locomotives over the next four years. This was an affirmation of Transnet's commitment to infrastructure investment in the country in spite of the weak economic climate. The procurement of 1 064 locomotives is part of a market demand strategy that is underwritten by a R300 billion rolling capital investment programme over seven years. At least two thirds of the market demand strategy investment programme will be allocated to rail projects to address ageing infrastructure and rolling stock. The remaining third of the programme has been allocated to ports and pipeline infrastructure and equipment so as to ensure that complementary capacity is created and sustained.

Since the inception of the strategy in 2011/12, Transnet has spent more than R80 billion, R31.8 billion of which was spent in 2013/14in line with the Market Demand Strategy with most of the expenditure in the past three years concentrated on rail infrastructure maintenance and revitalisation as well as acquisition and refurbishment of rolling stock. Transnet has also spent on the acquisition of ports equipment as well as on the New Multi Product Pipeline. The investment programme complements Transnet's role and participation in a number of existing strategic integrated projects, particularly as a coordinator of a project that focuses on a logistics and industrial corridor between Durban, Free State and Gauteng.

Due to this investment drive, the level of Transnet's debt related to its equity capital will come under pressure as Transnet continues to increase borrowings to fund infrastructure. However, Transnet is still expected to raise funding on the strength of its balance sheet and maintain a gearing ratio of less than 50 per cent.

In 2013/14, Transnet's revenue increased by 12.8 per cent, from R50.3 billion to R56 billion mainly due to tariff increases across various service lines as well as volume growth in certain components of the business. The increase in revenue enables Transnet to remain committed to the market demand strategy. . Over the past five years, rail volumes have increased at an average growth rate of 4 per cent, resulting in a total tonnage increase of 32 million tonnes. The volume growth in automotive and containers on rail for the 2013/14 was 25.2 per cent, which shows that migration from road to rail is beginning to gain momentum in alignment with the government objectives, and is expected to grow over the MTEF period.

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