Competition without privatisation? South Africa's experience of the corporatisation of state-owned enterprises

Genna Robb [1]

1. Introduction

State-owned enterprises (SOEs) are often criticised for being inefficient and under-performing due to political interference and the lack of profit motive and disciplining market forces (Shirley, 1999). Privatisation or the sale of state assets is cited as one solution to this problem; however, it has also been suggested that reform without a change of ownership, or corporatisation, can have similar positive effects. Through requiring SOEs to behave like private sector entities, it is argued that they will be subjected to the disciplining forces of profit motives and hard budget constraints. This should be good for competition and for consumers, levelling the playing field, incentivising entry, making SOEs more efficient and lowering prices.

However, there are also circumstances in which corporatisation may not achieve these benefits. First, if corporatisation is not fully implemented (for example if SOEs still enjoy soft budget constraints or other advantages) then the benefits to competition may not be realised. Second, where SOEs are given the incentive to compete more aggressively, but through natural monopoly or incumbency advantage enjoy a high degree of market power, they may be inclined to abuse their dominance. This may enable them to exclude competitors and deter new entry, either in the core market or other related markets. In fact, as discussed further below, economic theory suggests that SOEs may be more likely to engage in such behaviour than private firms.

International experience suggests that in addition to effective regulation, a framework that ensures that SOEs do not face any special advantages (sometimes called a competitive neutrality framework) may help to ensure that private sector competitors face a truly level playing field when competing with SOEs. If either of these factors is missing, then the efficiency and competition benefits to corporatisation may not be achieved.

In South Africa, so-called state-owned companies (SOCs) are those SOEs that are, in theory at least, fully corporatised and that fall under Public Finance Management Act of 1998 (PFMA) Schedule 2 as 'major public entities'. These entities are intended to generate profits and declare dividends. They enjoy the most autonomy of all the public entities, typically operate in a competitive market and are intended to be run in accordance with general business principles. These corporations are subject to the Companies Act as well as the PFMA. They also have the power to borrow money. They are thus the most relevant examples to look at when considering the question of the impact of corporatisation on competition in South Africa.

This paper considers the South African experience with the corporatisation of SOCs and the impact of this policy on competition. It begins with a brief history of the development of SOCs in South Africa and the move towards corporatisation, and then defines a list of criteria directly related to the concept of corporatisation. It subsequently assesses South Africa's

[1] Senior Economist, Competition Commission of South Africa. The views expressed in this paper are those of the author and not the Competition Commission.

SOCs against these criteria to determine if they are indeed fully corporatised. It then considers the effect that corporatisation (or the lack thereof) has had on competition in the relevant markets. Finally, it concludes on the experience of corporatisation and competition in South Africa. The evidence suggests that in South Africa, corporatisation has not led to improved SOE performance or higher levels of competition.

2. Background on SOEs

2.1. Rationale for the existence of SOEs

According to Black et al. (2003), market failures provide a *prima facie* case for government intervention. The authors list the reasons why in reality markets may fail to provide the optimal solution promised by the perfectly competitive model; these include lack of information, lags in adjustment, incomplete markets, non-competitive markets, macroeconomic instability and non-optimal income distribution. Some of these are explained in more detail below.

A natural monopoly exists in industries where economies of scale are so high that only one firm can cost-effectively serve the market and it does not make economic sense to duplicate core infrastructure (Black et al., 2003). Frequently cited examples of natural monopoly sectors are fixed-line telecommunications, electricity transmission and rail infrastructure. In this situation, it may be more appropriate to deliver the service through an SOC since in theory government can ensure it does not abuse its monopoly power (more on this later).

An externality exists when the action of a firm or individual has a cost or benefit for others which it fails to take into account in its production or consumption decision (Black et al, 2003). For example, capital markets may fail to provide funding for a project because its risk-return profile is not attractive enough, but fail to take into account the long-term benefit to society from the project. Similarly, absent intellectual property rights, the market will typically under-provide research and development due to the fact that its social benefit is higher than the private benefit which firms can derive from undertaking it. In such situations, governments may intervene to ensure that the socially optimal outcome is achieved.

Public goods are goods or services which the market will typically under-provide due to a free-riding problem. This occurs in products like street lighting and national defence, where there is no way of preventing one consumer from free-riding (gaining the benefit from a good or service while not paying for it) on the decision of another to pay for the good or service. Public goods may therefore be better provided by governments[2].

Governments may also intervene in markets to try to meet social objectives. First, there might be distributional or equity objectives that governments want to meet which differ from market-determined outcomes. Although competitive markets can maximise total welfare, the distributional outcome arrived at by the market is determined by the initial distribution of capital and labour between individuals. If this initial distribution is highly unequal, then so too will be the final distribution, even if it is efficient in terms of total welfare (Black et al, 2003). For this reason, government may wish to influence distribution patterns in order to ensure greater equity. For example, the private sector alone may not serve remote regions or poorer

[2] Note: here ‘provided’ means paid for and not necessarily delivered. There is a rationale for government paying for the public good, but not necessarily for delivering it itself – i.e. private firms may still deliver the good or service but contracted by government. See Black et al (2003) p.35.

customers if it is not profitable, but from a social perspective it may be desirable to do so. In this situation, government intervention may be required to ensure that products and services are delivered to the required consumers at the right price.

The discussion of these market failures leads Black et al. (2003) to conclude that government intervention has three main functions: allocative, distributive and stabilisation functions. The allocative function relates to actions to correct the allocative distortions arising from incomplete and non-competitive markets. The distributive function arises from the distributional failures of competitive markets described above. Finally, the stabilisation function is concerned with macroeconomic objectives such as ensuring economic growth, full employment, price stability and a sound balance of payments.

If a rationale for some form of intervention exists, Shirley (1999) notes that the economic literature is generally neutral on the choice between state ownership versus the regulation of privately owned firms. But he notes that the case for ownership is stronger where there are large projects with specific assets where the state may be able to mobilise more capital at lower cost and spread the risk over all citizens or where information asymmetries make the effective regulation of private firms particularly difficult.

2.2. South Africa's SOEs

The term state-owned enterprise (SOE) encompasses a wide range of institutions. The recent Presidential Review Committee on SOEs commissioned by the Presidency (PRC, 2013) found that South Africa has over 700 SOEs, from constitutional organisations like the South African Human Rights Commission, to government entities (museums, research institutions, regulators) to commercially run companies (also called Schedule 2 entities or major public entities). It is this last category that the paper will focus on, as they are the most likely candidates for corporatisation. For the purposes of the rest of the discussion, we will refer to these entities as state-owned companies (SOCs).

Many of South Africa's SOCs were established in the first half of the 20th century in support of the development of the infrastructure required to build a resource-based economy (Mokwena, 2012). State ownership of the entities was necessitated by the huge capital requirements for these infrastructure investments. Sasol was established in 1950 in order to improve national fuel security and from the 1960s onwards, the state also became involved in defence-related industries, creating Armscor and later Denel. Until the 1980s, these entities were funded by the state as instruments of industrial policy and their products and services were often provided on a subsidised basis. Around this time a global disenchantment with state intervention began to prevail and a wave of privatisations followed internationally. In South Africa, from the mid-1980s onwards, government tried to foster the private sector and privatised a number of key state industries (PRC main report, 2013).

For South Africa's first democratically elected government in 1994, the question of whether to privatise some of the entities or assets was the subject of much debate. In 1999 the government announced that priority would be given to the restructuring of the four largest SOCs – Telkom, Eskom, Transnet and Denel (Fourie, 2001). Some assets were sold off, for example a 30% stake in Telkom was sold to private investors. There has, however, been little change in the status of SOCs since, with the majority remaining 100% state-owned but, in theory at least, corporatised. Some attempts have been made to bring in equity partners (for example at SAA and ACSA); however, these partnerships have not typically proved to be sustainable, with the private investor exiting quite soon (sometimes at a substantial profit) after the initial investment.

The following table describes South Africa's SOCs. It categorises them according to their activities, the responsible line ministry, the rationale for their existence, the level of government ownership, the extent to which they face competition and the date on which they were corporatised (according to the companies' own documents).

The table reveals a number of interesting features of South Africa's SOCs. First, there are several SOCs for which there does not seem to be a clear rationale in terms of the possible rationales suggested by the literature and discussed above. Armscor, ATNS and Denel all seem to exist for reasons of national security, while the Central Energy Fund has energy security as its rationale. Although not listed above, national security and energy security are commonly cited rationales for government intervention internationally and may fit into the category of ensuring macroeconomic stability.

Alexkor, Broadband Infraco and SAFCOL seem to have little rationale for being state-owned – it is not clear why their activities would be better performed by government than by a private company. Broadband Infraco in particular claims to exist in order to improve access to and lower the cost of broadband[3], presumably through providing an alternative long-distance infrastructure network to the other state-owned provider, Telkom. At first glance at least, the need to provide competition to an existing state-owned provider does not seem to be a good rationale for the creation of a new SOC. Finally, although the Independent Development Trust (IDT) clearly has developmental and poverty alleviation objectives, it is not clear that the specific function catered for by the IDT (programme management and development advisory services) is one that best suits a corporatised SOC, rather than say sitting within government. The Trans-Caledon Tunnel Authority (TCTA) may have been created due to a natural monopoly; however, it is not clear why in this instance the infrastructure was provided by an SOC rather than by the relevant government department.

Second, the SOCs vary in the extent to which they face competition. Armscor, ATNS, TCTA and Transnet are, to a large extent, monopolies, facing little or no competition in any of the markets in which they operate. ACSA, Eskom, SAA and Telkom face competition in some of the markets in which they are active, but in others have a monopoly position. The others all face competition. For example, the development finance institutions compete to some extent with the commercial banks, SABC competes with eTV and Multichoice, and the Post Office competes with PostNet and the various courier companies.

The final difference between the SOCs relates to when they were corporatised. This appears to have happened from the beginning of the 1990s onwards with some entities, such as Eskom and SABC corporatising as late as 2002.

[3] Broadband Infraco website: http://www.infraco.co.za/CorpProfile/default.aspx

Table 1: Description of South Africa's SOCs

SOE	Area of operation	Responsible Department	Rationale	Government ownership	Date corporatized
ACSA	Airport operation	Transport	Natural monopoly Distributional objectives	Majority stake (PIC holds 20%)	1993
Alexkor	Diamond mining	Public Enterprises	Unclear	Wholly-owned	1992
Armscor	Defence programme management and acquisition	Defence	National security	Wholly-owned	Unclear
ATNS	Air traffic control	Transport	National security	Wholly-owned	Unclear
Broadband Infraco	Provision of telecommunications infrastructure	Public Enterprises	Improve access to broadband	Department of Public Enterrprises 74%, IDC 26%	From establishment (2009)
CEF (including PetroSA)	Acquisition, generation, manufacture, marketing or distribution of any form of energy and research connected therewith	Energy	Energy security	Wholly-owned	Unclear
DBSA	Development finance	National Treasury	Capital market failure	Wholly-owned	Unclear
Denel	Manufacturer of defence equipment	Public Enterprises	National security	Wholly-owned	1992
Eskom	Electricity generation and distribution	Public Enterprises	Natural monopoly, distributional objectives	Wholly-owned	2002
IDC	Provision of finance for industrial development	Economic Development	Capital market failure	Wholly-owned	Unclear
IDT	Development programme management for government	Public Works	Distributional objectives	Wholly-owned	Unclear
Land Bank	Provision of financial services to the agricultural sector	National Treasury	Capital market failure	Wholly-owned	Unclear

SAA	National airline	Public Enterprises	Distributional objectives	Wholly-owned	1999
SABC	Television and radio broadcasting	Communications	Distributional objectives	Wholly-owned	2002
SA Express	National airline	Public Enterprises	Distributional objectives	Wholly-owned	Unclear
SAFCOL	Owning and managing forestry plantations	Public Enterprises	Unclear	Wholly-owned	1992
SA Post Office	Delivery services	Communications	Distributional objectives	Wholly-owned	1991
Telkom	Telecommunications	Communications	Natural monopoly	Minority stake	1991
TCTA	Water supply	Water Affairs	Natural monopoly?	Wholly-owned	From est. (1986)
Transnet	Freight logistics: rail and port facilities operation	Public Enterprises	Natural monopoly	Wholly-owned	1990

Source: National Treasury, 2013; SOC websites and annual reports.

3. Corporatisation vs. privatisation

The debate over how best to improve SOE performance has been raging for many years. In the 1980s and 1990s a wave of privatisations took place across the developing and developed world. A vast literature has been devoted to studying the effects of this privatisation and contrasting its impact on performance with alternative attempts at SOE reform and 'corporatisation'. Shirley (1999) defines privatisation as 'the sale of state-owned assets' and corporatisation as:

> *efforts to make SOEs operate as if they were private firms facing a competitive market, or if monopolies, efficient regulation. The definition includes not only incorporating SOEs under the same commercial laws as private firms, but other steps to put state firms on a level playing field with private firms by removing barriers to entry, subsidies and special privileges, forcing SOEs to compete for finance on an equal basis with private firms, and giving state managers virtually the same powers and incentives as private managers*.

Empirical evidence looking at the impact of corporatisation on performance has been mixed. Shirley and Xu (1998) found that overall, performance contracts had not improved SOE performance across six developing countries, although some were more effective than others. On the other hand, a number of studies have suggested that corporatisation can lead to improvements in SOE performance. Aivazian et al (2005) study the reform of SOEs in China and find that corporatisation has a significant positive impact on SOE performance, largely due to the reform of the internal governance structure of these firms. Cambini et al (2011) find that for a sample of 33 local bus companies over the period 1993-2002, the corporatisation of municipal entities led to a reduction in production costs. Finally, Bilodeau et al (2006) use a before/after comparison methodology to test the impact of corporatisation on the behaviour and performance of 11 agencies in Canada. The authors find that following corporatisation, output and revenues increased, the revenues-to-expenditures coverage gap narrowed, and cost-efficiency and employee productivity improved for most agencies, although some agencies did not improve or even worsened on some measures.

Interestingly, a World Bank study of 12 countries found that the most effective reforms in terms of improving SOE performance were those that privatised and corporatised SOEs the most thoroughly (Shirley, 1999). Most of the more successful reforming countries chose not just to reform but also to privatise. Shirley (1999) argues that the political costs of privatisation and corporatisation are actually similar and, when countries are ready to commit to wholesale reform, the two methods can complement each other.

Nonetheless, the World Bank study did identify some instances where privatisation would be a superior outcome, particularly in situations where there is not a clear economic rationale for government ownership. Shirley (1999) gives the example of a state-owned airline, making the argument that this should be a low priority for a developing country government since only a small proportion of the population fly and the private sector is usually ready to provide the service. Privatisation would result in funds being freed up for other uses, as well as giving the regulator more independence. The author concludes that countries are likely to be better off selling firms that are competitive or potentially competitive, as long as they can be privatised in a way that facilitates competition. Where firms cannot be divested, management contracts may assist with performance as can the introduction of competition, cutting government subsidies, the removal of access to soft credit and managerial accountability and autonomy (Shirley 1999).

In South Africa since the 1990s, the focus has mainly been on SOC reform and corporatisation rather than privatisation. The rest of the paper aims to assess the degree of reform that has been undertaken and its effectiveness in terms of SOC performance and impact on competition.

3.1. Criteria for corporatisation

The New South Wales Government (1991) in Australia developed a set of criteria, similar to the definition of corporatisation above, which measures the extent to which an entity has really been ‘corporatised’. It is clearly not enough to have simply incorporated the entity into a company. Full corporatisation refers to a much more comprehensive set of reforms. Each criterion is discussed in turn below.

- Clear and non-conflicting objectives

The first criterion which must be met is that SOCs must have clear and non-conflicting objectives. They must receive clear guidance on trade-offs and the maximisation of investment value must be made a key objective. To the extent that SOCs have some kind of social mandate or objectives (sometimes referred to as community service obligations (CSOs)), these should be the subject of explicit contracts between government and the SOC with fees fully funded and budgeted for. Finally, the policy and regulatory functions of government should be separated so that the regulatory function, the funding of CSOs and the oversight role are not all the responsibility of one ministry/minister.

- Managerial responsibility, authority and autonomy

The management of SOCs must be given the authority and autonomy necessary to allow them to successfully run the company. Directors should be appointed based on experience and skills and should not represent other interests than those of the investor. For example, social and regulatory objectives are for government to determine, not the board. The board and management should have the authority to take major decisions which will affect performance. Government’s influence should be limited to dividend policy, expected rate of return and limits of capital expenditure and borrowing programmes. Everything else should be at arm’s length from government.

- Effective performance monitoring by the owner-government

The SOC’s performance must be monitored by government and the board and management held personally accountable for poor performance. SOCs inherently receive less oversight from equity and debt markets and therefore it is necessary for government to establish independent and objective mechanisms for performance monitoring. The focus should be on commercial performance. A central monitoring unit for all SOCs is a good idea.

- Effective rewards and sanctions related to performance

There should be effective rewards and sanctions related to performance and these should be pre-defined and strongly applied. This can be implemented in terms of performance management and remuneration frameworks, and in particular by ensuring that there are real consequences for non-performance, eventually culminating in dismissal.

- Attaining competitive neutrality in input or output markets

A critical component of successful corporatisation is the achievement of competitive neutrality in input and output markets. The concept of competitive neutrality means that SOCs should receive no advantage by virtue of being state-owned, and should face circumstances as close as possible to those faced by private firms. The Government of Western Australia describes the competitive neutrality principle in the following way:

> *Competitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership…*
>
> *…Competitive neutrality requires that governments should not use their legislative or fiscal powers to advantage their own businesses over the private sector. If governments do advantage their businesses in this way, it will distort the competitive process and reduce efficiency, the more so if the government businesses are technically less efficient than their private sector competitors. (Government of Western Australia, 1996)*

The key principles of the Australian framework are taxation neutrality, debt neutrality, and regulatory neutrality. SOCs must also earn a commercial rate of return and charge prices that reflect costs.

In a report for the OECD, Copobianco and Christiansen (2011) list the basic competitive advantages that SOCs often enjoy. These are:

- Outright subsidisation – this can range from financial assistance to benefits in kind or tax exemptions.
- Concessionary financing and guarantees – this refers to anything which reduces the cost of borrowing for the SOC to below market levels and includes implicit or explicit guarantees provided by government which reduce the perceived risk to lenders.
- Other preferential treatment by government – this can describe any other way in which government uses its powers to advantage SOCs such as exemptions from costly regulatory regimes, advantageous public procurement policies or access to government information.
- Monopolies and incumbency advantages – government may grant SOCs exclusive rights over certain activities.
- Captive equity – this refers to the fact that control of an SOC cannot be transferred in the same way as it can be in a private company – unless there is a change in policy stance, the government will continue to own and control the entity. This is an advantage for SOCs as there are more limited (if any) requirements for dividends or returns which may give them less incentive to operate efficiently and more incentive to engage in exclusionary behaviour. This will be dealt with in more detail below.
- Exemption from bankruptcy rules – this removes another disciplining factor for SOCs.

If any or all of these advantages are given to SOCs, it can distort competition in the markets in which they compete, resulting in lower levels of competition in the short or long term. Competitive neutrality therefore entails the removal of all such advantages for SOCs.

- Effective natural monopoly regulation

The final criterion to be met in order for corporatisation to be successful is that effective natural monopoly regulation should be implemented. Natural monopoly and incumbency advantages raise barriers to entry and SOCs may abuse their monopoly power, so effective regulation is vital. It is particularly important to ensure that competition is not stifled in related, non-monopoly markets.

4. Assessment of the level of corporatisation of South Africa's SOCs

Following from the corporatisation criteria discussed above, the following section will assess South Africa's SOCs in order to determine whether they are in fact fully corporatised.

4.1. Clear and non-conflicting objectives

In terms of this first criterion, the performance of South Africa's SOCs is poor. Confusion around mandates and conflicting objectives is a feature of South Africa's SOCs, particularly in terms of the balance between commercial and social objectives. Most South African SOCs have both a social and commercial mandate, and many operate in both competitive and non-competitive markets. The submission by Business Unity South Africa (BUSA) to the PRC sums this up in terms of a number of examples:

> *So, the SABC operates in competition with private pay TV operators with regards to sports and entertainment content, but is also required to provide universal access through the provision of radio and television services to isolated communities, at a specified level of local content. The DBSA provides loans at close to commercial rates for some borrowers but also makes loans for socially desirable investments available on concessionary rates and terms. Telkom competes in the competitive commercial cell phone markets but also has a developmental mandate to deliver fixed line services in unprofitable rural areas. The South African Post Offices supplies non-reserved services, such as logistics (express and courier services) and financial services in competition with private sector entities; but also receives government subsidies for the fulfilment of its universal service obligations, involving the provision of universal access to postal services.* (BUSA, 2011)

These dual mandates often lead to confusion and a lack of clarity around the SOC's objectives. The PRC found that:

> *In the survey of SOEs conducted, every entity highlighted the tension between profit and non-profit objectives, indicating that there is ambiguity regarding the expectations from the owner/shareholder. It is imperative that the tension between profit and developmental objectives be managed. This must be done by being explicit*

on economic returns on invested capital and by clearly identifying non-profit objectives. (PRC main report, 2013)

CSOs are not necessarily problematic in themselves; indeed they often form part of the rationale for an SOC's existence. As discussed above, CSOs can certainly be accommodated as part of a corporatised SOC's mandate, if treated appropriately. However, in direct contrast to the guidelines outlined above, the funding of CSOs by government in South Africa is typically not explicit, and SOCs are usually required to be self-funding, regardless of any social objectives they are required to fulfil. This is problematic as SOCs are required to earn a commercial return while being forced to undertake a number of non-commercial activities. Furthermore, there is often confusion around what the social mandate of the SOC actually is.

Steyn (2011) agrees that the mandates and objectives given to South African SOEs are often too broad, arguing that government often expects SOEs to assist in achieving diverse political and policy objectives, stretching managerial time and resources. This results in SOEs increasingly making political judgements in terms of the trade-offs this entails, which, in turn, encourages greater involvement by government in the SOE, undermining the arm's length relationship with government.

The lack of clear objectives for South Africa's SOCs may in part stem from the fact that they report to a number of different departments, which tends to increase the level of policy fragmentation and makes central monitoring difficult. As shown below, eight SOCs report to the Department of Public Enterprises; these companies operate across a broad range of sectors. Eight other departments are responsible for one or more SOCs.

Table 2: Government departments responsible for SOCs

Department	**Number of SOCs**
Public Enterprises	8
Communications	3
National Treasury	2
Transport	2
Defence	1
Economic Development	1
Energy	1
Public Works	1
Water Affairs	1

Source: National Treasury 2013

A study by the Industrial Development Group conducted as an input into the PRC recommended that all SOCs should be put under the management of one ministry or department so that policymaking is not affected by the need to protect the SOCs, and that lessons learned can be applied to all SOCs (Industrial Development Group, 2012).

Overall, the PRC report finds that South Africa has no common agenda for or understanding of SOEs. It sums this up by saying:

> *This diversity ranges from varying terminology used to denote SOEs to the perceived absence of a universal and obligatory long-term vision and plan for SOEs that clarifies their role in the country at large. There are no commonly agreed strategic sectors and priorities. In addition to the absence of a consolidated national repository for all SOEs, there is confusion regarding SOEs categorisation.* (PRC main report 2013)

4.2. Managerial responsibility, authority and autonomy

The governance of SOCs is mainly determined by the PFMA and the 2002 Protocol on Corporate Governance. According to the PFMA, the responsibility for the implementation of the SOC's mandate rests with its management, but it gives the executive (the relevant line minister) the authority to intervene in the instance of management failure. The Protocol sets out the envisaged role of the SOC's board, setting similar responsibilities for the board as for those in the private sector (PRC main report, 2013.) However, once again it states that the executive should take action if the board fails to meet its targets. A shareholder compact should govern the relationship between the executive and the board. The Protocol also suggests that the majority of directors on the board should be non-executive, in order to promote objectivity and independence (PRC main report, 2013).

Thus there is a mixed degree to which the management and board of the SOC have responsibility and autonomy to carry out their mandates. If the principles outlined in the Protocol are adhered to, then there should be a well-defined arm's length relationship between the executive and the board, where the board is appropriately skilled, held to account for its performance and allowed to perform the corporate governance role without undue interference. However, the ability of the executive to intervene in the management of the SOC suggests there is potential for some blurring of roles and accountability.

Indeed in practice it seems that government typically plays a more active role in the running and governance of SOCs. Often the line minister responsible for the SOC will appoint the Chairman and CEO of the company. According to the Centre for Corporate Governance in Africa, the guidelines in the Protocol regarding the independence and objectivity of board members are usually not adhered to: 'Most board members do not meet the traditional definition of independence due to the nature of their appointment. This also had an impact on the levels of independence within the committees.' (Centre for Corporate Governance in Africa, 2012).

Gumede (2012) suggests that the blurring of responsibility between the executive and the board has undermined operational effectiveness. The author suggests that while SOC boards have responsibility for achieving their mandate on paper, in practice they often lack the required authority to do so. This has led to conflict between CEOs and boards (Gumede, 2012). The author further argues that there needs to be a move towards a merit-based board appointment process for SOC boards.

Another area where South Africa's SOCs do not perform well is in terms of the arm's length relationship with government. As touched on above, major decisions taken by SOCs (particularly around capital projects and infrastructure expansion) are frequently subject to political interference and pressure. This most often arises in the form of a so-called 'unfunded mandate', where government pressures an SOC into an infrastructure expansion project that is not economically viable, and without providing funding (Steyn, 2011). The SOC is therefore required to fund the project itself and hope that the project costs can be recovered through tariff increases. This creates a problem for regulators as high double-digit tariff increases for multiple years become unavoidable if the regulator is to ensure the financial viability for the SOE (PRC main report, 2013). The result is often a situation where tariff increases are unavoidably high but still insufficient (PRC main report, 2013).

The building of King Shaka International Airport in Durban may be one such example. ACSA had determined there would be no need for a new airport until 2017-2020 and that the project would not be economically viable (even based on optimistic cost estimates) until then (Steyn, 2011). However, the company came under strong political pressure to bring the construction forward and eventually did so, resulting in a very high tariff increase application. The regulatory committee granted a much lower tariff increase, which was also more staggered over the three-year permission period. ACSA contested the tariffs granted and eventually the Minister was forced to intervene. Due to the protracted legal process between ACSA, the regulator and the Department of Transport, the tariff increase of 34.8% was only approved after six months of the relevant tariff year had passed, and therefore the actual increase implemented by ACSA was 68.6% in order to allow them to 'claw back the required annual tariff (Politics Web, 2011).

Such large tariff increases impact negatively on consumers and contribute to the high cost of infrastructure in South Africa, something which has been identified numerous times as a constraint on growth (see for example IATA (2011), CSIR (2011) and Business Day (2014)).

4.3. Effective performance monitoring by the owner-government

Unsurprisingly, given the decentralised ownership model in South Africa, there is no overarching framework for performance monitoring of SOCs. Challenges in oversight identified by the PRC are: a lack of a coordinated and unitary oversight framework; the multiplicity of reporting institutions; the absence of a uniform approach to implementing oversight; lack of capacity to perform the oversight task; lack of oversight over subsidiaries; and the lack of inter-governmental cooperation and collaboration.

There are a number of different institutions responsible for the oversight of SOCs. Parliament interrogates their annual financial statements and parliamentary portfolio committees exercise oversight relating to service delivery and enhancing economic growth (PRC main report, 2013). The Minister of Finance and National Treasury are responsible for financial oversight. On top of this, SOCs are also accountable to their shareholder ministries. The PRC found that SOCs are often required to report to a number of different institutions which may all require different information or information compiled in different formats (PRC main report, 2013).

4.4. Effective rewards and sanctions related to performance

According to the PRC, most SOC chief executives surveyed complained that ‘they submit reports but receive no, or extremely belated, feedback from the relevant department or ministry’ (PRC main report, 2013). Furthermore, the PRC also found that the remuneration of executives and senior staff was inconsistent across SOCs and was not subject to any clear guidelines. Other problems with performance management of SOCs highlighted by the PRC are inconsistency in the measurement of performance, the inadequacy of mandates, difficulties with shareholder compacts, the lack of a standard reporting framework, the absence of a horizontal performance assessment and the absence of a central authority to set performance targets and monitor and evaluate performance.

4.5. Attaining competitive neutrality in input markets

As discussed above, the concept of competitive neutrality states that SOCs should not benefit from any special advantages from being state-owned, either through direct subsidies, explicit or implicit guarantees, policy advantages or a lack of consequences for poor performance. In South Africa, SOCs receive a number of such advantages, both explicit and implicit, which means that competing private firms often do not face a level playing field.

4.6. Subsidies/Guarantees

The Industrial Development Group notes that:

A surprising number of Schedule 2 SOEs continue to be dependent on government support, whether in the form of explicit government guarantees or subsidies. Of the sampled entities SABC, SAA, Denel, CEF, Pilansberg International Airport, Alexcor and Eskom (as a result of its massive build program) have relied on government support. (Industrial Development Group, 2012).

According to financial results published by the PRC, government subsidies to the major public entities (SOCs) grew by a compound annual growth rate of 10.3% between 2006 and 2010. Government subsidies as a percentage of revenue remained relatively constant over the period at an average of 0.4%. On the other hand, government guarantees grew very quickly – at a CAGR of 89% between 2006 and 2010. Guarantees increased from R16.6 billion in 2006 to R211 billion in 2010. (Moloto and Sujee, 2012), guarantees as a proportion of revenue from 10.1% to a staggering 98.7% and guarantees as a proportion of assets from 3.1% to 29.2%.

Table 3: Government guarantees to major state-owned entities 2006 - 2010

	2 006	2007	2008	2009	2010	Average	CAGR
Government guarantees (R, million)	16 576	18 286	7 051	210 572	211 036	92 704	88.9%
Government guarantees as a % of revenue	10.1%	10.1%	3.5%	100.9%	98.7%	48.0%	
Government guarantees as a % of assets	3.8%	3.8%	1.2%	31.9%	29.2%	16.1%	

Source: Moloto and Sujee, 2012.

This suggests that SOCs are receiving significant financial support from government, both in the form of direct subsidies and guarantees, neither of which are enjoyed by private firms.

4.7. Policy advantages

Policy decisions can significantly advantage SOCs over private companies. A recent complaint received by the Competition Commission illustrates this point. In 2011 the Commission received a complaint from Petroline RSA, which alleged that policy decisions taken by National Treasury and a tariff decision taken by the National Energy Regulator (NERSA) of South Africa had unfairly advantaged Transnet and forced Petroline's exit from the market (Loopoo and van Wyk, 2013). In 2007, NERSA granted Petroline a licence to build a petroleum pipeline from Maputo to Gauteng, in competition with Transnet's existing pipeline and another pipeline under construction. Petroline alleged that its project was rendered unviable when Transnet received a subsidy from the National Treasury as well as an unusual and favourable tariff decision from NERSA as the tariffs granted for Transnet's pipeline were too low for Petroline to be able to operate profitably. (Loopoo and van Wyk, 2013). Petroline argued in its submission to NERSA on the 2011 tariff determination: 'The regulated cross subsidies presented render it impossible to compete with the state enterprise.' Transnet's coast to inland tariff is kept artificially low through cross-subsidisation. The Commission did not have jurisdiction to consider the complaint as it is not empowered to review decisions of National Treasury or NERSA, but it seems that Petroline subsequently put its investment on hold (Loopoo and van Wyk, 2013).

A further example of this is in telecommunications policy, where Telkom, the state-owned incumbent, was given a five-year monopoly in fixed line communications as part of the policy of 'managed liberalisation' in return for providing fixed-line infrastructure to underserved areas, rolling out public phones and upgrading its telephone exchanges from analogue to digital technology (Gillwald, 2011). As will be discussed further below, since this decision was taken, Telkom has repeatedly abused its dominance.

4.8. Lack of disciplining poor performance

Another way in which SOCs may be advantaged relative to private sector firms is if poor performance and even persistent losses are tolerated by the state shareholder. In South Africa, the SOCs' financial performance has generally been poor in recent years. According to the Industrial Development Group (2012), many SOCs are performing below their required return on assets (ROA) hurdle rate and have low asset utilisation rates. Moloto and Sujee (2012) confirm this, stating that combined ROA figures for the major public entities (schedule 2 SOEs) are disappointingly low, showing an average of 0.7% between 2006 and 2010. As illustrated in the table below, overall return on assets for the major state-owned entities ranged from a maximum of 1.4% to a minimum of -0.1% over that period.

Table 4: Return on assets for major state-owned entities 2006 - 2010

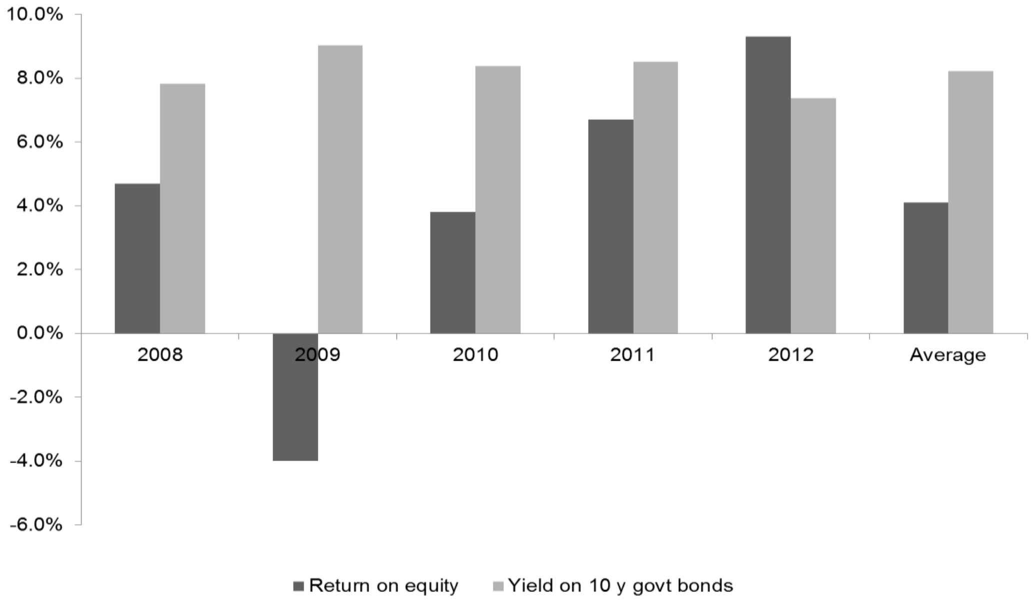
	2 006	2007	2008	2009	2010	Average
Return on assets	0.50%	1.40%	0.90%	-0.10%	0.80%	0.70%

Source: Moloto and Sujee, 2012

Although benchmark ROA rates vary by sector, by most standards an average ROA of less than 1% is extremely low and suggests that capital, particularly in such large quantities, is not being optimally deployed (Moloto and Sujee, 2012).

Furthermore, data on the return on equity (ROE) achieved by the SOCs also paints a less than impressive picture. As illustrated in the graph below, between 2008 and 2012, the ROE of the major SOCs averaged 4.1% and ranged from -4% to 9.3%. This compares unfavourably with the average yield on ten-year government bonds over the same period, which was much higher at 8.2%. This comparison is apt both as a proxy for the 'risk-free' return on investment, but also as the opportunity cost for government capital, which could be used to pay down government debt.

Figure 1: Return on equity for major state-owned companies: 2008 – 2012



Source: National Treasury 2013, SARB data.

National Treasury has three broad management categories for SOCs (PRC, 2013). At present, seven SOCs fall into the category of 'Urgent Management Attention (Red Zone)'. These are Eskom, SABC, Denel, CEF, SAA, Transnet and IDT. A further six are categorised as 'Close Monitoring (Yellow Zone)'. These are Land Bank, DBSA, ACSA, ATNS, Broadband Infraco and SA Express. Only four SOCs qualify for the least concerning category of 'Ongoing Monitoring (Green Zone)'. These are Armscor, SAPO, IDC and SAFCOL.

All in all, it is clear that from a financial perspective the SOCs are not providing government with anything close to a market-related return on investment and that below-market returns are routinely accepted by government. There are also numerous high-profile examples of SOCs that have performed particularly poorly and even made persistent losses for a number of years. For example, Broadband Infraco, created in 2009, had received R1.8 billion of capital injections by the end of March 2011. It made a loss of R207 million (-69%) in 2011 and received a qualified audit, which revealed irregular expenditure of R151 million and fruitless and wasteful expenditure of R1.9 million (Steyn, 2011). In 2012 it made a loss of R95 million (-24%) and in 2013 of R181 million (-76%) (Broadband Infraco Annual Reports 2012, 2013). Other SOCs averaging losses over the seven-year period from 2006 – 2012 are Alexcor (-12%), Denel (-11%), IDT (-1289%, data available for 2006 to 2010 only), SAA (-1%), SABC (-0.4%), and the Trans-Caledon Tunnel Authority (-15%)[4].

Finally, the performance of SOCs can also be measured by considering the extent to which they have achieved their strategic objectives. The PRC report (2013) found that 51% of SOCs' strategic objectives had been fully achieved and only 15% had been not or under-achieved.

Table 5: Achievement of strategic goals by Schedule 2 entities (SOCs)

	Not/under achieved	Achieved	Substantially achieved	Fully achieved	Over achieved	No information
	0-49%	50-79%	80-99%	100 – 109%	>109%	
Total	29	19	47	51	49	5
%	15%	10%	24%	26%	25%	3%

Source: PRC, 2013.

Schedule 3B entities on the other hand had only fully achieved 41% of strategic objective, with 14% under-achieved. Schedule 3B entities are referred to as national government business enterprises. These entities generate income, but may be either substantially self-funded or substantially government funded. They have less autonomy than the schedule 2 public entities even though they are still run in accordance with general business principles. These entities also have limited borrowing powers. This suggests that the supposedly fully corporatised SOEs are doing slightly better in terms of achieving their strategic goals, but there is less difference between the performance of the two than would perhaps be expected.

Table 6: Achievement of strategic goals by Schedule 3B entities

	Not/under achieved	Achieved	Substantially achieved	Fully achieved	Over achieved	No information
	0-49%	50-79%	80-99%	100 – 109%	>109%	
Total	29	31	28	56	27	32
%	14%	15%	14%	28%	13%	16%

Source: PRC, 2013

4.9. Effective natural monopoly regulation

South Africa has struggled with numerous challenges in the regulation of its SOCs. Steyn (2011) discusses a number of these, including: ad-hoc and inconsistent regulatory frameworks, unavoidably high and inefficient tariff increases, poor choice and execution of capital projects (also known as 'unfunded mandates'), and regulators that are ineffective in preventing monopoly abuse. The PRC report suggests several possible causes of these problems, stating that 'studies have stressed that limits to regulatory independence, lack of

[4] Data compiled from Moloto and Sujee, 2012 and SOC annual reports.

technical and specialist regulatory capacities, as well as political interference are the most pressing challenges facing the regulatory system in South Africa.' Steyn (2011) sees the problem as primarily one of policy failure, which, in turn, then drives regulatory failure. The author highlights the fact that regulators are often expected to resolve conflict between the high cost of infrastructure projects and tariff increases that are politically or economically unfeasible (Steyn, 2011).

4.10. Conclusion on the level of corporatisation of South Africa's SOCs

In conclusion, it is clear that South Africa's SOCs are mostly corporatised in name only. While the entities have been incorporated and in theory face similar corporate governance frameworks to their private sector counterparts, in reality not one of the criteria for effective corporatisation has been fully met and most are far from being met. Reflecting on the findings of the World Bank study cited above, which found that commitment to reform is critical to success, it is then unsurprising that the performance of many of the SOCs has often been poor. This lack of effective reform has had significant implications for competition in the sectors where SOCs are active, as will be discussed below.

5. SOCs, corporatisation and competition

5.1. SOCs and competition

The previous section emphasised the need for special advantages to be removed from SOCs in order to prevent distortions of competition and level the playing field for private firms. A second, but related, concern with regard to the impact of SOCs on competition is that SOCs often have a very strong market position (market power) or even monopoly control over an essential input by virtue of past (or present) policies and/or natural monopoly. Firms which have high market shares are not a competition concern per se, but only insofar as they use (or abuse) their market power to extract monopoly prices or exclude competitors. Contrary perhaps to perceptions, some authors have suggested that SOCs may be more prone to abuse their dominance than private sector firms.

Despite the social goals that they are often created to achieve, some literature suggests that SOCs may be more and not less likely to abuse their dominance (Sappington and Sidak, 2003). This stems from the fact that SOCs are likely in many cases to have revenue as well as profit objectives, since managers often have the motive to expand output and revenue instead of, or as well as, profit. SOCs are more likely to get bailed out and their managers are less likely to be fired. They are also in many cases not required to generate high returns and are expected to fulfil a social mandate (such as ensuring wide access) which detract from their ability to earn market returns. Therefore often managers are motivated to expand the scale and scope of the operation instead of its efficiency (OECD, 2009).

Sappington and Sidak (2003) show that where SOCs are maximising a combination of profit and revenue, they have a greater incentive to abuse their dominance, especially by charging prices that are below cost or by raising rivals costs. The SOC pricing decision is shown to be less sensitive to the higher costs associated with increased output, making SOCs more likely to set prices below the marginal cost of production. The authors show that this becomes more likely the less profit-focussed the SOC is. SOCs may also be more likely to engage in strategies to raise rivals costs, since this behaviour causes profit-maximising competitors to lower their level of output and/or increase prices which increases demand for the SOCs products, leading to an expansion of output for the SOC. Again, the authors demonstrate that there are stronger incentives for an SOC than a profit-maximising firm to raise rivals costs and attempt to exclude them.

SOCs may also have greater ability to abuse their dominance due to the soft budget constraints which they face and other advantages they receive. For example, under South African competition law it is prohibited for a dominant firm to charge prices below marginal or average variable cost unless it can show technological, efficiency or other pro-competitive gains which offset the anti-competitive effect of the below cost pricing. This is based on the theory of predation, which suggests that there may be instances when it is rational for a dominant firm to charge below-cost prices for a period of time in order to foreclose competitors or potential competitors from the market (O'Donoghue and Padilla, 2006). Central to these theories is the idea that the dominant firm must reasonably be able to expect prices to increase in the long run as a result of this weakening of competition, such that they can 'recoup' the lost profits associated with the period of below-cost pricing. This theory may not fit the case of SOCs as there is no need for an SOC to recoup as they are not required to make profits. They would, however, still have an incentive to attempt to exclude competitors in order to expand their own output. While SOCs may rationally engage in predatory behaviour without any expectation of recoupment, they may nonetheless have the ability to recoup ex-post through increasing prices in the market in which they have a monopoly. The conduct may also deter entrants and create a reputation for the SOC that it will respond aggressively to entry, leading to a lessening of competition.

These features of SOCs are interesting as traditional tests for abuse of dominance have been set up assuming profit-maximising firms, implying that a different approach may be required for SOCs. It is important to note also that competition authorities can only deal with problems after they have arisen, by which time competitors may already have been foreclosed from the market and entrants deterred. A competitive neutrality framework would be more effective in ensuring that such problems do not arise in the first place.

5.2. Competition and South Africa's SOCs

The South African experience tends to bear out the theory expressed above. A large proportion of the abuse of dominance cases prosecuted in South Africa to date has related to conduct by SOCs or former SOCs. In summarising the enforcement actions of the South African competition authorities, Roberts (2012) confirms this:

> *The abuse of dominance cases are notable for the fact that most have been against a former state-owned company (or currently state owned in the case of South African Airways). These include referrals against Telkom (2 cases), SAA (2 cases), Sasol (3 cases), Mittal Steel, Foskor (owned by the Industrial Development Corporation) and Safcol. Moreover there have been several involving firms whose position is based in historic state support and/or regulation in agriculture markets namely Senwes, Rooibos, Patensie. There has also been cases referred against the beer and cigarette quasi-monopolies, SAB and BATSA, with historic ties to the apartheid state.* (Roberts, 2012)

In particular, both SAA and Telkom have been the subject of more than one abuse of dominance investigation and prosecution – as will be discussed in more detail below.

The discussion above suggests that there may not be much alignment between competition policy and SOC policy, perhaps due to the fact that the competition authorities are constrained to act ex-post, after anti-competitive conduct has occurred. The relevant legislation governing SOCs is mixed in terms of whether it references the Competition Act or competition principles. The table below illustrates the extent to which the concept of competition features in the enabling legislation for some selected SOCs and their regulators. In some instances, competition is mentioned as one of the objectives of the Act or the regulator, and for one regulator (ICASA) it forms an explicit part of the regulatory mandate. For Eskom and SAA, however, competition seems to form no part of the considerations in the Act or the regulator's mandate.

Table 7: Competition alignment of SOC legislation for selected SOCs

SOC	Relevant legislation	Reference to competition
ACSA	Airports Company Act of 1993 (and amendments)	The company shall "*conduct its business in such a manner as to ensure that the company does not engage in any restrictive practice as defined in section 1 of the Maintenance and Promotion of Competition Act, 1979 (Act No. 96 of 1979)*" The regulatory committee should try to "*restrain the company from abusing its monopoly position, in such a manner as not to place undue restrictions on the company's commercial activities*"
Broadband Infraco, Telkom	Broadband Infraco Act of 2008 ICASA Act of 2000 (and amendments) Electronic Communications Act of 2005 (and amendments)	None None Reference to Competition Act Section on competition (Chapter 10) as part of ICASA's regulatory mandate Competition an objective of the Act
Eskom	Electricity Act of 1987 Eskom Conversion Act of 2001 NER Act of 2004 Electricity Regulation Act of 2006	None None None None
SAA	South African Airways Act of 2007	None

Transnet	National Ports Act of 2005	Regulator mandated to '*negotiate and conclude an agreement with the Competition Commission established by section 19 of the Competition Act, 1998 (Act No. 89 of 1998), to co-ordinate and harmonise the exercise of jurisdiction over competition matters, and ensure consistent application of the principles of this Act*;' and '*promote regulated competition*'
	Petroleum Pipelines Act of 2003	Objective of Act to '*promote competition in the construction and operation of petroleum pipelines, loading facilities and storage facilities*' Duty of the Petroleum Pipeline Authority to '*promote competition in the petroleum pipeline industry*'

Source: Relevant Acts of Parliament.

Furthermore, even where SOC legislation does speak to competition concerns, this does not seem to have led to better competitive outcomes. For example, in the Telkom case (discussed in more detail below), the sector regulator, ICASA, did have a competition mandate as per the Electronic Communications Act of 2005, being tasked to 'create competition in the telecommunications, broadcasting and the postal industries' in order to bring about 'affordable prices for goods and services rendered and provides value for money to consumers'[5]. Furthermore, the Commission and ICASA had signed an MOA in 2002 with the intention of determining how the two would work together in the event of a merger or complaint in the telecommunications sector (Government Gazette no. 23857 of 2002). However, none of this prevented Telkom from repeatedly abusing its dominance and harming competition. Indeed, in spite of the MOA there was a jurisdictional debate which lasted several years before the Supreme Court of Appeal's decision finally established that in spite of sector-specific legislation and the existence of a designated sector regulator responsible for regulating some aspects of Telkom's conduct, the competition authorities still have jurisdiction to prosecute instances of anti-competitive conduct in relation to the regulated entity.

Furthermore, the Commission has negotiated a relatively limited set of MOAs with economic regulators responsible for SOCs (as well as the MOA with Telkom, the Commission also signed an MOA with the National Energy Regulator in 2002 and with the Postal Regulator in 2004). This suggests that there may be more scope for the Commission to build stakeholder relationships in this area and advocate for a more competition-focused approach to the regulation of SOCs. This would be consistent with the mandate of the Commission, as expressed in Section 21 of the Competition Act, which gives the Commission the responsibility to:

[5] See ICASA website: https://www.icasa.org.za/AboutUs/OverviewMandate/tabid/631/Default.aspx

(h) negotiate agreements with any regulatory authority to co-ordinate and harmonize the exercise of jurisdiction over competition matters within the relevant industry or sector, and to ensure the consistent application of the principles of this Act;

…

(j) advise and receive advice from, any regulatory authority;

(k) over time, review legislation and public regulations and report to the Minister concerning any provision that permits uncompetitive behaviour. (Competition Act no. 89 of 1998)

The following table summarises the competition impact of selected SOCs and whether or not they are subject to economic regulation. A striking discovery when conducting desktop research on SOCs is the scarcity of information available. Some do not even have their most recent annual reports on their websites (IDT). In particular, there is a distinct scarcity of independent reviews of SOCs and their performance, beyond the financial results published in annual reports. Where such reviews have taken place, their results are often not made public (for example, National Treasury commissioned a review of the development finance institutions in 2008 but has never released the findings). Even the PRC, which attempted to conduct a very thorough review of South Africa's SOEs, revealed almost no information on individual entities. This position is surprising given that these are public entities that should by definition be accountable to the public. It also makes it difficult to review individual SOCs and their impact on competition. Nonetheless, those SOCs for which information was available are discussed in the following table.

The table indicates that several of the SOCs have had a significant impact on competition in the markets in which they are active. This may have been due to the advantages they enjoy as a result of being state-owned, or through intentional anticompetitive conduct, or both. For example, both SAA and Telkom have benefited from government assistance and policy decisions that may have distorted competition, and both have also abused their dominance and engaged in conduct designed to exclude competitors. The cases of Broadband Infraco and Eskom on the other hand are more illustrative of how policy decisions regarding SOCs can have serious negative consequences for competition. Finally, we can observe from the table three instances of concerns being raised by firms competing with SOCs relating to government assistance reducing their ability to compete effectively with SOCs (see CEF, SAA and Transnet discussions).

Table 8: SOCs and competition

SOC	**Competitive dynamics/impact on competition**	**Economic regulator**
ACSA	Monopoly in scheduled flights in most of SA (except Gauteng) Competition in unscheduled flights Settled with the Commission[6] on restrictive vertical practice case relating to exclusive agreement with taxi company at ORTIA.	Regulatory Committee appointed by Dept. of Transport

[6] Tribunal case number: 016725.

Alexkor	Diamonds globally traded commodity Intention to diversify into coal	N/A
Armscor	N/A	N/A
ATNS	Regulated monopoly	Regulatory Committee appointed by Dept. of Transport
Broadband Infraco	In theory competing long-distance network to Telkom but in practice not a strong competitor – only 11 customers, Neotel switched away during 2013 leading to a 40% decline in revenue (BI Annual Report, 2013) Questionable impact on competition - few customers, loss making, poorly run (see above). Decision to give network to Broadband Infraco instead of SNO Neotel may have negatively impacted on competition in the retail market (BI has no intentions of entering the retail market).	ICASA
CEF (including PetroSA)	Funding can distort competition - complaint to Commission[7] alleging that interest-free loan to state-owned mining company was anti-competitive.	N/A
DBSA	No information on impact and effect on competition available.	N/A
Denel	Faces global competition	N/A
Eskom	2003 Cabinet decision – future power generation capacity divided 70:30 Eskom:IPPs. 2007 Cabinet designated Eskom as the single buyer of power from IPPs in South Africa. Little progress towards IPP goal. Some (renewable) IPPs (3% of generation capacity (Das Nair et al, 2014) Eskom still single buyer so competitors have to sell to Eskom.	NERSA
IDC	IDC enjoys distinct competitive advantages: • Cheap financing • Strategic assets accumulated over 60 years • Significant support from government • Privileged access to government officials and ministers These need to be wielded carefully to provide maximum economic benefits without disrupting or crowding out the activities of the private sector (Flatters and Stern, 2008) The IDC is an institution faced with mission confusion and conflict, and within the area of industrial policy it faces major issues of accountability, effectiveness and potential conflict of interest. (Flatters and Stern, 2008)	N/A

[7] Commission case number: 2012Nov0665.

Independent Development Trust	No information on impact and effect on competition available.	N/A
Land Bank	No information on impact and effect on competition available.	N/A
SAA	Monopoly on some routes Several contraventions of Competition Act – abuse of dominance (see below), price fixing[8] Competitors claim that bailouts distort competition	N/A
SABC	No information on impact and effect on competition available.	ICASA
SA Express	No information on impact and effect on competition available.	N/A
SAFCOL	No information on impact and effect on competition available.	N/A
SA Post Office	No information on impact and effect on competition available.	ICASA
Telkom	Competing national networks - Broadband Infraco and some private providers investing in backbone, but local loop unbundling not being pursued Two contraventions of Competition Act[9] – abuse of dominance (see below)	ICASA
Trans-Caledon Tunnel Authority	No information on impact and effect on competition available.	N/A
Transnet	Monopoly in rail, ports, pipelines. Complaint to the Commission[10] that 7.5c/l fuel levy to fund NMPP, and Transnet's cross-subsidisation of petroleum pipeline tariffs is anti-competitive	Ports – Ports Regulator Pipelines – NERSA Rail – N/A

Due to the lack of available information on SOC performance described above, this summary likely excludes other problems with SOCs and competition. However, the existing information does suggest that the lack of real corporatisation and distorted incentives of South Africa's SOCs has led to competition related problems in several industries.

The two main examples of deliberate conduct by SOCs to frustrate competition are the abuse of dominance cases against SAA and Telkom. A short discussion of each is presented below.

5.2.1. SAA

SAA is the South African national airline and is wholly-owned by government. In October 2000, a complaint against SAA was lodged with the Competition Commission by a competing domestic airline, Nationwide. The Commission's investigation concluded that SAA

[8] Tribunal case numbers: 18/CR/Mar01, 83/CR/Oct04, 80/CR/Sep06, 42/CR/Apr10.
[9] Tribunal case numbers: 11/CR/Feb04, 016865.
[10] Commission case number: 2011May0059.

had abused its dominance by concluding agreements with travel agencies in terms of which they were incentivised to sell SAA tickets ahead of those of competitors. The Commission argued that because travel agents could and did distort consumer choices to accomplish their own commercial objectives, this led to two competitive harms. The first was that consumers in the short run would be flying on more expensive tickets and at less preferable times than if the ticket offering had been unbiased. The second was that SAA was able to perpetuate its existing dominance by restricting new entry into the market and to inhibit its rivals from expanding in the market. The Tribunal found that SAA had contravened section 8 (d)(i) of the Act through the commission payments made to travel agents and SAA was fined an administrative penalty of R45 million[11].

Two further complaints were subsequently made to the Commission by Nationwide and another competing airline, Comair; again focusing on incentive schemes offered by SAA to travel agents. Following its investigation, the Commission agreed a settlement with SAA whereby SAA agreed to pay the Commission an administrative penalty of R15 million but with no admission of liability. The settlement also included a behavioural remedy designed to prevent SAA from pursuing similar conduct in future. This settlement was confirmed by the Tribunal[12].

However, Comair and Nationwide chose to continue to fight the case at the Tribunal, as a finding of contravention is a prerequisite for the institution of an action in the High Court for damages. Comair and Nationwide alleged that the new incentive scheme was effectively a continuation of the first, with similar effects in terms of inducing travel agents not to deal with SAA's competitors. The Tribunal again ruled that SAA had contravened Section 8 (d)(i) of the Act and foreclosed competitors, extending its market power in the travel agent segment[13].

5.2.2. Telkom

Telkom is an integrated provider of telecommunications services, and is partially owned by the Department of Communications (40%) and the Government Employees Pension Fund (GEPF) (10.5%). The Commission has dealt with a number of complaints regarding Telkom's conduct over the years, particularly around strategies that appear to have been designed to raise rivals' costs. Telkom is regulated by the Independent Communications Authority of South Africa (ICASA), but this has not prevented it from repeatedly abusing its dominance and attempting to stifle the growth of competitors in the market.

In 2002 the Commission received a complaint against Telkom from the South African Value Added Network Services (VANS) Association (SAVA) and 20 other internet service providers (ISPs). The Commission conducted an investigation into the allegations and on 24 February 2004, referred the case to the Tribunal. The Commission found that Telkom had:

- refused to supply essential access facilities to independent value added network service (VANS) providers
- induced their customers not to deal with them
- charged their customers excessive prices for access services

[11] Tribunal case number: 18/CR/Mar01.
[12] Tribunal case number: 83/CR/Oct04.
[13] Tribunal case number: 80/CR/Sep06.

- discriminated in favour of its own customers by giving them a discount on distance related charges which it did not advance to customers of the independent VANS providers.

Telkom challenged this referral in the High Court on various grounds, including the jurisdiction of the Tribunal to hear the case. Telkom argued that the relevant jurisdiction to investigate the complaint lay with ICASA and not the competition authorities. Following legal proceedings lasting several years, the Supreme Court of Appeal eventually rejected Telkom's argument and referred the matter back to the Tribunal to be heard, finding that the competition authorities not only had the required jurisdiction but were also the appropriate authorities to deal with the complaint referred.

The Tribunal hearing took place between October 2011 and February 2012, with the Tribunal subsequently finding that Telkom had abused its dominance in contravention of section 8 (b) and 8(d)(i) of the Act. The Tribunal found that Telkom had leveraged its upstream monopoly in the facilities market to advantage its own subsidiary in the competitive VANS market and that Telkom's conduct had caused harm to both competitors and consumers and impeded competition and innovation in the dynamic VANS market. The Tribunal imposed an administrative penalty of R449 million on Telkom for this conduct[14].

In the meantime, the Commission had been investigating a second complaint against Telkom. Between 2005 and 2007, complaints were received from Internet Solutions, Multichoice, Verizon and the Internet Service Providers Association. The Commission's investigation found that Telkom had once again abused its dominance, contravening sections 8 (a), (b), (c) and (d) (iii) of the Act. Telkom had engaged in a margin squeeze where it had charged prices for the wholesale services used by first-tier ISPs to construct their internet access and IP VPN services which precluded cost-effective competition with Telkom Retail's own internet access and IP VPN services. Telkom had also engaged in anti-competitive bundling by selling its IP VPN and internet access services together with Diginet and ADSL access services that were priced far lower than the equivalent access services which end customers would purchase when considering the purchase of IP VPN and Internet access from other licensed operators.

Following the Tribunal's ruling on the earlier case (in August 2012), the Commission negotiated a settlement with Telkom which included an admission of guilt, a further penalty of R200 million and, perhaps most importantly, structural and behavioural remedies aimed at preventing Telkom from pursuing similar conduct in future and ensuring that competitors are able to access the services they need from Telkom on equivalent terms to Telkom's own retail division. These remedies included the implementation of a functional separation between Telkom's retail and wholesale divisions and a transparent transfer pricing programme to ensure non-discriminatory service provision by Telkom to its retail division and ISPs. Finally, Telkom agreed to wholesale and retail pricing commitments for the next five years estimated to yield R875 million in savings to customers. The settlement was confirmed by the Tribunal in July 2013[15].

[14] Tribunal case number: 11/CR/Feb04.
[15] Tribunal case number: 016865.

6. Conclusions

The main conclusion of this study is that South Africa’s SOCs are corporatised in name only and that this has had significant implications for competition in several key sectors. The evidence shows that SOCs meet none of the benchmarks for effective reform, although some of them are achieved in part. Competitive neutrality, the most important criteria from a competition perspective, is far from being achieved in a number of aspects. The lack of full (or potentially even significant) functional corporatisation may explain why the performance of SOCs in general has been poor.

The findings share many similarities with those of the recently published PRC report; indeed, we have relied on some of the PRC’s conclusions in our assessment. This paper has attempted to go further than the PRC report, however, and illustrate the implications of the lack of effective reform for the performance of SOCs and particularly for competition in the various relevant sectors. SOCs have a huge impact on competition, partly due to the special advantages that they still enjoy and partly due to an incentive to abuse their dominance. In some key sectors this has tended to distort competition and raise barriers to entry.

The PRC report touches on the issue of competitive neutrality and the impact of South Africa’s SOEs on competition very briefly in its discussion of economic regulation. The review makes recommendations around improving the quality of economic regulation. It also mentions that the regulation framework should have regard to competitive neutrality but fails to go into any further detail on what this would mean in practice. This paper suggests that the implementation of a competitive neutrality framework of the type discussed above, as well as further reforms to promote the true corporatisation of South Africa’s SOCs, is critical to achieving improved performance from SOCs as well as higher levels of competition and lower barriers to entry in several sectors. This would result in cheaper and better quality products and services being delivered to consumers, increasing the level of efficiency and competition within the South African economy. This would not preclude SOCs from fulfilling a social as well as a commercial mandate, but would require that such obligations are contracted explicitly and transparently by government.

The paper has also highlighted the lack of alignment between competition policy and SOC policy and regulation. This suggests that it may be beneficial for the Commission to advocate more strongly for the consideration of competition principles by government and regulators when it comes to SOCs.

This study has highlighted the lack of publicly available information on SOCs, which would assist a more detailed assessment of each entity against the criteria discussed above. There is therefore a need for greater transparency with respect to SOCs, which would enable a more detailed study that looks at each individual entity in terms of its achievement of its objectives (and how these objectives are specified), degree of corporatisation, interaction with policy and relevant policymakers, and impact on competition.

References

Aivaziana, V., Geb, Y. and Qiu, J., 2005. Can corporatization improve the performance of state-owned enterprises even without privatization? *Journal of Corporate Finance* 11 (2005) 791– 808.

Bilodeau, N., Laurin, C. and Vining, A., 2006. Choice of organizational form makes a real difference: The impact of corporatization on government agencies in Canada. *JPart* 17:119–147

Black, P., Calitz, E. and Steenekamp, T, 2003. *Public economics for South African students*, 2nd edition. Oxford University Press 2003.

Business Day, 2014 *EDITORIAL: Heed World Bank advice on exports*, available at http://www.bdlive.co.za/opinion/editorials/2014/02/06/editorial-heed-world-bank-advice-on-exports.

Business Unity South Africa, 2011. *The role of state owned entities in South Africa: a submission prepared by Business Unity South Africa to the Presidential Review Committee on State Owned Entities September 2011.*

Cambini, C., Filippini, M, Piacenza, M. and Vannoni, D., 2011. Corporatization and Firm Performance: Evidence from Publicly-Provided Local Utilities*. Review of Law & Economics,* 2011, vol. 7, issue 1, 191-213.

Capobianco, A. & Christiansen, H., 2011. *Competitive Neutrality and State-owned Enterprises: Challenges and Policy Options*. OECD Corporate Governance Working Paper, No. 1, OECD Publishing. Available online: http://dx.doi.org/10.1787/5kg9xfgjdhg6-e

Centre for Corporate Governance in Africa, 2012. *Rating Corporate Governance of State-Owned Enterprises: Moving towards improved performance*.

Capobianco, A. & Christiansen, H., 2011. *Competitive Neutrality and State-owned Enterprises: Challenges and Policy Options*. OECD Corporate Governance Working Paper, No. 1, OECD Publishing. Available online: http://dx.doi.org/10.1787/5kg9xfgjdhg6-e

CSIR, 2011. *South Africa's logistics costs hamper economic growth* available at http://www.csir.co.za/enews/2011_mar/06.html.

Das Nair, R., Montmasson-Clair, G. and Ryan, G., 2014. *Regulatory Entities Capacity Building Project Review of Regulators Orientation and Performance: Review of Regulation in the Electricity Supply Industry*. Trade and Industrial Policy Strategies (TIPS) 2014.

Flatters, F. and Stern, M., 2008. *Trade and Industrial Policy in South Africa.* Presented at TIPS Annual Forum in Cape Town, October 2008.

Fourie, D., 2001. The restructuring of state-owned enterprises: South African initiatives. *Asian Journal of Public Administrat*ion 23 (2), 205–216.

Flatters, F. and Stern, M., 2008. *Trade and Industrial Policy in South Africa*

Gillwald, A., 2011. *SA fails test of network society*. The Mail and Guardian (October 7).

Government of Western Australia, 1996. *Policy statement on competitive neutrality*

Gumede, W. 2012. *South African State-Owned Enterprises: Boards, Executives and Recruitment,* PRC Commissioned Report.

International Air Transport Association (IATA), 2011. *IATA urges partnership to drive aviation benefits in southern Africa*. Available at: http://www.iata.org/pressroom/pr/pages/2011-10-14-01.aspx

Industrial Development Group, 2012. *Viability and Funding of SOEs,* PRC Commissioned Report.

Loopoo, N. and van Wyk, M. 2013. *State aid and competition in South Africa*. Presented at the 7th Annual Conference on Competition Law, Economics and Policy, 5 and 6 September 2013, Sandton, Johannesburg.

Mokwena, T., 2012. *Restructuring of State Owned Enterprise in South Africa*. PRC Commissioned Report.

Moloto, M. and Sujee, Y., 2012. *State Owned Enterprises Business Case Analysis*, PRC Commissioned Report.

National Treasury, 2005. *Governance Oversight Role over State-owned Entities (SOEs)*, Available online: http://www.treasury.gov.za/publications/other/soe/Governance%20Oversight%20Role.pdf.

National Treasury 2013 – *Budget Review 2013*. Chapter 5: Asset and liability management.

National Treasury 2013. *Parent Departments and their Associated Public Entities PFMA Schedule 1, 2, 3a, 3b, 3c and 3d as at 15 March 2013*.

National Treasury 2013. *Public Institutions Listed in PFMA Schedule 1, 2, 3a, 3b, 3c and 3d as at 15 March 2013*.

New South Wales Treasury, 1991. *Characteristics of a fully corporatised government trading enterprise and checklist for national stocktake of GTE reforms*. Background papers prepared by the Special Premier's Conference Coordinating Task Force on GTE Reform. Reproduced by the NSW Treasury August 1991.

O'Donoghue, R. and Padilla, J, 2006. *The Law And Economics Of Article 82 EC.* Hart, 2006.

Office of Fair Trading (OFT), 2009. *Government in markets Why competition matters – a guide for policy makers*.

Politics Web, 2011. *ACSA tariff increases to hit travellers hard*, 21 August 2011. http://www.politicsweb.co.za/politicsweb/view/politicsweb/en/page71654?oid=251959&sn=Detail&pid=71654

Presidential Review Committee on State-Owned Entities, 2013. Main Report.

Roberts, S., 2012. *National Dominant Firms, Competition Law and Implications for Economic Development in Southern-Africa: case study of energy, beer and food*. Presented at IESE conference, Maputo, 4-5 September 2012.

Sappington, D. and Sidak, G, 2003. Competition law for state-owned enterprises. *Antitrust Law Journal* No 2 (2003). American Bar Association.

Shirley, M., 1999. Bureaucrats in business: the roles of privatization versus corporatization in state-owned enterprise reform. *World Development* Vol. 27, No 1, pp. 115-136, 1999. Elsevier science.

Shirley, M. and Xu, L., 1998. Information, incentives and commitment: an empirical analysis of contracts between government and state enterprises. *Journal of Law, Economics, and Organization,* October 1998*.*

Steyn, G., 2011, *The impact of economic regulation on the management and performance of State Owned Enterprises*, PRC Commissioned Report.