

State-Owned Enterprise Bailouts on Economic Growth: A Case on South African Airways

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Abstract: This paper reports on the effects of bailouts on crippling South African economic growth. South African Airways has been receiving endless bailouts since 1999 without becoming sustainable and economically efficient. Just like other State-Owned Enterprises (SOEs), the objective of the airline is to boost the receiver of revenue in meeting the state's obligations; by creating job opportunities and contributing to economic development. However, for the past ten years, its obligation is somewhat muted by the not insignificant contributions made by the taxpayer to keep SAA afloat. When debates on whether to trade it or parts of it to the private sector, or to keep it, little or nothing is said on how bailouts of SOEs impact the economy. This paper uses a qualitative desktop study approach to analyse the bailout history of SAA and for the periods 1999 to 2019 and its significance towards the economy. The SOE's policies and strategic operation plans were used as conceptual and theoretical (policy) framework to track areas of mismanagement that have caused its financial downtrend. The bailout history of the entity was also used to determine the impact on economic growth in South Africa. It concludes that SOEs, through recapitalisation (bailouts) absorb scarce resources which could be used more efficiently by private enterprises, therefore reducing economic growth.

Keywords: Bailout, Governance, Economic growth, South African Airways, State-Owned Enterprises

1. Introduction

State-owned enterprises (SOEs) are independent entities partially or fully owned by the state to achieve the various socio-economic goals of government – they are expected to fulfil a dual commercial and developmental mandate (Gillis, 1988). Most of these SOEs have a direct impact on the lives of citizens through the services and infrastructure they provide. The establishment of SOEs is basically a governance approach adopted by governments to promote economic growth, in order to increase government's ability to delivery public services, as well as to help develop the state. Of late however, major State Owned Enterprises (SOEs) in South Africa have come under scrutiny, with the media accentuating their shortcomings. Poor governance, mismanagement, fraud and corruption claims and a lack of financial sustainability at some of the SOEs have often been cited as some of the issues that the South African State Owned Enterprises are faced with (Sultan, 2014). There are frameworks in place that guide the operations of SOEs; this is in order to make them efficient and effective.

There has been controversial literature on the impact of SOEs on growth, while other authors have a different view, some suggest that SOEs are beneficial for the development of the country. These include,

amongst others; Buge *et al.* (2013), Fourie (2001), Chavez and Torres (2014). However, studies by Qi and Kotz (2019), Smith and Trebilcock (2001) and Enns-Jedenastik (2014) suggest that SOEs have a negative impact on economic growth because they are inefficient on the micro level. Data (Public Enterprises, 2019) has shown that most of them including SAA depend on Government support in the form of bailouts to sustain their operations. This has sparked a call for commercialization of state owned enterprises suggesting that it may be the only hope of making them profitable and essentially promote effectiveness and efficiency. The fact that some of South Africa's major SOEs still fall short of fulfilling their mandate begs the questions and calls for a need for an examination of how bailouts on SOEs impact the economy. In this paper, using the South African Airways as a case study, the conceptual framework of SOEs and legislative acts put in place to ensure efficient and effective management were outlined, as well as, the bailout history and the impact towards the economy of South Africa.

2. Theoretical Exposition

2.1 Significance of SOEs

South Africa adopted the use of SOEs as key tools for socio-economic expansion. The existence and

primary purpose of twenty-one major public entities listed on the PFMA Schedule 2 (National Treasury, 2013) is to contribute to the South Africa socio-economic development agenda. They were created solely for economic development and seen as key performers in the development of infrastructure. Chilenga (2016) indicates that SOEs in developing countries were created by their colonial masters to speeding up economic growth. They were set-up to aid in the provision of services by the government thus ensuring that the state provides effective and efficient goods and services to the citizens while also providing the state with revenue for further capital investment (Fourie, 2001). Moreover, SOEs can contribute by improving the living conditions of the citizens. According to Balbuena (2014) SOEs mainly focus on the fiscal development of utilities and infrastructure, thus suggesting that SOEs are significant vehicles for job creation and employment. Chavez and Torres (2014) add that SOEs further aid in the provision of vital services for the citizens at a rather affordable and cheaper rate to protect consumers from being exploited. This can be achieved by establishing SOEs in strategic sectors of the country's economy and obtaining control of such sectors in order to avoid the abuse of private industries monopolizing these sectors at the expense of citizens. SOEs can also help to generate revenue, so their main aim is to ensure that revenue generated in the local economy does not leave the country (Chavez & Torres, 2014). Suggesting that, SOEs are often established to eliminate foreign and private control over the domestic economy.

2.2 Regulatory Framework of SOEs

There are a number of regulatory frameworks for SOEs which range from frameworks common to a range of enterprises, to those enterprises that have specific sector or individual regulatory frameworks and structures (Bronstein & Olivier, 2011). Regulatory framework is determined by the type of entity and it includes economic regulation, safety and environmental regulation, to regulation of standards. This study will discuss legislation which applies to all SOEs. These include, among others; financial regulations, protocol on corporate Governance in the public sector and Companies Act (Act 71 of 2008).

2.3 Financial Regulation

SOEs may be financially regulated under the provisions of the Public Finance Management Act (PFMA),

Municipal Finance Management Act (MFMA) and, in many cases, the Companies Act. The focus here is on the PFMA, since much of what applies in the MFMA is to be found in the PFMA. In addition, as the principal legislation governing financial matters of SOEs, all other legislation is subordinated to the PFMA.

The aim of the PFMA is to; firstly, regulate financial management in both national and provincial governments; secondly to ensure that revenue, expenditure, assets and liabilities of those governments are managed efficiently and effectively; thirdly to provide for the responsibilities of persons entrusted with financial management in those governments; and lastly, provide for matters connected therewith (PFMA Act 1999). The objective is to have transparency, accountability, and sound management of the institutions to which the Act applies. The PFMA applies to national and provincial government and SOEs under their control, whilst the MFMA is applicable to local government and SOEs they control. These acts have similar requirements and introduce the same treasury norms and standards for the whole public sector and SOEs in South Africa. Although the PFMA has to be considered in its entirety, Sections 46 through 86 are of particular importance for financial governance issues. Every public entity governed by the PFMA must have an accounting authority, which must be accountable for the purposes of the PFMA. This is usually the board. However, if there is no board, the statutory governing body will be considered the 'authority.' In special circumstances, the relevant treasury may approve or instruct that another body serve as the accounting authority for that public entity. Accounting authorities must ensure that accurate books and records are kept and that financial statements and other statutory reports are prepared. These delegations are normally delegated to senior management, and their progress and accuracy monitored by a committee(s) of the board or authority. This delegation must be done in writing. The fiduciary duties imposed on directors are set out in section 50 of the PFMA. In addition to obligation contained in the PFMA, directors of SOEs are required to carry out their fiduciary duties in accordance with the common law and to meet the same obligations as directors of private sector companies. The Accounting Authority must seek at all times to prevent irregular, wasteful and fruitless expenditure.

2.4 Protocol on Corporate Governance in the Public Sector

Corporate governance, as embodied in the new and revised Protocol in 2002, was seen as one of the cornerstones of a strategic vision to restructure SOEs. It was the Government's intent that the principles of this Protocol should apply to all public entities and their subsidiaries. The corporate governance provides processes and systems by which corporate enterprises are directed, controlled and held to account. Corporate governance in South Africa was institutionalised by the publication of the King Report on Corporate Governance in November 1994, which report has subsequently been superseded by the King Code of 2002. The purpose of the King Report is to promote the highest standards of corporate governance in South Africa. The Code of Corporate Practices and Conduct contained in the King Report applies, *inter alia*, to SOEs and agencies that fall under the PFMA. First published in 1997, with a view to inculcating the principles of good governance in the SOEs and this Protocol constitutes a substantial revision thereof in light of the King Code and international developments. The principles enunciated therein are specifically intended to apply only to specific entities, *i.e.* those listed in Schedules 2 and 3(B) and (D) to the PFMA and any unlisted public entities that are subsidiaries of a public entity, whether listed or not. Accordingly, unlike the King Code, which covers a wide spectrum of entities in both the private and public sectors, the Protocol seeks to provide guidance specifically to the public sector, taking into account the unique mandate of the SOEs, which includes the achievement of socio-politico-economic objectives of the Government. It is recognized further that since the King Code is of general application, there are various specific public sector related issues which may not be fully addressed therein, and which issues require to be addressed in the Protocol. The Department stressed that the principles of the Protocol only sought to amplify and not supersede (or conflict with) those contained in the King Code and that the Protocol should be read in conjunction with the King Code.

2.5 Companies Act (Act 71 of 2008)

The Companies Act (Act 71 of 2008), as revised by the Companies Amendment Act 3 of 2011, and the Companies Regulations 2011, was brought into effect on 1 May 2011. According to section 2, the purpose of the Companies Act is to provide

the incorporation, registration, organization and management of companies, define relationships between companies and their respective shareholders and establish a financial rerouting standard council to advise on financial record-keeping.

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

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

3. South African Airways

SAA started operating after the South African government took over the assets and liabilities of Union Airways in February 1934. Since then, it remained 100 percent state-owned except between 1999 and 2002, when Swissair held 20 percent of the equity in the company. The SAA group is a diversified airline group providing passenger and cargo transport, and related services which connect South Africa to its major trade and tourism partners. The group has four wholly-owned subsidiaries (SAA, 2017); Mango (domestic low-cost carrier), SAA Technical (aircraft maintenance), Air Chefs (catering business) and South African Travel Centre (retail travel business).

The SOE plays a vital role as a catalyst for growth and development across the African continent. The SAA mandate is defined in the SAA Act, Act No 5 of 2007 and is reconfirmed in the Shareholder's Compact, drafted by National Treasury in its capacity as the SAA Shareholder Ministry. That being, to "engage in passenger airline and cargo transport services, air charter services and other related services in support of the state's desire to promote air links with the Republic's main business, trading and tourism markets within the African continent and internationally." The company is required to follow this mandate in a manner that is financially sustainable, while submitting to applicable operational regulations and legislation.

4. SAA Bailout History

Request from SAA for a bailout should create a feeling of *déjà vu* to South Africans since the government has given SAA more than 57 billion in bailouts since 1994 (Business Maverick Analysis, 2019). According to Mantshantsha (2019), SAA is an over-staffed, inefficient and ancient dinosaur that, except for a steady stream of taxpayer funds, has been bankrupt for the past 25 years. He argues that SAA has been draining national treasury coffers since its founding in 1934. In that time its mission was to fly South African government officials between SAA and the capital of London. The introduction of other airlines during the liberalisation of the market in the democratic era brought competition, forcing the government to operate SAA as a commercial entity (Rakabe, 2018).

It was a productive move as the whole economy benefitted, with the airline industry becoming more efficient, cheaper and accessible to the general public. However, in this new mission, and in the face of the new competition, SAA has never succeeded. In the last 25 years, the government provided the airline with funds that could have been used more profitably in more pressing government activities, such as building schools and clinics and funding the university education of poor students (Mantshantsha, 2019). These funds have been wasted bailing out a perennially loss-making entity, thus giving its management and workforce no incentive to run as a successful commercial entity.

In the past 25 years of taxpayers' money being used for bailouts to fund to SAA, the taxpayer has not seen any return on the investment (Mantshantsha,

2019). Dividends to the shareholder in the past 25 years were not paid as well, with reports indicating that SAA is unlikely to generate sufficient cash flow to sustain operations. Data on SAA has not been published because audited financial statements for the two years ending March 2018 and this year were not provided. After the cumulative cash bailouts of more than R50 billion, SAA still has an outstanding debt of R9.2 billion. According to National Treasury (2019) Government will repay this debt over the next three years to honour its contractual obligation. According to Korhonen (2019) SAA did not present optimal figures during the 2011/2012 financial year. It was reported that the entity incurred fruitless and wasteful expenditure of R4 million, R3 million of which was due to baggage claims, penalties and fines. A further R128 million was also incurred for the purposes of business continuity, due to non-adherence to supply-chain management processes. All these irregular spending hampers the performance of the airline and the State has to chip in to ensure that operations continue.

5. SOE Bailouts on Economic Growth

The growth effect of SOEs has always been controversial in literature. According to Qi and Kotz (2019) a large share of SOEs has a positive impact on long-run GDP growth. However, conventional wisdom (Chen & Feng, 2000; Lin & Liu, 2000) suggests that SOEs are inefficient on the micro level and absorb scarce resources that could be used more efficiently by private enterprises, therefore reducing economic growth. SAA's fruitless and wasteful expenditure dates back to 2011/12 financial year. Their financial results for the period 2016/17 indicated that the group reported a negative revenue growth of R-30 billion and more (SAA, 2017). The companies' new turnaround strategy showed no gains as the entity remained unprofitable and continue to be under-capitalized, with weak financial positions (Fourie, 2014). Furthermore, the entities compliance with sound corporate governance practice score was lower than that expected when compared to major SOEs (Eskom, Transnet and Telkom). This was due to; bailouts, poor provision of information, no code of ethics, poor accounting and auditing standards, no direction of the board and no provision of clear strategy. Thus, this raises a concern on the entities significance to the economy. Recapitalisation of SOEs creates a number of moral hazards which are illustrated by the behaviour of SAA. Because national government has created an expectation

that they will provide bailouts, SAA has felt free to take on excessive and perhaps unjustified risks (Jitsing, 2012). Unfortunately, the burden is shifted to taxpaying South Africans, making them indirect funders of the numerous losses incurred by the airline. Therefore, we need to understand whether the economic benefits associated with recapitalising SAA outweigh those arising from investing these funds in other alternatives.

Similar to the previous arguments for bailouts, the current is also unconvincing. SAA claims that their bad financial position was caused by the difficult economic environment. The stakeholders mostly focus on the SOE's need for money, while paying little care to where the money comes from. Financing a bailout can be done in a number of ways. According to Jitsing (2012) government can reprioritise funds from other programmes to finance the bailout. To achieve this, additional expenditure cuts are made on core programmes or alternatively on infrastructure projects. In this case, the brunt of the bailout is endured by the beneficiaries of such programmes or capital projects.

Secondly, Government may choose to increase the budget deficit to fund the bailout. Should government choose to borrow the budget deficit will grow. Thus, in turn the state debt costs would increase. Government could also choose to use funds from its contingency reserves finance the bailout, and risk having insufficient funds to cope with a national disaster. However, in both cases, the general taxpayer has to provide additional monies to pay for the bailout. Roets (2017) states that SOE bailouts have direct or indirect knock-on effects on the economy. He argues that funding SOEs leaves the government with less funds available for basic service delivery and infrastructure development. The burden on South African consumers will be increased as this would impact the investment potential of the country to outside investors and may lead to possible higher rates of unemployment.

6. Methodological Approach

This is a qualitative desktop study which consists of mainly two parts. Firstly, a literature review of the concept of SOEs; and secondly, a case study on SAA. A case study approach is employed in order to generate an in-depth, multi-faceted understanding of a complex issue in its real-life context. This research design is used extensively in a wide variety

of disciplines, particularly in the social sciences (Crowe, Cresswell, Robertson, Huby, Avery & Sheikh, 2011). According to Kohlbacher (2006) the case study method is increasingly being used and with a growing confidence as a rigorous research strategy in its own right. This method is a relevant approach primarily because this study seeks to explore and give a descriptive analysis of SAA governance issues' impact on the economy.

The purpose of the research is exploratory and descriptive, meaning it aims to establish a background on SAA's bailout history and the impact on the Economy and analyse the policy framework relating to SOEs. The objective of exploratory studies is to supply reasonably new information as well as describe events or situations while explanatory aims to provide explanations as to why certain things are occurring (Babbie & Mouton, 2001). To obtain this, Legislation and policy documents were analyzed to establish the legal framework of SOEs in South Africa. Primary sources include newspapers, various reports by government departments and theses from academic institutions. While secondary sources used are published books and journal articles. Lastly, a thematic analysis approach was used to for data analysis. The approach is a method for; identifying, analysing and reporting patterns within data. A thematic minimally organizes and describes your data set in detail as well as, interpreting various aspects of the research topic (Braun & Clarke, 2006).

7. Conclusion and Recommendations

This paper, focusing on SAA, examined the burden of SOE bailouts on the economy in South Africa. It was noted that the role of SOEs in South Africa are critical to achieve government developmental objectives. SAA as well was established to play a role as a catalyst for growth and development in South African. However, the SOE has failed to live up to its expectations for the last ten years, remaining unprofitable and undercapitalized, thus, depending on government support in the form of bailouts to sustain their operations. As such, very little attention is given regarding recapitalization repercussions to the economy. It's against this background, that this paper argues that SAA is inefficient and bailouts on the SOE impact the economy negatively, because government reprioritises funds from other programmes to sustain the entity, captivating scarce resources that may have been used more efficiently, therefore reducing economic growth.

In view of this, the paper makes several recommendations. First of all, SAA must be allowed to fail to discourage the moral behaviour, the practice of being overly risky or imprudent knowing the costs will be endured by the state. To ease the broader risks to the economy, conditions and restrictions on bailouts as well as the approval process need to be tightened. Feature undertaking a process of identifying policy inconsistencies and conflicts to develop a blueprint to guide regulatory designs. In a lighter manner, the SOE must develop a long-term strategy which must be in line with NDP objectives to consolidate legislative framework. To achieve this, the state should be a conversant and active owner formulating policy which warrants that governance is carried out transparently and accountably. In terms of governance, the management of SOEs needs to be depoliticised, allowing managers to manage without interference and be subjected to disciplinary overtures of the market as well as corporate code of good governance, also ensuring that employees bear the brunt of management failures and imposing sanctions for corrupt activities. As recommended by PRC (2013), the state must employ a common performance management system, which serves as a benchmark of how SOEs need to perform. The last resort would be partial privatisation and listing of the SOE on the financial market. The company would be obliged to comply with the King Reports which encourage high standards of corporate governance. Listing the company may also provide a barrier against state intervention.

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