GOVERNMENT OF SWAZILAND
Ministry of Finance

PROCEDURES TO IMPROVE MONITORING, ANALYSIS AND CONTROL OF PUBLIC ENTERPRISES

Main report

May 1986

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Hon. B.S. Dlamini
Minister of Finance
P.O. Box 443
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Kingdom of Swaziland

30th April 1986

Dear Minister,

MONITORING, ANALYSIS AND CONTROL PROCEDURES FOR PUBLIC ENTERPRISES

We have great pleasure in submitting the final report and recommendations from the study, sponsored by USAID, on procedures to improve monitoring, analysis and control of public enterprises. Our report is in two volumes: the first contains the main report and recommendations, including an Executive Summary; the second contains appendices to the report.

We were very grateful for the opportunity to discuss the main recommendations in our draft summary report with yourself and the Principal Secretaries during the final week of our stay in Swaziland. Additionally, we received minutes of a further meeting of the Principal Secretaries, where the report was discussed in more detail. At these meetings, three main, interrelated concerns were expressed:-

(a) our recommendations on the process of policy approval would lead to the "politicisation" of enterprise decision-taking;
(b) the recommended central organisation to monitor and analyse the enterprises, OFPEN, would become too powerful;
(c) our recommendations that OFPEN be a Statutory Body resulted in it being attached to the "political wing" rather than the administrative wing.

We would like briefly to address each of these concerns.

Politicisation of Control

At our meeting with the Principal Secretaries, it was pointed out that, generally speaking, those countries where political interference in public enterprise decisions had been greatest tended to be those with the least successful record of public enterprise performance. This is a most valid point. However, we believe that the control process we have recommended avoids this problem as far as possible.

First, vesting control in a four-man Cabinet Committee spreads power and responsibility, rather than concentrating it in one Minister's hands. Second, in giving our recommendations on which enterprise policy decisions should be subject to government scrutiny, we stress the need for control to be flexible, allowing the market to restrain tariff or salary increases, wherever feasible, rather than imposing legal sanctions on such increases. And third, the main thrust of our recommendations on control is that government should aim to effect control through the establishment of corporate plans and performance targets, adherence to which can be monitored at "arms length", negating the need to interfere continually in every decision to ensure that the enterprises are following government policy. All these measures serve, we believe, to reduce the level of direct political interference - whilst increasing government's useful and necessary control of the enterprises.

OFPEN's Powers

As we stressed in our draft summary report, we recommend that OFPEN be an advisory body, with no executive powers of its own. Its role would be to assist the existing agencies of Government in the control of public enterprises, through the application of its financial and management expertise. In particular, it would be responsible for advising Government on financial policy towards the enterprises, and would assist the enterprises in implementing planning and performance review procedures. But overall responsibility for determining the objectives of the enterprise will remain with the line ministries; OFPEN will assist each responsible ministry in interpreting the latter's broad policies into detailed plans and targets. So, whilst the ministry sets down what it wishes the enterprise to achieve, OFPEN concentrates on improving the efficiency of the enterprise in achieving it. Given this definition of OFPEN's role, we believe that the possibility of OFPEN becoming "too powerful" is small, and that sufficient checks and balances exist to alleviate worries in this regard, particularly the existence of the OFPEN Board and the fact that the line ministries as well as OFPEN will have direct access to SCOPE.

OFPEN's Status

Concern was expressed to us that OFPEN was to be attached to the political wing of Government, which referred to its links to SCOPE, and that it was to be a Statutory Body and not part of the Government administration. We believe that the former perception - that OFPEN's link to the political wing was too direct - resulted from a failure on our part to make quite clear in the summary report that we recommend that the Director of OFPEN report via the Secretary to the Cabinet to the Prime Minister (or, perhaps, the new Minister in the Prime Minister's office). Our statement that he should report "direct to SCOPE" was in that sense misleading; the link to the Minister would be through a Civil Servant. And in all day-to-day matters, OFPEN will work closely with the Government administration and continually exchange views and opinions with officials in the ministries.

The choice of whether the Office should be a Government department or a separate Statutory Body should therefore be made, we believe, on the relative technical merits of each option rather than being influenced by concern over "politicising" the public enterprises. In Appendix K we have described briefly the "models" used in other countries for their central agency overseeing public enterprises. Both government departments and separate Statutory Bodies have been set up elsewhere, there have been successes and failures with each model. We have preferred a model based on a Statutory Body for reasons which are fully described in the main report (Chapter II, paragraphs 2.70 et seq.) but are summarised below.

The main point which we stress is that the responsibilities, status and staffing of this body are inextricably linked. The duties and objectives which are to be given to the body determine its required status and staffing. Accordingly, we believe that the Government department would be appropriate for developing the monitoring and budgetary procedures and the simple performance targets which we describe in our report. But the detailed technical discussions on the "Performance Agreements" (Chapter III, paragraphs 3.60 to 3.91), which will involve the central body acting as a mediator between Government and the enterprises in negotiations on objectives, financial assistance and corporate strategy, and the subsequent need, as part of the Agreement, to analyse, evaluate and advise Government on management's performance, require a degree of independence and type of staff which we believe could only be achieved by establishing a Statutory Body.

We trust that this helps clarify our recommendations regarding the institutional arrangements for control. Chapter II discusses these issues in detail.

We would like to thank all the people, in Government, the public enterprises and the private sector, who gave time to talk to us during our stay in Swaziland. We received the fullest co-operation from all those whom we contacted.

We trust that our report and recommendations will be useful in developing a strategy to improve the efficiency and performance of the public enterprise sector. Should you wish to discuss the report, or if you have any further enquiries, please do not hesitate to contact us.

Yours truly

COOPERS AND LYBRAND ASSOCIATES

PROCEDURES TO IMPROVE THE MONITORING, ANALYSIS AND CONTROL OF PUBLIC ENTERPRISES

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MONITORING, ANALYSIS AND CONTROL OF PUBLIC ENTERPRISES

EXECUTIVE SUMMARY

Introduction

S1. The Government is concerned about its lack of information on and control over public enterprises in Swaziland at a time when its financial exposure to the parastatal sector is increasing markedly. It therefore wishes to implement procedures which will enable it to exert clearer and stronger control, based on a better understanding of the enterprises and the environment in which they operate, while at the same time enhancing their performance and efficiency.

S2. We define the purpose of control as: to improve the performance of the public enterprises in achieving Government's objectives.

S3. This definition makes clear the importance of the following when seeking to increase control:

(a) Objective - setting and planning: Government must define the objectives it wishes the enterprise to pursue. This broad statement of objectives should be translated into a corporate plan, which provides management with clear financial and operational targets to achieve, both over the medium-term and in detailed annual budgets;

(b) Performance review and policy advice. Where targets are not achieved, Government must work with the enterprise to identify problems and constraints and formulate policies to overcome them. Control must not be a punitive structure but should go hand-in-hand with measures to improve performance;

(c) Monitoring: In order to observe whether an enterprise is adhering to specified targets or whether a particular policy change has improved performance, regular up-to-date information is required from the enterprise. Thus the development of plans and targets must be matched by the establishment of comprehensive monitoring procedures and information flows.

S4. Thus 'control" is defined as ensuring the adherence of an enterprise to a structure of plans and targets, through the monitoring of actual against planned performance and the formulation of policies to correct observed variances from the plans. Implementing an effective control structure is therefore seen to focus as much on improving the efficiency of enterprises as it does on the creation of new laws or "watchdog" authorities.

S5. However, the laws and the institutions which administer them are also of critical importance: indeed, they establish the framework within which the planning, performance review and monitoring procedures must be effected. Accordingly, we consider this framework of control first. We make recommendations on:

(a) the nature of control - the number and importance of policy decisions which are to be subject to government control and the means by which such control is to be exercised; and

(b) the structure of control - the institutions which are to administer the control, planning, performance review and monitoring procedures and the relations between them

S6. We next consider the procedures for developing corporate plans, budgets and performance targets, and the establishment of monitoring procedures. Finally, we provide case studies of four parastatals, highlighting the main issues for each and drawing some general lessons of relevance for the parastatal sector as a whole.

<u>Nature of control</u>

S7. Public enterprises have hitherto enjoyed a high degree of autonomy. Whilst allowing management the benefits of full freedom of action, this has also resulted in important decisions being taken without Government, the owner, being fully able to analyse and debate the consequences of enterprise actions, thus restricting its ability to direct the enterprises towards its objectives. We recommend that all enterprises now be required to seek government approval for:-

* Budgets
* Tariff adjustments
* Major investments/divestments
* Salary increases
* Selection of Board members
* Selection of Chief Executive/ Financial Controllers
* Selection of auditors

S8. With regard to controls on tariffs and salaries in particular, it is important that the "intensity" of control should vary according to the nature and status of the enterprise: clearly, closer control is required of a monopoly's prices than of the prices of an enterprise which faces substantial competition. More generally, Government should attempt gradually to reduce its reliance on legal regulations to effect control, wherever possible allowing management the freedom to set whatever policies it thinks most likely to achieve the performance targets established by Government. This both reduces the chance of frequent, harmful political interference in enterprise decision-taking and increases the scope for management initiative. Accordingly, our recommendations for new legislation allow the intensity of control to be varied.

S9. In addition, all enterprises should be required to submit the following documents to government:-

* Annual audited accounts, including the auditor's internal control letter;
* Annual budgets;
* Quarterly financial statements.

Structure of control

Cabinet Committee

S10. In order to:

* recognise the wide-reaching impact of public enterprise operations, particularly on fiscal and macroeconomic policy; and
* allow for the harmonisation and co-ordination of government policy towards public enterprises.

we recommend that control of all public enterprises be vested in a Cabinet Committee, the Standing Committee on Public Enterprises (SCOPE).

S11. The Committee would consist of: the Prime Minister (Chairman) (or a Minister nominated by him); the Minister of Finance (Deputy Chairman); the Minister for Commerce, Industry and Tourism (Member). It would co-opt the Minister of the line Ministry responsible for an individual public enterprises when that enterprise was being discussed.

Administrative and Technical Support

S12. We have stressed the need for control to be effected not just through legal regulations, but through a more performance-oriented structure of plans and targets. The development of such plans, and the subsequent monitoring and analysis of the enterprises, to ensure adherence to the plans and identify the reasons for divergence from them, obviously requires a considerable technical input But monitoring and analysis of the public enterprises is presently weak, since the line ministries do not have the necessary expertise to perform these tasks.

S13. Clearly, to build up sufficient expertise within the line ministries would take a long time and a large number of staff. We do not believe that this is the most cost-effective way of improving Government control over the public enterprises. In order to achieve "economies of scale" in monitoring and analysing enterprises across six different ministries, and in order most effectively to co-ordinate government policy towards them, we recommend that a central body be established with responsibilities for technical liaison with all public enterprises.

S14. The precise status and staffing of such a body are dictated by the role the body is to play in government-enterprise relations. We believe the most effective role of such a body is not just as a monitor of the enterprises, or a "watchdog" over them, but as an advisor and indeed an advocate for them in their dealings with Central Government. In particular, the body would be a mediator between Government and the enterprises in the negotiation of agreements on future performance.

S15. This role requires the body to be independent of Central Government, both to ensure its objectivity and to be able to attract the type of staff required (i.e. people skilled in company analysis and familiar with the operations of commercial organizations). Accordingly, we recommend that an

"Office for Public Enterprises" (OFPEN) be created, as a separate Statutory Body under the Cabinet Office.

S16. OFPEN's Chief Officer (the Director) should report via the Secretary to the Cabinet to the Prime Minister. He should have extensive experience in financial analysis and corporate planning in public enterprises. Under him should be four staff - economists or accountants - trained in company analysis Technical assistance may be necessary in the first few years.

OFPEN Advisory Board

S17. The Director should be advised by a Board consisting of:-

* the Secretary to the Cabinet, who will chair meetings of the Board;
* the PSs of Finance, Commerce and DEPS;
* an MP or Senator, appointed by the Prime Minister;
* a Chairman or Chief Executive of a large private-sector company, appointed by the Prime Minister;
* a Chairman of one of the public enterprises, nominated by his fellow Chairmen as their representative.

S18. This Board will meet at regular intervals to discuss the key issues facing the public enterprise sector, thus giving the Director a wider perspective and providing a forum through which different parties' views can be fed into the policy formulation process. The Office will also liaise closely on a day-to-day basis with the central agencies of government and, in particular, the line ministries, which will remain responsible for the individual enterprises in their sector.

Line Ministries

S19. OFPEN's role is to relieve the line ministry of the technical burden of analysis; interpret ministry policy into financial and operational plans; and ensure consistency of ministry policy with other fiscal and macroeconomic policies. Thus the line ministry will be mostly concerned with the setting of broad development policies and will liaise with the enterprises on technical matters, whilst OFPEN will be concerned with the more detailed financial and operational implications of ministry policy. The two roles are clearly complementary: a financially sound enterprise is better able to further the developmental interests of the ministry.

Boards

S20. The creation of OFPEN would not change the essential function of the Boards of public enterprises as bodies charged with overseeing the direction of each enterprise and advising management on policy. However, we recommend that the Boards be re-constituted, in order to:-

(a) make the General Manager an equal contributor to the debate on overall policy direction, not just a receiver of instructions;
(b) ensure that the role of the Board as an independent advisor to Government is not compromised; and
(c) clarify the fact that formal Government approval for a policy is obtained from SCOPE, and not through ad hoc statements by Government representatives - often junior staff - at Board meetings.

S21. We therefore recommend that:-

(a) all General Managers be made Managing Directors;
(b) Boards be re-constituted, generally to consist of 5 - 7 people, none of which should be civil servants, who should be nominated by the line Minister, subject only to SCOPE ensuring that an overall balance of technical, commercial and financial personnel is maintained on each Board;
(c) the Director of OFPEN and the PS of the line ministry (or their representatives) be given observer status on all Boards. They will have no say in the final decision of the Board. If government wishes to overrule the Board, it must do so explicitly, via a policy ruling from SCOPE. However, the Director and the PS may provide advice to the Board on government policy, and will obtain a valuable insight into the style and method of decision-making within the enterprises. In exceptional circumstances - for instance, where a PS has a particular technical skill not elsewhere available - the PS could be accorded voting powers.

Planning, Budget and Performance Review Procedures

S22. There are still some public enterprises which do not produce a budget, even for internal management use. Where budgets are prepared, their usefulness and accuracy is impaired by the lack of a longer-term corporate plan.

S23. We believe it essential that each public enterprise develop a corporate plan in order to translate the broad objectives of the enterprise into quantified targets for management. The corporate plan should:-

* set out broad medium - term financial and operational performance targets consistent with the objectives of the enterprise

* identify the need for investments or restructuring

* project resource requirements (financing and staff)

* identify external constraints (e.g. government policy or macroeconomic factors)

* provide detailed financial projections based on the above analyses.

S24. The annual budgeting process will then be a part of this medium-term planning framework, incorporating detailed short-run performance targets consistent with the medium-term targets embodied in the plan.

<u>Budget procedures</u>

S25. However, we feel that establishing such a complex planning process will take a considerable time and require external technical assistance. In the interim, there is an immediate need to collect the most basic budgetary information on each enterprise and establish some simple performance targets. We recommend a two-stage budget submission:-

(a) a cash-flow and capital expenditure budget, submitted in late August to coincide with the government budget process. The prime purpose would be to identify the need for government funding in the following financial year, whether for specific projects or to finance an overall cash deficit. In requesting government assistance, an enterprise would be required to have considered and costed alternative options;

(b) a full budget, incorporating a forecast profit and loss account and balance sheet for the coming year, as well as revised cashflow and capital expenditure forecasts, to be submitted at least one month before the start of the enterprise's financial year (in most cases, therefore, in February). This would be the budget which would form the basis for performance review during the year, with OFPEN monitoring actual against budgeted performance on all the key indicators.

Performance targets

S26. OFPEN's primary task in reviewing the first budget submission would be to check the validity of the assumptions. But with the second, more - detailed submission, it would also be concerned with examining the scope for the enterprise to achieve a higher level of performance then had been budgeted. Specific performance targets would be negotiated for the key financial and operational indicators.

S27. A full performance - targeting exercise will have to await the completion of the corporate plan which will enable targets to be related to the agreed objectives of the enterprise, as set out in the medium-term planning framework and to recognise the external constraints facing management. But in the interim, we recommend that targets are set which focus on indicators that are "unequivocal" measures of "good performance", regardless of the longer-term objectives of the enterprise. These are in two categories:-

(a) Productivity targets - measuring not what the enterprise achieves but the efficiency in achieving it;

(b) Financial management targets - measuring the speed, accuracy and efficiency of the financial control function.

S28. Final approval of the budget would be granted by SCOPE, on the recommendation of OFPEN and after prior consideration by the enterprise Board. The aim should be for all enterprises to have approved budgets by the beginning of their financial year. The Minister responsible will then lay the budgets before Parliament.

Performance Agreements

S29. The above processes establish a degree of scrutiny and control of public enterprise budgets. But there is need for a more thorough corporate planning exercise for each enterprise, which would involve a process of detailed analysis of the enterprise, and negotiation between management and government (the line Ministry, Finance, DEPS), to agree a kind of "contract" in which both parties state their mutual obligations and commitments. Such an agreement would include:-

(a) a statement of objectives delineating the fundamental goals of the enterprise;
(b) a statement on relations with government, including:
    (i) the need for approvals for key decisions;
    (ii) specific non-commercial services (if any) to be run;
    (iii) government financial assistance to the enterprise;
    (iv) tax and dividend payments to be made;
(c) a medium-term corporate plan (as described in S23 above);
(d) detailed short-run performance targets, consistent with the annual budget and the medium-term plan;
(e) a package of incentives - rewards and sanctions - for enterprise management to achieve the targets set;
(f) a procedure for monitoring and assessment of the performance of the enterprise and its management.

S30. OFPEN will have a crucial role in formulating this agreement, as the mediator in the negotiations between government and the enterprise. Clearly, the strength of the Office will be a key factor in the success of the negotiations.

Monitoring Procedures

S31. Central Government's information on the public enterprises is currently inadequate. There is little regular financial reporting by the enterprises. But collecting timely and accurate information is a crucial part of the control and performance improvement process.

S32. We recommend that an improved monitoring effort should have four strands:

(a) the collection of key historical information (e.g. past accounts, Board papers, previous studies etc);
(b) the instigation of quarterly financial reporting, incorporating:-

(i) a profit and loss account, balance sheet, cash-flow forecast and capital expenditure report, showing actual against budgeted performance, and explaining variances;

(ii) a statement of the performance against a set of pre-agreed performance targets;

(iii) a report, written by the Chief Executive, describing the key trends of the quarter and looking forward to the main issues of the next few months;

(c) quarterly meetings between the enterprises and OFPEN to discuss the results and to air management problems;

(d) attendance by OFPEN staff as observers at all Board meetings.

S33. The financial information should be provided by the enterprises in a format as close as possible to a given standard format, to facilitate analysis and consolidation. To this end, we have designed simple forms for each of the main financial statements.

S34. Several enterprises have severe weaknesses in their accounting and management information systems. This presents a most serious obstacle to any programme aimed at improving performance and control. There is an urgent requirement to review the accounting and management information systems of all public enterprises in the light of the response to OFPEN's request for information. Where an enterprise is unable to provide the quarterly financial information in the time allowed - initially eight weeks, gradually reducing to four - OFPEN should identify the problem and arrange for the external auditors or other financial advisors to assist the enterprise as necessary.

S35. OFPEN should prepare a report to SCOPE every quarter, and annually in more detail, setting out:

(a) the financial and operational performance of each enterprise;

(b) the performance of the management of each enterprise, (noting the impact of factors beyond management's control);

(c) the key problems and constraints facing each enterprise, future actions planned and policy decisions pending;

(d) the consolidated impact of the public enterprises on the public sector's finances (in the GFS format) and the macro-economy;

(e) key issues for the public enterprise sector as a whole (e.g. government policies, external events such as exchange rate movements).

S36. Each year, OFPEN should also report on the operations of the Office itself, and its internal development, including the recruitment of staff. It should inform SCOPE of its activities during the year and set out its recommendations for more effective control of the public enterprise sector.

Public Enterprise Case Studies

S37. We were specifically requested in our Terms of Reference to review the policies of a select number of public enterprises and to formulate performance criteria. The importance of these public enterprise reviews should be viewed in terms of their relevance to the future operation of the proposed Office for Public Enterprises (OFPEN).

S38. The purpose of these reviews therefore, is to establish a framework of analysis within which performance criteria can be agreed for all public enterprises. In line with this purpose the primary objectives of the reviews are to:-

(a) examine the present relationships between the Government and the public enterprises;
(b) assess the effectiveness of the present management control mechanisms; and
(c) suggest ways of improving (a) and (b).

S39. Our analysis in these reviews has focussed upon the following topics:-

* corporate objectives
* framework for control
* policies and strategic plans
* management information
* financial and operational performance.

General Lessons from the Case Studies

S40. Case studies were undertaken on the following enterprises:-

* Swaziland Electricity Board (SEB)
* Swaziland Television Authority (TVA)
* Royal Swazi National Airways Corporation (RSNAC)
* Swaziland Railway (SR).

S41. Regarding <u>corporate objectives</u> we conclude that:-

(a) objectives specified in the legislation setting up the enterprise are in all cases so widely and generally worded as to provide virtually no guidance to management in setting operational objectives;
(b) the failure to define objectives clearly can result in conflicts between objectives, as in SEB, and an inadequate framework for taking decisions;
(c) there is a conspicuous absence of clear statements of financial policy in the legislation setting up the enterprises; and
(d) the non-commercial objectives expected of enterprisess by government have tended to be obscured and have, moreover, been excluded from the legislation.

S42. Our conclusions on the <u>external framework</u> for control may be summarised as follows:-

(a) there is a lack of coherent and appropriate tariff policy;
(b) the enterprises are relatively autonomous in salary determination with the notable exception of the TVA; it is appropriate that they should have the latitude to determine remuneration levels in accordance with market principles so long as there exist satisfactory guidelines controlling the salary levels of parastatals, particularly those which are monopolies; and
(c) channels of communication between the enterprises and the Government are in general inadequate.

S43. In respect of the <u>internal framework</u> for control it is apparent that the potential effectiveness of the <u>Boards of Directors</u> is constrained by:-

(a) a general lack of financial expertise; and
(b) the over-reliance on representation of Principal Secretaries on the Boards relative to their capacities to attend regularly.

S44. We observe also from an examination of the <u>organisation structures</u> of the four enterprises that the span of control of the Chief Executive is often too wide. That is, there are too many senior officers reporting directly to him which dilutes the latter's capacity to lead and control and in particular to devote time to planning and policy thinking.

S45. Concerning corporate planning we note that none of the four enterprises reviewed possessed a strategic medium-term plan covering the next three to five years. We accept that there exist practical difficulties in forecasting arising from the impact of external factors but we consider this does not obviate the need for planning: rather this highlights the importance of making assumptions regarding external factors explicit, and of assessing their potential impact.

S46. Further we note the absence of medium-term projections of principal and interest payments on outstanding loans. This represents a lack of financial planning which could affect the capacity of the enterprise to service its loans.

S47. We observe that all the four enterprises have prepared budgets for the forthcoming financial year; we understand that in the case of SR this is the first budget which has been prepared. The budgeting procedures currently adopted are weak in that:-

(a) insufficient supporting documentation is provided with which to test the validity of the assumptions made; and
(b) expenditures are generally estimated on a simple incremental basis.

In addition we note that it is exceptionally difficult to draw up accurate budgets as a basis for Government subventions nine months prior to the start of the budget year, which is the government requirement.

S48. Regular management accounts are prepared by all enterprises reviewed, with the exception of SR However, we conclude that the existing management information systems are deficient in a number of respects:-

(a) forward cash flow projections, an important management tool, are rarely made;
(b) there is no narrative report explaining major adverse variances and corrective action proposed;
(c) the management accounts are generally not used as instruments of management control; and
(d) the management accounts are too detailed for management review in the cases of TVA and RSNAC.

S49. Regarding operational and financial performance, the historical data and next year's projections demonstrate that, for three enterprises, there is relatively little scope for significant improvements in performance in the short-run related to growth in output and revenues. (The notable exception is SR which, since the opening of the Northern Railway Link in January 1986, has enormous potential for immediate improvements in freight hauled). For the most part, improvements in efficiency must arise from the cost side. This demonstrates the importance of subjecting variable and overhead costs to greater scrutiny in order to reduce costs per unit of output to acceptable levels.

S50. We draw the following conclusions regarding the profitability of the four enterprises:-

(a) only SEB is currently profitable;

(b) SR is potentially highly profitable since the opening of the Northern Rail Link;

(c) in respect of TVA:-

   (i) the rental operation (STAR) is potentially profitable provided is is required to operate on a commercial basis;

   (ii) STBC, the broadcasting arm, is currently unprofitable with little prospect of improvement in the immediate future; and

(d) RSNAC is currently very unprofitable with little prospect of becoming profitable in the foreseeable future.

S51. As regards requests for financial subvention, we observe that the criteria and basis for estimating the deficit to be financed are radically different from those required for a government department. In principle, subventions for public enterprises should comprise support for the cash flow deficit, the provision of non-commercial services and capital expenditure. In respect of the Government subventions in 1986/7 for TVA and RSNAC, none of these criteria were met

S52. Finally, the indebtedness to Government of two enterprises, RSNAC and SR, is not subject to formal agreements specifying terms and conditions of the loans. It is essential that the repayment terms are formalised between the Government and the relevant public enterprise.

S53. With the exception of RSNAC which sets targets for a wide range of performance indicators and ratios, performance criteria are not used by any of the enterprises which we reviewed. These criteria should embrace operational, financial and manpower indicators and not be restricted to measures of profitability which may simply reflect monopoly power or requirements to perform non-commercial services.

I INTRODUCTION

1.1 The Government has in recent years become increasingly concerned about the performance of its public enterprises. This concern was expressed repeatedly in the Fourth Development Plan, which highlighted the need to improve "control over parastatal expenditure and policies" (page 297) as an urgent requirement for the immediate future. More recently, the Minister for Finance, in his 1986 Budget speech, commented on "the drain imposed on the Government budget by public enterprises" (page 11) and stated his intention to introduce measures to improve the monitoring and forecasting of public enterprise performance.

1.2 The parastatal sector now accounts for a significant portion of government expenditures. In 1985/6, estimated grants, loans or subventions of E19.1m were provided to the public enterprises (out of total government-financed expenditure of E225.6m); the budgeted figure for 1986/7 is E11.6m (of a total E263.3m). More importantly, however, public enterprises accounted for 22.1% of total public or publicly-guaranteed external debt in 1981/2; 29.0% in 1982/3; 36.6% in 1983/4; and 43.6% in 1984/5.

1.3 Most worrying, though, is the fact that government has had no means of predicting requests for financial support from enterprises, since no formal financial projections or monitoring of parastatal performance have been carried out. During the last year, the government has been faced with large funding requirements from parastatals, for which it has been given mere days notice.

1.4 Government - whether by formal loan agreement or simply as the shareholder - is the guarantor of all its public enterprises. At the same time, it exerts little effective control over them

1.5 Most enterprises have enjoyed a high degree of autonomy, and have been subject to little formal control in the way of legal regulations, and even less in practical terms since such controls as there are have often not been enforced. The government now wishes to establish stronger and clearer controls for the parastatals. But in doing so, we understand that these controls are but a means to an end, that end being the more efficient performance of the enterprises, to prevent the need for the large subsidies that have recently been required.

1.6 This distinction is of crucial importance and it underlies all of our recommendations on the monitoring, analysis, and control of parastatals. The purpose of control must first be examined; put simply, this is to ensure that public enterprises follow Government policies. But more revealingly - and more positively - the purpose can be restated as being to improve the performance of public enterprises in achieving the Government's objectives.

1.7 This makes clear that, first, Government must specify what those objectives are, in such a way that they can be translated into a definitive corporate plan for each enterprise. Such a plan should comprise both financial and operational targets, quantifying the broad medium and long-term objectives set by government. And, in turn, the medium - term plan must be reflected in annual budgets, incorporating detailed targets for the key indicators, so that a clear and immediate picture can be given to management of what is expected of it. Thus "control" is interpreted as ensuring the adherence of an enterprise to a structure of plans and targets which define the policies of government in quantified form.

1.8 Second, defining the purpose of control in performance-related terms brings out the need for government to work with the enterprises and to assist them where internal or external constraints are preventing an enterprise from achieving its targets. Control should thus not be seen purely as a punitive structure designed to keep the public enterprises in check: control must go hand-in-hand with a process of performance review which does not just identify failures to achieve targets but also identifies measures which enable the enterprises to overcome existing problems and contraints and thereby improve their performance.

1.9 Third, in order to discover whether an enterprise is adhering to specified targets, or to analyse whether a particular policy change has improved performance, it is clearly essential to have extensive information on the enterprise's operations. There is no point in setting a target unless the enterprise's performance in meeting it can be monitored. Therefore, the development of plans and targets must be matched by the establishment of comprehensive monitoring procedures, which ensure the ability of government - and the enterprise's own management - to review regularly the actual performance of the enterprise against the budget.

1.10 Steps to "strengthen control" must therefore include all these three processes: the clarification of government objectives and their interpretation in the form of a medium-term plan, setting the framework for annual budgets which in turn incorporate detailed targets; the analysis of enterprises to examine problems and constraints and to identify measures to alleviate them; and the establishment of monitoring systems to inform the planning and analysis.

1.11 Crucial to each of the above is an appropriate structure of control - which depends on the strength of the institutions which administer the above processes and the relations between them - and the nature of control, which relates to the means by which control is exercised and the balance between government intervention and enterprise autonomy, in terms of the number and importance of policy decisions subject to government scrutiny.

1.12 It is this institutional aspect of control which we consider first, in Chapter II below, for it establishes the framework within which the planning, performance review and monitoring procedures, described later, are to operate. But we would stress the essentially "circular" logic of the proposals: the institutional requirements are defined by the tasks which those institutions are to perform, namely planning, performance review and monitoring. And in turn, these three processes re-inforce and rely on each other for their effectiveness and rationale.

II INSTITUTIONAL ARRANGEMENTS

Introduction

2.1 This chapter considers the appropriate nature and structure of control of public enterprises in Swaziland. We examine first the present arrangements for the control of the enterprises. We then establish some broad principles for the manner in which control should be exercised and set out the range of policy decisions which we recommend should be subject to government scrutiny. The institutions presently responsible for effecting such scrutiny are discussed and we make recommendations for the establishment of a new structure of control within government, centred round the creation of a new policy-making committee. We consider the need for technical advice to this committee and recommend the establishment of a central, independent body to monitor, analyse and advise on all public enterprises. We discuss the necessary status of this body, its relations with other government agencies, and its staffing requirements.

Present Arrangements for the Control of Public Enterprises

2.2 Formal control of and responsibility for each public enterprise is vested in a Minister of one of the "line" ministries, which each look after a broadly defined sector of the economy or area of social activity. They are nominally responsible for monitoring performance and presenting requests for subventions, loans or grants to the Ministry of Finance and the Principal Secretary for the line ministry is accountable before the Public Accounts Committee for the use of public funds invested in the parastatals.

2.3 However, we have found that there is little in the way of regular reporting or contact between the parastatals and their line ministries. Financial plans, budgets, annual accounts and more frequent management accounts are rarely submitted to the ministry, and little or no effective analysis is performed by the line ministry on the financial or operational performance of the enterprises under its control.

2.4 The Principal Secretary of the line ministry, along with other government representatives, usually (though not always) has a seat on the Board of the parastatals under his ministry. However, actual representation on the Board is often delegated to junior officers, as the Principal Secretaries are too busy with their other duties. When they do attend, they often lack the background knowledge of the problems of the corporation that only regular, thorough analysis can provide; and thus their contribution to the Board is diluted. It is at the best of times difficult for a civil servant to give at a Board meeting a full and detailed statement of the application of government policy to a particular part of a public enterprise's operations; but without a full briefing on the affairs of the enterprise and an analysis of the implications of a policy both for the government and for the financial performance of the enterprise, it is impossible to give sound advice. Board representation tends therefore to be a poor mechanism for ensuring public enterprises follow government policies.

2.5 The only other form of control over public enterprises is provided by the Acts under which most enterprises are established. These are, however, only broad and general statements of the legal framework within which the organisation must operate, and are not intended to provide strict operating guidelines for commercial corporations. Acts can establish certain basic requirements on public enterprises, but many of the current Acts do not do this. We comment further on this point in Appendix F.

2.6 The public enterprises have thus operated with a high degree of autonomy, but with little accountability or formal performance review. Indeed, in some quarters of government there has been a mistaken belief that the mere creation of a parastatal entity relieves government of a financial burden since parastatals are automatically self-supporting. The Government have now recognised this as a fallacy and decided that control over the enterprises must be strengthened and accountability heightened, while at the same time maintaining a sensible degree of commercial autonomy.

The Nature of Control

2.7 The nature of such control and the means by which it is exercised have a large impact on the efficiency of the public enterprises. Government has to ensure that the activities of the parastatals are in line with broad government policy, are effectively run by management and that they are not leading to a drain on government resources. But more detailed day-to-day policies and operational decisions must be left to individual parastatal management. It is vital, first, that public enterprise activities are not "politicised", by being constantly subject to interference by government to ensure that short-run political ends are met, at the expense of the longer run commercial health of the enterprise. And second, enterprises must not be restrained by excessive administrative procedures which unduly slow down the decision-making process. In fact, these principles are well recognised in Swaziland, have been expounded to us by several government officers and are explicitly stated in the Fourth Development Plan.

2.8 The aim, then, is to achieve control without interference, to keep watch on the main parameters of corporate policy but not to be involved with the minutiae of daily decision-taking We believe that such control should be effected in two closely related ways First, there is need for a Statement of Objectives for each parastatal, in which Government would set down its fundamental goals for the enterprise. This would provide the broad framework of policy within which the enterprise had to operate. (The content of such a statement is discussed further in Chapter III). Second, the Government must set down the <u>detailed</u> policy decisions which it wishes each parastatal to refer to it for official scrutiny and approval.

2.9 We believe that the following should be referred to Government for approval:-

* budgets;
* tariff adjustments;
* major loans and investments (physical or financial);
* major diversification or divestments (e.g. starting or closing

key services);

* salary increases;
* selection of auditors;
* selection of Chief Executives and Financial Controllers;
* the composition of Boards and selection of their Chairman.

2.10 The controls required fall into two broad groups; those on the major parameters of financial and operational policy; and those on the people responsible for such policy. The budget should incorporate all the key financial policies of the enterprise; it should set out the budgeted results and the impact of the planned performance on all the major financial and operational indicators. The scrutiny and approval of the budget and the negotiation of appropriate performance targets is thus one of the most crucial of government decisions. Presently, several public enterprises do not produce a budget; some that do produce it many months late and with inadequate back-up documentation; and none is required by its Act to submit a budget to Government.

2.11 The control of tariffs by Government is essential for the large monopoly organisations that constitute most of the public enterprise sector. Government policy on public enterprise tariffs has hitherto been uneven: there has been little or no direct control over some enterprises' prices (e.g. Royal Swazi) whilst other enterprises have effectively had their prices frozen (e.g. TVA, IHC). All price adjustments should rightly be scrutinised by government because of the impact of public enterprise pricing on the economy at large; but due attention needs to be given to the commercial requirements of the enterprise. We comment further on this point below.

2.12 The making or receiving of large loans, investments or divestments, and other diversifications into new services all represent major changes in corporate direction and should not be put through without the approval of the owner of the company i.e. Government. In most cases, such decisions are already referred to Government, if only because of the need for government money or a guarantee to effect them. But often that has been the only reason for referring to Government, and no detailed analysis of the loan or investment has been offered to the Government, nor has any been called for or carried out by the Government.

2.13 With regard to <u>salaries</u>, we understand that the Government is presently extremely concerned about discrepancies between parastatal and government salaries, and indeed between the salary scales of different parastatals. Such discrepancies have arisen largely because of the present lack of control of most parastatals' salaries, whilst others such as TVA and SNPF, are tied to Civil Service rates. As with tariffs, there is a need to balance the need for control of salaries - since operating as monopolies, there is no real market control exerted via reduced profitability - with a recognition of the commercial requirements of the organisation if it is to compete in the labour market.

2 14 The second group of decisions relates to the people charged by the government to look after its corporations. The <u>external auditors</u> of the public enterprises in Swaziland have a vital role to play in monitoring their performance. There is a dearth of financially trained personnel in the country and the majority of public enterprises do not have a qualified accountant on their staff. Given the size of these organisations, this is a worrying state of affairs. (We comment on the accounting standards of the enterprises in Appendix G). The external auditors frequently have to do significantly more than simply audit a fully prepared set of accounts: extensive accounting assistance must often be given to prepare final accounts. The implication of this is that the calibre of the audit firms and their on-the-job performance is of the utmost importance. It is thus necessary for government to scrutinise the standards of these firms, ensuring in particular that no one firm spreads its resources too thinly by being responsible for too many audits.

2.15 The selection of the <u>Chief Executive and Financial Controller</u> is a concern of government for a related reason: the shortage of management skills in the country is perhaps the most serious general constraint facing all the public enterprises. Government should thus be involved in the selection of the top management staff of its enterprises, in order to satisfy itself that they are of sufficient calibre to run the organisations and to retain the right to dismiss a manager who is either not performing to a sufficient standard or who otherwise enacts policies not in accord with government policy.

2.16 The government already selects the Board of all public enterprises. The composition of the Boards is considered further below.

2.17 In establishing controls on these key decisions, it is important to note that the "intensity" of control, of tariffs and salaries in particular, should vary with the enterprise. Those enterprises which are monopoly suppliers of a good or service clearly require tighter controls on their prices than enterprises which face competition; and since monopolies can recoup increased labour costs by raising prices, the same principle holds with regard to salaries.

2.18 More generally, extreme care needs to be taken to ensure that management initiative is not continually frustrated by subjecting them to unnecessary government control. There is need for a legislative framework, but sufficient flexibility must be built into this framework to allow Government to vary its intervention in enterprise operations with changing circumstances.

2.19 An important consideration, therefore, is how the "intensity" of control should be varied. We believe it to be essential that government set out as clearly as possible the legal control framework within which the enterprises are to operate, so that enterprise management is well aware of the limits of its autonomy and the need to make a case to government before particular policies are implemented. Accordingly, we recommend that flexibility be built into the control framework as described below. (These points are taken up in Appendix F, which sets out our recommendations for new legislation.)

2.20 First, an "overriding" clause should be included, which gives government power, notwithstanding any other legislation, to approve all those policy decisions listed in paragraph 2.9; the wording of the clause should be that government is thereby empowered to approve "major" tariff increases (or salary adjustments or investments etc.). A sub-clause would then give government the right to determine what were the limits of "major" for each individual enterprise.

2.21 Second, a clause should be included which enables government to waive its right to scrutinise any of these policy decisions for any particular enterprise for any given length of time.

2.22 Together, these two clauses allow government to vary at will the degree of control it exercises over each enterprise, and thus to make the intensity of control conditional on the competition facing the enterprise, or on performance (the better-performing enterprises could be allowed greater autonomy), or on the nature of a particular policy (for instance, Government may wish to review alterations to the structure of tariffs but leave the overall level to be determined by management, or vice versa).

2.23 The appropriate place for Government to set down the degree of control it intends to exercise is as part of the agreement between the Government and each enterprise setting out the Statement of Objectives, as discussed in paragraph 2.8. Such an agreement would thus clarify for management both the objectives it had to achieve and the limits of its own decision-making freedom. This will be a matter for negotiation; management may feel it impossible to achieve certain objectives without fuller freedom of action in a particular policy area.

2.24 As set out in the introductory chapter and discussed further in Chapter III, such an agreement would be part of a comprehensive corporate planning exercise which interpreted the objectives of government into quantified targets for each enterprise. The most desirable end result of such an exercise would be to be able to "control" an enterprise purely by the formulation of such plans and targets, with no specific intervention in individual policy decisions at all. Thus the maximum freedom of action would be assured for management, thereby leaving the maximum scope for initiative.

2.25 One further safeguard would then be needed, however, in the event that a serious divergence from government policy occurred when Government had otherwise formally waived its right to scrutinise a particular policy decision. Government should have the power to direct an enterprise to change such a policy, since it clearly breaks the spirit of the agreement. The legal clause which gave effect to this would, however, have to be very carefully worded; it would not be desirable to give the impression that Government could run the enterprises entirely by directive. A precedent for such a clause can be found in the Act establishing the Monetary Authority (now Central Bank) of Swaziland, which enables the Prime Minister to direct the Bank to change a policy which is felt to be "not adequate for or conducive to the achievement of the objects (of the Bank)", provided that Government duly inform the Bank that it takes full responsibility for that policy. This might be a suitable "model" for such a clause (and is discussed further in Appendix F).

The Structure of Control

Boards

2.26 We have identified in paragraph 2.9 above the key policy decisions which we believe should be subject to government scrutiny and approval. There remains the question of how that scrutiny should be effected and by what process approval should be granted. In the past, government control has to a great extent been exercised through representation on the enterprises' Boards. Most public enterprise Boards have at least one civil servant on the Board, usually the Principal Secretary from the line ministry, and some Boards have a majority of government officials.

2.27 We do not think that government control over public enterprise decisions can or should be effected primarily through this channel, for three main reasons. First, and most importantly, if Principal Secretaries serve as voting members of Boards, this compromises both the Board's independence and the PS's position as the principal adviser to his Minister. If the PS is overruled on a particular issue by the other members of the Board, he will still advise the Minister of his own opinion (for it is his duty to give such advice). Yet the Board, having passed a motion in a forum at which the PS consented to a vote, may feel that it has obtained, by majority vote, the approval of Government. It is thus important not to confuse the role of the PS with that of the Board, which should be an independent body, comprising people chosen for their particular knowledge of the enterprise, which advises both Government and the enterprise on policy issues There is no advantage, and potentially much harm, in having a PS take an active part in formulating advice which is then to be filtered back through the PS before he puts a final recommendation to the Minister. The PS is thereby effectively advising himself. Conversely, where the Board is deliberating a decision for which the Act states it does not need government approval, the presence of a voting government representative detracts from the purpose of allowing the Board such autonomy, namely to ensure decisions are arrived at on the basis of commercial judgement only

2.28 Second, as noted above, the record of attendance by senior government officers at Board meetings has been patchy. This is hardly surprising, since such officers are extremely busy with their other duties, and could not possibly attend all the Boards of which they are nominally members; this is particularly true of the officers in the central agencies of government, who may be on 10 or more enterprise Boards, which may meet on average once every two months Simply in terms of the length of time spent at the meetings - 4-5 days per month - this is an inordinate burden on these officers' time it is clearly quite impossible for them to prepare fully for such meetings. Consequently, it is not feasible for Government to direct its public enterprises by relying on statements by these officials at the periodic Board meetings this can only lead either to a lack of control or to rash and unconsidered decisions, made without a full consideration of the situation.

2.29 Third, there is the question, raised already, of co-ordination of government policies towards the public enterprise sector. There can only be effective co-ordination if there exists a forum for comparing policies towards different parastatals and harmonising decision-making. There is presently no such forum and Government control of each parastatal is effected through individual line ministries' Board representatives; only through the attendance at every Board meeting of a representative from a central agency - e.g. Finance or DEPS - could any form of co-ordination be achieved at Board level, and for the reasons given above this is clearly not possible.

2.30 We therefore believe that there is a need to re-define the relations between Government and the Boards of the public enterprises. We recommend that the Boards of public enterprises be re-constituted so that government representatives only have observer status at Board meetings, and that the number of government representatives on the Board be kept to a minimum. (In exceptional cases, for instance where a PS had a particular technical skill not elsewhere available, he could be given full, voting status, and thereby play the dual role of both government representative and technical advisor). Government control of the parastatals will then be seen quite clearly to be effected not through its Board representatives - they would be there merely to gather information and advise on the broad interpretation of government policy - but through more formal and specific channels.

2.31 These channels, in turn, need to be improved, as is discussed in the paragraphs below. First, however, we would note that the exercise to re-constitute the Boards as described above will give government the opportunity to review the membership of all the Boards. In doing so, it should place the greatest emphasis on ensuring that Board members are chosen for their particular knowledge of and experience in the affairs of the enterprise which they serve. It has been noted that there is a serious shortage of management talent, and that filling some 17 public enterprise Boards with experienced businessmen will not be easy if any one individual's directorships are to be kept to a sensible level. (We suggest that this should be 3 at the most; and no one should be Chairman of more than one public enterprise). Keeping the total membership of Boards to 5-7 people, plus perhaps two government observers, will ease this problem.

Channels of Control in Government

2.32 Control of parastatals is vested in the line Ministers. The formal process for obtaining government approval for a policy decision (though not always followed) is thus to request the Minister responsible, through the Principal Secretary, for his sanction. But we have also noted that contact between the public enterprises and their "parent" ministry is generally infrequent, and the degree of monitoring and analysis performed on the enterprise by the ministry inadequate. The ability to make informed decisions has been thereby impaired.

2.33 But there are more fundamental reasons to re-appraise the present procedures for effecting control over the enterprises. First, the operations and financial performance of the public enterprises have such widespread implications for the whole economy that policy formulation towards them needs to be the brief of more than just the parent ministry. Second, government policies towards the various enterprises need to be co-ordinated and consistent; though they operate in very different fields, the parastatals do form an identifiable sub-sector, and there is thus a need to maintain comparability in their treatment, particularly on such issues as the legal framework, terms and conditions of service, pricing policy and investment criteria, and the nature of reporting to Government.

2.34 At present, with control of the parastatals spread across six ministries, such co-ordination is impossible. As a result, there are large discrepancies in the treatment of different enterprises, and there is a danger that policy decisions will be taken without full regard for their consequences for other parts of government or the economy as a whole. There is therefore a need to create a forum in which co-ordination of policy can be effected, to ensure both that policy towards different public enterprises is harmonised and that policy towards the public enterprise sector in general is consistent with other social, fiscal and macroeconomic policies.

2.35 We therefore recommend that control of all public enterprises be vested in a Cabinet Committee, consisting of, as permanent members, the

Prime Minister (or a Minister nominated by him), the Minister for Finance and the Minister for Commerce, Industry and Tourism. The Minister of the line ministry responsible for a parastatal would be co-opted as a full member when that parastatal is discussed by the Committee. The secretary to the Committee would be the Secretary to the Cabinet.

2.36 In order to adhere to the principle of Cabinet collective responsibility, decisions on public enterprises taken by the Committee would be formally ratified by Cabinet However, for the purpose of the following discussion we do refer to "The Committee" or, as a suggested acronym for "Standing Committee on Public Enterprises", SCOPE.

2.37 The Committee would be the forum in which Government decided whether to approve or change any policy decisions of public enterprises regarding any of the issues listed in paragraph 2 9 The legal changes necessary to empower the Committee to do this are discussed in Appendix F.

2.38 Legal regulations, if used unwisely, can have a detrimental impact on performance. It must be stressed that the Committee is providing approvals of policy decisions, not initiating policy, which must remain the brief of public enterprise management. The Committee should aim to rely increasingly on control via a s ructure of corporate plans and performance targets rather than via legal directive.

Administrative and Technical Support

2.39 Of course, such plans and targets need to be negotiated in the first instance at the administrative level of government, by management and officials. More generally, there is a need for the Ministers' deliberations on policy issues to be informed by an ongoing monitoring and analysis of the present performance and future plans of the public enterprises. But we have already noted that monitoring and analysis are presently weak. There is not the necessary expertise in the line ministries to perform these tasks

2.40 It was in recognition of this fact that Government initially considered setting up a Public Enterprise Unit which, it was originally envisaged, would be a part of the Ministry of Finance. The expected activities of the Unit were set out in the letter from the Principal Secretary of the Ministry of Finance to the Director of USAID, requesting Technical Assistance for the Unit These activities were:-

(a) to build up a comprehensive base of public enterprise financial statistics;
(b) to conduct at least an annual survey of public enterprise performance and future plans;
(c) in the immediate future to undertake a detailed review of the functions and objectives of all public enterprises to clarify their relationship with Government and establish performance criteria;
(d) in the long run, to develop specific policies for each enterprise.

2.41 We endorse the need for such a body. But we believe that its position within the Ministry of Finance would only be compatible with the efficient execution of the first of these activities. The straightforward collection of data on public enterprise performance is not an unduly complex matter and, if the prime aim of such an exercise were to identify the need for government financial assistance, a small unit within the Ministry of Finance would be the most appropriate specification.

2.42 However, the requirement that it should act as an analyser and formulator of policy, and not just as a monitoring agency; and our recommendation that it should do so within a modified structure of government control which stresses the need to harmonise and co-ordinate policy, militate against the "unit" being just a section in any one line ministry. A more independent and technically more highly-powered office is called for than could be achieved within that structure.

2.43 The need for independence relates not only to being impartial but also to a need to act as an effective liaison between government as a whole and the public enterprises. To do this, the body must be seen as not just a government "watchdog" on the enterprises, but also as an advocate for the parastatals, putting their case - after careful preparation and scrutiny - to government and helping them solve their problems.

2.44 The need for a strong technical capability derives from a similar point: the body must be seen to be capable of performing the necessary financial, operational and organisational analyses to maintain credibility both within government and with the parastatals; only from this credibility can its advice and recommendations derive authority.

2.45 We believe that these requirements for the body can most effectively met if it is constituted as a separate Statutory Body, under the Cabinet Office. This would give it the necessary independence of individual government departments and indeed of Government as a whole, thereby facilitating liaison with and acceptance by the public enterprises, and also making it easier to recruit the necessary calibre of commercially experienced staff. The staff needed for such an Office would have to be attracted primarily from the private sector, where people with skills in company analysis will presently be working, and accordingly salaries will have to be commensurate with those found in private sector firms. (The staffing requirements are considered further below).

2.46 An independent organisation of this nature cannot properly be called a "unit". We suggest that it be known as the Office for Public Enterprises, and that "OFPEN" be considered as a suitable acronym. We use this abbreviation throughout the rest of the report.

2.47 The suggested detailed Terms of Reference for OFPEN are set out in Figure 2.1. In general, it would be responsible for advising SCOPE on all matters which impinge on the financial performance of parastatals and its main duty could be expressed as being "to improve the performance of public enterprises in achieving Government's objectives", thus echoing the definition of the purpose of control given in the introductory chapter, and imposing on OFPEN the responsibility of implementing the processes of planning, performance review and monitoring that are required to help meet this stated aim.

Figure 2.1

TERMS OF REFERENCE FOR OFPEN

Financial

1. Monitor the financial affairs of all public enterprises (PEs) on a regular basis and alert Government to impending problems.

2. Review budgets of PEs and establish performance targets.

3. Identify problems within PEs in producing regular accounts or budgets; assist, or arrange and co-ordinate external assistance as necessary.

4. Advise SCOPE on financial policies towards PEs, in particular regarding:

* tariff approval
* investment approval
* loans/grants/subvention approval
* diversification/divertments

5. Advise PEs on financial policy, in particular regarding:-

* pricing policy
* investment appraisal
* marketing strategy
* corporate planning
* budget preparation
* financial reporting
* applications/negotiations for loans or subventions
* selection of auditors

Organisation and Personnel

6. Advise SCOPE on the composition of all public enterprise Boards, attend Board meetings as an observer.

7. Advise SCOPE on the recruitment of the Chief Executive and Financial Controller of all public enterprises.

8. Advise SCOPE on the terms and conditions of service in public enterprises.

9. Review from time to time the organisational structure and manpower requirements of all public enterprises.

10. Examine as required the decision-making process within each enterprise and analyse the performance of management.

<u>General Corporate Planning</u>

11. Instigate, for each enterprise, a detailed periodic review of its operations, performance and relations with government, and in particular:-

* review the statutory instrument establishing the enterprise to ensure its adequacy as a basis for flexible control and efficient operation

* clarify the fundamental objectives of the PE and draft a formal Statement of Objectives

* clarify general and specific government policies towards the PE

* develop medium-term financial and operational plan

* establish detailed performance targets

* develop staff incentive schemes based on these targets

12. Prepare a report to SCOPE each quarter, providing information on the past performance and future plans of each enterprise, and the impact of and prospects for the sector as a whole.

Figure 2.1 cont'd

13. Prepare a report to SCOPE each year on the operations of the Office and its internal development.

14. Commission external consultants and advisers as necessary to assist with any of the above issues and liaise with the consultants and advisers on all aspects of their work.

2.48 The head of OFPEN - who we suggest is titled the Director - would formally report via the Secretary to the Cabinet, to the Prime Minister. But in effect, he would serve as an advisor to <u>all</u> the members of SCOPE; in particular, of course, he would work closely with the PSs of the line ministries, who in turn brief the line Ministers responsible for individual enterprises. It is necessary to expand on the relation between OFPEN and the line ministries, for it is a crucial link which must work smoothly if effective and efficient control of the enterprises is to be achieved.

<u>Relations with Line Ministries</u>

2.49 A key reason for setting up OFPEN is to gain the advantages from having a central body, with qualified staff, able to monitor, analyse and assist <u>all</u> public enterprises, rather than each line ministry having to perform these tasks just for the enterprises under its control. Thereby, not only are significant "economies of scale" reaped, but it also becomes easier to co-ordinate and harmonise policies towards the parastatals. Similarly, the importance of co-ordination was stressed when recommending that all major policy decisions be channelled through the Cabinet Committee, SCOPE, which would also ensure that all the implications of such policies on different parts of the economy - and specifically on government finances - were considered.

2.50 However, these new institutions and relationships should not be seen as altering the line ministries' responsibility for the technical development of the public enterprises. The enterprises are executing agencies of the line ministries' sectoral policy, albeit with a high degree of autonomy. The new arrangements will enhance the ability of public enterprises to carry out such policies efficiently and effectively. It is OFPEN's role to ensure that the broad developmental policies of the ministry are translated into detailed medium-term plans, annual budgets and specific financial and operational targets and to inform the ministry and the other members of SCOPE on a regular basis of the enterprise's performance in carrying out the plans and achieving the targets thus set.

2.51 OFPEN should thus be an advisory body which assists the line ministries in ensuring the most effective execution of government policy by the enterprises; but will be independent of any line ministry and directly answerable to the Cabinet Office rather than individual line Ministers, because of the need for it to take into consideration the wider implications of parastatal operations and, specifically, to ensure the compatibility of all parastatals' policies with fiscal and macro-economic constraints. Clearly, OFPEN will liaise closely at all times with line ministries; and whilst it will not need to gain permission from a line ministry to study a public enterprise under that Ministry, or to review a policy decision of the type set out in paragraph 2.9, it will always inform the ministry of its findings and discuss them fully with senior officials of the ministry, prior to making its final recommendation to SCOPE. This will ensure that the Minister concerned is himself fully briefed of OPFEN's views when SCOPE meets to discuss the issue, and he will, of course, receive the usual briefing from his own staff.

2.52 Such briefing and discussion is particularly important should one of the ministry's developmental objectives be potentially incompatible with the commercial viability of the enterprise. It is OFPEN's responsibility to spell out the financial consequences of any particular investment or service that the ministry wishes the enterprise to make or run. Such cases should not involve OFPEN and the ministry in any kind of conflict; in the final analysis, the ministry's policies will be better carried out by a financially healthy organisation, than by one which has to carry a large burden of unviable services. To repeat, therefore, OFPEN's role is to enable the ministry better to judge the costs and benefits of its policies, and to assist it in identifying how the enterprise can achieve the objectives of the ministry in the most efficient manner, and in a manner fully consistent with other national priorities.

2.53 Clearly, then, the new arrangements will not replace the need for close liaison between enterprises and their line ministries; they will merely enhance the efficiency of such contacts

2.54 Specifically, there are some "technical" matters on which OFPEN will not be able to advise; for instance, for the WSB, say, the appropriate standards of water cleanliness; or the type of educational programmes to be carried on STBC (though, as stated above, OFPEN will be concerned in any financial implications that arise from these "technical" choices).

2.55 Further, the direct contact which the line ministry presently gains through its representation on the Board will remain; whilst recalling the comments made in paragraphs 2.26 - 2.31, we recommend that the Principal Secretary of the line ministry or his representative have observer status on the Boards of those parastatals which operate under the ministry's aegis. And we further recommend that the line Minister continue to be responsible for nominating the members of the Board whom he judges are best able to guide the enterprise in formulating its overall policy; subject only to a general requirement that SCOPE must ensure, so far as possible, an overall balance of technically, commercially, and financially skilled personnel on the Boards.

Advisory Board to OPFEN

2.56 OFPEN of course needs to discuss and exchange views with other parties as well. We have stressed in our recommendations the need for the Office to have a broad and balanced outlook, and to be aware of developments elsewhere in the economy and in government, so as to be able to formulate policies towards the public enterprises in the light of a sound understanding of the fiscal and macro-economic environment. Accordingly, we recommend that the Director be advised by a Board to consist of:-

* the Secretary to the Cabinet, who will chair the meetings;
* the Principal Secretaries of Finance, DEPS and Commerce;
* an MP or Senator, appointed by the Prime Minister;
* a Chairman or Chief Executive of a large private sector company appointed by the Prime Minister;
* a Chairman of one of the public enterprises, nominated to act as a representative of his colleagues.

2.57 This Board will be a forum for discussing general issues relating to the public enterprise sector, and specifically for discussing the key current issues. These might relate to individual enterprises - for example, a tariff increase application, or simply the latest financial results - or to external events affecting the sector as a whole - for instance, the impact of an exchange rate devaluation or tax change on the sector. The Board should meet at least four times a year, or more frequently as and when major issues arise which the Director feels need to be discussed in this forum.

2.58 This Board is advisory to the Director. It is a forum for debate and exchange of views and opinions, but it should not be seen as a policy making body in itself. The Director will be finally responsible for putting up recommendations on public enterprise policy to SCOPE; he will naturally gain from the wider perspective which Board discussions afford him. He should not be under any formal obligation to agree with any representation put to him there, but the Board's views should be made known to SCOPE.

2.59 Whilst it should take note of a breadth of opinion, OFPEN should maintain a strong independence in advising SCOPE on policy towards public enterprises. This is not to confer any special powers on the Director; the PSs of Finance, DEPS and Commerce - and, of course, the PS of the line ministry - also have direct access to members of SCOPE. But the main point of establishing OFPEN as a Statutory Body, separate from any line ministry, is to ensure that advice emanating from the Office would be independent - and be seen by the enterprises to be so. It is thus important that the Director's opinions can also reach the Cabinet Committee without there being an obligation on him to amend his views to accord with those of other interested parties.

Staffing

2.60 The credibility and efficiency of OFPEN will naturally depend heavily on the quality of its staff, and particularly on the Director. The Director will be finally responsible for all advice emanating from the

Office, and for the presentation of papers to his Minister. He will be required to chair meetings between senior government officials and enterprise management during the negotiations on government-enterprise agreements and corporate plans, to attend the major Board meetings and to liaise on a day-to-day basis with enterprise Chairmen and Chief Executives.

2.61 The Director must therefore be an experienced negotiator, able to present and argue a case at the highest level of government. Technically, he must have a thorough knowledge of corporate planning methods, be skilled in financial and business analysis, and have a firm grasp of economics. He must have experience of working in and with public corporations in Africa and be familiar with their organisational and manpower requirements and constraints. The recruitment of such a person should have the highest priority: none of the planning or performance review procedures described here can be effectively implemented without the Director being in post.

2.62 We recommend that there be four technical staff under the Director, and one administrative officer. The technical staff would each be assigned to a group of enterprises as the "desk officer" responsible for the initial liaison with those enterprises on all issues. Accordingly, to cover the wide range of different enterprises, staff should be sought who have experience and could specialise in one of four sectors:-

* Financial (SDSB, SNPF, SRIC, NIDCS)
* Agricultural (CCU, SDB, NAMB, NMC)
* Transport and Communications (SR, RSNAC, PTC)
* Utilities/social infrastructure (SEB, WSB, NHB; and including STA)

2.63 For each enterprise, the following tasks will have to be regularly performed:-

(a) financial analysis (balance sheet ratios; operating costs and revenues trends and relationships; cash management etc);
(b) budget analysis (testing validity of assumptions, consistency of forecasts of different variables etc);

(c) performance targeting (choosing indicators; analysing past performance and future prospects; constructing target "hierarchies");

(d) pricing and costing analysis (cost allocation: development of pricing policies; elasticity analysis etc);

(e) project appraisal;

(f) analysis of macro-economic and fiscal impact of the enterprise;

(g) marketing analysis (market surveys, marketing strategies);

(h) organisation analysis (reviewing function of and relations between the different parts of the enterprise);

(i) manpower analysis (reviewing the need for and availability of skills);

(j) assistance with budget and accounts preparation;

(k) review of accounting and management information systems.

2.64 Clearly, it would be difficult to find any one person skilled in all of these types of analysis. Broadly speaking, tasks (a)-(c) are best performed by a business analyst; tasks (d)-(g) require an economics training; tasks (h) and (i) are the domain of an organisation and management specialist; whilst for tasks (j) and (k), an accountant is required.

2.65 Accordingly, staff skilled in each of these areas of functional specialisation and in each of the four sectors need to be recruited. This will create within OFPEN a matrix of skills, with each officer directly responsible for one group of enterprises, but also possessing a functional skill which could be applied to each of the other groups. For example, an economist might be recruited who specialised in the transport sector; but he would assist his colleague (say, an accountant) in the utilities sector with project appraisal, and would ask that colleague for assistance in analysing accounting systems within the transport sector enterprises.

2.66 Further, there is a general requirement for all the staff, whatever their functional skill or sectoral specialisation, to be familiar with the operations of commercial enterprises and acquainted with the concept of corporate planning. This is particularly important for the accountant; the accounting systems within commercial organisations differ greatly from government systems.

2.67 It is recognised that such a neatly interlocking group of skills will be hard to build up; but the principle of recruiting people with complementary specialisations is crucial if the office is to be kept small yet effective.

2.68 Initially, there may only be a couple of staff recruited to the office - perhaps one expatriate on technical assistance and one Swazi. In this case, the priority would be to get the monitoring and planning procedures "off the ground", and to begin to collect the essential information on each enterprise and to introduce the concept of corporate planning to enterprise management. The immediate need, therefore, would be for financial analysis and accounting skills, so that the staff can comprehend and work with the information contained in the rather sparse financial statements presently produced and, since so many enterprises have such poor financial statements, so that they are able to identify the main bottlenecks constraining the production of information and assist the enterprises in improving the flow of regular statistics to the Office.

Legislation

2.69 Clearly, new legislation is required to vest control of public enterprises in SCOPE and to establish OFPEN and set out its duties. In Appendix F, we discuss the main clauses required and a possible format for the legislation.

Options

2.70 We are aware that the recommendations put forward here represent a significant change to the present arrangements for controlling public enterprises. And we further recognise that the institutions we have described will take some time to be established, and that there are constraints - in particular on the staffing and financing of the proposed

Office for Public Enterprises - in the way of a rapid implementation of some of the policies and procedures recommended in this report.

2.71 Accordingly, in the Action Programme which we set out in Chapter VI, we have provided guidelines for a staged approach to setting up the Office and implementing planning, performance review and monitoring procedures. And in order to provide a clearer structure for discussion within Government of the appropriate development of the Office, we present Figure 2.2 overleaf, which describes several different models for a Public Enterprise Office.

2.72 The most important message from this presentation is that the responsibilities, status and staffing of such an Office are inextricably linked. The more duties that the Office is to undertake, the greater needs to be its authority and independence, and the more highly-trained its staff. Thus, for a monitoring unit, charged only with the collection and synthesis of data, the staff requirements are minimal: accordingly, such a unit could easily be set up within a section of one of the existing ministries.

2.73 Such a unit could not, however, be expected to effect any policy judgement of any kind, for this requires a degree of analysis which in turn necessitates the employment of staff adequately trained in economics and finance. Knowledge of the commercial environment in which public enterprises operate and of their financial statements is a rare commodity within the Civil Service. The person or people responsible for the analysis would thus be required to provide briefing to many different parts of government, including the central agencies (Finance, DEPS), the line ministries and the enterprises This would require the body to be in a central ministry itself and to be headed by an official able to discuss on a level with senior government and enterprise officials. He would thus have to be relatively senior himself, reporting directly to a PS.

2.74 This type of unit could act as an "early warning" system for government, identifying impending funding requirements and instances of divergence from government policy. But it would be restricted to this

POSSIBLE MODELS FOR PUBLIC ENTERPRISE OFFICE

<u>Figure 2.2</u>

MODEL	RESPONSIBILTIES	STATUS	STAFFING
1. Monitoring Unit	Collection & storage of data - Simple analysis e.g. conversion of individual PE returns to common format. Presentation of data to Government.	Section of government Ministry	2-3 people with some accounting training.
2. "Early Warning" Watchdog	Analysis of regular returns, budgets, accounts; raising queries/seeking explanations on such returns. Alerting government to impending funding requirements, or to possible breaches of government regulation/policy e.g. reporting requirements on budget/accounts. Consolidation of PE returns: analysis of budget/macro-economic impact.	Separate Government department.	At least 1 trained economist/ accountant and/or 1 senior (US or above) official 2-3 support staff as above.
3. Policy advice office	Analysis of tariff increase applications, minor investment appraisal. Analysis of management performance. Advice to PEs on long-run planning; clarification of issues in government - PE relations; negotiation of Performance Agreements; mediator in government - PE disputes. Involvement in all major policy decisions as observer/adviser.	Authoritative, independent organisation	Commercially-experienced head of unit. 1 competent economist/accountant per 4 major PEs, as "desk officer". Thus perhaps 3-5 professional staff in all.
4. Consultancy Company	Detailed policy reviews of selected PEs e.g. analysis of major investments: tariff structures: organisation/manpower studies; detailed market surveys.	Technical agency	At least 5-6 highly trained economists/accountants/ management experts, experienced in commercial enterprises.

"watchdog" role, unless it were significantly expanded to enable it to play the wider role of liaison with the enterprises, and advisor to them on the implementation of planning, performance review and monitoring procedures. This would require an authoritative, independent organisation. It must be authoritative so that its advice is listened to with respect; and it must be independent so as not to be unduly influenced either by short-term budgetary considerations (which might cause undue caution in raising finance) or by developmental needs (which might favour sectoral investment and expansion over commercial viability), and, crucially, so that the enterprises can come to "trust" it as a useful contact point in their discussions with government.

2.75 This is, of course, the model for OFPEN; its independence deriving from its status as a Statutory Body under the Cabinet Office and its authority deriving from the quality of its staff - particularly the Director - and its central position working with the line ministries and the other central agencies to brief the Ministers responsible for decisions on the public enterprises.

2.76 Finally, we can consider the requirements for an organisation which would be charged with detailed, specific policy reviews of public enterprises, i.e. not just ongoing monitoring and analysis, and not just the type of general policy analysis required in developing a corporate strategy, but more in-depth studies of, for instance, major investment projects, or the fundamentals of pricing policy (including full-scale costing exercises and market surveys). This would require a team of specialists, able to devote significant portions of time to the study of individual enterprises, accordingly skilled in the technical analysis necessary, and knowledgeable of and experienced in the particular sectors in which the enterprises operate. Such an outfit would have to be a special technical consultancy agency, staffed at least for the first few years by expert external advisors.

2.77 We do not believe that there is the "market" for such a company i.e. a continuing need for it; nor do we think it cost efficient to employ staff full-time who may only be needed once every few months to carry out an in-depth study on a particular enterprise. This is a role better filled by short-contract external consultants, liaising with "desk officers" from the office charged with ongoing analysis.

2.78 There is of course a continuum of options between the monitoring unit and the consultancy company. We have picked out these four options as the main stages on the continuum; there is some blurring of the lines between them. In particular, the "policy advice body" - OFPEN - should involve itself to a certain extent in specific policy studies, and conduct one-off investigations into enterprises requiring special assistance, in the way a consultancy company might operate.

2.79 There is also scope for some of the tasks listed in OFPEN's terms of reference to be carried out by an "early warning" type unit. For instance, simple budgetary and performance targeting exercises - described in Chapter III, paragraphs 3.22 to 3.59 - could be developed by such an organisation. It is the more detailed technical discussions involved in developing "Performance Agreements" which call for the greater level of skill and degree of independence which can only be achived by the OFPEN-type organisation.

2.80 We now turn, in Chapters III and IV, to a discussion of the planning, performance review and monitoring procedures which we recommend are implemented by the Office and which thus dictate its precise specifications.

III BUDGET AND PERFORMANCE REVIEW PROCEDURES

The Need for Planning

3.1 One of OFPEN's key tasks is to institute budget and performance review procedures for all public enterprises, similar to those presently in force for government ministries. The immediate aim, as expressed in our Terms of Reference, is to give Government a more complete picture of the likely claims on its resources at budget time and to afford Government the opportunity to initiate remedial action at an early stage for those enterprises in financial difficulty. But the role of a budget is not just in "crisis management", as an early warning of impending problems; it should be part of a longer-term process of corporate planning and efficiency enhancement.

3.2 At present, there is very little formal planning in any of the public enterprises. Generally, the only medium or long-term forecasts of financial and operational performance are to be found in special consultancy reports, commissioned at the time of major investments; such reports are now mostly out of date. Neither do the public enterprises have a clear statement of the objectives they are expected to achieve, other than the general statements found in the Act.

3.3 Most - though not all - of the enterprises do produce annual budgets. These vary in their level of detail, accuracy and timeliness, but a general comment would be that they concentrate too much on a government-style detailed breakdown of expenditure, and not enough on providing a similarly carefully considered estimate of revenue. Supporting documentation, setting out assumptions and providing an analysis or commentary, is almost always missing. The concentration on expenditure - recurrent and capital - is not matched by analyses of resource availability to finance the expenditure: few enterprises produce anything other than the most rudimentary forecast of cash movements over the year. Nor are balance sheet forecasts generally provided

3.4 Budgets are generally not submitted to government - or Parliament - for scrutiny or approval. The major exceptions to this are the Special Fund organisations and enterprises requiring a subvention to finance an operating deficit (e.g. Royal Swazi National Airways). Other enterprises, which require a government grant, loan or loan guarantee to finance capital expenditure, submit project proposals for the project in question and, if approved, this expenditure will appear as a line item in the government budget: but, again, little supporting documentation is generally submitted.

3.5 The lack of plans and detailed budgets in the public enterprises is a serious shortcoming. And the absence of clear statements of objectives for the enterprises means there is no explicit framework of government policy within which such plans could be developed.

3.6 Without such a framework, management of an enterprise has no clear basis for taking decisions. It follows that the worth of a "performance review" system is accordingly devalued, for it is not possible to state precisely what management should be trying to achieve and hence there is no yardstick against which to measure performance. Further, without a comprehensive medium-term plan in which the financial and operational implications of various policies are calculated and the existence of constraints to the development of the enterprise is recognised, it is not possible to gauge the "realism" of any targets set, that is, the extent to which it is within management's power to achieve them.

3.7 Therefore, if a meaningful and effective budget and performance review system is to be established, there is first a need to conduct a thorough corporate planning exercise in which the overall direction of the enterprise is laid down and a medium-term plan is developed in the light of a definitive statement on fundamental objectives. Such a plan must include an appraisal of the need for major investment or re-structuring to meet those objectives and the financing implications thereof, and show projected financial and operational performance, based on a set of carefully defined assumptions. In making these projections an analysis of constraints affecting the enterprise's performance must be made, including a study of the impact of government policies on the enterprise; the macro-economic environment; and, internally, the need for organisational strengthening or re-structuring.

3.8 Within this overall framework, the annual budget can be drawn up as part of the rolling medium-term plan, and detailed performance targets agreed. These detailed targets will be steps along the road to achieving more general targets set out in the medium-term plan, and these in turn will be interpretations, in quantified form, of the broader Statement of Objectives made by the Government, setting out the rationale for and mandate of the enterprise. Management should be given incentives to achieve the targets, and be held fully accountable for the success or failure of the enterprise within the limits of its control, these limits having been established during the analysis of the constraints facing the enterprise.

3.9 This planning exercise, which sets the scene for the annual budgets and performance targets, is clearly a complex process. It would require an extensive investment of time on behalf of enterprise management, OFPEN and other government agencies, notably the line ministry. It is also a highly technical exercise; given that many of the public enterprises presently have difficulty even in producing an adequate one-year budget, there is clearly need for external assistance to develop medium-term plans, comprising detailed financial and operational forecasts. And since there is need for OFPEN to play such a pivotal role in the process - mediating between government and the enterprise on such matters as the government policy framework, financing needs and performance targets - it is also essential that the Office be strong enough to participate fully.

3.10 The arrangement of technical assistance and the creation and strengthening of OFPEN will take some months; and, even once the process is started with a few enterprises, it will take a considerable time to develop this planning framework for every public enterprise. In the interim, there is an immediate need to begin to collect the most basic budgetary information from the enterprises, especially where such budgets require an injection of government money; and to establish the principle of performance targeting and monitoring as a precursor to the more comprehensive systems to be introduced later. This requires the enterprises to be brought into a more formal procedure of submitting budgets to government and, accordingly, we concentrate first (in paragraphs 3.11 - 3 59 below) on developing basic budgetary procedures, which can form the foundation on which the more complex planning and performance review system could be built. We return to the discussion of such a system in the paragraphs following 3.60.

Budget Procedures for Public Enterprises

3.11 The development of budget procedures for the public enterprises requires co-ordination with the present government budget process. It is helpful at this stage to summarise briefly the main features of the Government budget and performance review system.

Present Government Budget and Performance Review System

3.12 The budget process starts in April of each year with the issuing of budget guidelines to ministries, which set out, inter alia, the maximum increases on each item of expenditure that the government thinks can be permitted in the following financial year, based on medium-term forecasts of revenue and projections of future commitments made by the Ministry of Finance and Department of Economic Planning and Statistics. (These forecasts are, in turn, partly based on a macro-economic forecast which has been made in the preceding January).

3.13 Ministries are required to submit their requests for new expenditure by end June - mid July and between then and October, discussions are held with the Planning and Budget Committee (PBC) Working Groups to go through each ministry's submission in detail. Ongoing project expenditure submissions are received by the end of September.

3.14 "Performance review", meanwhile, is effected by the submission by Ministries each month of Budget Management statements, showing actual against budgeted expenditure for the past month (generally received by the Ministry of Finance by the middle of the following month). Meetings between Finance and the line ministries to discuss expenditure trends are held at least every quarter, and more frequently if serious over-expenditures arise.

3.15 The budget and performance review system come together at the half-yearly review stage, around October/November. By this time, the Ministry of Finance has revised its revenue forecast (based partly on a re-run of the macro-economic forecasts in June), has received all expenditure requests for the following financial year from the line ministries, and has a record of those ministries' expenditure performance against budget for the first half of the current year. In the light of this information, the budget estimates are finalised in November/December, presented to Cabinet in December and to Parliament and the country in February.

3.16 For the line ministries, therefore the budget estimates and "performance review" refer almost exclusively to <u>expenditure</u> control. And it is noteworthy that the vast majority of ministries' expenditure is wholly predictable from year-to-year, being last year's expenditure plus a mark-up for inflation. Unforeseen expenditure requirements can still occur, of course, especially recurrent expenditure linked to on-going capital projects, but, in general, such overruns will be a small percentage of total expenditure.

3.17 In setting up similar procedures for the public enterprises a comparison with two features of the above system must immediately be made:-

(a) the budgets of a public enterprise, which must naturally consist of both revenue and expenditure forecasts, are far more "volatile" than those of a government Ministry. These enterprises are open to the vagaries of the commercial market and their revenues can vary greatly from month to month. Further, expenditures are not fixed, but to a considerable extent are dependent on trends in output, and hence also subject to large fluctuations. Critically, also, public enterprises borrow externally on their own account and, accordingly, meet their own foreign debt payments. They are thus open to the potentially wild fluctuations of the currency markets, as has recently been the case. In mitigation of this, many of the public enterprises are monopolies and/or providers of basic goods or services, and thus effectively facing a "captive" market, which makes sales forecasting rather easier. Nevertheless, in general, the budgeting of a large commercial enterprise's performance is an appreciably more difficult and less exact science than the comparable exercise for a government Ministry. This has implications for the methods to be used for both budgeting and performance review, necessitating far more attention being given to the setting of assumptions and the choice of performance indicators, and on the behalf of the central agencies, a greater awareness and understanding of the environment facing the corporation and of the fluctuations which will inevitably occur;

(b) the "performance review" of government Ministries is designed primarily to pick up cost overruns and hence the need for cutbacks elsewhere or supplementary expenditure approvals, It does not concern itself at all with the <u>economic efficiency</u> of expenditure, that is, what the country is getting out of the money being spent. To the extent that such considerations are taken into account, it is in the <u>budget</u> process, in the initial setting of priorities and then in the analysis of the various ministries' expend ture requests, which must necessarily involve decisions on trade-offs between different end-users of the available revenues. But since, as set out in (a) above, the financial results of public enterprises depend on a complex set of factors, and since, in particular, correcting poor financial performance in a commercial enterprise requires more detailed analysis than simply identifying a need to cut costs, there is a need for a much more sophisticated performance review system for the public enterprises. Such a system must enable government to identify the fundamental causes of poor performance (and hence need for government support), the "value for money" it derives from investments in its commercial enterprises and the efficiency of management of those enterprises in using the resources at their command to achieve the corporation's objectives.

3.18 We have already outlined the process required to establish a comprehensive performance review system within an overall planning framework, and stated our belief that it would require extensive external assistance and considerable time to implement. But clearly, even in the early stages, when simpler systems are being used, there is a need to monitor enterprise performance on a far wider range of indicators than simply heads of expenditure and a need to conduct detailed analyses of the reasons for sub-standard performance on each indicator, if a fair picture of enterprise efficiency is to be gained.

Priorities in the Budget Process

3.19 The immediate aim of the budget procedure for public enterprises must be to alert government to financing requirements in the coming year. The request for funds will stem from two main sources: loans or grants for specific capital projects; and 'deficit-financing' i.e. cash-flow support, The key budget tools are thus a cash-flow forecast and a capital expenditure budget. The emphasis, for the cash-flow forecast at least, should be on giving as much prior warning as possible of the order of magnitude of a potential cash requirement.

3.20 But the second, perhaps more crucial aim of the budget procedures is to provide a detailed account of the plans of the public enterprises for the coming year, and to set performance targets linked to those plans. This process must necessarily focus in more detail on individual revenue and expenditure items, and operating performance, and not just concentrate on the "bottom line". Further, a cash budget is submitted mainly as a monitoring tool - alerting government to a cash requirement - and the analysis of it will be mostly concerned with testing the validity of assumptions; whereas the more detailed budget is submitted mainly as a tool to measure intended performance, and the analysis of it will be mostly concerned with identifying and testing the scope for improved performance.

3.21 These differences - between the need for detail as opposed to speed, and between "objective" forecasts and "subjective" targets - call for a two-stage budget process, with a cash and capital expenditure forecast being submitted early in the year to coincide with the government budget process, and then a more detailed budget being submitted just before the year start as a basis for performance monitoring. We concentrate first on the requirements for the first submission.

Cash-flow Budget

3.22 As described above, the government ministries have to submit requests for new expenditure by late June/mid July and this is followed with submissions on recurrent and ongoing project expenditure by the end of September. Subventions, grants and loans to public enterprises do not fit easily into either category: the most appropriate rule for the enterprises is that they should forewarn government of the need for finance in the coming year as soon as possible, and not later than September 30th (i.e. 6 months before the next fiscal year begins).

3.23 The best way of formalising this is to request the public enterprises to provide an extended cash forecast with their first quarter results. (As set out in Chapter IV, these should be submitted to OFPEN within eight weeks of the end of the quarter i.e. by the last week of August*). As part of their regular reporting, the enterprises should be producing a rolling cash-flow forecast covering the next twelve months. With the first quarter results, however, a forecast extending twenty-one months will be necessary, from the end of this year's first quarter to the end of the next financial year. This could be presented as a monthly forecast for the first twelve months, plus a quarterly presentation for the last nine months, i.e twelve monthly and three quarterly figures.

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* A few enterprises have year-ends other than March. Some will not have finished their first quarter (e.g CCU, NMC) whilst others will have finished their second (SRIC). But they should still be able to produce the cash-flow forecast as described.

3.24 The cash flow forecast should show, on a cash basis, expected operating revenues and expenditures, loans to be received or repaid, capital expenditure planned, and the changing bank balance position, indicating external financing if required (i.e. where the overdraft facility is exceeded). (In Appendix H we set out a suggested format for the cash-flow reporting).

3.25 It would be unrealistic at such an early stage to ask enterprises for fully detailed calculations of each item of revenue and expenditure. But OFPEN should require from the enterprises sufficient back-up detail for it to perform the analyses discussed below.

Operating Revenue

3.26 Cash revenue is, of course, quantity of each good sold times price, adjusted for debtors' terms. Accordingly, each enterprise should break down its revenue figure in this manner. This will enable OFPEN to check:-

(a) the feasibility of the implied growth rate in the quantity of sales. Initially, this may simply mean comparing the growth rate with previous years and inquiring of the enterprise the state of its "order book' or equivalent e.g. known major users' requirements over the period. In the longer run, and in conjunction with the sales and marketing staff of the enterprise, a more detailed analysis of the determinants of sales should be undertaken. Attempts to link company sales to macroeconomic variables (e.g. national income) are notoriously fraught with the danger of "casual empiricism", especially so in Swaziland where at present the National Accounts are two years in arrears. But some rough causality may be able to be gleaned from such analysis and the enterprise should at least attempt a reconciliation with the macro-economic forecasts produced by DEPS i.e. if it has assumed a sales growth rate different from the overall growth rate forecast by DEPS, it should give clear reasons for the difference. This exercise, in conjunction with a closer analysis of the environment facing the major users, could yield a significant improvement in forecasting. Such an exercise is for OFPEN to initiate in those enterprises where it does not already happen, but the enterprise itself must take primary responsibility for improving its long-term sales forecasting and marketing capability;

(b) the assumptions on average price. No <u>unapproved</u> increases in price should be imputed in the budget. The price of each good or service should thus be forecast to be as it presently stands. So long as the cash revenue figure is broken down into its constituent parts, it is an easy matter to impute price increases into the forecast; and indeed, as appropriate, OFPEN should ask those enterprises likely to require tariff increases to show their cash forecast under a number of different price scenarios. Care should be taken to investigate the allowance for consumer reaction to any price increase; again, such calculations are hazardous and difficult to perform, but broad guesstimates can at least help establish the likely range of responses;

(c) the seasonality of demand. The forecast provided will be for twenty-one months. It should <u>not</u> consist of a forecast for a year, divided by twelve to get monthly figures, but allow carefully for seasonal fluctuations in demand. Again, to expect an exact month-by-month forecast is unrealistic, but past analysis of seasonal trends - a simple graph is often very revealing - can point up the most marked peaks and troughs. Clearly, this is crucial in a cash-flow forecast, even if not so important in a full profit and loss statement, for a seasonal cash revenue trough, which can not be matched by expenditure cuts, may push the company into overdraft;

(d) working capital requirement. It must be stressed that what is required is a <u>cash</u>-flow forecast, not a statement of future billings. We make this point particularly strongly because, even in those organisations which are otherwise producing good management information, a proper cash-flow forecast is rarely being produced except in times of crisis This is ironic, since a cash-flow forecast is precisely the monitoring tool required to provide prior warning of crises. The assumptions on debtor receipts are thus vital: if large debtors' balances are not generally a problem (and this can be seen from the latest balance sheet) then this is obviously not such an issue; but in several of the public enterprises - and the TVA and Posts and Telecommunications are particularly clear examples - severe problems with non-payment (by government, in the latter case) have arisen. It would in such cases be only realistic to assume, for the purpose of the forecast, that the problem will remain.

Operating Expenditure

3.27 The focus should fall on the assumptions on three items:-

(a) Payroll. For most organisations, this will be the largest item that can be predicted with some confidence, even 21 months in the future (at least, at the level of detail expected for this initial forecast). The figure should be broken down into staff numbers and average salary, possibly by grade or category, though at this stage a detailed person-by-person calculation of emoluments over the next 21 months is not necessary. Assumptions about average salary increases should be clearly stated. Payroll costs are the one item that cannot be delayed in order to tide a company over a temporary cash-flow trough. They should thus be separately identified in the cash-flow forecast;

(b) Other direct costs. It has been noted that a complete breakdown of costs cannot be expected at this stage of the budget cycle, looking so far ahead. But a rough analysis of costs, to test the reasonableness of the assumptions, can be achieved by comparing in quantity terms (i.e adjusted for imputed inflation) forecast sales with direct costs i.e. those which by definition vary directly with output. The rates of increase of both should be similar;

(c) Indirect costs (overheads). The major factor affecting the trend of overhead expenses is the inflation rate. This is forecast by the DEPS as the beginning of the year and the enterprise should either use this rate or give a clear explanation as to why it feels its costs will increase at a different rate.

Loan Repayments

3.28 One of the first tasks of OFPEN should be to bring together each public enterprise with the Ministry of Finance and reconcile the two parties' records of public enterprise debt. external, internal and, of course, government's own loans to the enterprises. Once this exercise has been completed and both sides' records are up-to-date and reconciled, the public enterprises should keep government fully informed of their debt position by:-

(a) listing each quarter the loan payments made in that quarter, and their forward commitments on each loan for the next year;
(b) providing a complete loan schedule each year in the cash-flow budget, showing the source of each loan, total amount originally borrowed and the terms of the loan; total currently outstanding; repayment of principal and interest over the period of the forecast i.e. to the end of the next financial year, by month; and projected total remaining principal by the end of this period.

Capital Expenditure

3.29 The capital expenditure submission is a budget in itself, not just another item contributing to the bottom line of the cash-flow forecast, since some public enterprise projects are financed directly by government, or require a government guarantee.

3.30 Accordingly, each project for which government funds or a government loan guarantee are sought should be separately identified. For each project, a clear indication must be given of the expected benefit from the expenditure. It is recognised that there are two constraints on the detail of such "cost-benefit" analysis:-

(a) for some expenditures, especially on maintenance projects, isolating the precise benefits of the project can be extremely difficult or even impossible. Such projects often form part of a "network" of projects, the total effect of which might be measurable but the individual components are not. Similar considerations apply to "overnead" capital expenditure e.g. on buildings;
(b) such calculations are complex to perform even when theoretically possible. A manager may not have the expertise himself, nor the technical staff, to convert his intuitive project idea, based on business knowledge, into a detailed project appraisal. There are

very few economists or other suitably trained staff in either the public enterprises or the ministries able to perform such analyses.

3.31 Despite these constraints, the government should be able to satisfy itself at least on the fundamental soundness of the project. One way to help ensure that management only puts forward viable projects is to ensure that all loans to public enterprises to finance such expenditure are made at commercial rates of interest irrespective of the source or cost of funds. Poor project choice will thus impinge directly on the enterprise's performance, and if, as recommended below, management is assessed on the basis of that performance, that will be an incentive to improve the enterprise's own project appraisal capability.

3.32 To a certain extent, of course, OFPEN can assist public enterprises in such exercises, particularly for the larger capital projects. But it is important that, over time, the enterprises develop their own staff for this work, especially in those enterprises with large investment programmes.

3.33 One further caveat must be made in establishing such procedures for evaluating capital projects. There are some projects which are quite clearly not commercially viable, but which the enterprises are requested to carry out to further the wider social aims of government. This complex but important area of government - public enterprise relations is considered further below.

Unfunded Deficits

3.34 Where the "bottom line" of the cash flow shows a closing bank balance deficit greater than the overdraft facility, the enterprise must be required to put forward alternative suggestions for dealing with the deficit. Unapproved tariff increases will not have been imputed into the revenue calculation, and thus one possible solution might be such an increase. (It is not possible or appropriate here to enter an extended discussion of public enterprise tariff policy; but it is important to state that, in general, tariffs should be related to the enterprise's long-run cost structure, not driven by short-term financing needs.

However, adjusting the timing of tariff increases, which are justified on cost grounds, in order to meet short-term cash deficits is clearly a tool of financial control that cannot be ignored where constraints (such as on external borrowing) exist).

3.35 Other suggestions for easing cash crises - investment cut-backs, loan re-scheduling or new borrowing or even operational cut-backs - should also be presented and the implications both for the cash-flow and operations of the enterprise worked through. These calculations are essential if Government is to be able to judge the costs and benefits of providing finance to the enterprise (and thus, by implication, not providing it to some other project in the public sector).

3.36 It is obviously extremely difficult in August of one year to forecast all the expenditure which will be required up to March of the year after next. This problem applies right across public enterprise operations, of course, and to all the items in the cash-flow forecast. But the production of completely accurate forecasts is not the prime aim; in this case at least, broad estimates based on sound assumptions are more valuable than detailed expenditure breakdowns showing financing requirements to the last cent, produced only a week before the money is needed.

3.37 The major implication here, of course, is that this process of requesting forecasts of cash-flow for each enterprise, in order to highlight the government's future commitments in the way of deficit-financing, can never guarantee to pick up all the commitments any more than the present budgeting process within central government can do this. There will always be unexpected events leading to the need for previously unsought finance. The aim is to minimise the number of these instances.

3.38 OFPEN has an important role to play in trying to assess where such "shocks" might impact most severely and to identify the "high-risk" enterprises. For example, those with large external debts, or those facing particularly volatile markets (especially where a high proportion of costs are fixed) can be considered "high-risk". When budgets are submitted -

and, indeed, throughout the year as part of its regular monitoring and analysis function - OFPEN should conduct "scenario analyses" to gauge the impact on each enterprise of different "shocks". Such exercises have two main objectives; at best, they might lead to measures to reduce the identified risk if the analysis deems it worthwhile and feasible (such as taking forward insurance cover on foreign exchange risks) or, at least, they can assist the government by making it aware of possible "contingent liabilities" that might arise during the year.

3.39 It is not possible to give precise instructions to OFPEN on how to analyse each enterprise's budget. The above notes are designed to serve as guidelines to the type of analysis that might be undertaken to check the validity of an enterprise's budget. The external auditors and other financial advisers can play a role in improving budgetary systems within the public enterprises; OFPEN should be empowered to instruct the public enterprises to ask for such assistance. In the final analysis, if a public enterprise is unable to produce a meaningful budget, OFPEN will not be able to do its job of alerting government to financial and operational problems, no matter how skilled its analysis. Thus, improving this capability within the public enterprises is an urgent priority.

Budget Discussions

3.40 The initial cash-flow budget should be prepared by the end of August. As soon as possible thereafter, it should be discussed with OFPEN and the parent ministry. OFPEN's primary aim will be to study the technical aspects of budget preparation as described above. The parent ministry might be expected to be particularly concerned with the capital expenditure programmes, ensuring that the enterprise's investment programme is in line with its plans for sectoral development

3.41 The enterprise, OFPEN and the parent ministry should then go together to meet with the PBC, such meetings will naturally be longer and more intensive when the enterprise is requesting government funds, but the PBC should meet at least briefly at this time to review all public enterprise budgets. The main budget co-ordinating committee should be aware of all the activities of the public sector, even where no direct call on central government resources is to be made.

3.42 These meetings - the one with OFPEN and the parent Ministry and that with the PBC - may result in changes having to be made to the original budget. In particular, where the cash forecast shows an unfunded deficit at some point, the enterprise will have put forward a number of alternative proposals to finance the deficit. It will be for these meetings to decide on the best solution: a government grant or loan or a cost-cutting exercise, capital or current. OFPEN's advice in this regard will be crucial. It is in this forum that it must hold the most delicate balance between being a controller of the public enterprise - which requires it to question closely all the assumptions and forecasts made - and an advocate for the enterprise, which requires it, once it has satisfied itself of the validity of the enterprise's case, to argue for the enterprise in the PBC meetings. Clearly, however, the Minister of Finance is responsible for all budget allocations and the size of any grant or loan to an enterprise must remain his final decision.

Profit and Loss Budget

3.43 In line with the rest of government, a decision on allocation can be expected by late November/early December, and will be announced to Parliament in early February. By the end of February, therefore, the public enterprises will know definitely the monies they are to receive from government in the next financial year, and should have their results for the first nine months of the year complete. It is at this stage that they should aim to produce a full, revised budget In addition to a revised cash-flow forecast for the next financial year (i.e fifteen months forward from the last complete actual figures) and the capital expenditure budget, a full profit and loss budget and balance sheet forecast should be provided.

3.44 The profit and loss budget should give full details of each item of revenue and expenditure. For the major items (i.e. those items of revenue and costs separately identified on the regular P&L reporting form as set out in Chapter IV) the budgeted figure should be broken down by the four quarters of the year. For each quarter, the budget should be compared to the latest "actual" figures for that quarter; where no "actuals" are yet available (e.g. for the final quarter) the budget should be compared to the latest estimate for that quarter.

3.45 The analyses performed by OFPEN will be similar to those for the original cash-flow budget, though more detail will now be available. In particular, OFPEN will be able to cross-check the profit and loss, cash-flow and balance sheet budgets, through a simple "source and application of funds" analysis. Put simply, such an analysis will consist of:-

(a) comparing the accruals-based profit and loss budget with the cash operating receipts and expenditure in the cash flow forecast and the movements in working capital in the forecast balance sheet;
(b) comparing the net movements in loans shown in the cash-flow with the change on the balance sheet; and comparing capital expenditure with fixed assets movements on the balance sheet, adjusted for depreciation as found from the profit and loss budget.

3.46 A more detailed scrutiny of the individual items of the profit and loss account will also be able to be performed, and justification of each major assumption called for. As outlined in the cash-flow analysis, the key assumptions are:-

(a) growth in quantity of sales;
(b) sales price and demand elasticity;
(c) seasonality of demand;
(d) debt collection and other working capital movements;
(e) relation of direct costs to output/sales ("margin analysis");
(f) growth in overhead costs (inflation)

3.47 It should again be stressed that OFPEN can not possibly "audit" every enterprise's budget so that 100% accuracy is ensured. And even to scrutinise in full detail all enterprise budgets is a large task for an office which it is hoped can remain small and indeed is constrained by available staff to do so. A more effective means of producing accurate and meaningful budgets from the enterprises is to ensure that the budgeting systems within the enterprises themselves are efficient. This is a task for OFPEN to initiate but for others - the external auditors and other financial consultants - to implement.

Performance Targets

3.48 OFPEN's role in reviewing this second, more detailed budget submission is not just to check assumptions. It must take the budget drawn up by enterprise management and investigate where better performance can be achieved, and budgeted results thereby improved. This cannot be done "unilaterally" however, but only through negotiation with management and the line ministry responsible for the economic sector within which the parastatal operates.

3.49 It is important at this stage to point out the essential dichotomy between a budget and a performance review system, however simple or complex it might be. A budget is a forecast of what will happen. It can be seen as an "advance monitoring" tool, and is or should be essentially objective. It should be an honest appraisal of the probable, based on the likely external environment and internal efficiency, rather than a wishful guess at the possible, if all went absolutely perfectly.

3.50 "Performance review", on the other hand, implies setting targets to bring about desired improvements in efficiency. It is thus to some extent subjective but must equally be realistic. Problems arise when a budget and a performance review system run side by side, and the budget becomes the target against which performance is to be judged. This naturally tends to subvert the integrity of the budgeting process; the enterprise now has an incentive to underestimate likely performance in its budget submission, in order that its ex-post performance will appear over-budget. Conversely, the Government, naturally keen to see the enterprise operating as efficiently as possible, may be inclined to push for unrealistically high performance as the basis of the enterprise's budget.

3.51 This requires OFPEN to play a key role as the mediator between the enterprise and the government viewpoint, seeking agreement on a realistic set of targets to be incorporated in the budget, which stretch management but are possible to achieve. For this role, OFPEN must be thoroughly knowledgeable of the environment facing the enterprises, and thus able to make a realistic appraisal of their feasible performance.

3.52 Vague requests to management to "improve performance" will not work; and nor will a simple paper adjustment to make the "bottom line" more palatable bring about the actions necessary to achieve such an improvement in practice. OFPEN must express its desire for better performance in terms of <u>concrete targets</u>; and it must analyse with management in detail the <u>actions necessary to achieve the target</u> thus set.

3.53 OFPEN and the enterprise's management must therefore first agree on a set of indicators of "performance". Any such exercise can only be useful if a thorough exercise to clarify the enterprise's fundamental objectives and medium-term corporate strategy has first been undertaken, for without a clear idea of the direction in which government wishes the enterprise to go, OFPEN can obviously not identify whether the enterprise is achieving the goals desired of it. Even those indicators which would appear to be obvious measures of "good performance" for any firm - e.g. return on capital employed - cannot be taken as such in the parastatal sector, where most of the enterprises are monopolies, easily able to make a profit through tariff increases if they wished to, but with potentially adverse effects on the rest of the economy. Conversely, line ministries, being primarily concerned with sectoral development, may wish to prioritise operational indicators - such as the proportion of the population served by the enterprise - even though such objectives can conflict with the commercial requirements of the enterprise.

3.54 Nevertheless, certain useful targets can be set before the full performance review exercise is undertaken, to help focus management attention on areas where unequivocal improvement can be achieved without jeopardy to any other possible objectives of the corporation. Such targets will be mostly in one of two categories:-

(a) productivity targets; and
(b) financial management targets.

3.55 Productivity targets are not so much concerned with what the enterprise achieves as with the efficiency in achieving it. To take the example above; we noted that setting population access to a service as an indicator might be problematic if it conflicted with commercial requirements (and no explicit trade-off had been agreed). However, whatever proportion of the population does receive the service, should be supplied at least cost; so setting "service accessibility per emalangeni expenditure" might be a more appropriate target. Most overhead expenditure categories can be targeted in this fashion: labour costs are the only category where there may be some hesitancy about declaring an unequivocal desire to see these reduced. Operational indicators relating to single tasks - such as fuel efficiency or repair turnround times - can also serve as meaningful productivity targets. The process of target-setting does most to improve overall performance when the operational indicator chosen has an important direct influence on the financial health of the company as well.

3.56 Financial management targets are those which focus attention on the various aspects of financial control within the enterprise; two broad sorts can be distinguished. First, what might be called the balance sheet indicators: debtors and stock control (days outstanding) and treasury management indicators for example. Secondly, and very importantly given the monitoring and budgeting procedures described elsewhere, are targets relating to the speed and accuracy with which budgets and accounts are produced. We have already suggested for all public enterprises the first targets in this regard by recommending that enterprises be given eight weeks to submit their quarterly reports to OFPEN, then reducing to six, and hopefully four in time. And we have set two target dates for budget preparation: 31 August for an initial cash-flow budget and 28 February for a full budget.

3.57 Further targets should be set regarding accuracy. For example, at present most public enterprises will be hard pushed to produce a budget of any sort by 31 August, and a very broad-brush estimate will initially have to be acceptable. But, in time, a more sophisticated budgeting procedure must be introduced. (This is different from saying the budget must be able to forecast actual results exactly, which is obviously impossible; but the budget must be seen to make the best possible use of the available information at the time). Management accounts can be more readily checked for accuracy, since revisions must be brought to book with each new quarter; and at year-end, of course, their accuracy is most thoroughly checked by external auditors. A qualitative system of targets could be agreed with the auditors before the commencement of each audit and explicitly commented on in the auditors' Management Letter.

3.58 The process of choosing indicators and developing targets will be a protracted one, involving often lengthy negotiations between enterprise management and OFPEN, especially when they are first introduced. We suggest that the choice of the indicators to be targeted should commence immediately, and that the public enterprises begin to report, in their quarterly financial statements, the performance on these indicators. In the full budget which the public enterprises should be asked to submit by the end of February, they should explicitly state their budgeted performance on the chosen indicators. The discussions which then ensue with the OFPEN should focus, inter alia, on agreeing target performances on these indicators (probably a higher performance than the original budget); the rest of the budget will naturally have to be changed to allow for the financial implications of the changed assumptions on performance which OFPEN's target-setting imply

<u>Budget Approval</u>

3.59 The final budget - agreed to by management, OFPEN and the line ministry - must first be referred back to the Board for formal approval; they should already have seen management's initial (end-February) budget. Once Board approval is received, OFPEN will pass it on to SCOPE for their approval. SCOPE approval will be sufficient for the budget to be operational; the final stage, however, will be for the budget to be laid before Parliament for MPs to scrutinise.

Performance Agreements

3.60 Each enterprise needs a corporate plan to provide a definitive framework within which to monitor enterprise performance. The procedures outlined above establish a routine of budget preparation and review and allow for ad hoc analysis of the performance of enterprises within that budget. They would be sufficient to act as a good "early warning" system for government, which would be aware of financial commitments arising, with OFPEN monitoring and reporting on problems and identifying possible corrective action. But the emphasis would remain on "firefighting", and policy formulation by OFPEN would be constrained to short-term crisis avoidance, unless a more thorough periodic exercise is performed with each enterprise, to set a longer term context within which annual budgets and policies can be developed. Without such an exercise, the value of "performance review" will remain strictly limited and the most useful form of such a review - where management can be directly assessed and held accountable for its performance in achieving the clearly-stated objectives of the enterprise - will not be able to be instituted.

3.61 We discuss in the following paragraphs an agenda for discussion between the public enterprise and government, which can lead to the drawing up of a formal document between the two parties containing agreements on each of the key elements of the planning framework, namely the enterprise's fundamental objectives, the government policy environment, detailed short and medium-run performance targets, a management incentive system and a procedure for assessing management performance. Such a document is called a Performance Agreement.

3.62 In setting out below the actions required to develop an Agreement we are aware that whilst some of the work can and should be done as soon as possible for each enterprise, other parts of the work will take longer to implement and require expert technical assistance. In Chapter VI, in which an Action Plan for the next few months is presented, we discuss the prioritisation of the various steps described below.

3.63 We discuss the key actions required to develop a Performance Agreement under the major "heads" of such an agreement, namely:-

(a) clarification of enterprise objectives;
(b) clarification of relations with government;
(c) performance targets;
(d) rewards and sanctions;
(e) administration of the Agreement.

Clarification of Enterprise Objectives

3.64 In our interviews with senior managers of the public enterprises, when we inquired as to what they see as their corporation's objectives, we have been referred to the Act which set up the organisation. And, indeed, in most public enterprises Acts there is a paragraph, normally entitled "Objects of the Corporation", which sets out a list of aims which the corporation is to achieve. However, such objectives are invariably so broad and vague (e.g. "to secure the fullest development of the undertaking") as to be little guidance to management or the Board in their deliberations over corporate policy. (In Appendix F we provide a fuller discussion of the Acts of public enterprises) Crucially, they rarely give any indication of the priority of different objectives, in particular, where developmental and commercial objectives are potentially in conflict. Thus, as an example, an Act might require the Board to secure "the fullest development, consistent with economy, of the undertaking of the corporation". This only serves to confuse management as to the objectives it should be trying to achieve.

3.65 We do not, in fact, believe that the Act is the appropriate place for definitive statements of corporate policy. It is primarily designed for use in legal actions and is thus rightly general in tone. But the public enterprises must have such a statement of government policy to guide them, especially if they are to be given an otherwise highly autonomous status, as has been the case. For the only reasonable alternatives are either to enforce government policy on an ad hoc day-to-day basis through continual interference in the affairs of the corporation or not to enforce it at all The former option is undesirable first, because it necessarily leads to uncertainty within the corporation, dilutes any long-run planning effort and disaffects management, and second, because the only practical way of applying it is through civil service representation on Boards which has proved unsatisfactory or inadequate

3.66 The option of not enforcing government policy at all is quickly set aside when one considers the impact of these corporations on the economy and the potential for good - or bad - that they have. Government must have a policy towards such large and strategic organisations as the parastatals

3.67 Thus, before any more detailed performance targets can be drawn up, government - the parent Ministry, the Ministry of Finance, the Department of Economic Planning and Statistics - and the enterprise must agree to a policy statement covering:-

(a) the fundamental goals of the enterprise (a brief, general statement akin to those given in the Acts);
(b) the extent of the enterprise's operational responsibilities (a precise statement of the goods and services the corporation is to provide, including a geographic delimitation of its market where appropriate);

(c) the enterprise's market position for each of its main goods or services (i.e. whether it is to have a monopoly or face competition);

(d) the quality of service expected from the enterprise (e.g. in terms of average access to the service by urban population etc);

(e) a general statement of the enterprise's financial policy (e.g. whether a standard rate of return is required).

3.68 To agree on such a statement will require extensive negotiation. OFPEN should be responsible for drafting initial statements, after discussion with both enterprise management and government, and for chairing meetings between the parties at which the key points are debated. Within the same forum, the next stage of the process could also be developed, namely the agreement on the government policy framework.

Clarification of Relations with Government

3.69 There are four parts to this process, the first two of which can be discussed simultaneously with the basic statement of objectives described above. First, management of the enterprise must seek a general statement on its autonomy, that is, what it is empowered to do itself, for what actions it needs Board approval, and for what actions ministerial approval is required. This would cover, inter alia, tariff increases, investments (of different sizes and types), new services, staff recruitment, salary increases and promotions.

3.70 Secondly, and closely related, government must lay down precise instructions on reporting. This would include requirements to submit budgets, accounts, management accounts, operational information, and so on, to OFPEN.

3.71 In Chapter II we have set out our recommendations on the general procedures for government scrutiny of key public enterprise decisions. We have also stressed the need to build "variable control" of such decisions into the legislation to reflect the differing requirements of different enterprises. It is in this forum where the "intensity" of control of each enterprise should be formally agreed.

3.72 Third, government and the public enterprise must regularise their mutual financial commitments. This will entail a once-and-for-all clearing up of debts due, formalising loan agreements where these do not exist i.e. agreeing on loan terms and conditions, and in general, ensuring that both sides have the same record of their financial relations. From our interviews with the enterprises, their auditors and the Ministry of Finance, we are aware that there are several cases of large sums of money outstanding from the enterprises (and in at least one case to an enterprise) for which there is no formal agreement and where neither side is sure of the precise status of the transaction.

3.73 Once this initial task is complete, agreements must be drawn up to regularise the future financial relations between the government and the enterprises. Standard debtors terms should be agreed to, and procedures should be drafted for arranging loans, with clearly specified terms and conditions, in the event of any financial requirement of the enterprise. This would also be an appropriate place to discuss the tax and dividend policies which are to apply to the enterprises: presently, none of them pay either, with the exception of the SRIC.

3.74 The Statement of Objectives would help clarify the fourth and perhaps most difficult issue in government - public enterprise relations: where the developmental role of the enterprise should take precedence or be subjugated to the requirements for commercial viability. But it would only do so in general terms. For specific cases where there is a conflict between the two, that is, where the enterprise is required to run a service which is less profitable than the standard rate of profit laid down, a definitive agreement needs to be drawn up between government and the enterprise, clarifying:-

(a) whether the service should continue to be run at all costs, or whether some minimum financial return is to be sought;
(b) how the loss is to financed and accounted for.

3.75 Further questions arise from this - for instance, whether the enterprise is the most suitable organisation to perform the service, and exactly how the loss on the service is to be calculated. Here again OFPEN has a key role to play in advising the parties.

Performance Targets

3.76 For targets to be realistic and thus effective incentives and worthwhile indicators of management performance, they must be compatible with long-term objectives, individually physically achievable and as a group internally consistent, and adaptable to changing external events.

3.77 To develop detailed targets which reflect the longer-term objectives of the enterprise the broad Statement of Objectives described above must be translated into a financial and operational plan for the enterprise. This must certainly include, over perhaps a five year period:-

* the expected trend for sales;
* the implications of this trend for investment and hence financing requirements;
* the implications of both the above for recurrent expenditure, particularly staffing requirements;
* the organisational implications of the enterprise's planned operations;
* possible new directions (including divestiture of certain activities);
* detailed financial projections

3.78 The plan must be checked for compatibility with the Statement of Objectives: thus to conform with a statement on quality of service, in terms of the proportion of the population which should have access to the service, the enterprise might have to plan a major investment. If, however, it does not expect sales to rise accordingly with widened accessibility, and it has a financial policy dictating standard rates of return, then it must build in the appropriate implication for tariffs. Thus would the government be informed of the practicality and the cost of its stated policies.

3.79 Of course OFPEN will have an important role to play in developing this medium-term plan, and in checking its conformity with stated government policy. OFPEN should negotiate medium-term targets with enterprise management - for the later years these should probably only be broad ranges and magnitudes - which highlight the key variables indicative of performance towards achieving the key objective of the corporation.

3.80 Within this medium-term context, one-year budgets can be developed. The annual budgetary procedure will be made markedly smoother by being part of the medium-term corporate plan. The basic problems of forecasting will remain, and assumptions on uncertain external events will still have to be made, but a present major source of uncertainty - the relation with government - will be greatly reduced

3.81 Detailed, annual performance targets could now be set, for the framework would be in place to ensure that such annual targets were truly in keeping with the objectives of the enterprise, and were within management's power and responsibility to achieve. Such targets would be applied to similar variables as for the medium-term targets, only they would be more specific, and there would be more of them. For one year, a number of different indicators could be used as proxies for the eventual improvement of one key variable. for example, improvement in fuel efficiency, average load per wagon and turn-round time would, for the railways, point to the basis for improved profit per train.

3.82 It has been stressed that such targets would have to be internally consistent: thus, improvements in one indicator must not be automatically at the expense of deterioration in another indicator. Moreover, there is need to establish a hierarchy of "high level" and "low level" indicators, such that movements in a "high level" indicator can be effectively analysed through the study of the "low level" indicators which are its constituent parts (in the railways example quoted above, "profit per train" would be the "high level" indicator, the others "low level" indicators).

3.83 Such an approach not only ensures internal consistency and clarifies analysis, it also makes it easier for management to translate the targets which it must meet, and which OFPEN sets and monitor, into targets for the lower levels of the organisation. Thus the three "low level" indicators in the railways example could be made targets for three different departments

3.84 The final requirement of such targets is that they are adaptable to changing external circumstances· that is, they must be flexible enough for the monitoring body to be able to discern whether movements in the indicators are caused by events outside the control of management or are directly due to management's action It is impossible ever to design targets that are completely clear in this respect. but through careful analysis of the forces "driving" each indicator, it should be possible for OFPEN to get at least a broad idea of management's influence over each chosen indicator. The use of target "hierarchies" can help here too: for instance, if "fuel cost per kilometer" were a target, broken down into "fuel cost per litre" and "fuel efficiency" (litres used per kilometer), it would be clear that the former is completely outside management's control, but the latter is to a considerable extent within it.

Rewards and Sanctions

3.85 Setting detailed performance targets is a vacuous exercise unless management is to be given real incentives to achieve those targets. At present, few enterprises operate a system of staff bonuses; it would thus be a new concept for managers and government alike, and would have to be gradually and cautiously implemented.

3.86 Both the form and structure of incentives will vary from one enterprise to another, and over time. The decision on the form of incentives will be based on a judgement as to what will prove the most effective spur to management: financial bonuses, or some form of non-pecuniary incentive. For example, greater autonomy from government is an incentive which can be both attractive to management and makes good sense, in that the successful companies are, in any case, the ones which government need interfere with least.

3.87 The structure of incentives must llow for significant variances in performance, with a rising scale of rewards and sanctions in line with increasingly above (or below) target results. And so far as is possible, the incentives given should be "sub-divisible", so that top management can pass the incentives down the organisation (in the same way that it passes down the "high-level" targets it must meet as a series of "low-level" targets for junior staff).

Administration of the Performance Agreement

3.88 The credibility of the administration of the Performarce Agreement system hinges on two factors:-

(a) the technical capability of OFPEN, as the liaison body;
(b) the objectivity and fairness of the assessment procedure.

3.89 It will be SCOPE which finally decides on the rewards or sanctions to hand down to enterprise management. But if management is to feel fairly treated, it must know that its performance has been judged on a clear, pre-agreed basis, by an objective assessor. Therefore, it is vital that OFPEN, as advisor to SCOPE, is seen to be both objective and technically proficient in evaluating enterprise performance.

3.90 Indeed, it is largely the credibility of OFPEN that will determine the success of the whole process of management assessment, for it plays such a pivotal role in the negotiations between management and government on objectives, policies and detailed targets; and, of course, must proffer technical advice on each part of the process.

3.91 OFPEN's authority and independence must therefore be considerable; and that in itself will take time to build up, another reason why this more comprehensive but ultimately crucial process of management review can only begin some time after the creation of OFPEN.

IV MONITORING PROCEDURES

The Requirement

4.1 At present, Central Government receives very little information from its public enterprises. Most public enterprises' Acts require the submission to the relevant Minister of annual audited accounts but many of the enterprises are considerably behind in their submission of accounts; and as we have noted in the previous chapter, full budgets are rarely sent to Government. In any case, such information is usually out of date by the time it reaches the Ministry and of little use in assisting government in formulating policy towards the enterprise or, crucially,in alerting government to problems arising within the enterprise.

4.2 Regular financial and operational information fails to reach Central Government for one of two reasons. Either the enterprise simply does not produce the necessary information, or the information is presented only to the Board. In the latter case, although Ministries do have a seat on most public enterprise Boards, Board meetings are often attended by junior staff and the information presented does not always filter back to the senior officers in the Ministry. Where the Principal Secretary himself attends, he will be able to comment on the information presented at that meeting but, because there is no systematic collection of past reports within the Ministry, and no analysis thereof, the PS is not easily able to keep a regular watch on the affairs of the enterprise. The lack of regular analysis results in a failure to predict the development of crises within the enterprise, an inability to check on the policies instigated by PE management and thus on whether they conform to government policy, and, in general, to a situation where central government does not have sufficient depth of knowledge of the enterprises to enable it to assist, advise and control them in the way that it would like to

4.3 It should be stressed that information on public enterprises it not just required to <u>control</u> them. As an important sector of the economy, the activities of these large corporations impinge directly on macroeconomic performance and particularly of course on the government's fiscal performance. The health of these corporations is thus vital to the health the economy. Even if government had no power over them at all, it would wish to keep a very close watch on such enterprises as the electricity board, railway, post and telecommunications, airline and water board - all of which are monopolies as well as being suppliers of vital goods and services.

4.4 Most importantly, however, the monitoring of public enterprises is a vital part of the overall process of performance improvement which OFPEN should instigate. Government needs to know whether its public enterprises are adhering to the targets set for them, and if not, the causes of the variance; the impact of any measures consequently taken to correct the situation must similarly be closely monitored and analysed.

4.5 More specifically, then, the government must monitor:-

(a) the impact of the public enterprises on the government's finances;
(b) the impact of the enterprises on the economy, in terms of the quality and quantity of their service or output and its price;
(c) the developmental impact of the enterprises;
(d) the impact of government policy on the enterprises;
(e) the profitability of the enterprises;
(f) the performance of management.

Impact on the Government's Finances

4.6 In particular, the need for new subventions or loans and the ability of the enterprise to meet its outstanding commitments must be carefully monitored. A record must also be kept of the total borrowing activities of each enterprise, both because such borrowing is a contingent liability on government, and, more immediately, because it forms part of the overall public sector borrowing requirement and thus affects the overall fiscal stance of the public sector.

Impact of the Enterprises on the Economy

4.7 Tariff increases, efficiency of service, the opening of new outlets/connections/branches and, of course, the impact of the financing of such investment expenditure are valid concerns of the government. As major employers, the public enterprises are also important influences on employment and inflation within the economy: monitoring of hirings, redundancies and wage increases is thus also necessary.

Developmental Impact of the Enterprises

4.8 This relates not only to new investment but also to the wider issue of ensuring balanced development within the country. Many of the enterprises provide infrastructural services - such as telecommunications, electricity and water, - and government must ensure that such services develop in line with the needs of the commercial and industrial sectors and domestic consumers.

Impact of Government Policies on the Enterprises

4.9 The public enterprises are subject to a wide range of explicit and implicit controls on their operations - restrictions on tariff increases, requirements to run commercially non-viable services for social reasons, regulations on staffing and salary policy, and so on. For the government to be able to judge the efficacy of these policies - normally directed at income re-distribution or general economic development - it must know their cost, which involves monitoring their impact on the financial health of the corporations.

Profitability of the Enterprise

4.10 Government is the shareholder in the public enterprises and, like all shareholders, has a right to be informed of the performance of its investment. The money invested in the public enterprises may not be so readily transferable as with a normal shareholding, but the principle remains that, whilst allowing the enterprises commercial autonomy on a day-to-day basis, government must monitor whether they are achieving a satisfactory level of performance and, if not, have the right to instruct changes in policy. This is intimately linked, of course, to the monitoring of the performance of management.

Performance of Management

4.11 It is right that management should be given a free hand to enact the policies it sees as most likely to achieve the objectives of the Corporation. But government must continually check on whether these objectives are being met, and whether management is performing to acceptable standards.

4.12 These information requirements call for a far more regular and comprehensive monitoring of public enterprises than has hitherto occurred. This implies both asking for more information, on a more frequent basis, than previously, and conducting a more thorough and systematic analysis of that information. Both of these will be facilitated by the setting up of OFPEN.

Procedures for Monitoring

4.13 The strengthened monitoring effort should have four strands:-

* Collection of all relevant historical information on each enterprise
* Instigating a regular financial monitoring system
* Regular review meetings
* Board meetings

Historical Information

4.14 Such information must include:-

(a) the Act setting up the enterprise and, where applicable, the Articles of Association or other legal documents;

(b) all government policy statements on the enterprise. These might include references in past budget speeches, Development Plans, Ministerial speeches and so on;

(c) all past copies of the Annual Report of the enterprise (or, at least for ten years), including a complete historical record of its financial performance;

(d) past copies of the Management Letters provided by the external auditors to management each year, commenting on the internal accounting systems of the corporation;

(e) board papers;

(f) a complete record of the key operational indicators of the enterprise, including in particular the opening of new facilities and their impact on the total output of the enterprise and its productivity;

(g) a current organisation chart and a historical record of employment levels;

(h) a history of price increases (when they were instituted and the amount of the increase) for each major good or service.

4.15 Such information should be mostly obtainable from the enterprise itself, but it may also be necessary and useful to conduct a search through existing government files on the enterprises - particularly at the Ministry of Finance and the parent ministries - and take copies of relevant documents.

Quarterly Financial Reporting

4.16. This would entail requesting each enterprise to supply OFPEN each quarter with the following financial statements:-

(a) Balance sheet;
(b) Profit and loss account;
(c) Cash-flow forecast;
(d) Capital expenditure progress report.

4.17 A separate statement, detailing basic operational data (e.g. total staff numbers) and performance on a set of pre-agreed financial and operational performance criteria, should be added when such criteria have been instituted.

4.18. Appendix H sets out these reporting requirements in detail, including the provision of standard formats for each form. This does not imply that it is necessary for every public enterprise to conform exactly to this format. Rather, what is important is that all the information necessary for OFPEN to complete the forms is provided. The sample forms are not complex accounting statements: they are the basic management information required of any commercial enterprise. If an enterprise is not presently producing any one piece of this information - including the analyses against budget, the rolling forecasts and the various breakdowns required, not just the basic statements - it should be made to start doing so. An indication of the present state of the financial reporting by the main public enterprises is given in Appendix G.

4.19 Where an enterprise has genuine difficulty in producing such information, because of internal accounting system weaknesses, the reaction must not be to use that as an excuse not to report, but to use it as a trigger to initiate corrective action within the company. In the first instance, this should entail requesting the external auditors to report on the precise causes of the bottleneck, including an estimate of the work, or new staff, or improvement to systems required to allow the necessary information to be produced.

4.20 The aim, initially, should be to get this basic information from the enterprises within eight weeks of the end of the quarter to which the figures relate. Up to ten weeks could be allowed if there was good reason to think that the delay was due to early teething problems only and would soon be improved upon. Any longer delay than that should be investigated as discussed above. The long-term aim should be a four-week deadline.

4.21 The quarterly financial statements should be accompanied by a management report, written personally by the CEO. This need not be a long document but a brief summary of the key trends of the quarter should be given and the main features of the results highlighted.

4.22 In particular, of course, the CEO should comment on any impending cash requirements, or other problems needing immediate remedial action whether financial, operational, personnel-related or administrative. More generally, he should identify the main issues for the coming months and prospective problems arising therefrom. The report might be perhaps two to three pages long - but <u>must</u> be signed personally by the CEO and not delegated to junior staff. This will serve to heighten the CEO's sense of accountability for his enterprise's performance. The receipt of the quarterly report should trigger the third part of the monitoring programme, the quarterly review meetings.

<u>Quarterly Review Meetings</u>

4.23 These meetings will have three broad purposes: monitoring, performance analysis and general discussion. The monitoring aspect of the meeting will involve going over the quarterly figures, identifying the major events of the quarter and discussing the points raised by the CEO in his report. The aim of such discussions is both simple information exchange and also the development of strategies to counter problems arising.

4.24 The performance analysis aspect of the meeting - which in practice is inextricably linked to the basic monitoring exercise - will involve questioning management more closely on the major variances from budget and enquiring how management intends to correct such variances. These meetings should explicitly <u>not</u> involve telling management what to do, but merely enquiring what it intends to do, proferring advice on particular issues where asked, and noting the effect of management's actions in resolving past problems.

4.25 General discussion on any aspect of the business can also ensue at such meetings; the aim of the meetings should be to "build bridges" and engender a feeling of mutual understanding. This might involve explaining and clarifying government policy on various matters, or listening to particular grievances of management. These might be personnel or administrative problems as much as matters of financial or operational policy; and, most certainly, they could be complaints about delays or other constraints in dealing with government - or, indeed, with the Board, which provides the fourth strand of the monitoring effort.

Board Meetings

4.26 We recommend elsewhere that the Boards of the parastatals be re-constituted and in particular, the commercial strengths of Boards be increased. This will necessitate a reduction in civil service representation on Boards. It is right, however, that government be aware of the deliberations of Board meetings and, just as importantly, be on hand to give on-the-spot advice to the Board on the interpretation of government policy.

4.27 This is the natural role of OFPEN and accordingly, we recommend that OFPEN be accorded, ex-officio, observer status on the Board of all parastatals. OFPEN's representative would have a right to attend all Board meetings but have no voice within the Board in the granting of tariff, investment or loan approvals, staff selection, or any other policy matter. He would, however, be able to gather information on various aspects of the enterprise, be privy to the policy-making environment of the firm, thus enabling him better to understand the reasons for management's decisions, and ensure the closest possible liaison between the enterprise and the Office.

Reporting

4.28 OFPEN must report on the findings of its monitoring and analysis of the public enterprises, to enable the rest of Government and particularly, of course, SCOPE, to be aware of the key developments in the enterprises.

4.29 Following the receipt of quarterly accounts, and the review meetings with management immediately afterwards, OFPEN should prepare a brief report on each enterprise. This report should highlight the key statistics for the enterprise and provide a succinct analysis of its performance. The following statistics should be given:-

(a) net profit/loss for the quarter and the year to date, compared to budget;

(b) key financial/operational indicators for the quarter and year to date, compared to target (once these have been agreed);

(c) major deviations from budget that have occurred in the key variables, and the reasons for these deviations;

(b) forecast profit/loss for the year;

(e) cash position : latest balance; forecast net flow for next twelve months; any assistance required (i.e. overdraft facility or Government subvention or loan required).

4.30 The report should include the following analysis:-

(a) an interpretation of the quarter's results. It should be remembered at all times that the readers of the report are mostly laymen and all very busy. Detailed, technical analysis of the figures should not be given. OFPEN should, however perform such analyses in the preparation of the report. Similarly, wherever figures - actuals, variances, indicators or ratios - are quoted, the significance of them should be absolutely clear to the non-technician. The drift of the report should be directed at the basic facts of the enterprise's performance - whether it is performing above or below budget, whether Government financial assistance is or is likely to be required and whether there are any major problems impairing the enterprise's performance;

(b) an assessment of management's performance. OFPEN's assessment should be based on the performance indicators agreed with the enterprises, OFPEN's knowledge of and regular contacts with enterprise management and its knowledge of the external environment facing the enterprise. Once the Performance Agreements, described in Chapter III, are in force, and an incentive scheme is operating based on management performance, OFPEN's analysis and judgement of management will clearly be a crucial factor in determining management rewards under the scheme. In the interim, before the Office has built up the necessary depth of knowledge on the enterprises to be able to make such important judgements, the report on management performance should concentrate on highlighting major divergencies from policy or management actions particularly worthy of mention,

(c) an analysis of the major issues in the immediate future (the next quarter or two) taking into account seasonal market trends, commissioning of investments, major problems looming and key policy decisions pending such as on tariffs or investments).

4.31 The whole report should be no longer than 3 pages: 1 page of statistics and a 2 page written report. It will naturally draw heavily on the quarterly report of the enterprise's CEO.

4.32 At the end of the year, once the final results are ready, a report of the year's performance of each enterprise should be submitted by OFPEN. The format should be similar to the above, though giving rather more detail. In particular, the year's results should be compared to those of the past three to five years, showing trends in the major items of revenue and expenditure and agreed performance indicators and explaining the factors behind the trends.

4.33 Again, the report should concentrate on the fundamental factors affecting the health of the corporation : the profitability of different parts of the business; the cash-flow situation, the state of the market facing the corporation; and the outlook for each The policy agenda for the coming year should be set out including the need for tariff increases or major capital expenditure or personnel actions (such as filling of key staff vacancies or training). Finally, an updated estimate of the likely sufficiency of government financial assistance will be a crucial part of the report.

4.34 OFPEN should also prepare consolidated quarterly and annual reports on the public enterprise sector as a whole. The quarterly report, submitted as soon as all the individual enterprise returns for that quarter are received, or within three months of the quarter's end even if some are still missing by then, should show simply the "GFS", macro-economic and other consolidations set out in Appendix H.

4.35 An annual report should contain these consolidations for the year as a whole and forecasts on the basis of enterprise budgets for the coming year. The report should also contain a discussion of issues relevant right across the public enterprise sector, for example, progress with implementing the reporting system, the workings of the control structure; delays experienced by enterprises in obtaining government approvals; the impact of government policy or major economic events (such as large exchange rate movements); and the reaction OFPEN has experienced in its dealings with the enterprises and parent ministries

4.36 OFPEN should also report on its own internal development where possible; an ongoing record should be kept of OFPEN's major activities and its progress in achieving its main objectives, including the recruitment of appropriately qualified staff for OFPEN itself.

V PUBLIC ENTERPRISE CASE STUDIES

Introduction

5.1 The Principal Secretary, in his letter of 10 June 1985 to the USAID Mission Director, sets out the intended activities of the "Public Enterprise Monitoring Unit" (now referred to as Office for Public Enterprises - OFPEN) as follows:-

(a) to build up a comprehensive base of public enterprise financial statistics;

(b) to conduct an annual survey of public enterprise performance and future plans allied to the process of preparation of Central Government budget estimates;

(c) to undertake a detailed review of the functions and objectives of all public enterprises to clarify their relationship with Government and to establish performance criteria; and

(d) in the long run, to develop specific policies for each enterprise, in conjunction with the line Ministry responsible and the Department of Economic Planning.

5.2 Under item (c) in the Terms of Reference provid d by USAID, the contractor is requested to review the policies of public enterprises and to formulate performance criteria for the functions each enterprise is expected to perform. This task evidently corresponds to the third activity of the Principal Secretary's letter referred to above. In addition the TOR state that "the contractor will initially focus on only a few enterprises..... and in so doing will formulate guidelines for the further work of the unit". We have interpreted this to mean that these select reviews will be used to determine procedures, methodologies and guidelines for OFPEN to look at all public enterprises

5 3 The importance of the public enterprise case studies should thus be seen in terms of their relevance to the future operation of the proposed Office for Public Enterprises (OFPEN) The overriding purpose of these reviews, therefore, is to establish a framework for the OFPEN to analyse and agree performance criteria for the public enterprises. We observe that the accountability for enterprise efficiency and performance is ultimately the responsibility of the management of the corporation To this extent any system of monitoring and control introduced by OFPEN can only be as

effective as the corporation's own internal systems of monitoring and control.

5.4 We further point out that the ultimate purpose of monitoring and control systems is to strengthen internal efficiency and performance consistent with the overall goals of the corporation and taking account of external influences. Monitoring systems introduced by OFPEN, therefore, should not be viewed in the negative sense of constraining management action but should be judged in terms of the way they can assist and facilitate improvements in internal efficiency and performance.

5.5 Accordingly the primary objectives of the public enterprise case studies are:-

(a) to examine the present relationships between the Government and the enterprises;
(b) to assess the effectiveness of the present management control mechanisms; and
(c) to suggest ways of improving (a) and (b)

5.6 In addition the secondary objectives of these reviews are to:-

(a) indicate methods of analysis which OFPEN could adopt in analysing other enterprises; and
(b) suggest some possible measures for improving performance in the four enterprises studied.

5.7 The remainder of this chapter is divided into two sections:-

* methodology for the case studies
* lessons from the four case studies.

Methodology for Case Studies

5.8 We have set out in Chapter III a general approach to the formulation of Performance Agreements. This approach is reflected in the methodology we have adopted for the public enterprise case studies although in the time available we have only been able briefly to consider each of the key elements of this approach. Accordingly, our analysis has focussed upon the following stages:-

* corporate objectives
* framework for control
* policies and strategic plans
* management information
* financial and operational performance.

Corporate Objectives

5 9 In our analysis of corporate objectives we have firstly examined the clarity of each enterprise's stated objectives. In addition we have determined the extent to which these objectives are understood by and agreed between enterprise management and the Government. Finally we have addressed the issue of the internal consistency of objectives.

5 10 Objectives should not simply be vague aspirations (e g. "to promote rural development") the achievement of which cannot be verified. They should be capable of translation into operational objectives and performance targets which are capable of verification and which can therefore measure performance or efficiency Accordingly we make comments where appropriate on the "verifiability" of corporate objectives.

Framework for Control

5.11 The framework for management control over corporate activities has two dimensions - external and internal - both of which we have examined. The external framework is represented by:-

(a) legislation,
(b) communication with the Government, and
(c) formal Government policy guidelines not reflected in legislation.

5.12 The external framework can either assist or hinder the internal management of the enterprise. Legislation defines the formal approval processes and broad policy guidelines which individual enterprises must follow. These will include, for instance, procedures for tariff adjustments. The relevant sections of the legislation should be unambiguous and comprehensive both to enable management to take purposeful action and to reduce the opportunities for external interference. In addition, government exercises guidance of a general nature for all enterprises which are not embodied in legislation and we have also examined the nature and content of such guidelines. Finally, the lines of communication to government ministries and agencies have an important bearing on operational efficiency within the enterprise. In this respect we have studied the de facto communication channels in order to assess whether these assist or constrain management within the enterprise.

5.13 We have investigated the internal framework in order to make judgements regarding:-

(a) the organisation structure, its clarity, relevance and functioning;
(b) the composition of the Board of Directors, its effectiveness and relationship to enterprise management; and
(c) the availability of qualified manpower in key managerial, professional and technical positions.

Policies and Strategic Plans

5.14 Planning is a prerequisite of management control; the planning process sets operational targets to be achieved over a specified time period and thereafter management control is the process of measuring actual performance against targets and initiating action to remedy deviations from plans. Plans must reflect the overall goals and direction of the corporation and cannot be formulated independently of them. Accordingly we have reviewed the quality of medium-range strategic planning in each enterprise, which is the process of formulating strategies, over a three to five year period, to achieve the objectives of the enterprise.

5.15 Medium-term strategies and policies (including pricing policies) should be designed both to contribute towards corporate goals and improve profitability and efficiency. They should be converted to verifiable operational targets and decomposed into annual targets as part of an annual plan. The annual plan should include both operational and financial targets, which are subject to management control and monitored over the course of the year. Accordingly, we have examined the extent to which operational and financial targets have been used to measure efficiency and performance levels in the corporation.

Management Information

5.16 In order to apply effective management control mechanisms and to meet Government reporting requirements, the enterprises need to generate information of both a financial and an operational nature. Therefore we have reviewed the present management information systems in order to assess whether the information generated is comprehensive, accurate and timely.

5.17 A prime requirement of any management information system is that the information should be both useful to management, and actually used by management. In this respect, we have endeavoured to assess whether:-

(a) any variance analysis is performed and corrective action taken; and
(b) historical information is used as a basis for forecasting.

Financial and Operational Performance

5.18 Our analyses of the public enterprises have been concluded with a review of financial and operational performance. These have included an assessment of both current performance and recent trends with a view to identifying the main factors likely to impinge on future performance. This analysis provides a basis for determining:-

(a) how profitability/efficiency can be improved; and
(b) where more effective controls are required.

Lessons from the Case Studies

5.19 Our case studies, which have adopted the analyses outlined in paragraphs 5.9-5.18, have focussed on four public enterprises, namely the:-

* Swaziland Electricity Board (SEB)
* Swaziland Television Authority (TVA)
* Royal Swazi National Airways Corporation (RSNAC)
* Swaziland Railway (SR).

5.20 We summarise in this section the general lessons which can be drawn from the individual reviews. (Appendices B-E consider each of the enterprises in more detail). We focus on weaknesses in order to draw attention to improvements which can be made.

5.21 We discuss these broad lessons under the following sub-headings:-

* corporate objectives
* external framework
* internal framework
* strategic planning
* budgeting and management information
* operational and financial performance
* performance criteria and performance appraisal.

<u>Corporate Objectives</u>

5.22 The general observations arising from our analysis of the objectives of the four corporations are discussed under the following sub-headings:-

(a) clarity of objectives
(b) financial obligations
(c) non-commercial objectives.

<u>Clarity of Objectives</u>

5.23 The objectives specified in the legislation setting up the enterprises are in all cases vague and indisputable statements of purpose which provide virtually no guidance to management in setting operational objectives. In the case of TVA and RSNAC attempts have been made in other policy statements to make these objectives rather more concrete and meaningful. For instance, The Fourth National Development Plan charges the airline with:-

(a) developing the route network and services to the extent that they are commercial propositions; and

(b) promoting the development of tourism.

5.24 The lack of clarity in objectives increases the possibility of conflicts between objectives. This is apparent in the case of SEB where, on the one hand, legislation requires that the Board endeavour to "cheapen" supplies of electricity and, on the other, the Government is clearly pursuing the goal of national self-sufficiency in electricity generation which in practice has meant higher supply costs. (This is evidenced by the decision to invest in the Luphohlo-Ezulwini hydro scheme rather than continue to purchase electricity from ESCOM in South Africa)

5.25 The failure to define objectives comprehensively and unambiguously can result in inaccurate interpretations by management of their mandate. This is clearly illustrated in the case of SR where commercial objectives are not clearly specified and management perceives that the railway exists to help industry rather than make a profit.

Financial Obligations

5.26 There is a conspicuous absence of overall financial performance criteria in the legislation establishing the enterprises. In the case of TVA and RSNAC there is no provision for any standard of financial performance. In the Acts setting up both the SEB and SR reference is made to the broad requirement for costs, chargeable to revenue account, not to exceed revenues. In the case of SR it is not apparent what these costs should include, for instance, whether depreciation and interest should be recovered. More significantly, however, the enterprises are not expected to achieve a specified rate of return on net fixed assets or capital employed.

Non-Commercial Objectives

5.27 Parastatals are frequently requested, in both developing and developed countries, to carry out non-commercial activities in accordance with government's broader development goals. In the enterprises we have examined, these non-commercial objectives have tended to be obscured and no explicit recognition of the need to carry out such activities nor of how the costs should be borne is included in the legislation.

5.28 There are three specific examples which illustrate this point. First, RSNAC is entrusted with promoting tourism, the costs of which are incurred by the corporation whereas the benefits are largely enjoyed by the Government through tourism revenues. Secondly, TVA is expected to provide a national communications service (and possibly also an educational and cultural service) on behalf of the Government, particularly in the form of news and other current affairs broadcasts. Thirdly, the legislation establishing SEB does not explicitly delineate the areas of the country which should be served and, by implication, SEB is expected to supply electricity to potentially non-profitable rural areas.

5.29 These examples represent "non-commercial objectives" to the extent that the full benefits of achieving them are not captured or enjoyed by the enterprise whereas the full financial costs <u>are</u> incurred by the enterprise. If these non-commercial objectives expected of individual enterprise were formalised and made explicit then a satisfactory basis for compensation of the enterprise by the Government could be worked out.

<u>External Framework</u>

5.30 The external framework which regulates the operation of individual enterprises is represented primarily by:-

(a) Government policy guidelines; and
(b) Government-enterprise communication channels.

<u>Government Policy Guidelines</u>

5.31 We note that there is a lack of a coherent and appropriate <u>tariff policy</u> for three of the enterprises we studied, SEB, TVA and SR. In recent years, SEB tariff adjustments have been required to meet short-run cash payments in the form of loan repayments for the new Luphohlo-Ezulwini hydro-electric scheme. This can result in exceptional tariff increases in the short-term to the detriment of the longer term development of a rational tariff structure. In the case of the TVA, there are no guidelines provided for licence and rental fee revisions, and although in theory TVA can adjust these as it sees fit, in practice, TVA management and the Board have been reluctant to introduce licence and rental fee adjustments without involving the ministry. Finally, SR's tariff adjustments have apparently borne little relation either to the Railway's cost structure or to its financial needs. With the completion of the Northern Rail Link there is a clear case for a price discrimination policy, with transit traffic from RSA being charged a higher tariff. This would allow SR to maximise its profits from the transit traffic by forcing RSA industry to share its cost savings achieved as a result of the reduction in the distance travelled, with SR.

5.32 In the determination of salaries, with the notable exception of the TVA, the enterprises are relatively autonomous. TVA's salaries are closely linked to Government salary scales, which prevents the authority from paying bonuses or commissions to its salesmen and arrears collectors. This appears inappropriate for an organisation which operates in a commercial environment.

5.33 The more general observation on salaries policy is that the enterprises must compete with the private sector for scarce managerial, professional and technical skills. To this extent, they should have the latitude to determine remuneration levels in accordance with market principles. By the same token, for skills which are strictly non-transferable e.g. studio technicians at TVA, salaries cannot be set by reference to the labour market In these instances, therefore, remuneration should be based on the relative worth of the job to the organisation in comparison with other jobs.

5.34 However, this observation should be tempered in the case of parastatals which are monopolies. SEB is a case in point. At present, in principle, SEB can pass on wage and salary increases in the form of higher electricity prices, since there exists no other electricity supplier. It is necessary, therefore, to ensure that salary increases are related to underlying improvements in real productivity and to focus on indicators which can be used to guide salary determination, for instance, energy sales per employee.

Government-Enterprise Communication Channels

5.35 There is evidence that the lines of communication between the Government and individual enterprises need to be significantly improved. This observation is most clearly illustrated in the requests for financial subvention submitted to the Government by the TVA and the RSNAC in the current year. In both instances, the approved subvention was substantially less than the submission from the enterprise and neither enterprise understood clearly the basis for the revised estimate.

5.36 Another example concerns SEB's attempts to renegotiate its external loan commitments consequent upon the devaluation of the Rand. In this case, SEB understood that the Ministry of Finance had agreed to pay SEB's external debt at the current exchange rates and that SEB would make payments to government fixed in Emalangeni at the exchange rate prevailing as at 31 March 1985. It has transpired recently that the Ministry had not formally agreed to this position. This incident highlights the importance of formal agreements which clearly specify the enterprises' financial commitments to government.

Internal Framework

5.37 We have been unable to investigate in depth the internal management of each of the four enterprises and we restrict our comments here to some general observations regarding:-

(a) the Board of Directors;
(b) organisation structure;
(c) management and manpower issues.

Board of Directors

5.38 There are wide differences in the responsibilities and effectiveness of the Boards of Directors for the four enterprises. For instance, the SEB Board in practice approves all tariff adjustments although the Minister in principle has the power to make alterations in the public interest. In contrast, the Board of the TVA has been clearly reluctant even to initiate licence and particularly rental charge adjustments Although it is not explicitly stated in the legislation, the real power behind pricing approvals would appear to lie with the line ministry

5 39 Regarding the potential effectiveness of the Boards we make two observations:-

(a) there is a general lack of financial expertise on the Boards, with the possible exception of SEB; and

(b) Principal Secretaries tend to be over represented on the Boards, particularly in relation to their capacity to attend regularly; this results in the nomination of junior officers which can in turn result in a lack of both continuity and policy direction.

Organisation Structure

5.40 In general we conclude from an examination of the organisation structures of the four enterprises that the span of control of the Chief Executive is too wide. That is, there are too many senior officers reporting directly to him which dilutes the latter's capacity to lead and control and in particular deflects attention away from longer-term planning in favour of day-to-day matters. This observation is valid for TVA, RSNAC and SR.

5.41 In terms of the functioning of the organisation, we note the special importance of the reporting relationship between the Accounts Department and the Chief Executive. With the exception of RSNAC, the accounting function is perceived as more of a "service" than an "advisory" department, and is not part of the management team. This is perhaps illustrated most clearly in the TVA where the Accounts Department is physically separated from the main office, thereby impairing communications and reducing the possibility for the department to make an impact on senior management.

Management and Manpower Issues

5.42 We note the dependence of all four parastatals studied on expatriate management. Further, with the exception of SEB which has two unfilled engineering positions, there are no vacancies in key managerial, technical and professional positions indicating shortages of skilled manpower.

5.43 We have been unable to assess in any detail the existing management practices in the four enterprises we have studied. Nevertheless we are able to make a comment of a more general nature. Management, including financial managers, should be capable of capitalising on opportunities to improve performance. We note later that there are few short-run prospects for improving the financial performance of SEB, TVA and RSNAC. In contrast, the completion of the Northern Link has provided a tremendous opportunity for SR to improve its financial performance. In order that maximum advantage is gained from this opportunity to generate revenue for both SR and the country, the Government should be convinced that SR management is sufficiently versatile to realise the potential revenue benefits from a radical change in the nature of its operations.

5.44 We further observe that middle management in the four enterprises we studied is weak. Competent middle managers are vital to the implementation of policy decisions and plans and accordingly we suggest that more attention be paid to the recruitment of qualified staff and the training, especially in-service, of existing staff.

Strategic Planning

5.45 None of the four enterprises under review possessed a strategic medium-term plan. The absence of this medium-term framework for control is explained, although not fully justified in our view, by the difficulties of forecasting. SEB's experience of forecasting errors for instance has led it to abandon any medium-term planning, with the possible exception of capital budgets which are prepared for a two year period. Similarly, RSNAC is highly dependent upon its external environment, specifically fuel prices, exchange rate fluctuations and the volatile nature of the passenger market, which makes forward planning a hazardous exercise

5.46 However, the difficulties associated with forecasting, say, energy sales or passenger volumes does not remove the use of or need for planning. Defining strategic options is the process of choosing between alternatives which can best achieve the overall goals of the corporation, given the anticipated environment in which plans are expected to operate The selection of appropriate strategies will therefore attempt to identify those which are least sensitive to adverse external factors. In this regard it is important that enterprises test the sensitivity of future performance to alternative assumptions. Of particular relevance to RSNAC, SEB and SR (the latter two having high levels of external debt), would be to assess the impact of possible exchange rate fluctuations on future profitability and cash flow and develop contingency plans to deal with major fluctuations.

Budgeting and Management Information

5.47 All of the four enterprises we reviewed have prepared budgets for the forthcoming financial year. (In the case of SR this is the first budget which has been prepared by the Railway). The main issues arising from the current budgeting procedures are as follows:-

(a) insufficient supporting documentation is provided with which to test the validity of the assumptions made;
(b) expenditures are generally estimated on a simple incremental basis i.e. an inflation factor applied either to the previous year's expenditure or budget, rather than built up from a "zero base";
(c) it is extremely difficult to draw up accurate budgets as a basis for Government subventions nine months prior to the start of the budget year, which is the Government requirement. (Hence our recommendation for a two-stage budget process, as set out in Chapter III).

5.48 Regular management accounts, comparing actual with budgeted performance, were produced for three of the four enterprises, the exception being SR. The following points may be made on these presentations:-

(a) no regular cash flow projections are produced;
(b) there is no narrative explaining major adverse variances;
(c) the management accounts are generally not used as instruments of management control, i.e. to improve performance by identifying the causes of variances from budget;
(d) the management accounts were too detailed for management to review in the cases of TVA and RSNAC.

Operational and Financial Performance

5.49 The historical evidence and next year's projections demonstrate that, for three enterprises, there is limited scope in the short-run for significant improvements in performance related to growth in output and revenues. The notable exception is SR which, with the opening of the Northern Rail link in January 1986, has enormous potential for immediate improvements in freight hauled.

5.50 It is clear, therefore, that improvements in financial performance must originate from the cost side. Accordingly, operating expenditures, including both variable and overhead costs should come under closer scrutiny in order to reduce costs per unit of output. There is clear evidence, in the cases of TVA and RSNAC, where adverse expenditure variances are frequently high, of the need for better control over expenditure.

5.51 In terms of overall financial performance only SEB is currently profitable. SR, as indicated above, is potentially highly profitable since the opening of the Northern Rail Link. RSNAC is currently very unprofitable with little prospect of becoming profitable in the foreseeable future. Finally, TVA is a more complex case being both a broadcasting and a rental operation. Our analysis has shown that the rental operation (STAR) can become profitable by operating on a commercial basis but that STBC is currently unprofitable with little prospect of improvement in the immediate future.

5.52 In our examination of financial performance we also reviewed the need for subventions for both TVA and RSNAC. The conclusion which may be drawn here is that the criteria and basis for estimating the deficit to be financed are radically different from those required for a government department. In principle, subventions for public enterprises should comprise support for the cash flow deficit, the provision of non-commercial services or specific capital projects. But money actually provided to the enterprises is usually just a lump-sum payment, with no indication being given of the justification for or purpose of the subvention. Moreover, we note that it is not the annual operating deficit which requires financing but the cash flow deficit. These two deficits can be radically different as the case of TVA aptly demonstrates. Yet there appears to be confusion over the principle of providing finance to the public enterprises to cover short-term cash crises as opposed to operating deficits arising from particular non-viable services.

5.53 Our analysis has also demonstrated the importance of working capital management. The SEB, RSNAC and SR have all experienced recent increases in debtors outstanding. Clearly, therefore, debtors outstanding in relation to sales should be subject to constant review with a view to reducing debtors to an acceptable level. TVA has the opposite problem of a dangerously high level of creditors, which has built up due to TVA's cash problems. TVA thus runs the danger of film suppliers refusing to provide additional film material to the authority.

5.54 Finally, we observe that the indebtedness to Government of the RSNAC and SR, is not subject to formal agreements which specify the terms and conditions of the loans. It is essential that the repayment terms are formalised between the Government and the enterprises. We suggest that the Government should not provide any loan unless the terms and conditions of that loan are agreed in advance.

Performance Criteria and Performance Appraisal

5.55 With the exception of RSNAC, which sets targets for a wide range of performance indicators and ratios, performance criteria are not used by any of the enterprises which we reviewed. Performance criteria should be agreed with each enterprise in the near future, as part of the overall process of establishing Performance Agreements (see Chapter III). Particularly in the case of enterprises, such as SEB and the rental operation of TVA, which do not operate in a competitive environment, these criteria should embrace operational, financial and manpower indicators and not be restricted to measures of profitability which may simply reflect monopoly power.

5.56 Within the enterprise, performance targets can be disaggregated and allocated to responsibility centres or departments; then it becomes the responsibility of the head of department to motivate his subordinate staff to achieve the targets set. In this regard we observe that none of the four parastatals we studied, with the exception of RSNAC, has any performance appraisal system which could be used as a basis for motivating staff to achieve individual targets.

VI ACTION PROGRAMME

Introduction

6.1 In this final chapter we set out the actions required to implement our recommendations, should they be accepted. Figure 6.1 summarises the action programme.

6.2 We have indicated the broad priority of each action, and the person or persons primarily responsible for its execution. We have divided the programme into six stages; action on each new stage of the programme is dependent on completion of the actions listed in the previous stage. We have also given indications of the possible timing of each stage of the programme. We discuss each stage below.

Government approval

6.3 Clearly, the first priority is to gain Cabinet, Parliamentary and Royal approval for the main recommendations in the report. Once Cabinet has debated and accepted the principal recommendations, legislation should be drafted by the Attorney-General's office encapsulating all those recommendations which require legal enforcement. To this end, we have prepared a layman's draft of a Bill, which we present in Appendix F.

6.4 Once Cabinet has approved the form of the legislation, it can be brought before Parliament by the Prime Minister, who should sponsor the Bill, as the Minister responsible for OFPEN (and Chairman of SCOPE). We understand that the next session of Parliament will be held within 3-6 months; this appears to us to be a realistic length of time to complete the drafting of the legislation. Once the Bill was passed by Parliament, Royal assent would then be sought.

6.5 Meanwhile, once the full Cabinet has given its agreement in principle to the main recommendations contained in this report, the Standing Committee on Public Enterprises - SCOPE - should be formed and meet to discuss the main report. (We have provided an Executive Summary to facilitate this discussion). SCOPE's first task will be to identify a person to act as an "Interim Co-ordinator" (IC); that is, someone who can co-ordinate the main tasks which need to be undertaken between now and the time when full-time staff have been recruited to OFPEN. Such a person

Figure 6.1

ACTION PROGRAMME

(Bold type denotes actions requiring donor assistance)

PRIORITY		ACTION	RESPONSIBILITY
1 - A (Immediately)	i)	Government to accept report	Cabinet
	ii)	Draft legislation	Attorney General
	iii)	Cabinet to accept draft Bill	Cabinet
	iv)	Parliament to pass Bill	Parliament (Prime Minister to sponsor Bill) and Royal assent required.
1 - B (After full Cabinet agreement received for principle)	i)	SCOPE to meet; discuss main report	SCOPE
	ii)	Identify interim Co-ordinator (IC)	SCOPE
2 (After legislation passed (August - September))	i)	Begin recruitment process for Director/identify Caretaker Director	IC/SCOPE
	ii)	Recruit expatriate specialist in business analysis	IC/SCOPE
	iii)	Recruit Swazi specialist in business analysis	IC/SCOPE

3 - A (After Caretaker Direccor and technical staff in post: September - October)	i)	Introduce PEs to stipulations of new Act	Caretaker Director (CD)
	ii)	Introduce PEs to concept of OFPEN/SCOPE	" "
	iii)	Monitor adherence to Act (obtaining approvals etc)	CD and SCOPE
	iv)	Attend Board meetings as observer	CD and OFPEN staff
3 - B	i)	Send monitoring forms to all PEs	OFPEN staff/ Consultants
	ii)	Discuss reporting requirements with PEs (quarterly reports and budgets)	
	iii)	Identify bottlenecks in reporting (weak accounting systems)	" "
	iv)	Agree with PEs on: format; timings; assistance required	" "
	v)	Report on situation to SCOPE	" "

3 - C	i)	Begin to analyse quarterly reports (as they come in); hold review meetings with PEs	OFPEN staff
	ii)	Draft first quarterly report to SCOPE	"
3 - D	i)	Collect historical information	OFPEN staff
	ii)	Analyse main past trends for each PE	"
	iii)	Produce historic consolidated figures for PE sector	"
	iv)	Provide SCOPE with summary background report on historic performance of sector	"
4 (After Director in post: (January - March)	i)	Discuss with government and each PE the concept of corporate planning and Performance Agreements	OFPEN Line Ministries Min. Finance/DEPS PEs
	ii)	For each PE identify main issues and constraints	OFPEN
	iii)	Select PEs for more in-depth review	OFPEN/SCOPE

5 - A (From next April)	Develop Performance Agreements with selected PEs	OFPEN/Consultants
5 - B (From next June)	Instigate budgetary procedures with all other PEs - Cash and capital budgets - Profit and loss budget - Performance targets - Begin to develop corporate plans and Performance Agreements	OFPEN

needs to have a good grasp of the recommendations in the report and be familiar with the legislative and administrative procedures of government.

6.6 The IC will liaise closely with the Attorney General in the drafting of legislation, and will ensure that the recommendations as passed by Cabinet are properly reflected in the legal text of the Bill. In this regard, the IC should have a good working knowledge of the existing Acts governing public enterprises.

Recruitment of Staff

6.7 The IC will also be responsible, in liaison with SCOPE and the Principal Secretary at the Department of Economic Planning and Statistics (as the co-ordinator of requests to donors), for beginning the recruitment of external staff for OFPEN, especially the Director. It is probable that no formal request for donor funds could be finalised, and no definite negotiations with interested individuals concluded, until the legislation is on the Statute Book. However, in the meantime, informal contacts could be made with the agencies which have expressed interest in financing the Office (see Appendix J), to ensure that the process of recruitment is expedited once Royal assent is received. Similarly, early contacts should be made with institutions in Swaziland which have Swazi staff who might be suitable for the Office. (For instance, during our study we met with the Dean of the Faculty of Social Sciences at the University and with the Acting General Manager of NIDCS, who thought they would both be able to identify two or three individuals from their respective organisations with the necessary qualifications and experience for the Office).

6.8 Clearly, the recruitment of the Director is vital. We have stressed that none of the major planning or performance review procedures, on which the effective control of the enterprises depends, could be instituted without the Director in post, for his personality and technical abilities will be crucial to the credibility of the Office. We believe that, initially, the Director will have to be an expatriate funded by Technical Assistance.

6.9 It will, however, take perhaps 6-9 months from the date of the first advance to a donor agency before a Director is in post; such is the lead time on such appointments. In the meantime, we recommend that consideration be given to appointing a Caretaker Director; the main purpose behind this would be to ensure that the Office had, right from its inception, a senior figure at its head, who could handle the early, sensitive negotiations - with public enterprise Chairmen and Chief Executives in particular - concerning the role of the Office and its relationship to the enterprises and to government. We believe that it should be possible to identify such a person from within Swaziland, to serve for perhaps 6 months.

6.10 With regard to other staff required, we suggest that two people be recruited initially; one should be an expatriate, externally funded, but emphasis should also be placed on identifying and recruiting a Swazi citizen to the Office. Although there is a dearth of local managerial talent, in the financial field in particular, we believe it should be possible to fill one of the posts locally (a view based on our meetings at the University and NIDCS noted above). It may be necessary for this officer to be given substantial supervision in the early months, and special training may be able to be arranged for him (see below).

6.11 Clearly, it is desirable that further staff be recruited as soon as possible; but we believe that two specialist staff supporting the Director is the minimum necessary to establish the Office and begin to implement the procedures recommended in our report. We recommend that the Administrative Officer and the two other technical personnel - again, one expatriate and one Swazi would be desirable from the point of view of maximizing both the calibre of staff and the contribution of the Office to the training of local talent - should be recruited within a year of the Office commencing operations.

<u>Implementing procedures</u>

6.12 We believe that it could be possible to have passed the legislation, identified a Caretaker Director and recruited two professional staff by September/October. At this stage, the Office could start to function effectively and begin to implement the procedures recommended in this report. First, the Caretaker Director must introduce the enterprises to the new arrangements and ensure that, henceforth, all enterprises act in accordance with the new regulations. This may, initially, be a sensitive and difficult role, for there may well be a significant adverse reaction to the new controls, especially from those enterprises which have hitherto been the most autonomous. This calls for tact, but also firmness from the Caretaker Director.

6.13 On the technical side, the most urgent task is to implement the monitoring procedures, so that OFPEN and government begin to receive the key information on the performance of each enterprise. Implementing these procedures requires a detailed discussion with each enterprise on the precise format of the budget and management accounts it is to prepare; the identification of problems arising with the production of these statements; the arrangement of assistance to the enterprise to help solve these problems; the harmonisation of reports from the different enterprises, to ensure that a consolidation can be performed across the sector, and to ensure that the full information required for such consolidations is being produced by each enterprise; and the preparation of a report on the exercise to SCOPE.

6.14 We believe that in order to expedite this exercise, and to help with other tasks involved in this initial setting up of the Office (e.g. data storage, analysis and recall systems; detailed formats for reporting to SCOPE; general technical assistance to the staff) there should be at this time a further period of external consultancy to the Office; this would ensure that procedures were implemented as swiftly and smoothly as possible, and that advice would be on hand to deal with any particular problems arising with individual enterprises.

6.15 Once the quarterly information from the enterprises is being received, the regular analysis of and meetings with the enterprises can begin. Before this "ongoing" analysis can begin, however, we recommend that OFPEN complete the collection of historical information on each enterprise and prepare a short background report to SCOPE which describes the main developments in each enterprise, and for the sector as a whole, in recent years and thus sets the scene for future analysis of the sector.

6.16 The corporate planning procedures, discussed in Chapter III, can only begin to be implemented once the Director is in post, for this is a lengthy, technical exercise requiring substantial negotiation between government and the enterprises; the Director of OFPEN is needed as the mediator in the negotiations and the overall co-ordinator of the corporate plans for each enterprise. The need for continuity and co-ordination means that it would not be appropriate for the Caretaker Director to make any significant moves in the direction of instigating the corporate planning framework.

6.17 The Director should introduce all the enterprises to the concepts of corporate planning and Performance Agreements as described in Chapter III. He should discuss with management the major issues facing the enterprise over the medium term. The Director and his staff should attempt to identify the main "heads of agreement": that is, they should establish for each enterprise a broad agenda for discussion with government (e.g listing the major problems the enterprise has experienced in its dealings with government; setting down the range of possible objectives for each enterprise) and outline the contents of the corporate plan.

6.18 In discussion with SCOPE, the Director should then identify two or three enterprises for which detailed Performance Agreements are to be drawn up, incorporating a full corporate planning exercise and management review. Without wishing to pre-empt the choice of the enterprises, we feel that all of the following require urgent detailed study, within the context of such a planning exercise:

Swaziland Railways
Royal Swazi National Airways
Swaziland Television Authority
Swaziland Dairy Board
Swaziland Development and Savings Bank
Water and Sewerage Board.

6.19 In Chapter V we have set out some initial findings on the first three of these enterprises. But these findings result from only a brief study of each enterprise; as we stress in that chapter, the prime purpose of conducting the studies was to show the type of analysis that needs to be performed on the public enterprises, and to identify and suggest possible solutions to some of the major problems of the enterprise. (That is, the sort of preliminary analysis that OFPEN should initially perform on each enterprise, as discussed in paragraph 6.17 above.)

6.20 To conduct detailed reviews and develop the corporate plans and Performance Agreements for the two or three selected enterprises will require external consultancy assistance; OFPEN staff themselves would not initially have the time or the experience required to perform such in-depth studies. However, OFPEN staff should work closely with the consultants, for the concepts and techniques employed in developing these detailed Agreements should be applied by OFPEN in setting up budgetary and corporate planning procedures with the remaining enterprises.

6.21 In Chapter III, in describing annual budgetary procedures, and the nature and content of a typical Performance Agreement, we set out a number of steps to be taken in drawing up such an Agreement. These are measures which should be undertaken in any case, regardless of whether a full Performance Agreement is subsequently drawn up, for they are essential to establishing a basis for the sound future operations of the enterprise. Some of these measures are more urgent than others. We therefore suggest that, for the enterprises not selected for detailed review by the external consultants, priority be accorded as follows:

(a) the development of cash-flow and capital expenditure budgets for the coming financial year;
(b) the development of a full profit and loss budget, with detailed supporting documents, incorporating basic performance targets;
(c) the drafting of a Statement of Objectives;
(d) the agreement between government and each enterprise on the "intensity" of government control i.e the decisions for which approval must be sought from SCOPE;
(e) the agreement between government and each enterprise on mutual financial commitments;
(f) the agreement between government and each enterprise on the non-commercial services which the latter is to run, and the principle of how to account for such services.

6.22 The first two steps are required to establish basic budgetary control over each enterprise. Steps (c) - (f) then set the framework within which it is possible to instigate a full corporate planning process, incorporating a detailed management review, and establishing medium and short-run performance targets, backed by incentive schemes for management. As stressed before, this process is a highly complex one; but OFPEN staff will gain first-hand experience of the methodology of such an exercise from the initial two or three studies undertaken by external consultants.

6.23 Clearly, it is not possible to put precise timings on the completion of each of the above steps for each enterprise. For some, the exercise will be quicker than for others; and in some cases, for the smaller enterprises, perhaps, the Office itself will be able to implement all the steps, including the detailed planning and targeting exercises; whilst with other enterprises, external assistance will again be required.

6.24 To conclude, therefore, the priorities for the immediate future are to:

* gain Government approval for the report

* gain Cabinet, Parliamentary and Royal approval for the necessary legislative changes

* recruit a Director and two professional staff to the Office

* implement the budgetary and monitoring procedures

* prepare the ground for the negotiation of Performance Agreements for the key enterprises.

GOVERNMENT OF SWAZILAND
Ministry of Finance

PROCEDURES TO IMPROVE MONITORING, ANALYSIS AND CONTROL OF PUBLIC ENTERPRISES

Appendices

May 1986

Coopers
&Lybrand
associates

- APPENDICES -

TERMS OF REFERENCE

(1) USAID Terms of Reference

Background:

The Government of Swaziland (GOS) is concerned about the lack of control of its parastatals, but before considering specific action, the GOS wants more information on how they run, what policy options exist and what changes might be implemented. The Ministry of Finance plans to set up a public enterprise monitoring unit in an attempt to improve its financial monitoring of the whole of the parastatal sector, to provide policy guidance to public enterprises, particularly through the use of performance criteria, and to rationalize central government assistance to such enterprises. There has up to now been no section in the central agencies of government with specific responsibility for public enterprises; the responsibility for individual public enterprises rests with line ministries which are ill-equipped to monitor their financial performance and to perform functions related to overall coordination.

General Objectives:

The contractor will be required to furnish the services of one or more members of its' professional staff for approximately three person months of work, most of which will be done in Swaziland. The individual(s) will advise and assist the Ministry of Finance in the evaluation of parastatals in Swaziland, the development of a work program and operational guidelines for the public enterprise monitoring unit and formulation of parastatal policy and objectives

Specific Objectives:

(A) To establish a regular financial monitoring procedure for the public sector as a whole. At present the ministry produces monthly reports on central government finances in the IMF government financial statistics format (GFS; the format classifies transactions into deficit - creating and deficit financing). It is intended that the unit should produce at least quarterly reports on the financial status of the public enterprise sector in a GFS format compatible with the reports on central government, so that a complete picture of the public sector will be available. This will require setting-up of a system of regular returns by public enterprises and a system to convert these into GFS format.

(B) To establish a system of financial and budget review of individual public enterprises. At present the Ministry reviews expenditures within central government on a quarterly basis, and the process of budget preparation is closely allied to this review. It is envisaged that the financial performance and budgets of public enterprises will be similarly reviewed. The objectives of the reviews are to recommend remedial action where necessary, to identify GOS funding requirements or surplus generation; to specify the need for loans or subventions, and to provide overall fiscal stance and debt position of the parastatal sector.

(C) Policy guidance and performance criteria.

The objective is to review policies of public enterprises, e.g. pricing policies and to measure rates of return on investment in order to examine whether these are consistent with central government policy, and to formulate performance criteria for the functions each enterprise is expected to perform. These tests will require close coordination with the department of economic planning and the line ministries. It is expected that the contractor will initially focus on only a few enterprises (e.g. Swaziland Development and Savings Bank, National Industrial Development Corporation of Swaziland, Water and Sewerage Board), to be selected in consultation with the Ministry, and in so doing will formulate guidelines for the further work of the unit.

It is not intended that this outline of objectives should be taken as exhaustive. The unit is being set up as a result of the GOS's concern over the public enterprise sector. Another important function of the Contractor would be to identify other objectives which could contribute to more effective monitoring and guidance of public enterprises, and to outline a work program to attain these objectives.

(2) <u>Original Letter from Ministry of Finance to USAID</u>

Mr. R. Huesmann,
Mission Director,
United States Agency for International Development
P.O. Box 750
MBABANE

10th June, 1985

Dear Mr. Huesmann,

We heard with very great interest of the Indefinite Quantity Contract (IQC) for parastatal studies, restructuring and divestiture awarded by USAID to Coopers and Lybrand in association with others.

The purpose of this letter is to initiate discussion on a request for technical assistance from this source to the Public Enterprise Unit in this Ministry. We understand the IQC is intended mainly for studies of individual parastatals, but we feel our request is nevertheless very much in line with the spirit of the Contract and hope it may be given favourable consideration.

As evidenced in the Draft Fourth National Development Plan and more recent policy documents such as the Budget Speech, we share USAID's concern with the performance of public enterprises.

Public enterprises have an important impact on the fiscal stance of the public sector as a whole and on the evolution of public debt, on the central government budget through the need for loans and subventions, and on the achievement of national developmental priorities For these reasons regular monitoring of their financial performance and future plans is essential; in addition, while the decentralization of decision making embodied in the creation of a parastatal implies that direct Government interference is undesirable, the operation of public enterprises should be subject to national guidelines, relating particularly to pricing policies and to appropriate rates of return on investment.

Without clear definition of the functions each enterprise is to fulfill and without performance criteria based on the commercial viability of these functions, public enterprises do not consistently further Government's development objectives, while at the same time evaluation of their performance is impossible. Currently performance criteria do not exist, and with the exception of the Swaziland Electricity Board both capital budgets and recurrent budget deficits and financed on an ad hoc basis.

For these reasons Government has decided to set up, within the Ministry of Finance, a Public Enterprise Unit with responsibility for financial overview of public enterprises The Unit's activities are envisaged to fall broadly into two classes First it will be expected to build up a comprehensive base of public enterprise financial statistics and conduct at least an annual survey of public enterprise performance and future plans allied to the process of preparation of central Government budget estimates. Secondly, it will, in the immediate future, undertake a detailed review of the functions and objectives of all public enterprises to clarify their relationship with Government and to establish performance criteria. In the long run it should aim to develop specific policies for each enterprise, in conjunction with the line Ministry responsible and the Department of Economic Planning.

This is a wide-ranging and very general brief A detailed work programme is yet to be worked out, yet the skills and experience required to do this are not available to us at present. Since the tasks of the Unit will be similar, though of course in less depth, to the kind of task the IQC Consultants will be performing for particular parastatals, it is our hope that USAID may be able to provide a consultant from the IQC to help set up the Unit. We have in mind a three-month period initially, followed by regular month-long visits every four months or so over the following two years. The consultant's task would be primarily to formulate a plan of action, to train the local members of the Unit in carrying out the required tasks, and in the later stages to ensure that the Unit was performing adequately.

I look forward to your early response on this matter, and remain

Yours sincerely,

signed K MBULI

PRINCIPAL SECRETARY

cc. P.S. Economic Planning

SWAZILAND ELECTRICITY BOARD

B1. We discuss our brief review of the Swaziland Electricity Board (SEB) under the following headings:-

* corporate objectives
* Government policy guidelines and relations
* organisation and management
* strategic planning and tariff policy
* management information
* financial performance
* productivity indicators
* performance criteria
* conclusions

Corporate Objectives

B2. The Electricity Act of 1983 empowers the SEB to:-

(a) generate, transmit, distribute and supply electricity; and
(b) secure the development, extension and cheapening of supplies of electricity.

The statute confers a legal monopoly status on SEB in respect of both the generation and distribution of electricity within Swaziland. Making the SEB responsible for the "cheapening" of supplies of electricity is clearly intended, in part, to ensure that this monopoly power is not abused.

B3. The Act, however, does not specify which areas of the country should be supplied with electricicy and whether this should be on a commercial or non-commercial base. In practice, SEB has interpreted this lack of mandate by charging users for the capital cost for connections outside the Board's transmission network. Normally these capital expenditures have been paid on behalf of the users by either GOS or donor funds

B4. An implicit objective required of the SEB by government is relative independence from ESCOM in electricity generation. This is clearly a political, non-commercial objective which was reflected in the decision to finance the Luphohlo-Ezulwini hydro-electric scheme rather than to continue purchasing residual electricity requirements from ESCOM, the least financial cost option. The consultants engaged to conduct the financial appraisal of various options for additional generating capacity in Swaziland estimated that this scheme, backed up by ESCOM supplies, was 11 per cent more expensive (in discounted cash flow terms) than the option of continuing to import electricity from RSA. Its effect has been to impose additional costs on the Board which in effect penalises consumers to the extent that these extra costs are passed on in the form of higher tariffs. It may be appropriate, therefore, for the Government to compensate the Board for these estimated additional costs in order to limit the rate of tariff increases to consumers, especially in order to promote industrial development in Swaziland.

B5. It can further be argued that this decision conflicts with the mandate provided to SEB in the Act to "cheapen" supplies of electricity. Clearly the existence of conflicting objectives can make future planning an exceedingly difficult exercise

Government Policy Guidelines and Relations

B6. There are no existing Government policy guidelines which govern the day to day operations of the Board. The Electricity Act gives the Minister powers to direct the Board in the "public interest" but, in practice, this provision has not been applied except during the recent debt repayment crisis precipitated by the devaluation of the Rand. In this instance, it was decided that the proposed tariff increase to meet debt repayment obligations at prevailing exchange rates was unacceptable.

B7. There is no clear Government tariff policy for the electricity industry restricting SEB's powers to set its own tariffs. Such a policy would, for instance, take account of the likely affect of tariff increases on industrial investment in Swaziland. Such a policy dictates, for instance, that SEB be required by GOS to keep tariff increases below or at least in line with, say, ESCOM increases or changes in the retail price index. If a policy of this nature had existed at the time of the debt repayment crisis this would have made the financial obligations of the Government more transparent and should have facilitated a faster solution to the problem.

B8. SEB is currently autonomous in determining its salary scales and annual increases in salaries. In principle this is acceptable provided that it is recognised that SEB is a legal monopoly (with no explicit incentives to control costs) and regulatory guidelines governing salary increases set accordingly. These guidelines might, for instance, state that the rate of increase of the salary bill should not exceed the growth in the cost of living index or that payroll growth should be geared towards improvements in real productivity.

B9. Although it does not depend upon the Government for major decisions, it deals with various departments of government on a day to day basis. Its main relationships are with the Principal Secretary of Finance, in respect of external loan repayments, and the Department of Economic Planning and Statistics (DEPS) for new projects. The SEB's dealings with the relatively new Ministry of Natural Resources are limited because this ministry has yet to establish a planning office The SEB at present merely informs its ministry of its submission of new projects through the DEPS. In respect of external loan negotiations and rescheduling the Board has the authority to deal directly with financiers.

B10. The major difficulty which SEB experiences with its external relationships is in respect of non-commercial projects to be financed through government where it is frequently obliged to deal with a number of different ministries. This underlines the importance of establishing a planning capacity within the Ministry of Natural Resources to liaise directly with other government departments on behalf of the SEB.

B11. In the context of SEB's relations with government, we refer to SEB's attempts to renegotiate its external loan commitments consequent upon the devaluation of the Rand. In this case, SEB understood that the Ministry of Finance (MOF) had agreed to pay SEB's external debt at the current exchange rates and that SEB would make payments to government fixed in Emalangeni at the exchange rate prevailing as at 31 March 1985. It has transpired recently that the MOF had not formally agreed to this position. This incident highlights the importance of a formal agreement which clearly specifies the extent of SEB's indebtedness to government.

Organisation and Management

B12. The formal organisation structure is currently undergoing revision and we understand that proposed changes will be shortly put to the Board. Whilst we consider that there are a number of specific weaknesses in the official reporting relationships these do not seem to impair SEB's overall operations. Moreover, informal working relationships are frequently a more accurate guide to the functioning of an enterprise than formal structures. In the case of SEB, the corporation's operational performance is apparently unimpaired by the existence of two key vacancies, Chief Engineer and Deputy Chief Engineer, which the corporation is having difficulty in filling.

B13. The organisation structure, reporting relationships and division of activities should reflect changes in the nature of operations. Since the commissioning of the new hydro-electric scheme, SEB has become more concerned with electricity generation relative to distribution and consequently a revised organisation structure should reflect this change in its operations.

B14. In the SEB the accounts department currently performs as a "service" rather than an "advisory" function to top management We understand that the GM would like to receive financial advice, particularly in terms of financial planning, from his Chief Accountant for which he currently relies on his Board. It is intended, therefore, to send the Chief Accountant for further training and, whilst we commend this decision, we point out that the present incumbent is well qualified and should be already capable of providing the type of advice which management requires. We consider, therefore, the issue is rather a failure by top management to recognise the potential role of the accounting function rather than the absence of training.

B15. As at mid-January 1986, SEB employed 376 permanent staff. The recent history of permanent employment is shown below:-

Date	No.
31/3/81	308
31/3/82	326
31/3/83	342
31/3/84	376
31/3/85	374
14/1/86	376

Evidently in the last two years there has been no increase in staff numbers although between 1981 and 1984 permanent employment increased at a rate of 6.5 per cent p.a. We understand there are currently no vacancies in key positions with the exception of the two engineering professionals referred to in paragraph B12 above.

B16. The three main decision points for an enterprise are the Government, the Board and the Chief Executive Officer. For the SEB no major decisions are taken by the Government; the SEB and its Board have considerable managerial autonomy. The Board is responsible for approving tariff adjustments, capital expenditures in excess of E20,000, external loan negotiations, the annual budget, staffing levels, salary increases, and contract awards. The General Manager is entrusted with initiating tariff adjustments, approving capital expenditures below E20,000, negotiating local loans, recruitment, dismissal, promotions and the creation of new posts.

B17. The Minister is empowered under the Act to approve "substantial" (not specified) capital expenditure and to agree to the SEB's research and training programme. In practice, we understand, these powers are rarely exercised.

Strategic Planning and Tariff Policy

B18. The SEB does not possess a medium-term strategic plan. The absence of this medium-term framework for control is explained by the difficulties of forecasting. The SEB's experience of forecasting errors has led the Board to abandon any medium-term planning, with the possible exception of capital budgets which are prepared for a two year period. We consider, however, that the problems of forecasting do not invalidate planning and, in the case of the SEB, energy sales forecasts should be made which take account of the key external factors influencing sales.

B19. Given, say, a three year sales forecast, the SEB would be in a position to assess, for instance, its future capacity to service its external debt. In this respect we observe that no projections of debt servicing exist beyond the next financial year, 1986/87. We consider that this is a serious weakness in an organisation with such a high level of outstanding debt, E68 million as at 31 March 1985.

Tariff Policy

B20. SEB's record of tariff increases vis-a-vis that of Escom is indicated in Table B1 below:-

	SEB	Index	Escom	Index
1 February 1981	15%	115		100
1 January 1982	19%	137	14.7%	115
1 July 1982		137	10%	126
1 December 1982	20%	164		126
1 January 1983		164	14%	144
1 January 1984	20%	197		144
1 January 1985	10%	217	10%	158
1 September 1985		217	10%	174
1 October 1985	15%	249		174
1 January 1986	15%	287	10%	191

B21. It is apparent that the magnitude of SEB's individual tariff increases has been much greater than those introduced by Escom. The cumulative effect of these relative increases is that, since the beginning of 1981, SEB's tariffs have become significantly higher than those of Escom, taking 1981 as the base The SEB tariff for large commercial and industrial consumers is currently 4 6c/Kwh compared with Escom's tariff of 2.3c/Kwh.

B22. The Electricity Act states that the Board's revenues should exceed its outgoings including expenditures on revenue account, allocations to reserves and the depreciation or renewal of assets or loan repayments whichever is larger. This requirement has become especially significant in relation to tariff policy since the financing of the new hydro-scheme. At the present time loan repayments exceed depreciation allowances by a significant margin and so the value of the former is taken into account in estimating tariff adjustments.

B23. The magnitude of debt servicing is currently significantly greater than was anticipated at the time of commissioning the scheme. This has occurred for two reasons:-

(a) cost overruns on the construction work; and
(b) the devaluation of the South African Rand.

Concerning the cost overruns, we note that the contractor is currently engaged in legal action against the Board in settlement of outstanding fees and consequently the final magnitude of cost overruns is yet to be determined. Should the Board lose the action it will require additional loans which will result in further increases in future debt servicing.

B24. The loan terms (from IBRD, EIB, CDC) vary from 15 to 20 years. However, the fixed assets of the Luphohlo - Ezulwini Hydro Project are depreciated on average over a period of 100 years. The effect, therefore, of including loan repayments rather than depreciation as a cost to be recovered through the electricity tariff, is to import a significant upward movement to tariffs over the first 15 to 20 years of the project life. After this period we assume that tariffs would be adjusted sharply downwards, unless new loans are taken to fund further investment.

B25. At this time these major external loans will have been repaid and then presumably depreciation will be charged as a cost to be recovered. In terms of tariff policy this would mean in effect that part of the capital costs are covered twice.

B26. In principle tariffs should be based upon long-run revenues and expenditures (derived from the budgeted operating results) rather than short-term cash flow projections. The effect would be to "smooth" the tariff adjustments over the lifetime of the Corporation's fixed assets rather than imparting a short and medium term upward shift to tariffs as a reflection of short and medium-term loan repayments.

B27. The feasibility study report of 1978 recorded that: "The suggested tariff increases are unlikely to affect significantly the competitive position of industry in Swaziland vis-a-vis other countries in Southern Africa". However, as we have observed earlier, the actual tariff increases introduced in the last five years have been greater than those anticipated in the World Bank Appraisal Report of 1980. It is possible, therefore, that this statement is no longer valid and that tariff adjustments in future should be subject to greater scrutiny regarding their impact on customers' investment decisions.

B28. We understand that this basic tariff structure has not changed since 1978 so that overall tariff adjustments maintain the differentials between the seven tariffs. We further understand that the tariff structure is currently under review. We consider that this review is long overdue and that one of its purposes should be to ensure that relative industrial tariffs are fixed at a level which reflects long-run marginal costs.

Management Information

B29. SEB's regular management information comprises:-

* monthly cost and sales statistics
* monthly cumulated capital expenditures against budget
* operational statistics on generation.

B30. The monthly cost and sales statistics show revenues and expenditures cumulated for the year to date in comparison with:-

(a) budget; and
(b) previous year.

B31. The current presentation of the monthly management accounts is weak because:-

(a) no month by month comparisons are made; and
(b) there is no variance analysis for major deviations from budget.

B32. We understand that major deviations from budget could lead to budget revisions and in this sense the monthly management accounts are used to project future performance. However, these accounts are largely perceived as providing historical information rather than as a device for management's use to control and guide future performance. Regular cash flow projections are not provided which we consider to be a serious weakness in an organisation whose major financial problems relate to cash flow.

Financial Performance

B33. Our financial analysis for SEB is largely restricted to the profit and loss account as regular balance sheets and cash flow projections are not produced. The latest balance sheet available is at 31 March 1985, the date of the last audited accounts. A cash flow projection has been produced for the financial year 1986/87 but this was a special exercise designed to make SEB's case for future tariff increases. We discuss the financial performance for SEB under the following headings:-

* operating results
* outstanding debt
* working capital management.

Operating Results

B34. In Figure B1 the operating results are summarised for the last five years and the financial year 1985/86 to date. In all five years the Board made a net profit after depreciation and interest. The magnitude of this net profit in relation to revenues has varied sharply over the period and reached a peak of 21 per cent of revenues in 1985.

B35. Revenues increased from E9 million in 1981 to E22.2 million in 1985 which is in excess of the World Bank projection of E18. 6 million for 1985 made at the time of the appraisal of the Third Power Project in 1980. (See Figure B3). Underlying this increase in revenues was a relatively slow increase in energy sold from 298.4 Gwh in 1981 to 345.0 Gwh in 1985. The World Bank projected sales of 430.0 Gwh in 1985 but in the event this has proved an overestimate as sales to irrigation consumers in particular but also to domestic and commercial consumers have fallen short of those projected. In response to both the lower than anticipated sales and higher than anticipated expenditures, SEB has increased tariffs to 6.4 cents per per Kwh in 1985 in excess of the World Bank estimate of 4.3 cents per Kwh (both estimates at current prices). The major increase in tariff levels has occurred since 1983.

B36. There is evidence, however, that growth of electricity sales is recommencing. In the period April to December 1985 they had reached 301.4 Gwh an increase of 20 per cent, compared with 251.5 Gwh in the same period the previous year.

B37. At the foot of Figure B1 we have expressed certain items of expenditure as a percentage of revenue. Generation, distribution and Administration and General expenditures are declining as a proportion of revenues. On the other hand, both depreciation and interest increased significantly as a proportion of revenue in 1984/85 and 1985/86, reflecting the additions to fixed assets for the new hydro - scheme which were financed through term loans.

B38. Figure B2 shows the operating results for the last five months in 1985 in comparison with the same period in 1984. (Unfortunately cost and sales statistics for November 1984 are not available and so we have been unable to compute the month operating results for both November and December 1984.) A net profit was achieved in all of the previous five months but there is insufficient information to determine whether this performance is significantly different from the same period in 1984. It is evident, however, that operating profits increased significantly in 1985. The increase in operating profit has been necessary to meet an increase in fixed costs over the period, especially interest charges but also to some extent depreciation. In the coming years the higher level of operating profit will be requested to meet interest and loan repayments.

Outstanding Debt

B39. We have analysed some historical information in the balance sheet for the period 1981 to 85 in Figure B4. This figure indicates a fundamental change in the gearing ratio between 1982 and 1983 when loans were drawn down to finance the new hydro-electric scheme. The change in this ratio is a precursor of the significant increases in interest and loan repayments which has subsequently occurred.

B40. A schedule of loan repayments for the financial year 1986/87 has been provided to the Government. This has been incorporated in a cash flow projection which is used to justify tariff increases of 15 per cent in

January 1986 and 10 per cent in July 1986 on the assumption that the SEB is responsible for external loan repayments fixed in Emalangeni at the exchange rate prevailing at the end of March 1985. It is expected that the Government will agree to meet the additional of the loan repayments consequent upon the depreciation of the Rand subsequent to 31 March 1985. Should the Rand appreciate above the level of 31 March 1985, the Board will continue to pay at the stabilised exchange rate and the Government will benefit to the extent of the difference between the actual external loan repayments and the payments made by SEB to Government.

B41. Although the Board has only made a projection of interest and loan repayments for 1986/87, we requested the MOF to project these schedules beyond this year. We show below anticipated debt servicing for the next two years:-

	E'000	
	1986/87 (1)	1987/88 (2)
Principal repayment	4,504	4,067
Interest	8,093	6,922
Total	12,597	10,989

Note: 1 External loans converted at exchange rates prevailing 9/9/85.
2 External loans converted at exchange rates prevailing 27/3/86.

The figures demonstrate that SEB's debt servicing is projected to fall between 1986/87 and 1987/88. However, we would suggest that these forecasts be continually revised in the event of significant changes in the external value of the Rand.

Working Capital Management

B42. The corporation's current ratio has exhibited a significant deterioration since 1983. The deterioration has occurred as a result of portions of the long-term loans becoming current and due for payment, although in the last two years debtors have exceeded other creditors by a significant margin. (See Figure B4).

B43. Figure B4 shows the pattern of creditors and debtors over the previous five years. Debtors stood at 19.2 per cent of sales in 1982, exactly equivalent to 60 days overdue, and creditors were at 12.9 per cent of sales, which suggests that payment to creditors was not unduly delayed. We have been unable to obtain up to date information on creditors but the recent trend in debtors below represents a potentially disturbing situation, at minimum one which should be monitored carefully.

Schedule of debtors as at end of:-		E'000	% of 1984/85 revenues
March	1985	3 994	18
July	1985	4 421	20
August	1985	4 593	21
September	1985	4 996	23
October	1985	5 105	23
November	1985	5 406	24
December	1985	5 670	26
January	1986	6 189	28

B44. Clearly one would expect debtors to rise as sales are rising. Nevertheless, debtors now represent 23 per cent of projected sales for 1985/86, apparently the highest level for five years. This means that in effect outstanding debts are on average 70 days overdue. It is possible that consumers are delaying payments longer because their bills are significantly higher since the recent tariff increase in October 1985. We suggest therefore that debtors be carefully monitored, especially after the recent January 1986 tariff increase, as the continuation of recent trends could have a significant impact on the corporation's cash flow. (It is unlikely that any significant part of the increase in debtors can be explained by increases in government debtors as these stood at E532 339 at the end of February 1986, representing only 8.6 per cent of outstanding debtors.)

Productivity Indicators

B45. Judging the performance of a corporation with monopoly powers solely by its financial performance is inadequate as good performance may reflect an ability to pass on cost increases to the consumer in the form of higher prices. Similarly, poor performance may be caused by an unexpected increase in the cost of inputs over which it has no control, such as the purchase of electricity from Escom or, as in recent months, an adverse exchange rate movement. The use of productivity and performance indicators, however, allows one to measure the underlying performance of a business or corporation.

B46. We have built up a number of productivity and performance indicators for the SEB from a time series of financial and operational statistics which are recorded in Figure B5. The values of these indicators, shown in Figure B6 are expressed as trends over the last five years. Where relevant, that is, in the cases of ratios of various costs to operational statistics, we have inflated the results to 1984/85 prices to ensure comparability between years.

B47. The indicators are divided into three categories:-

* financial
* manpower
* operational

B48. In the financial category significant declines in both return on capital employed and revenue on capital employed have occurred, particularly in the last three years. These trends reflect the large additions to fixed assets which have resulted from the construction of the new Luphohlo-Ezulwini hydro-electric scheme. Both total costs and added costs per unit of energy sold have increased slightly in real terms over the five year period. On the other hand distribution costs relative to consumers served have remained constant in real terms. Administration and General expenses per consumer declined The trends in these two indicators reflect a steady growth in the number of Board customers.

B49. The manpower indicators reveal a mixed picture. While the number of employees per 1 000 consumers declined over the period, the number of employees for each energy unit sold increased in the last two years as a consequence of slow growth in energy sales.

B50. The percentage of units purchased and unaccounted for remained constant until 1984/85 when there was a significant increase. The recent increase may be due to the increasing incidence of electricity theft with which SEB is presently concerned. The System Load Factor has not changed in the last five years.

Performance Criteria

B51. Performance indicators may be used by both the SEB and the Government to measure performance. We discuss in this section, those indicators which the Government may usefully expect the SEB to provide on, say, a quarterly basis. For each of these indicators the Government would need to establish a "target" agreed jointly with the SEB and any adverse deviations from target would need to be systematically investigated.

B52. In the context of establishing performance criteria we observe that SEB is a legal monopoly which has generally been free to set its tariffs unhindered, and, therefore, indicators which measure "profit" and "revenue" performance tend to reflect monopoly power rather than underlying efficiency. Accordingly, a more relevant set of performance criteria should include measurements of both physical output and unit costs.

B53. We would suggest that the following indicators could be used as performance criteria by the Government for the SEB. Basically these include those indicators listed in Figure B6 plus two cash management indicators in view of the need for the Board to monitor its cash flow very closely.

Financial

- F1 Return on capital employed
- F2 Net profit/revenue
- F3 Revenue on capital employed
- F4 Total costs per energy unit sold
- F5 Added costs per energy unit sold
- F6 Distribution costs per consumer
- F7 Administration and general expenses per consumer
- F8 Payroll costs per energy unit sold

Manpower

- M1 Employees per 1 000 consumers
- M2 Employees per energy unit sold

Operational

O1 Percentage of units purchased and unaccounted for

O2 System Load Factor

Cash Management

C1 Average Working Capital/Total Income

C2 Debtors/Income

Conclusions

B54. We summarise the main conclusions arising from our brief review of the SEB under the following headings:-

* corporate objectives
* Government policy guidelines
* measures for improving performance
* performance criteria

Corporate Objectives

B55. We do not propose any fundamental changes in the objectives set for the Board although we consider that there should be a greater emphasis on the Board's mandate to "cheapen" the supplies of electricity. Clearly since the SEB operates as a legal monopoly and if it can freely obtain tariff increases to cover increases in costs, there is little incentive to keep down costs. There are various means by which SEB might be encouraged or required to contain cost increases including possibly a requirement that increases must be less, by a specified percentage, than the increase in the consumer price index.

B56. The political decision taken to finance the new hydro-scheme rather than purchase electricity from Escom, the cheapest financial option, has in effect imposed additional costs on the SEB. These may be measured in terms of the difference between the net present values of the financial costs of the two alternatives. At present this decision does not penalise SEB to the extent that it is able to increase tariffs to reflect cost increases. However, if the objective of the Board is to "cheapen" electricity, then it may be appropriate to compensate the Board for the additional cost in order to limit the rate of tariff increases to consumers.

Government policy guidelines

B57. Concerning tariff policy the Act establishing the SEB requires the Board to recover the costs of loan repayments where these exceed the provision for depreciation. Loan repayments reflect short and medium-term debt obligations rather than the long-run costs of depreciating capital assets, which have a longevity beyond the redemption of SEB's current loans. Therefore, basing tariffs on loan repayments rather than depreciation can result in relatively large tariff adjustments in the short and medium-term because of cash flow considerations. It may be appropriate, therefore, for the Board to borrow in order to "smooth" the tariff adjustments over the lifetime of the Board's fixed assets.

B58. SEB is currently autonomous in determining its salary scales and annual increases in salaries. In principle this is acceptable provided that it is recognised that SEB is a legal monopoly and regulatory guidelines covering salary increases set accordingly. These guidelines might, for instance, state that the rate of increase of the salary bill should not exceed the growth in the cost of living index or that payroll growth should be geared towards improvements in real productivity.

Measures for Improving Performance

B59. Although SEB is a comparatively well-run organisation it is apparent from our limited survey, that there is some scope for improving performance. We suggest that consideration be given to:-

(a) strengthening the nature and use of the monthly management accounts particularly to:-
   (i) introduce cash flow projections;
   (ii) investigate variances from budget; and
   (iii) review monthly as well as cumulative operating results;

(b) monitoring changes in the pattern and level of debtors more closely; and

(c) improving management information systems generally through the introduction of performance indicators.

Performance Criteria

B60. SEB is a legal monopoly which has generally been free to set its tariffs unhindered and therefore indicators which measure "profit" and "revenue" performance tend to reflect monopoly power rather than underlying efficiency. Accordingly a more relevant set of performance criteria should include measurements of both physical output and unit costs. They should also include "cash management" indicators in view of the need for the Board to monitor its cash flow closely.

Figure B1

SEB OPERATING RESULTS (1981-85)

E'000

YEAR ENDING 31 MARCH	1981	1982	1983	1984	1985	1985 (April-Dec)
Revenues	9,334	11,829	16,071	18,793	22,155	19,015
Expenditures						
- generation	4,900	6,026	10,121	11,116	10,474	8,081
- distribution	842	1,122	1,451	1,378	1,851	1,374
- A & G	692	758	858	1,085	1,174	1,027
- bad & doubtful debts	40	46	45	261	306	-
Operating expenditure	6,474	7,952	12,475	13,840	13,805	10,482
Operating profit	2,860	3,877	3,596	4,953	8,350	8,533
Depreciation	892	1,003	1,094	1,076	2,612	2,448
Interest	447	501	302	203	1,009	3,015
Extraordinary item	-	-	-	438	-	
Net profit/(loss)	1,521	2,374	2,200	3,236	4,729	3,070

Percentage of revenue

- generation expenditure	52	51	63	59	47	42
- distribution expenditure	9	9	9	7	8	7
- A & G expenditure	7	6	5	6	5	5
- depreciation	10	8	7	6	12	13
- interest	5	4	2	1	5	16
- net profit/(loss)	16	20	14	17	21	16

Figure B2

SEB OPERATING RESULTS (1984-85)

(E'000)

	August		Sept		Oct		Nov		Dec	
	1984	1985	1984	1985	1984	1985	1984[2]	1985	1984[2]	1985
Revenues	1,703	1,993	1,657	2,135	1,672	2,411	-	2,205	-	2,482
Expenditures										
- fuel & Escom purchases	756	739	769	887	666	1,030	-	826	-	902
- generation	112	156	136	94	110	127	-	117	-	160
- distribution	140	155	131	64	125	165	-	103	-	171
- A & G	138	171	141	114	76	107	-	93	-	104
Sub-total	1146	1,221	1,177	1,159	977	1,429	-	1,139	-	1,337
Operating profit	557	772	480	976	695	982	-	1,066		1,145
Depreciation[1]	215	271	216	272	216	272	-	272	-	272
Interest	24	368	26	447	23	138	-	-	-	315
Net profit	318	133	238	257	456	572	-	794	-	558

Notes: 1 Assumed to be at same level during October to December as in August and September.

2 November 1984 Cost and Sales Statistics not available.

Figure B3

[illegible]

ACTUAL	1981 GWh	1981 (%)	1982 GWh	1982 (%)	1983 GWh	1983 (%)	1984 GWh	1984 (%)	1985 GWh	1985 (%)	1985 (April-Dec) GWh	1985 (April-Dec) (%)
Consumer category												
Domestic	51.5	(17.3)	60.1	(18.5)	63.6	(19.5)	67.1	(20.6)	70.1	(20.3)	73.6	(24.4)
Commercial	27.0	(9.0)	30.4	(9.3)	31.5	(9.7)	32.4	(10.0)	33.0	(9.6)	29.6	(9.8)
Industrial	116.6	(39.1)	131.7	(40.5)	152.9	(47.0)	154.2	(47.4)	147.5	(42.8)	129.2	(42.9)
Irrigation	103.3	(34.6)	101.2	(31.1)	117.2	(36.0)	94.9	(29.2)	94.4	(27.4)	69.0	(22.9)
Total	298.4	(100.0)	323.4	(100.0)	365.1	(100.0)	348.6	(100.0)	345.0	(100.0)	301.4	(100.0)
Av.Revenue/kwh	0.031		0.037		0.044		0.054		0.064			
Total Revenue (E'000)	9,334		11,829		16,071		18,793		22,155			

IBRD ESTIMATES (1980)

Consumer category	1981	1982	1983	1984	1985
Domestic	57.0	65.0	73.0	81.0	89.0
Commercial	28.0	31.0	34.0	37.0	40.0
Industrial	113.0	123.0	137.0	146.0	157.0
Irrigation	107.0	133.0	137.0	142.0	144.0
Total	305.0	352.0	381.0	406.0	430.0
Av.Revenue/kwh	0.030	0.039	0.040	0.040	0.043
Total Revenue (E'000)	9,302	13,904	15,392	16,402	18,619

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Figure B4

BALANCE SHEET ANALYSIS (1981-85)

(E'000)

	1981	1982	1983	1984	1985
Gearing ratio	17:83	29:71	70:30	75:25	75:25
Current ratio	1.07	1.43	2.32	0.77	0.52
Debtors	1,660	2,563	3,571	4,151	4,268
Creditors	608	1,088	1,762	1,757	2,866

Percentage of revenue

	1981	1982	1983	1984	1985
Debtors	17.8%	21.7%	22.2%	22.1%	19.2%
Creditors	6.5%	9.2%	11.0%	9.3%	12.9%

Figure B5

SEB STATISTICS (1980/81 - 1984/85)

		1980/81	1981/82	1982/83	1983/84	1984/85
Financial (E'000)						
(1)	Net profit	1,521	2,374	2,201	3,235	3,070
(2)	Capital employed (Year end)	18,564	29,773	53,127	80,179	101,331
(3)	Revenue	9,334	11,829	16,071	18,793	22,155
(4)	Total costs	7,813	9,455	13,871	15,120	17,426
(5)	Added costs[1]	3,515	4,159	4,657	5,055	8,324
(6)	Distribution costs	842	1,122	1,451	1,378	1,851
(7)	A&G expenses	692	758	858	1,085	1,174
Operational						
(8)	Energy sold (GWh)	298.3	323.4	365.1	348.5	345.0
(9)	No. of consumers (Year end)	10,626	11,462	12,498	13,221	14,025
(10)	No. of employees	308	326	342	376	374
(11)	Energy generated & purchased (GWh)	333.9	356.4	405.8	390.0	391.2
(12)	Maximum demand (MW)	65.9	72.7	70.4	78.0	78.0
(13)	Works energy & system transmission/ distribution losses (GWh)	35.6	33.0	40.7	41.5	46.2

Note: 1 Total costs minus fuel and Escom purchases

Figure B6

SEB PRODUCTIVITY AND PERFORMANCE INDICATORS (1980/81-1984/85)

	1980/81	1981/82	1982/83	1983/84	1984/85
Financial (Figures in parentheses refer to Figure B5)					
Return on capital employed (1)/(2)	8.2%	8.0%	4.1%	4.0%	3.0%
Net profit/revenue (1)/(3)	16.3%	20.1%	13.7%	17.2%	13.9%
Revenue on capital employed (3)/(2)	50.3%	39.7%	30.3%	23.4%	21.9%
Total costs per KWh sold (4)/(8)	2.62c (4.32c)	2.92c (4.27c)	3.80c (4.92c)	4.34c (5.06c)	5.05c (5.05c)
Added costs per KWh sold (5)/(8)	1.18c (1.95c)	1.29c (1.88c)	1.28c (1.66c)	1.45c (1.69c)	2.41c (2.41c)
Distribution costs per consumer (6)/(9)	E79.2 (E130.7)	E697.89 (E143.0)	E116.10 (E150.2)	E104.23 (E121.4)	E131.98 (E131.98)
A & G expenses per consumer (7)/(9)	E65.12 (E107.4)	E66.13 (E96.6)	F68.65 (E488.8)	E682.07 (E95.61)	E83.71 (E83.71)
Manpower					
Employees per 1,000 consumers (10)/(9)	29.0	28.4	27.4	28.4	26.7
Employees per GWh sold (10)/(8)	1.03	1.01	0.94	1.08	1.08
Operational					
Percentage of units purchased and unaccounted for (11)-(8)/(11)	10.7%	9.3%	10.0%	10.6%	11.8%
System Load Factor (11)-(13)/(12)	58%	56%	66%	57%	57%

Note: Figures in parentheses are expressed at 1984/85 prices.

C1. We discuss our review of the Swaziland Television Authority (TVA) under the following headings:-

* corporate objectives
* GOS policy guidelines and relations
* organisation and management
* budgeting and management information
* financial performance
* strategic planning and pricing policy
* sales and marketing
* performance criteria
* conclusions.

C2. The Swaziland Television Authority (TVA) was established in 1983 as a combined broadcasting and rental operation, the latter having been previously been run as a private company. Its main purpose stated in the Act was to "establish, erect and operate television broadcasting stations in Swaziland and maintain all facilities". The TVA was also empowered to impose and implement control in regard to:-

(a) TV and rentals, selling and dealing in TV receivers and associated equipment; and
(b) the technical quality of the transmissions.

C3. There is no provision in the Act which limits TVA's broadcasting operation to the urban areas of Swaziland or to those locations to which a service could be provided on a commercial basis. By implication it is entrusted with broadcasting on a national scale although this has never been made explicit. It would appear therefore that TVA exists to:-

(a) provide a national broadcasting service; and
(b) rent television sets as the sole licensed supplier.

C4. No other objectives are laid down for TVA elsewhere other than in a statement made in 1978 by the late King Sobhuza II in his inaugural address which sets out four goals for the television broadcasting service, in order of priority, as follows:-

(a) to boost rural development;

(b) to boost formal and informal education;

(c) to improve national communications;

(d) to serve as an entertainment medium.

C5. These goals were articulated before the establishment of the present authority. The first three mentioned are essentially development objectives which television cannot alone achieve. While it may be appropriate that they should be included as corporate objectives of the TVA, the extent of the Authority's obligations and the means of meeting their costs should be clearly specified. We discuss here the educational objective as this is clearly of paramount interest at the present time.

C6. It is essential in this context that the Government clarify precisely what type of television service it requires; for instance, a commercial operation limited to the main urban areas or a full range of entertainment, cultural and educational programmes covering the whole country.

C7. In this regard, the Ministry of Education should be responsible for the provision of formal and non-formal education and, in attaining its established targets for adult and non-formal education, say, it should examine the potential impact and cost effectiveness of a number of alternative delivery systems, including radio, rural education centres, existing non-formal education organisations, and television. The TVA should then be in a position to make decisions on the content and volume of educational broadcasting within clear government guidelines and with appropriate financial support. In respect of educational broadcasting it should act as an implementing agency under the guideline of the Ministry of Education which would compensate the TVA for the costs of producing agreed programmes.

Government Policy Guidelines and Relations

C8. In this section we examine TVA's relationship with government under the following sub-headings.-

(a) remuneration, staffing levels and conditions of employment

(b) external relationships

Remuneration, staffing levels and conditions of employment

C9. TVA's current salary scales are closely allied to those of Government. The present structure, which we understand is one grade above government scales for comparable positions, was recommended by the Establishments and Training Department of the Government. Revisions in salaries, therefore, cannot be introduced by either TVA management or the Board without Government approval. The effect of this restrictive policy is that it does not recognise the semi-commercial nature of the TVA operation. For instance, the TVA is unable to pay commissions to either the arrears collectors or its advertising salesmen. As a corporate body, it should be free, within certain limits, to determine its own employment and salary levels commensurate with its functions as a public corporation. It should further have the authority to introduce performance related remuneration schemes designed to promote advertising sales and improve debt collection.

C10. In addition, the Authority cannot set its own establishment levels. We understand that current establishment levels are too low for efficient operation but TVA is powerless to create any new posts without going through the formal approval channels This would appear to be inappropriate for an enterprise which has its own sources of revenue from which to pay salaries and wages. Further this situation would appear to be legally untenable as section 11(1) of the Act gives the Board of Directors powers to set terms and conditions of employment.

External relationships

C11. The relationships between the TVA and its parent ministry, Interior, have room for considerable improvement. There is evidence of direct interference in the affairs of the TVA as in the case of the agreement establishing a reduced licence fee for Sun International which was determined by the ministry against the advice of the Board. While we believe that government should ensure that the Board is conducting its affairs in the public interest, it is clear that this was a non-commercial decision forced upon the TVA, which has made it difficult for the Authority to enforce higher licence fees on private viewers

C12. It would also appear that there is a significant communication gap between the TVA and the ministry which is partly a function of lack of attendance by ministry officials at Board meetings. An illustration concerns the level of the 1986/7 subvention to the TVA. A meeting in December 1985 at the Ministry of Finance apparently agreed to a subvention level of E1.7 million, representing E1.1 million accumulated operating deficit and E.6 million current operating deficit, but in the final analysis the subvention tabled before Parliament was only E 500,000. We understand that there is a basis for the revised subvention but this basis has not been communicated to the TVA.

C13. Within the TVA there is a perception on the part of senior management that it cannot trust any external agency to represent its case. There is a view held that TVA is constantly battling against insuperable odds without any external support. We believe that these management attitudes can only change if there is a significant improvement in the level and quality of communication between outside bodies and the TVA.

Organisation and Management

C14. The organisation structure of the TVA is illustrated in Figure C1. TVA is divided into two separate operations, STBC, the broadcasting arm, and STAR, the television rental business. The TVA is headed by a Managing Director and his deputy; the post of deputy is currently occupied by the Chief Engineer. In practice, the area manager of STAR and all the departmental heads of STBC report directly to either the MD or the acting MD. There are currently eight departments in STBC namely news, programmes, advertising, engineering, accounts, operations, transport and administration.

C15. We consider that the span of control of the MD and the DMD is too wide; there are at present nine positions reporting to top management. We understand that the Authority is at present recruiting an Operations Supervisor to address the recognised problem of poor studio supervision and this would clearly relieve top management of immediate responsibility for some technical aspects of the Authority's activities such as programme operations, programmes and news. In the long-run we believe it would be appropriate, if STAR is retained as part of the Authority, to have the area manager of STAR reporting to the DMD and for the non-technical departments of the STBC i.e. advertising, accounts, transport and administration to report directly to the MD. The technical departments would report to the MD through the Operations Supervisor.

C16. TVA currently employs 93 staff (as at March 1986) compared with 81 in August 1984, the main reason for this growth being the introduction of the accounting function which was previously carried out by the external auditors. However, as stated in paragraph C10, we understand that these staffing levels are too low for efficient operation and we would suggest, therefore, that a staffing review be carried out in the near future. In addition we observe that the Authority is relatively new and, that the broadcasting corporation, in particular, would benefit from both technical co-operation with other similar corporations as well as external training.

C17. At present, because of the lack of space at Hospital Hill, the Chief Accountant and his staff reside in Johnson Street in the centre of Mbabane. This arrangement is not conducive to effective liaison with senior management on financial matters. Given the precarious financial situation of the TVA it is essential that the Chief Accountant be perceived as part of the management team. We believe, for instance, that the value of the monthly management accounts could be significantly improved if the Chief Accountant were based at Hospital Hill, thereby providing direct physical communication with top management

C18. The Board of the TVA, according to the Act, should comprise a chairman appointed by the Minister of Interior, four persons representing the Ministries of Interior, Education, Finance and Commerce, three non-civil servants and the managing director We understand that, although a number of principal secretaries (of Planning, Commerce, Interior and Education) are members of the Board of Directors, they frequently either do not attend or nominate junior officers to represent them. Moreover, there is a conspicuous lack of financial expertise at Board level.

C19. It is not readily apparent that such a high level of representation from government is required. In Chapter II, we have recommended that civil servants only attend Board meetings as observers, and that the basis for selecting Board members should be technical or commercial expertise. The number of Government Ministries represented could be reduced to two, say, Interior, as the line Ministry and Education, to advise specifically on educational broadcasting. We would suggest that industrial and commercial representation on the Board be correspondingly increased.

C20. The Board is responsible for taking decisions in respect of licence and rental fee adjustments, budget approval and the negotiations of loans. In all other matters, with the notable exception of salaries and staffing levels which are directly controlled by the Government, the TVA management has authority to make the necessary decisions. These include recruitment (except for senior appointments which are referred to the Board), dismissal, promotion, capital expenditure, procurement and contract awards.

C21. We consider that the TVA management has too much discretion in respect of decisions regarding capital expenditure, procurement and contract awards. It would seem appropriate that formal financial limits be set for each of these which when exceeded would require Board and/or Government approval. On the other hand, the Authority's management has insufficient control over the human resources aspect of the operation.

Budgeting and Management Information

Budgeting

C22. The TVA produces annual budgets for both the profit and loss account and the balance sheet. The latest budget for 1986/7 was produced in March 1986 and shows the estimated budget in comparison with the projected unaudited results for 1985/6. The assumptions used in this budget are set out clearly in an attachment. From a cursory review of these assumptions it is apparent that, in respect of expenditure budgeting, some attempts have been made to improve upon the "incremental" approach.

C23. In general we consider that TVA's current budgeting procedures are good. Our only reservation concerns the apparent lack of involvement in and commitment to expenditure budgeting by departmental heads As a result the budget has been essentially the product of the Chief Accountant.

Management Information

C24. Management accounts are produced by the Chief Accountant on a monthly basis. These include a current profit and loss account, a current balance sheet, and a manual cash flow projection for the next two months. This financial information is the only regular management information generated.

No operational statistics are maintained by the Authority and no annual report is produced.

C25. The profit and loss and balance sheet formats show both budgeted and actual results for the month and cumulatively for the year to date. Percentage variances are also shown for each item. The cash flow projection is artificial in the sense that only debtors receipts are projected to indicate to management the funds it is likely to have to pay creditors. We consider that this type of cash flow projection is inappropriate as the same purpose can, in principle, be achieved by simply monitoring the Authority's bank balance.

C26. With the exception of the TVA's latest requests for subvention the profit and loss statement and balance sheet are not used by management on a regular basis. Management's main concern at present, quite correctly, is with cash flow. Accordingly it has required schedules of actual monthly cash collections for licences, rentals and advertising sales as against billings. Management also monitors monthly credit purchases and film contracts accepted. These schedules have been used to generate the monthly cash flow projection. For management the importance of this projection (which also records previous month's actuals) is in motivating staff to improve arrears collection and in estimating available cash to pay film and trade creditors.

C27. The weaknesses in TVA's current management information package are that:-

(a) no explanations are provided for adverse variances;
(b) management does not apparently use the monthly profit/loss or balance sheet results as a vehicle for expenditure control; and
(c) the cash flow projection, which is for too short a period ahead, effectively hides the medium-term effect of credit purchases by projecting debtors receipts only.

Financial Performance

C28. We discuss the financial performance of the TVA under the following sub-headings:-

* profitability of STBC and STAR
* cash flow
* subventions request.

Profitability of STBC and STAR

C29. The TVA's operating results for the last three years are summarised in Figure C2. Clearly the Authority is currently unprofitable and the magnitude of the loss is increasing rapidly; net loss after depreciation had reached E466,000 in the first 10 months of 1985/6. In the absence of any moves to increase rental fees, which represent approximately two thirds of total revenue, it is inconceivable that the TVA can break-even.

C30. The analysis in Figure C2, however, obscures the fact that the Authority is comprised of two separate operations - broadcasting (STBC) and a television rental service (STAR). In figure C3 we show the operating results, derived from the monthly management accounts for STBC and STAR separately for the first nine months of 1985/86. During this period the STBC made a net loss after depreciation of E939,000 while STAR made a net profit of E484,000. This is, however, a misleading picture. STAR's profitability, and by implication STBC's loss, is based on the assumption that all STAR's income represents payments for rental services. However, if one were to deduct the value of the current licence fee from STAR's current revenues, total revenues would fall by E715,000 (over 10 months) resulting in an operating loss before depreciation for STAR. If this additional revenue were attributed to STBC its losses over the period would fall to E224,000 after depreciation.

C31. This analysis clearly demonstrates the sensitivity of both STBC and STAR profitability to assumptions apportioning revenue collected by STAR between rental charges and licence fees Whilst an analysis based on the management accounts overstates the relative profitability of STAR, an adjustment based upon the unrealistically high current licence fee understates true profitability. Accordingly we suggest that the underlying profitability of both STBC and STAR is best represented after adjusting STAR's revenue to reflect the proposed monthly licence fees of E15 for colour, E8 for monochrome mains and E5 for monochrome portable. This produces adjustments to STAR revenue of E441,000 which results in the following picture for the period April 85-January 86.

Table C1: Adjusted Profitability of STBC and STAR (April 85-Jan 86) (E'000)

	STBC	STAR
Revenue	985.1	652.1
Direct expenses	485.9	17.7
Gross profit	499.2	634.4
Operating expenses	890.8	501.7
Operating profit	(391.6)	132.7
Depreciation	106.0	91.7
Net profit after depreciation	(497.6)	41.0

C32. This analysis reveals that STBC's real loss after depreciation is E498,000 approximately half the level shown in the management accounts, and that, in spite of being a commercial venture, STAR only made a small net profit after depreciation of E41,000 in the first 10 months of 1985/6.

C33. These figures assume a depreciation provision based upon historic rather than replacement cost. If the depreciation provision were to enable STAR to replace its television sets it would show a substantial net loss. We estimate that depreciation would rise by E644,000 per month, or E440,000 over the first 10 months of 1985/6, thereby resulting in a net loss after depreciation of E399,000. This estimate is based on the following assumptions:-

(a) replacement prices of E150(,700, E300 for colour, monochrome mains and monochrome portable televisions respectively;

(b) average life expectancy of seven years for colour and monochrome mains televisions and five years for monochrome portable televisions;

(c) current depreciation provisions in the accounts of E6,000 per month for television.

C34. It is clear therefore that STAR does not subsidise STBC except in the cash sense to the tune of E133,000 in the last 10 months. In fact STAR makes insufficient profit to replace its television sets.

C35. Figures C4 and C5 analyse the trends in STAR and STBC profitability respectively over the last six months (before allocation of STAR revenues for licence fees to STBC). These figures show that STAR profitability has remained relatively constant over the last six months whereas there has been a marked increase in STBC losses over the period October 1985 to January 1986. This has implications for the level of subvention required in the financial year 1986/7 which we discuss later.

Cash Flow

C36. The financial difficulties experienced by TVA are not solely those related to operating profitability. An analysis of the Authority's balance sheet shows a large fall in the current ratio particularly between March 1985 and January 1986 when it fell from 0 95 to 0.48. This reflects a sharp increase in the level of creditors in recent months without comparable growth in debtors. In January 1985 creditors stood at over 50 per cent of revenue, compared to 36 4 per cent in August 1985. Debtors, in contrast, increased from 14 1 per cent in August 1985 to 16.4 per cent in January 86. (see figure C6)

C37. The implications of these changes in debtors and creditors balances for the TVA's cash flow can be seen from Figure C7. Over the period August 1985 to January 1986 the cumulative negative cash flow has been E126,000. This may be compared with a total operating loss (i e. net loss before depreciation) of E184,000 over the same period The operating loss and the small level of capital expenditure have been financed by running down TVA's bank balance, and increasing creditors relative to debtors and stock. Creditors are now equivalent to six months' revenue

C38. In December 1985 a potential crisis was narrowly avoided when operating losses reached E130,000 TVA was able to meet this deficit by, firstly, increasing its creditors by E111,000 and, secondly, by collecting over E20,000 in overdue licence fees after the passage of the amending legislation. The Authority was able to reduce the level of creditors marginally in January 1986 although clearly the level of creditors is severely overstrained.

C39. As at 31 January 1986, the TVA had an overdrawn bank account of E59 000 although we understand it has no formal overdraft agreement. At the same time, creditors were at an exceptionally high level with no immediate prospect of the Authority paying any significant proportion of this through improved debt collection. Although debtors fell by over E20 000 in December 1985, they were reduced by only E7,500 in January 1986. In cash flow terms it is clear that TVA has been able to survive by running down its cash reserves and extending its creditors. (See Figure C6) Depreciation provisions, which have no cash flow implications, have also helped to reduce the extent of cash losses relative to the operating deficit although evidently in recent months operating losses have far exceeded depreciation, putting further pressure on cash reserves and creditors.

Subvention Request

C40. The discussions which informed TVA's request for subvention for the financial year 1986/7 were based on the view that the annual operating deficit rather than the cash flow deficit should be financed. This is an important practical distinction in the case of TVA because, if creditors are to be reduced to an acceptable level, finance over and above the operating deficit will be required.

C41. Notwithstanding this objection, the projected operating deficit for 1986/7 to be financed was estimated at E143 000 assuming no change in operations and no changes in either licence fees or rental charges. Now that the 1986/7 budget is available, the annual operating deficit can be re-estimated at E267,000 before taking account of the Government subvention. (However, we consider that this estimate is optimistic and it is likely that the 1986/7 operating deficit will exceed the 1985/6 level given the increase in the operating loss between October 1985 and January 1986). In addition to financing the operating deficit, it will be necessary for TVA to pay off its overdue creditors and to finance its capital expenditure projects. Assuming that creditors are reduced to, say, 16.7% of revenues (equivalent to 60 days overdue), this would require an additional E664,000 assuming no relative improvement in debtors receipts, thereby bringing creditors down to E330,000. Therefore, notwithstanding any provision for capital expenditure, TVA will require cash flow support in 1986/7 of E931,000, comprised of the budgeted operating loss and the necessary reduction in creditor balances

C42. The report to the Cabinet sub-committee on the Television Authority also estimates that E9 710 000 capital expenditure would need to be financed by Government over a five year period. This figure would generate an inflation - adjusted depreciation provision of E1 942 000 per annum over the period. In contrast to this "accounting" calculation the report of the consultant Frank Ord estimated that the replacement cost of current STBC equipment would be US$749 000 or E1 498 000 at current exchange rates. In addition, all of STAR's television sets will need to be replaced over the next 5 years. At December 1985 prices this would cost E3 210 000. However, as the televisions form part of a commercial operation, this capital expenditure should be financed by means of a commercial loan, guaranteed by Government. To this extent the estimate of E9 710 000 grossly overstates the amount which Government would need to provide by way of direct capital subvention, not least because it assumes that <u>all</u> TVA capital equipment would need to be replaced by government, including STAR's televisions.

C43. We have not investigated the alternative subvention levels based upon different levels and quality of service provision i.e. imported entertainment only or imported entertainment plus local news, as we consider that the Government should decide first what type of television authority it wants. That is, government should clarify the objectives for TVA and then estimate the level of financing required to meet these objectives. This decision should be informed by an estimate of the financial implications of the relevant alternatives. From our review of the Authority, however, it is clear that the Government is unlikely to accept a service based solely upon purely commercial considerations, namely entertainment only restricted to the main urban areas of Swaziland. In this regard the Board rejected the option presented by the MD in July 1985 to reduce operations, lower the quality of programmes and impose staff reductions and instead recommended that government be approached for a subvention "to keep the television service in the country in continuity for social, educational and entertainment reasons"

C44. On the assumption that TVA is to continue its present level of operations and, in the absence of adjustments in either rentals or licence fees, then the following comments can be made in respect of the Ministry of Finance paper to a Cabinet sub-committee which set out the subvention options:-

(a) the estimate of E413 000 may be too high to finance the operating deficit for 1986/7 assuming that TVA's 1986/7 budget is reasonably accurate: this budget estimates an operating deficit of E267,000 in 1986/7;

(b) the subvention should enable the TVA to reduce its creditors to an acceptable level, say two months of revenues, as well as finance the operating deficit: this would require an additional E664,000 in 1986/7 based upon the January 1986 level of creditors; and

(c) the estimate of E9 710 000 grossly overstates the capital expenditure to be financed by Government over the next five years; not least because it implicitly assumes that the replacement of STAR televisions will be financed by government subvention when they should in fact be financed by a medium-term commercial loan to reflect the commercial nature of STAR.

<u>Strategic Planning and Pricing Policy</u>

C45. The TVA does not at present have a medium-term strategic plan which sets out, for instance, forecasts of advertising revenues or television viewers over the next three to five years This is understandable given the magnitude and severity of the day-to-day problems to which the Authority is currently exposed As a result management's pre-occupation is with the day-to-day survival of the operation. Nevertheless, the establishment of an appropriate pricing policy is a key element in any strategic plan for the TVA and we consider, therefore, that the Authority's pricing policy should be resolved as a first step in formulating a corporate plan. In this section we examine the background and main issues relating to the Authority's pricing policy.

C46. Regarding both rental and licence fees there are no procedures for adjustment incorporated in the Act establishing the TVA We understand that all adjustment to both licence fees and rental charges require the consent of the Board of Directors, prior to formal approval by the Ministry of Interior.

C47. The Board has been reluctant to sanction increases in <u>the rental charges</u> in spite of the fact that charges have not been increased at least since the establishment of the TVA Today the majority of STAR televisions are in urgent need of replacement which makes it difficult to obtain increases in rental fees because of the poor quality of the picture. The other reason which prevents the approval of rental increases is poor transmission. In late 1985 the Managing Director requested an increase in rental fees of 15 per cent "to be implemented when the present problems of transmission are removed and normal signal levels have been achieved". It is expected that the new equipment to be purchased for the Coronation will result in the required improvements in signal quality.

C48. The licence fee currently stands at E25 and E10 per month for colour and monochrome television sets respectively. When this fee was introduced we understand that the legislation designed to enable the TVA to collect the licence fee was virtually unenforceable and as a result arrears grew rapidly. The Board has recommended that the present high licence fee should be reduced as soon as 80 per cent of licence fee debts are collected.

C49. Following the introduction of the legislation "Amendments to TV viewers (certificate and licence) regulation," giving TVA powers of disconnection, rentals and viewers debtors fell by E37 000 in December 1985. However, the level of these same debtors increased again in January 1986. This suggests that the improvement in licence fee collection in December may have been "once-for-all" change which will not be repeated without a long-term strengthening of the inspection machinery. If television owners are obliged to wait until 80% of licence arrears are collected before the licence fee is reduced, they may have to wait a very long time.

C50. It is evident that an immediate reduction in licence fees would in itself have a negative effect on profitability and cash flow. However, we believe there is considerable scope for increasing the level of rentals at the same time, to include an imputed licence fee, which could make STAR profitable and enable it to finance in part at least the operating deficit of the STBC. An increase in rentals should not have any noticeable effect on the number of viewers as we understand there is a long waiting list for rented television sets. This waiting list reflects the relative attractiveness of renting as opposed to owning a television. Excluding the costs of maintenance, at a discount rate of 10 per cent, the present value of the cost of renting a colour television is E2,128 compared with E3,065 for ownership (over an assumed television life of 7 years). It is unlikely, therefore, that an increase in rental charges will cause renters, and potential renters, to switch to private ownership.

C51. In this anlaysis, we have determined the required increase in rentals to enable STAR to achieve a net profit on capital employed of 10 per cent per annum. The results of this analysis are summarised in Table C2 and are constructed on the following assumptions; namely that:-

(a) "capital employed" is equivalent to net fixed assets only: that is, we assume that net current assets are zero;

(b) the estimate of net fixed assets values the television sets at their replacement cost and depreciates them over half their useful life; and

(c) STAR will discontinue the practice of repairing privately-owned televisions free of charge: we have accordingly revised STAR's television maintenance expenses downwards by 25 per cent, the estimated proportion of televisions held by private owners.

Table C2: Impact on STAR of Increased Rental Charges

(E'000 p.a.)[1]

	Option A Current Rentals	Option B Revised Rentals
Revenue		
- rental[2]	734	1281
- other	48	48
	782	1329
Direct Expenses	21	21
Gross profit	761	1308
Operating expenses	602	533
Operating profit	159	775
Depreciation	109[3]	638
Net profit after depreciation	50	137
Capital employed	N/A	1367

Notes 1 based upon results for first 10 months of 1985/6

2 reduced by recommended new licence fees

3 at historic cost

C52. If the imputed licence fee of E529,000 p.a. is added back to rental revenues under options A and B then the effective increase in total fees (licence and rental) paid by rental viewers would be 44%. The net effect of the increase in rental charges and the decrease in licence fees would be to increase TVA revenue by approximately E407,000 p.a., assuming 90% collection of the revised lower licence fee, the increase in rental charges more than offsetting the reduction in licence fees. In addition the annual operating expenses of STAR would be fall by an estimated E69 000 as, given the reduced licence fee, STAR would no longer be obliged to repair privately owned television at zero cost The net effect on TVA would be an improvement of E476,000 p a

C53. The effect on profitability of the STBC may be illustrated below:-

Table C3: Impact on STBC of Increased Rental Charges

E'000 p.a

Revenue	
Licence fees	694
Advertising	342
Other	6
	1042
Direct expenses	583
Operating expenses	1 069
Operating profit	(610)
Depreciation	127
Net profit after depreciation	(737)

C54. It is apparent, even with attributed revenue for licence fees collected from STAR viewers, that STBC will still not be profitable. In order to break even after depreciation (at historic cost only), advertising income would need to increase to exactly three times its present level. Given the small viewer base such a growth in advertising revenue is inconceivable. Therefore we conclude that STBC cannot become financially independent unless there is a substantial increase in the number of television viewers.

C55. The option we have presented here would enable STAR to make an operating profit of E775,000 Much of this amount could be devoted to the repayment of both interest and principal on a commercial loan secured to replace STAR's existing television sets. A margin, however, would be available which could be used to subsidise part of STBC's current operations. It is clear, however, from the analysis that STBC will still continue to require an annual Government subvention to meet the remainder of its annual cash flow deficit.

Sales and Marketing

C56. The TVA have made considerable efforts at improving their advertising income. Last August the marketing manager undertook a marketing course in Lesotho and later in the year a sales representative was recruited. In addition, agents have been contracted in both Cape Town and Johannesburg on a commission basis.

C57. Although there are no sales targets set and no explicit marketing strategy, TVA proposes to maximise its income earning potential by conducting a survey of viewership. It also intends to run cocktail/buffet parties to increase sales to local businessmen. The viewership survey has been postponed until after the Coronation in April this year when the new transmission equipment will be installed It is expected that the new equipment will increase the spillover to RSA and consequently increase the advertising revenue from that source.

C58. TVA management also plans to contract with an RSA based company to supply portable black and white televisions for sale in the rural areas of Swaziland. Again it is anticipated that if this deal is successful, potential advertising revenue from local businesses will increase.

C59. There is some evidence that the current intensive advertising effort is producing results. For instance, advertising fees increased to E40 000 in October 1985 and E53 000 in December 1985. However, on balance on a year-by-year basis, there is some underlying improvement. In the current financial year to February advertising revenue was E285 000 compared with E272 000 for the same period in the previous year, 1984/85.

C60. There are two major constraints to TVA increasing its advertising revenue: firstly, it is unable to offer its salesmen in Swaziland commission as an incentive to increase sales and secondly, it is hindered by its exceptionally small viewer base

Performance Criteria

C61. In measuring performance a distinction should be drawn between STBC and STAR. The latter should essentially run as a commercial operation and its performance can therefore be measured principally in terms of its profitability although some cost efficiency indication should be included in recgonition of the fact that STAR is a monopoly. We have shown earlier that, if an imputed licence fee is deducted from STAR rentals, STAR's operating profit is insufficient to replace its capital equipment, primarily its television sets.

C62. STBC, on the other hand, should be subject to different performance criteria taking account of its social and development objectives. At this stage it would be premature to establish a full range of performance indicators as they require the Government to clarify the objectives of the corporation. For instance, it has not been stated whether the Government wants a commercial operation which would have to be restricted to the major urban areas or a national operation which requires explicit subsidy. Until these objectives have bee made explicit, it will not be possible for the Authority to set specific performance targets based upon these objectives.

C63. We have endeavoured to show that STBC cannot be profitable under the present circumstances, even if STAR viewers pay an imputed licence fee. Advertising income would have to multiply three times and this in inconceivable given the present viewership bases. The University has estimated provisionally a daily viewersnip of 45,000 with a selective audience of up to 90,000. The consultant Frank Ord intimated that one million viewers should be the target to make the television broadcasting service self-sustaining. Further, he indicated that the current ratio of one TV to 100 persons should be increased to one to every 20 persons. If these targets are correct then achieving financial viability for STBC can only be a long-term goal.

C64. In the absence of explicit objectives for the STBC, we propose initially that government and the TVA assess the performance of STBC on the basis of financial criteria. Given the precarious cash flow position of he TVA these indicators should include cash flow as well as revenue/cost indicators. A suggested list of performance criteria are as follows:-

Financial

F1 Advertising revenue per viewer/broadcast hour

F2 Revenue/operating expenses

F3 Cost of film purchases per broadcast hour

F4 Operating costs per viewer

F5 Operating costs per broadcast hour

F6 Advertising revenue/sales and marketing costs

Cash Management

C1 Working capital/income

C2 Debtors/income.

Conclusions

C65. It is clear that the fundamental objectives of the TVA need to be clarified as a high priority. The Government needs to decide what type of television broadcasting service it wants, specifically whether the TVA should:-

(a) operate as a commercial venture restricted to the main urban areas or provide national coverage;

(b) be an entertainment medium or offer a full range of entertainment, cultural and news programmes; or

(c) offer an educational broadcasting service on behalf of the Ministry of Education for an explicit subsidy.

C66. Current Government policies towards the TVA have had a detrimental effect on TVA operational and financial performance. As a public corporation we consider that TVA should be able to set its own salaries and staffing levels, subject to general government guidelines, and to pay performance-related bonuses and commissions, particularly to sales and credit control staff. Indeed the Act specifically stipulates that the Board is empowered to set terms and conditions of employment. Control against profligacy could be imposed by setting targets for payroll growth in relation to revenues.

C67. There is evidently no pricing policy in respect of licence and rental fee adjustments. Licence fees have remained at an "unacceptable" level for the private TV owner while Sun International has enjoyed a significant discount for its hotel room televisions These factors have made it difficult to collect licence fee arrears Rental charges have not been revised in the history of the TVA in spite of the fact that STAR is in principle a commercial operation. Currently rental viewers are relatively privileged compared with private TV owners although the latter receive free maintenance which is difficult to justify. However, there is a perception on the part of TVA management and the Board that rental increases would not be acceptable in view of the current transmission problems and the old age of the televisions.

C68. Projecting the future financing requirements of the TVA cannot be accomplished satisfactorily in the absence of:-

(a) explicit objectives for the corporation; and
(b) a coherent pricing policy.

In principle, however, the annual subvention for the TVA should be reflect the extent to which Government wishes it to fulfil wider social and development objectives for which there should be an explicit and pre-determined subvention geared to the cash flow deficit rather than the operating deficit. This is especially relevant for TVA which will need to be reduced over 1986/7. In addition, the subvention should include a provision for annual capital expenditure based upon a budget provided by the TVA rather than an assumed expenditure based upon annual depreciation provisions adjusted for inflation. This point has practical significance in the case of the TVA as a major part of capital expenditure will be to replace the rental TVs of STAR. In view of the commercial nature of STAR this should be financed through a commercial loan and not by direct Government subvention. Basing the subvention for capital expenditure on the depreciation of both STBC and STAR fixed assets tends to overstate very substantially the future government financing requirement.

C69. Even if an imputed licence fee for STAR viewers is attributed to STBC revenues it is clear that STBC cannot become financially viable in the foreseeable future while providing the current level of service. We observed that self-sufficiency would require a three-fold increase in advertising income which is inconceivable given the current size of the viewership. Unless the TVA is instructed to perform a strictly commercial service, say for the urban areas of Mbabane and Manzini, the Government should recognise that in the short-term it will continue to require subvention until its viewership base expands significantly.

C70. In paragraphs C14-C21, we suggested measures for improving organisation and management, management information and Board representation within the Authority. We also indicated that external relationships need to be strengthened. These are medium-term recommendations. Although we have not examined these matters explicitly, we consider that there is a need to improve budgeting procedures and expenditure control, and to strengthen financial controls especially within STAR. Our most important short-term recommendations on improving performance is to operate STAR profitably by increasing rentals to a level which covers both replacement cost depreciation and gives STAR a cash profit based on a realistic return on capital employed which would offset to some extent the projected deficits of STBC. If this were implemented it would allow licence fees to be reduced to an acceptable level and result in a net improvement in revenue for the TVA as a whole. The reduction in the licence fee would also allow STAR to cease providing a free repair service for privately owned TVs. More significantly it should enable the Government to guarantee a medium term commercial loan which is requested to purchase new television sets.

C71. We consider that in the medium-term the Government should consider the option of divesting STAR to the private sector; we would suggest this action be taken after its potential profitability has been realised. This would have the major advantage enabling the Government to obtain a better price for STAR.

C72. Any medium and long-term plans for improving the operational and financial performance of the TVA must, however, be based upon a major expansion of the viewer base in order to generate additional licence fees and advertising income. This will require both improvements in transmission and the establishment of a television dealership network in the country.

C73. In the absence of any formal statement of objectives for the STBC and in view of the present static viewership base, we believe it is inappropriate to establish extended performance criteria for the STBC. At a later stage these might include technical quality, and growth in audiences, and quality of, cultural programmes offered. In the present environment, however, targets for specific financial and cash management indicators may be set which encourage the TVA to operate as efficiently as possible within the existing constraints. Setting out performance criteria for STAR poses no such problems: its operations should be governed by purely commercial criteria and it should be expected to make a profit, provided that its cost efficiency is controlled to reflect its monopoly status.

FIGURE C1

IVA ORGANISATION CHART

- MD
  - DMD
    - Area Manager STAR
    - News (News Editor)
    - PROGRAMMES (Producer)
    - ADVERTISING (Advertising representative)
    - ENGINEERING (Chief Engineer)
    - PROGRAMME OPERATIONS (Programming Officer)
    - TRANSPORT (Transport Manager)
    - ADMINISTRATION (Administration Officer)

Figure C2

TVA: PROFIT AND LOSS ACCOUNT (1983/4-1985/6)

(E'000)

	1983/4	1984/5[1]	1985/6 (to 31 Jan 86)
REVENUE			
Viewers certificate fees	388	335	254
Advertising fees	327	344	285
Rental fees	1,279	1,320	1,086
Other income	22	97	11
	2,016	2,096	1636
DIRECT EXPENSES[2]	833	797	700
Gross Profit	1,183	1,299	936
OPERATING EXPENSES[2]			
Rental operations	155	159	180
Broadcasting operations	159	167	136
Rental equipment maintenance	221	258	229
Broadcasting equipment maintenance	212	186	210
Sales and marketing	172	139	118
General and Administrative	497	647	529
	1,416	1,556	1,402
Profit/(Loss)	(233)	(257)	(466)

Note: 1 derived from Year-end audited accounts

2 including depreciation provisions

Figure C3

STBC AND STAR: PROFIT AND LOSS ACCOUNT (APRIL 85 - JAN '86)

(E'000)

	STBC	STAR
Revenue	544.1	1,093.1
Direct expenses	485.9	17.7
Gross profit	58.2	1,075.4
Operating Expenses	890.8	501.7
Operating profit before Depreciation	(832.6)	537.7
Depreciation	106.0	91.7
Net profit after depreciation	(938.6)	482.0
Revenue (adjusted for STAR licences)	1259.1	378.1
Operating Profit before depreciation	(117.6)	(141.3)
Net profit after depreciation	(223.6)	(233.0)

Figure C4

STAR: PROFIT AND LOSS ACCOUNT [1] (AUG '85 - JAN '86)

(E'000)

	AUG'85	SEPT'85	OCT'85	NOV'85	DEC'85	JAN'86
REVENUE						
Rental	105.6	105.6	105.6	105.6	105.6	105.6
Other	2.3	13.6	3.0	0.6	2.3	3.3
	107.9	119.2	108.6	106.2	107.9	108.9
...ect Expenses	0.6	1.3	0.9	7.4	1.5	2.0
...ross Profit	107.3	117.9	107.7	98.8	106.4	106.9
...RATING EXPENSES						
...ntal Branches	16.8	16.1	15.2	16.9	29.3	16.5
... Technicians	25.9	22.8	29.7	(13.3)	30.9	20.7
Properties	6.9	6.4	4.0	6.8	7.5	7.8
Finance Charges	2.1	0.9	0.9	1.6	2.4	1.2
	51.7	46.2	49.8	12.0	70.1	46.2
...T PROFIT BEFORE DEPRECIATION	55.6	71.7	57.9	86.8	36.3	60.7
...preciation	9.2	9.1	9.1	9.1	9.1	9.1
NET PROFIT AFTER DEPRECIATION	46.4	62.6	48.8	77.7	27.2	51.6

Note: 1 derived from monthly management accounts

Figure C5

STBC: PROFIT AND LOSS ACCOUNT [1] (AUG'85 - JAN '86)

(E'000)

	AUG'85	SEPT'85	OCT'85	NOV'85	DEC'85	JAN'86
REVENUE						
Viewers certificates[2]	26.2	26.2	26.2	26.2	26.2	26.2
Advertising	24.5	28.8	40.4	23.0	53.0	27.7
Other	1.9	-	-	-	-	-
	52.6	55.0	66.6	49.2	79.2	53.9
Direct Expenses	24.4	26.5	57.2	50.6	127.7	66.3
Gross Profit	28.2	28.5	9.4	(1.4)	(48.5)	(12.4)
OPERATING EXPENSES						
Sales & Marketing	7.1	15.9	9.6	17.0	16.0	11.1
Station Operations	15.3	11.8	12.8	13.2	13.3	12.8
Broadcast engineers	26.2	21.9	22.1	18.0	24.2	16.2
Admin & General	49.1	46.5	56.3	42.6	57.6	36.1
Finance Costs	(1.3)	0.3	(0.8)	-	-	
	96.4	96.4	100.0	91.1	110.4	76.4
NET PROFIT BEFORE DEPRECIATION	(68.2)	(67.9)	(90.6)	(92.5)	(158.9)	(88.8)
Depreciation	10.6	10.6	10.6	10.6	10.6	10.6
NET PROFIT AFTER DEPRECIATION	(78.8)	(78.5)	(101.2)	(103.1)	(169.5)	(99.4)

Notes: 1 derived from monthly management accounts

2 assumes 80 per cent collection

Figure C6

TVA: DEBTORS AND CREDITORS

% of projected 85/86 revenue	Aug'85	Sept'85	Oct'85	Nov'85	Dec'85	Jan'86
Debtors	14.1	13.9	16.6	17.9	16.8	16.4
Creditors	36.4	37.0	45.2	46.2	51.9	50.3

TVA: BALANCE SHEET INDICATORS

(E'000)

	March'84	March'85	Jan'86
Reserves	1,138.2	880.7	494.5
Current ratio	1.11	0.95	0.48

Figure C7

TVA: CASH FLOW (SEPT '85 - JAN '86)

(E'000)

	Aug'85	Sept'85	Oct'85	Nov'85	Dec'85	Jan'86
Debtors	277.7	275.2	327.3	352.9	331.4	323.9
Stock	289.8	316.4	400.3	423.6	371.7	410.1
Current assets	567.5	591.6	727.6	776.5	703.1	734.0
Less: Creditors	720.1	731.7	894.1	913.9	1024.9	994.4
Net current assets	(152.6)	(140.1)	(166.5)	(137.4)	(321.8)	(260.4)
Increase (Decrease)						
NCA	28.5	12.5	(26.4)	29.1	(184.4)	61.4
Capital Expenditure	4.1	5.0	3.7	2.0	3.9	2.4
Gross cash flow out (in)	32.6	17.5	(22.7)	31.1	(180.5)	63.8
Deduct (Add)						
Profit (Loss)	(32.1)	(15.9)	(53.8)	(23.3)	(142.1)	(47.7)
Depreciation	24.0	24.0	23.7	23.7	12.2	23.5
Cash Profit/(Loss)	(8.1)	8.1	(30.1	0.4	(129.9)	(24.2)
Net Cash Flow Out (In)	40.7	9.4	7.4	30.7	(50.6)	88.0
Cumulative Cash flow Out (In)	40.7	50.1	57.5	88.2	37.6	125.6

APPENDIX D

ROYAL SWAZI NATIONAL AIRWAYS CORPORATION

D1 We discuss Royal Swazi National Airways Corporation (RSNAC) under the following headings:-

* Corporate Objectives
* Government Policy Guidelines and Relations
* Organisation & Management
* Budgeting and Management Information
* Financial Performance
* Tariff Policy
* Sales and Marketing
* Performance Criteria
* Conclusions

Corporate Objectives

D2 The RSNAC was established in 1978 by the Royal Swazi National Airline Order. In this legislation the main purpose of the Airline is defined as the provision of "domestic and international air transport services, both scheduled and non-scheduled " Beyond this rather vague statement no concrete objections are specified The best formal statement of the objectives of RSNAC is to be found in the 4th National Development Plan as follows:-

(a) to operate the airline as efficiently as possible;
(b) to develop the route network and services to the extent that they are commercial propositions,
(c) to develop practical personnel and management capabilities; and
(d) to promote the development of tourism.

D3 In addition RSNAC has been requested by the Government to develop services between SADCC countries, in particular, and also to link Swaziland with overseas destinations. In spite of this we understand that the commercial viability of new routes should not be compromised.

D4 These represent a clear statement of objectives as a framework for planning the operations of RSNAC. In particular we note that RSNAC is charged with the promotion of tourism. It is apparent, however, that the benefits of tourism, in terms of foreign exchange earnings, are not reflected in the revenues of the airline. In order to judge the performance of RSNAC, therefore, it is necessary to measure its impact on increasing the total revenues from tourism.

Government Policy Guidelines

D5 RSNAC is relatively uninfluenced by Government policy guidelines except to some extent in salary determination. We understand that RSNAC salaries have been fixed by the Establishment and Training Department in relation to civil service salaries. In general salary revisions are thought to reflect increases in government salaries and require the tacit approval of the Government. In practice, however, proposed salary increases are not refused. No bonuses or commissions are paid to staff.

D6 As RSNAC does not operate any internal flights, the Government has not been involved in setting guidelines for tariff increases. Fare increases are negotiated through the IATA framework and approved formally by the Minister.

D7 Our discussions with the Chief Executive indicate that RSNAC's existing relationships with Government are good. The Chief Executive makes regular contact with the Minister or PS of Works and Communications and the Director of Civil Aviation. There is no evidence of any direct interference by Government officials in the affairs of the airline.

Organisation and Management

Organisation Structure

D8 The organisation structure of RSNAC is exhibited in Figure D1. The Chief Executive, who does not have a deputy, has the seven departments of the airline reporting directly to him. These comprise:-

* commercial
* ground operations
* accounts
* flight operations
* flight services
* engineering
* personnel

It would appear, therefore, that the existing span of control of the Chief Executive is too wide. We suggest that the organisation structure be reviewed with a view to reducing the number of managers who report directly to the Chief Executive.

D9 RSNAC employs a total of 166 staff compared with 149 in September 1981 a growth of only two per cent per annum which indicates that manpower growth has been carefully controlled. Currently we understand there are no vacancies in key managerial and technical positions, although we point out that the airline is currently heavily dependent on expatriate manpower.

D10 The Managing Director has considerable autonomy in decision making. He is responsible for initiating tariff adjustments, negotiating loans up to E1 million, recruitment, dismissals, promotions, approving new positions and procurements. More significantly he is able, in consultation with the Commercial Manager, to open new routes. The Board is merely informed after the decision has been taken. There is a provision in the Act which gives the Cabinet power to direct the airline "to perform certain operations of a commercially non-viable nature" This could be interpreted to mean the opening of non-viable routes. In practice, however, we understand that the airline has not been directed to open a specific route, potentially viable or non-viable.

D11 RSNAC has a smaller Executive Board in addition to the Board of Directors which is chaired by the Vice-Chairman of the main board and comprises three more of its members including the Chief Executive. The Executive Board has essentially the same functions as the main Board. Both the Board of Directors and the Executive Board have powers to approve capital expenditure, the annual budget, salary increases and loans over E1 million. Tariff approval is the only decision which is beyond the authority of the Chief Executive and his Board.

Budgeting and Managem.nt Information

D12 Budget preparations in RSNAC commence in January, that is 15 months before the start of the financial year to which it refers. The budget is normally consolidated around May/June by the Chief Accountant who submits it to the Chief Executive with his comments and advice. The Chief Executive then discusses the budget with individual department heads and finalises before submission to the Board. Subsequent to Board approval the budget is submitted to the Ministry of Works and Communications and forms the basis of the annual subvention requested from the Ministry of Financ .

D13 The main difficulties associated with the preparation of the budget relate to fluctuations in the exchange rate which, for instance, make it relatively difficult to project emalangeni expenditures which are incurred in foreign currencies. In fact the 1986/87 budget did not convert promissory note payments and spare part expenditures from their foreign exchange denominations. In our view the main weaknesses in the current budgeting process are that:-

(a) it is essentially incremental in respect of expenditures, adding different inflation factors to the previous year's budget; and

(b) the budget is based upon the previous year's budget rather than previous year's expenditure. (This is understandable given the early budget preparation; when the budget is finalised at most three months actual revenue and expenditure would be available).

D14 We point out that the government requirement to submit budgets nine months prior to the start of the financial year is particularly restrictive for a commercial operation. It is unrealistic to expect RSNAC to be able to provide accurate revenue forecasts, for instance, at such an early juncture. We have recommended, in Chapter III, a two-stage budget process to help overcome this problem

D15 RSNAC has a comprehensive package of monthly management information which includes:-

* balance sheet
* profit and loss account
* route performance
* departmental expenditures
* statistics, ratios and performance indicators.

This package is provided by the Chief Accountant 25 days after the end of the month and distributed to the Chief Executive. The Commercial Manager receives the profit and loss account, the route performance statement and the departmental expenditure figures. All other departmental heads receive the departmental expenditure statement only.

D16 The management accounts compare the monthly actual with budget and year to date with budget, indicating variances. The main weaknesses with the existing management information system are that:-

(a) no narrative reports explaining major adverse variances are provided;
(b) the statistics, ratios and performance indicators are too detailed at the present time and are generally not used except by the Commercial Manager who investigates a select number; and
(c) budget variances are not used as a vehicle for expenditure control.

<u>Financial Performance</u>

D17 In this section we discuss the financial performance of RSNAC under the following headings:-

* profit and loss account
* route performance
* debt position
* working captial management
* subvention request
* financial ratios/indicators
* conclusions

Profit and Loss Account

D18 In Figure D2 we show the profit and loss results for RSNAC for the period 1981/82 - 1983/84 derived from the annual audited accounts. The operating loss increased steadily between 1980/1 and 1982/3 to over E3 million but fell in 1983/4 to E2.3 million reflecting an increase in revenue from E3.4 million to E4.1 million. The loss declined further to E2.0 million in 1984/5 as indicated in Figure D4. However, this downward trend is likely to be reversed in the current year as, at 31st January 1986, the operating loss was already in excess of E2 million

D19 After taking depreciation into account, RSNAC losses increased between 1980/1 and 1984/5. In 1984/5 the net loss after depreciation stood at E3.3 million which was, nevertheless, significantly below the E4.6 million loss experienced in 1982/3.

D20 Adjusting net loss after depreciation for the various items of non-operating income and expenditure and exceptional items in some years increases and in others reduces the overall loss. In 1982/3 the overall net loss reached E5.6 million after deducting an exceptional item of E637,000 for aircraft hire while the F28 was out of service. In 1983/4 a net loss after depreciation of E4 million was reduced to E2.2 million mainly due to a profit on the sale of fixed assets. However, the overall loss has increased significantly in the last two years; in 1984/5 it was E4.8 million and in 1985/6 (in the 10 months to date) it reached E5.4 million.

D21 As of 31st January 1986 we estimate the accumulated losses of RSNAC to be E32.4 million We observe that these enormous losses have occurred in spite of an increase in revenues from E3 3 million in 1980.1 to E6.4 million in the first 10 months of 1985/6. In relation to revenues, the magnitude of this net loss has fallen substantially in the last two years. In 1984/5 the net loss was equivalent to 94 per cent of revenues compared with 160 per cent in 1982/3.

D22 In Figure D4 we estimate the revenue which RSNAC would need to earn in order to break-even on its current operations. In 1984/5 "break-even" revenue was E20.5 million compared with actual revenue of E5.1 million. Clearly, therefore, it is not possible for the airline to break even given the nature of its present operations.

Route Performance

D23 In Figure D5 we analyse the route performance for the first 10 months of 1985/6. For all routes revenue exceeds variable costs, the Johannesburg route representing approximately 50 per cent of the contribution at this level. However, with the exception of the Johannesburg route no route makes a contribution to overhead costs at level two.

D24 The difference between contribution (level 1) and contribution (level 2) requires explanation. It is unusual for a set of airline management accounts to analyse two levels of contribution but, in the case of RSNAC, this has been done to reflect the small size of the national carrier. The difference between the two contribution levels is represented by "direct fixed costs" which include:-

* fixed maintenance/overhaul costs
* flight operations
* cabin services
* depreciation of aircraft and spares
* aircraft insurance

These costs are considered to be "direct" in that they are directly associated with the operation of the flight; they are regarded as "fixed" because they would still be incurred if the route were not operated Expenditures on flight operations and cabin services (largely salaries) would still be incurred we understand if, for instance, the Gaborone-Lusaka route were to be cancelled.

D25 We have tested the validity of this proposition by comparing expenditures on "direct fixed" items before and after the opening of the new Maputo-Maseru route. If these expenditures are truly fixed then one would expect no additional costs to be incurred after the opening of the Maputo-Maseru route. Total "direct fixed" costs for the relevant period were as follows:-

	E'000
August '85	248.1
September '85	248.1
October '85	235.1
November '85	257.7
December '85	308.8
January '86	264.1

D26 Although "direct fixed" expenditure increased significantly in December 1985 (the time of opening the Maputo-Maseru route) in January '86 they fell back to approximately the level obtaining between August and October 1985. There is no evidence, therefore, to disprove the proposition that these items are fixed costs. Nevertheless, we observe that flight operations and cabin service are likely to be variable costs in the event of non-marginal route decisions, for instance the closure of two or three of the existing routes. The other three categories - maintenance/overhaul, depreciation and insurance - are, however, clearly fixed and would therefore not change as a result of a non-marginal route decision.

D27 Even if one were to assume that flight operations and cabin services are variable costs, all routes would still make a contribution with the exception of the recently opened Maputo-Maseru role. The contribution results i.e. revenue minus variable costs including flight operations and cabin services, are shown below:-

	Contribution (April 1985 to January 1986)
	E'000
Johannesburg	741.3
Harare-Lusaka	264.7
Dar-es-Salaam-Nairobi	55.8
Gabarone-Lusaka	202.8
Maputo-Maseru	(12.0)

D28 We conclude, therefore, that all routes with one relatively insignificant exception, make a contribution to RSNAC's overhead expenditures. There are thus no grounds for any route closures as a decision of this nature would increase the level of RSNAC's overall loss. The real problem is that small scale of the airlines operations makes it impossible to recover all necessary overheads for the operation of one aircraft.

Debt Position

D29 As of 31st January 1986, RSNAC had three outstanding long-term loans on the balance sheet:-

* Government of Swaziland - E25.6 million
* Fokker VFW - E6.7 million
* Boeing Equipment Holdings Co. - E2.2 million

D30 There is no formal agreement regularising the amount outstanding with Government. We understand that neither the Ministry of Finance nor RSNAC is able to confirm the terms and conditions of the apparent loan. It is clear, however, that RSNAC is financially incapable of repaying these monies regardless of the interest rate and the repayment period The amounts outstanding with Fokker VFW and Boeing Equipment Holdings for the F28 aircraft and spares are payable in the form of promissory notes. The repayment varies with movements in the exchange rate but for 1986/7 is estimated by the Chief Accountant at approximately E3.8 million.

Working Capital Management

D31 RSNAC's operating bank account is currently in credit although the Board has been requested to approve the negotiation of an overdraft facility for E1 million. This facility, we understand, is intended to tide the corporation over its cash flow difficulties until the Government subvention monies become available. RSNAC's bank overdraft in previous years is shown at Figure D3. As at 31st March 1983 the overdraft stood at E522,400, the year in which the highest net loss was recorded.

D32 We show the trend in RSNAC's current ratio in Figure D3 i.e. the ratio of current assets to current liabilities. As at 31st January 1986 this ratio is equivalent to 1.02. The increase since 1982/3 has been due to an increase in the level of debtors. As at 31st January 1986 debtors balances outstanding were E4.8 million compared with E2.6 million two years previously and E1.9 million as at the end of the financial year 1983/4. Clearly, therefore, RSNAC's cash flow has been adversely affected by the upward trend in debtors.

Subvention Request

D33 RSNAC has requested an annual subvention from the Government of E5.75 million for 1986/7. However, this amount excludes the promissory notes payable to Fokker which were denominated in Dutch Guilders. At current exchange rates the repayments convert to E3.8 million, the total request, therefore, was effectively for E9.55 million.

D34 The subvention approved by the MOF and tabled before Parliament was E3.5 million, considerably below RSNAC's request. We understand from the Ministry of Works and Communications that the amount of E3.3 million is not intended to finance RSNAC's operating deficit; it is instead designed to cover:-

(a) repayments on the Fokker loans, and
(b) specific operating expenses as identified under a Ministry budget item.

It is apparent therefore that the basis of the Government subvention is at odds with the expectations of the corporation that government is requested to finance the operating deficit, capital expenditure and loan repayments.

D35 The difference between the Government subvention and RSNAC's request is over E6 million and it is clear, therefore, that RSNAC will experience a cash crisis very early on in the new financial year. The shortfall, however, is based upon RSNAC's original budget for 1986/7 which was drawn up in June 1985, between 9 and 21 months before the start of the year. We note in this respect that revenue projections for the year have recently been revised and that any calculation of the projected shortfall should take account of both these and revised expenditure estimates based on the current year's experience.

Financial Ratios and Indices

D36 In tables D1 and D2 below we set out key financial ratios and indices respectively.

Financial Ratios

Table D1

As % of Revenues

	1979/80	1980/81	1981/82	1982/83	1983/84
Costs:					
Flying Operations	53.3	60.3	65.7	69.9	46.9
Maintenance and Overhaul	17.4	17.5	18.8	19.7	22.5
Ground Operations	13.2	13.6	15.6	19.2	15.5
Marketing and Publicity	16.2	19.4	25.9	29.4	31.0
General and Administrative	32.6	33.2	30.4	38.1	34.0
Net Loss	108.7	85.5	144.6	116.1	55.0
Operating Loss	93.5	56.3	66.8	88.4	57.4

Financial Indices

Table D2

1979/80=100	1979/80	1980/81	1981/82	1982/83	1983/84
Revenue	100	116	125	118	141
Flying Operations	100	131	155	155	124
Maintenance and Overhaul	100	116	136	134	182
Ground Operations	100	119	148	171	165
Marketing and Publicity	100	138	200	214	269
General and Administration	100	118	127	134	147
Total Operating Expenses	100	122	141	150	150
Operating Loss	100	135	174	216	168

D37 The main issues affecting the operating performance of KSNAC arising from these tables are as follows.-

(a) expenditures on flying operations, which include fuel costs as the major item, have been volatile since the opening of the airline and reached 70% of revenue in 1982/3 and fell back to 47% the following year;

(b) both "maintenance and overhaul costs" and "marketing and publicity expenditures", especially the latter, increased significantly as a percentage or revenue over the period and also faster than total operating expenses,

(c) total operating expenses increased faster than revenues up to 1982/3 thereby explaining the deterioration in operating performance relative to revenues since 1982/3, however, revenues have increased significantly which has had the effect of reversing the deterioration in performance.

D38 In sum, the costs of flying operations, and by implication, fuel costs have not had an adverse effect on the trend in performance except during 1981/2 and 1982/3 The deterioration in the operating loss relative to revenues until 1982/3 is explained by operating expenses, especially ground operations, marketing and publicity and to some extent flying operations, rising faster than revenues. Since 1982/3 this trend has reversed as revenues have increased faster than total operating expenses.

Conclusions

D39 The main conclusions arising from our analysis of RSNAC's financial performance are as follows:-

(a) the operating loss increased rapidly until 1982/3 reaching E3 million and has declined to E2 million in 1984/5; however, we note that the 1985/6 operating loss is likely to be in excess of E2 million;

(b) the net loss after depreciation and non-operating expenses has not improved to the same extent as the operating loss: this reflects increases in non-operating expenses in 1984/5 and 1985/6;

(c) all routes, with the current exception of the Maputo-Maseru route make a contribution towards the fixed costs of RSNAC;

(d) RSNAC has an outstanding long-term loan with the Government which has not been regularised and which should either be written off or converted to equity;

(e) there has been a deterioration in the corporation's control over debtors thereby increasing unnecessarily its working capital requirements;

(f) the basis for the annual Government subvention is to meet specified costs rather than the cash requirements of the corporation; and

(g) expenditures on "maintenance and overhaul" and "marketing and publicity" have increased faster than total operating expenditures and have grown in relation to revenues. There is a strong argument for controlling more closely the growth in "marketing and publicity" expenses.

Tariff Policy

D40 RSNAC's fares are revised on a regular basis, normally twice a year. Fare increases can either take the forms of a standard tariff increase of a "currency adjustment". We analyse in Table D3 below the past record of fare increases on select routes excluding the currency adjustments which we have been unable to determine. We have not analysed these adjustments in relation to revenues as currency fluctuations have a far greater impact on revenues than fare increases.

Table D3: Fare Increases on Select Routes from Matsapa (1980-86)

	Johannesburg	Lusaka (April 1981 - 100)	Nairobi
April			
1981	100	100	100
1982	122	112	110
1983	137	127	116
1984	144	130	119
1985	164	130	123
1986	172	137	129

Note: based on economy fare adjustments

D41 Although RSNAC is not a member of the IATA Tariff Co-ordinating Committee, it is represented at the IATA Tariff Fixing Conferences, normally by South African Airlines (SAA). Tariff adjustments, therefore, on RSNAC routes are set by IATA after SAA, or another African airline, has argued the case for RSNAC We understand that prior to the conferences, the Commercial Department has an idea of how much it would like to increase tariffs and that this rate of increase is communicated to its representative at the Conference

D42 RSNAC faces fierce competition with road transport on its major route to Johannesburg and tends, therefore to base its proposed fare increase on market factors rather than, for instance, on a cost based approach. The rate of fare adjustments can differ between routes and in addition special fares e g between Matsapa and Nairobi, are sometimes negotiated Fare increases are formally approved by the Director of Civil Aviation who otherwise has no influence on the fare setting process

Sales and Marketing

D43 In table D4 below we show the trend in passenger statistics over the last 5 years.

Table D4: Number of Passengers Carried

	1981/2	1982/3	1983/4	1984/5	1985/6 (to 31 January)
Number	24,199	22,267	31,735	33,993	30,346
% Change		(8.0)	42.5	7.1	

No underlying trend in passenger volumes can be determined from these figures. Passenger numbers are clearly higher today than they were in 1981/2 but the rate of increase has differed sharply from year to year. We have not compared these recent figures with the period 1978-1981 as these are available only on a calendar year basis.

D44 The Commercial department projects that passenger numbers will increase by 3 per cent in 1986/7 with the exception of the Nairobi - Dar es Salaam route where a growth of 5 per cent is anticipated.

D45 The commercial department has sales office in Johannesburg, Nairobi and Lusaka Annual sales targets and corresponding budgets are established for each of these offices by the commercial manger for the areas under their jurisdiction.

D46 The marketing strategy for RSNAC is formulated at the annual Sales Conference held in Swaziland The key features of the current marketing strategy are as follows.-

(a) to increase passengers on "high yield" routes;
(b) to concentrate efforts on in-coming travellers because of the limited side of the Swaziland market;
(c) to focus on switching the RSA holiday visitor from travelling by road; and
(d) to develop the shopping traffic from Lusaka.

D47 In order to develop the RSA market, Swaziland's largest market, RSNAC has offered promotional and family fares from Johannesburg. In addition, since 1984, it offers package tours in cooperation with local hotels and promotes this idea through a "road show" which develops contacts with sporting group, conference and tour agent organisers and advertises Swaziland through window display materials. The emphasis is both on increasing the share of the RSA tourist market and on switching existing tourists within Johannesburg and its environs from road to air.

D48 The impact of RSNAC's sales and marketing effort must take account of both:-

(a) additional passengers and consequently airline revenue generated; and
(b) additional income for Swaziland in the form of tourism revenues.

It may be premature to assess the effectiveness of RSNAC's marketing drive but we note that expenditure on Sales and Marketing has increased dramatically in the last five years and should be justified immediately in terms of both additional airline and tourism revenue generated. (We return to this point in more detail in the next section on performance criteria).

D49 The opportunities available to RSNAC for increasing revenues from both passengers and freight are constrained by the technical capabilities of the existing F28 aircraft The F28 has low freight capacity and insufficient fuel capacity by virtue of the fact that it only possesses one aircraft. This reduces its revenue earning opportunities. For instance, RSNAC is unable to capture fully the "business" market from Johannesburg in view of the fact that the aircraft is stationed in Matsapa in early morning when the majority of businessmen would prefer to fly to Swaziland. Instead the decision has been made on commercial grounds to maximise the number of passengers which can be captured from incoming flights from Europe.

D50 Given that there is little scope for extending and changing the route network with the existing aircraft to more profitable destinations, RSNAC must apply its sales and marketing efforts to existing markets. This inevitably imposes limits on potential passenger (and freight) volumes which can be achieved.

Performance Criteria

D51 A comprehensive set of performance criteria for RSNAC should be developed in the context of:-

(a) the objectives of the corporation; and
(b) a medium-term corporate plan.

D52 In these respects a number of issues need to be resolved. Firstly, the Government has apparently entrusted the airline with promoting tourism. However, although the benefits in terms of tourism earnings are not captured by RSNAC, they are currently incurring the costs of promotion. Clearly, therefore, RSNAC, as a commercial operation, needs to be compensated in part for the service it provides on behalf of government. The basis on which this subsidy is determined will depend upon a realistic assessment of the benefits and costs of the corporation's tourism promotion.

D53 This assessment is a complex exercise which is beyond the scope of this preliminary review. However, we indicate here the order of magnitude of these tourism benefits. In 1984/5, 16,563 visitors entered Swaziland through Matsapa airport. We estimate that 10,413 of these visitors represent additional tourism generated by RSNAC on the admittedly generous assumptions that:-

(a) tourists represent visitors of all types, i.e. business, holiday etc;
(b) all passengers originating from outside RSA are generated traffic;
(c) 50 per cent of passengers originating in RSA are generated traffic i.e. not switching from road transport; and

(d) no generated road traffic as a result of RSNAC promotion in Swaziland in RSA.

D54 Assuming further an average length of stay of 2.0 nights and average expenditure per night of E22.30 (based upon Central Statistical Office figures for 1985 to date), then tourism revenue generated by RSNAC is estimated at E464,000 in 1984/85. Although this is clearly a very rough calculation, it is apparent that this represents a small proportion (9 per cent on the above assumptions) of RSNAC total revenues. Further it should be estimated net of the sales and marketing costs attributable to this function. Therefore, we conclude overall that the tourism promotion function of RSNAC does not justify the losses that the airline incurs.

D55 The <u>second</u> issue relates to the medium-term plans of the corporation. We observe in this respect that RSNAC does no possess a medium-term corporate plan and that sales forecasts, for instance, are made one year ahead only. RSNAC objectives include the development of the route network in a commercially viable manner. It is clear, however, that:-

(a) all routes make a contribution to overhead costs; and
(b) there are few opportunities for substituting or adding more profitable routes.

But, in spite of this, RSNAC continues to make an operating loss as well as a net loss after depreciation and non-operating expenses. Although there may be scope, for instance, to reduce overhead costs and expand sales, the long-run profitability of the airline will depend upon fleet decisions. In this respect there would appear to be two major options which deserve appraisal, namely to:-

(a) replace the F28 with a smaller aircraft such as the Twin Otter and operate only one route between Matsapa and Johannesburg; or
(b) expand the fleet size by adding a large aircraft and open up routes to further more profitable destinations.

D56 Clearly this will involve fundamental policy decisions regarding the type of airline which the government wants to have as well as detailed financial appraisal of the alternatives. We do not believe that a third option, to close down the airline, is likely to be acceptable to the Government.

D57 In the absence of agreement regarding the treatment of the tourism promotion function of the airline and in the absence of any medium-term corporate plan, comprehensive performance criteria cannot be developed. However, in the short-term there are a number of indicators for which targets could be established which measure the efficiency of the RSNAC independently of these wider considerations

D58 In the context of performance criteria it is important to recognise that the achievement of agreed targets should be within the control of management. In the case of RSNAC performance it is critically affected by two factors outside the control of management, namely:-

* fuel prices
* currency fluctuations which affect both revenues and costs.

For instance, we note that, in the current year, RSNAC has benefitted from a revaluation of the Rand which has increased its revenues relative to the number of passengers. As a matter of principle performance targets should be goals which are achieved by design rather than by accident.

D59 The effect of external factors highlights the importance of building up a hierarchy of performance indicators so that the impact of uncontrollable factors on higher level performance indicators can be readily observed. They also indicate the need to measure the sensitivity of particular exchange rates, and we would suggest, therefore, that RSNAC forecast future scenarios which measure the impact of possible currency fluctuations.

D60 We suggest the use of the following indicators by Government for which targets should be agreed with RSNAC:-

Operational

01	Number of passengers, kilos of freight and mail by route
02	Seat load factor (%) by route
03	Number of passenger - kilometers (revenue passengers only)
04	Number of flights delayed by more than one hour.

Financial

F1	Gross passenger yield
F2	Overhead costs/revenue
F3	Variable costs/revenue
F4	Fuel costs/revenue
F5	Payroll costs/revenue
F6	Sales cost per passenger
F7	Overhead costs per passenger - kilometer
F8	Variable costs per passenger - kilometer
F9	Average working capital/income
F10	Debtors/income

Manpower

M1	Total passenger - kilometers per employee

D61 In the context of performance criteria and the need to introduce employee incentives to ensure that targets can be met, we note that RSNAC has recently introduced a performance appraisal system. The criterion for assessment is subjective rather than based upon the achievement of a set of objectives for the year agreed between the subordinate and his superior. The assessment is shown to and signed by the officer concerned. This performance appraisal is used as a basis for awarding increments, normally six months after the annual cost of living increase which all employees receive. We have been informed that an employee will be paid either zero or one increment. Our suggestion would be for RSNAC to continue operating the current performance appraisal system but to consider awarding a wider range of increments based on different levels of performance.

Conclusions

D62 We summarise the main conclusions arising from our brief review under the following headings:-

* corporate objectives
* management information
* financial performance
* sales and marketing
* performance criteria

Corporate Objectives

D63 The 4th National Development Plan charges RSNAC with the promotion of tourism. However, the benefits of tourism, in terms of foreign exchange earnings, are not reflected in the revenues of the airline but accrue to the government. On the other hand, the costs of promoting tourism are fully incurred by RSNAC. Clearly, therefore, the airline, as a commercial operation, needs to be compensated in part for the service it provides on behalf of government. The basis of which this subsidy is determined will depend upon a realistic assessment of the benefits and costs of the corporation's tourism promotion efforts.

Management Information

D64 RSNAC has a comprehensive set of management accounts. However, such regular financial information can only be valuable to the extent that it is both used by management to control performance and based upon realistic budgets. In this context we note at RSNAC that:-

(a) expenditure budgets are drawn up on an incremental basis and related to the previous year's budget rather than actual expenditure; and

(b) adverse variances from budgets are not used as a control tool by management to bring actual closer to budgeted performance.

D65 It is apparent that no effective mechanisms for expenditure control exist within RSNAC and we welcome the steps that RSNAC propose to take to address this deficiency.

Financial Performance

D66 The main conclusions arising from our analysis of RSNAC's financial performance are as follows:-

(a) the airline has a substantial operating loss which reached a peak of E3 million in 1982/3 and has subsequently declined to E2 million in 1984/5; however, we note that the 1985/6 operating loss is likely to be in excess of E2 million;
(b) all routes, with the current exception of the Maputo-Maseru route, make a contribution to the fixed costs of RSNAC; and
(c) the 1986/7 Government subvention to RSNAC, being designed to meet limited specified expenditures, is substantially below the cash requirements of the corporation by more than E6 million.

D67 The deterioration in the operating loss relative to revenues in 1982/3 is explained by the fact that operating expenses, especially ground operations, marketing and publicly and to some extent flying operations, have risen faster than revenues. Since 1982/3 this trend has reversed as revenues have increased faster than total operating expenses, mainly reflecting an increase in passenger revenue yields rather than a growth in the number of passengers.

Sales and Marketing

D68 RSNAC's current sales and marketing effort is directed towards the RSA tourist market. The impact of this strategy must be measured in terms of:-

(a) additional passengers and airline revenue generated; and
(b) additional income for Swaziland in the form of tourism revenues.

D69 Expenditure on sales and marketing has increased dramatically in the last five years and should be justified ultimately in terms of both additional airline and tourism revenue generation. It is appropriate, therefore, that consideration be given to initiate an evaluation of RSNAC's existing marketing strategy.

Performance Criteria

D70 A comprehensive set of performance criteria for RSNAC should be developed in the context of:-

(a) the objectives of the corporation; and
(b) a medium-term corporate plan.

D71 In the first instance, performance criteria must measure, among other things, the success of RSNAC in promoting tourism. Secondly, these criteria should reflect the medium-term goals of the corporation which at present are not clearly articulated

D72 The development of such medium-term goals is fundamental to RSNAC in view of the fact that the corporation continues to make an operating loss (as well as a net loss after depreciation and non-operating expenses) in spite of the fact that:-

(a) all routes make a contribution to overhead costs; and
(b) there are no opportunities for substituting or adding more profitable routes.

D73 The basic cause of this financial situation is that RSNAC is on the one hand, burdened with all the overhead costs of an international airline and, on the other hand, only possesses one aircraft. In this context there would appear to be two major options which deserve appraisal:-

(a) replace the F28 with a smaller aircraft, such as a Twin Otter, and operate only one route between Matsapa and Johannesburg; and
(b) expand the fleet size by introducing a larger aircraft and open up routes to further, more profitable, destinations.

D74 In the short-term there may be scope to:

(a) reduce overhead costs; and
(b) expand sales on existing routes.

and the performance criteria we have outlined are designed to reflect this opportunity.

Figure D1

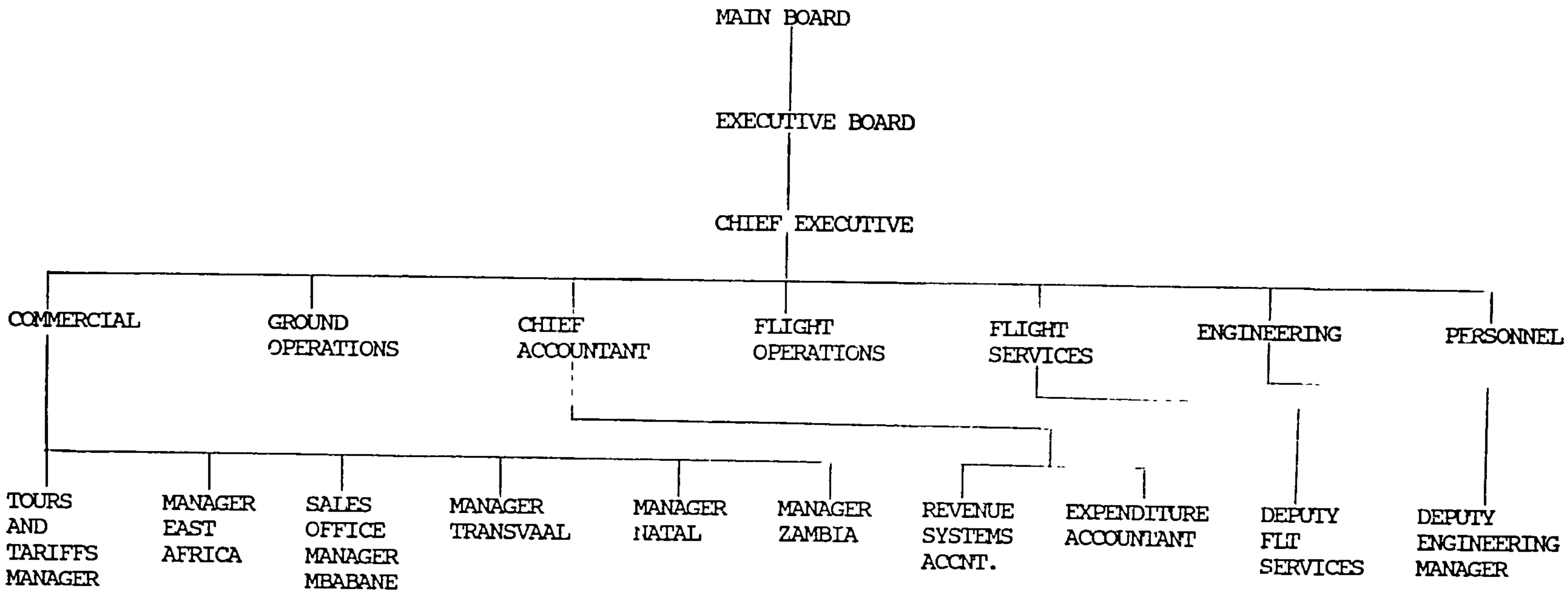
MAIN BOARD
EXECUTIVE BOARD
CHIEF EXECUTIVE
COMMERCIAL
GROUND OPERATIONS
CHIEF ACCOUNTANT
FLIGHT OPERATIONS
FLIGHT SERVICES
ENGINEERING
PERSONNEL
TOURS AND TARIFFS MANAGER
MANAGER EAST AFRICA
SALES OFFICE MANAGER MBABANE
MANAGER TRANSVAAL
MANAGER NATAL
MANAGER ZAMBIA
REVENUE SYSTEMS ACCNT.
EXPENDITURE ACCOUNTANT
DEPUTY FLT SERVICES
DEPUTY ENGINEERING MANAGER

Figure D2

RSNAC: Profit and Loss Account (1980/81-1983/84)[1]

(E'000)

	1980/1	1981/2	1982/3	1983/4
OPERATING REVENUES				
- Passenger	2,491.2	3.106.4	2,872.3	3,236.6
- Cargo and Mail	89.2	144.7	144.6	191.9
- Other	743.2	355.8	380.1	624.7
	3,323.6	3,606.9	3,397.0	4,053.2
OPERATING EXPENSES				
- Flying Operations	2,004.0	2,371.4	2,373.7	1,900.8
- Maintenance & Overhaul	580.7	667.4	670.8	910.7
- Ground Operations	452.7	562.3	650.6	627.6
- Passenger Services	291.1	321.2	369.6	304.7
- Marketing & Publicity	645.1	933.6	998.4	1,256.2
- General Administrative	1,104.6	1,098.1	1,295.2	1,379.2
Amortisation	118.0	53.8	40.7	-
	5,186.2	6,017.6	6,300.0	6,379.2
OPERATING PROFIT/(LOSS)	(1,872.6)	(2,410.7)	(3,002.0)	(2,326.0)
Depreciation	1,363.1	1,345.9	1,607.4	1,688.7
NET LOSS AFTER DEPRECIATION	(3,235.7)	(3,756.6)	(4,609.4)	(4,014.7)
Non-operating (income)/expense	(393.4)	1,444.8	351.8	(1,784.4)
NET LOSS	(2,842.3)	(5,217.0)	(5,643.8)	(2,230.3)

Figure D3

RSNAC: Balance Sheet Analysis (1981/2-1983/4)

(E'000)

	1980/81	1981/82	1982/83	1983/84
Bank Overdraft	-	58.2	522.4	186.8
Debtors	1,771.3	2,142.8	1,879.6	2,617.6
Creditors	2,356.0	2,410.9	2,468.1	1,909.3
Stocks	105.6	127.1	150.4	122.1
(Current Ratio)	(1.34)	(0.75)	(0.39)	(0.86)
% of Revenue				
Debtors	53.3	59.4	55.3	64.6
Creditors	70.9	66.8	72.7	47.1
Stock	3.2	3.5	4.4	3.0

Figure D4

RSNAC: Profit and Loss Account[1] 1984/85-1985/86)

(E'000)

	1984/85	1985/86 (to 31 January 86)
REVENUE		
Passenger[2]	4,385.2	5,676.7
Freight	261.9	220.7
Other Flown	226.8	408.7
Miscellaneous	253.1	48.2
	5,117.0	6,354.3
VARIABLE COSTS		
Fuel	2,018.9	2,666.7
Other	1,496.2	1,786.5
GROSS PROFIT	1,601.9	1,901.1
Fixed Costs and Overheads	3,619.9	3,992.9
NET PROFIT BEFORE DEPRECIATION	(2,018.0)	(2,091.8)
Depreciation	1,308.7	1,103.6
NET PROFIT AFTER DEPRECIATION	(3,326.7)	(3,195.4)
Non-Operating (Income)/Expenses	1,498.4	2,173.7
NET PROFIT	(4,825.1)	(5,369.1)
ACTUAL REVENUE	5,117.0	6,354.3
Break-even Revenue	20,437.1	24,315.1
Gross Margin	31.3%	29.9%

Notes: 1. Based on unaudited management accounts

2. Includes excess baggage

Figure D5

RSNAC: Route Profitability (31 MAR 1985-31 JAN 1986)

(E'000)

	Johannesburg	Harare -Lusaka	Dar-es-Salaam Nairobi	Gaborone -Lusaka	Maputo Maseru (Note 2)	Total
Revenue	1,956.2	992.0	1,492	1,033.2	168.2	5.642.1
Variable Costs	1,055.4	632.0	1,261.7	720.3	162.0	1,810.7
Contribution 1	900.8	360.0	230.7	312.9	6.3	1,810.7
Direct Fixed Costs	745.1	445.2	817.5	514.3	85.8	2,607.9
Contribution 2	155.7	(85.2)	(586.8)	(201.4)	(79.5)	(797.2)
Indirect Costs (Note 1)	715.0	432.7	849.5	382.6	60.6	2440.4
Operating Profit	(559.3)	(517.9)	(1,436.3)	(584.0)	(140.1)	(3,237.6)
Non-operating Expenses	539.3	389.5	807.7	370.7	66.6	2,173.8
Net profit/ loss	(1,098.6)	(907.4)	(2,244.0)	(954.7)	(206.7)	(5,411,4)

Notes: 1 Includes depreciation 2 Route commenced in December 1986

SWAZILAND RAILWAY

E1. We discuss our review of Swaziland Railway (SR) under the following headings:-

* corporate objectives
* Government policy guidelines and communications
* organisation and management
* strategic planning and tariff policy
* budgeting and management information
* operational performance
* financial performance
* performance criteria and employee incentives

Corporate Objectives

E2. SR was established under the Swaziland Railway Act of 1962 and its stated purpose in Section 12 is "to provide or to secure and promote the provision of an efficient and adequate system of public transport of goods and passengers by rail with due regard to economy and safety of operation and to supply the needs of Swaziland for rail services to the fullest possible extent consistent with the resources of the Railway". This is a vague and unequivocal statement which cannot serve as a basis for management to set any coherent operational objectives.

E3. Further, because objectives are not extensively defined, this has resulted in management holding questionable perceptions regarding the objectives of the Railway. In our discussions, it was apparent that management believes the Railway exists to benefit industry in Swaziland rather than to make a profit. It was felt that the railway should "break-even" on its operations although it is not clear precisely which costs should be recovered through revenues as these are not specified in the Act.

E4. Reference was made in an earlier report by the previous Chief Executive to the Ministry of Works and Communications to the goal of "self sufficiency" in relation to its capital equipment. The significance of this goal lies in the fact that SR does not own its steam engines and much of its rolling stock which is hired from South African Transport Services (SATS). However, there would appear to be no explicit recognition of this objective by the present SR management although there is a definite awareness of the costs of hiring steam engines and rolling stock from SATS.

Government Policy Guidelines and Communications

E5. SR is not constrained in any way by Government policy guidelines regarding either salaries or tariff approvals. Salary increases require the approval of the Board; the Minister is simply advised subsequent to the decision. Tariff adjustments require the formal approval of the Minister but we understand that SR has been able in the past to obtain the tariff increases which it requires.

E6. However, SR, we understand, suffers from the absence of any coherent government transportation policy. Currently the Railway experiences severe competition from road hauliers, particularly in the container and general goods categories. Permits for road hauliers are issued by the Road Transportation Board but we understand that hauliers frequently operate without permits which has resulted in lost business for the Railway. We consider, therefore, that the Government should determine in which freight categories SR should compete with private road hauliers and subsequently ensure that competition takes place on an equal basis. This would require that road hauliers be expected to pay for the full cost of their operations, to include road maintenance, similar to the Railways which maintains its permanent way, and that this policy be enforced through a rational permit system.

E7. Finally there would appear to be no difficulties experienced by the present management of SR in its dealings with government. Communications take place directly between the Chief Executive and either the PS or the Minister of Works and Communications. In recent months we understand that the main topic of discussion has been financial matters, especially the current 1986/87 budget.

Organisation and Management

E8. The previous Board of SR was dismissed by the Minister and a new Board has only recently been re-appointed. There are seven members including the Chairman but excluding the Chief Executive who does not sit on the Board. It includes two principal secretaries and business representatives and possesses some financial expertise. It is not possible to conclude at this stage how effective the new Board is as it has convened on only one occasion, in March 1986.

E9. With regard to the decision making powers of the Board vis-a-vis the Chief Executive, it is clear that the latter has an acceptable degree of autonomy. The Chief Executive has the responsibility for initiating tariff adjustments, recruitment and the creation of new posts (except for senior posts), capital expenditure approval not exceeding E20,000, and dismissal of staff. The Board, on the other hand, is empowered to approve capital expenditure in excess of E20,000, salary increases and the annual budget. In addition there is a Tender Board comprised of Board members and Railway officials which is responsible for making decisions on the award of contracts in excess of E100,000. The only power which resides with the Minister is the formal approval of tariff adjustments.

E10. We attach SR's organisation chart in Figure E1. The Chief Executive has a deputy through whom seven departments report to him. It is apparent, therefore, that the span of control of the Chief Executive and his deputy is too wide. There is a danger that this reporting arrangement can result in a dimunition of the Chief Executive's control over his department heads. It would appear appropriate for SR to consider a re-organisation of this structure with a view to distributing direct reporting from the main departments between the Chief Executive and his deputy.

E11. We further observe that the current reporting relationships are insufficiently supportive of top management. For instance, neither the accounts nor the operations department currently provide the Chief Executive with relevant financial and operational information to enable him to control the operation of the Railway.

E12. SR currently has a staff of 1026 (as at 31 March 1986) compared with 908 in 1980/81. There are no existing vacancies in key managerial positions with the possible exception of Deputy Marketing Manager, a newly created post which SR is presently trying to fill.

E13. The capabilities of the current management team should be seen in the context of the radical change in the operations of the Railway occasioned by the opening of the Northern Rail Link in January 1986. This has given the Railway an unprecedented opportunity to generate additional revenues from transit freight traffic passing through Swaziland to Durban and Richards Bay. From the revenue projections for 1986/87 it is clear that revenues from this traffic are likely to exceed those arising from traffic either originating or terminating in Swaziland. Management should be competent to respond to this opportunity in order to gain the maximum advantage for both SR and Swaziland. We consider, therefore, that the current management practices should be expeditiously appraised to ensure they are appropriate for optimising future performance in the context of this major change in the nature of operations.

Strategic Planning and Pricing Policy

E14. SR possesses no corporate plan which lays out strategic options for the Railway over the next three to five years. The Chief Executive is keen to introduce diesel locomotives, and is aware of the benefits in terms of both revenue generation and cost savings, but this is not part of a well conceived strategy which relates to medium term freight tonnage forecasts, for instance. Any proposal to replace the present steam engines with diesel engines must evidently be subjected to rigorous appraisal. Such an appraisal would examine technical, management, and financial aspects; it would also need to be consistent with management's strategy for realising its medium-term freight tonnage targets.

E15. Strategic planning also involves the establishment of an appropriate tariff policy to enable the objectives of the organisation to be achieved. The present tariff structure of SR is identical to that of SATS and it is fair to say that tariff increases have tended to follow those introduced by

SATS. For instance, as of 1 January 1986, SATS tariffs were increased by 15 per cent and SR tariffs were raised with effect from 1 February 1986 by 15 per cent and 10 per cent for goods and miscellaneous, and containerised traffic respectively. A comparison of tariff rates between SR and SATS indicates the near equivalence of the rates.

E16. The administrative procedures for tariff adjustments are relatively lengthy. The requested tariff adjustment is initially communicated by the Commerical Director to the Chief Executive with a written justification, referring, say, to increases in operational expenditures. After the approval of the Chief Executive, the intention to increase tariffs is advertised in the Swazi press and objections invited from rail users. After objections have been resolved the adjustment is passed to the Board and finally to the Minister for approval.

E17. The obvious weakness in this procedure is that there is no requirement to advertise the magnitude of the proposed tariff adjustment. In the previous round of tariff revision the Sugar Association raised an objection but had first to enquire of the magnitude of the intended increase before formally protesting it.

E18. Tariff adjustments have occurred on a regular basis, once yearly, rather than as ad hoc responses to poor financial performance. The record of past tariff increases in relation to the operating performance of SR is indicated in Table E1 below.

Table E1: Tariff Increases and Operating Results (1982-86)

	Net Loss after Depreciation (E'000)	Tariff Increase	
1981/82	(1409)	April 1982	10%
1982/83	(2085)	May 1983	17.5%
1983/84	(1753)	May 1984	15%
1984/85	(2531)[1]	April 1985	10%
1985/86	-	Feb 1986	15% (10% for containerised traffic)

Note: 1 from unaudited accounts

E19. There is no strong evidence to suggest that the magnitude of tariff adjustments has been geared towards the level of the net loss after depreciation. Moreover there is no suggestion that tariff increases have improved the financial situation Finally, we make the general point that the absence of any forward budget, until 1986/87, inevitably makes it impossible to estimate the magnitude of the increase required to achieve any financial performance targets.

E20. Given that SR is carrying a significant volume of transit freight, tariff policy requires an urgent re-thinking. In our view, for freight carried on behalf of South African industry, SR should fix its tariffs at a level where it maximises its profitability. Clearly, South African industry benefits from significant cost savings caused by a reduction in the distance travelled, and SR should endeavour to capture these cost savings in the form of higher tariffs. In effect this would be a policy of price discrimination towards transit traffic vis-a-vis non-transit traffic.

Budgeting and Management Information

E21. It is a requirement under the legislation for SR to produce both an annual revenue and capital expenditure budget to the Board and to justify all capital expenditures in excess of E12,000. However, SR has not prepared an annual budget until this year. Our inspection of this budget reveals that there are no attached schedules indicating the major assumptions used in the exercise It is clear that the budget was prepared by the Accounts Department. We understand that department heads were unable to produce expenditure budgets on request and to this extent, there are prima facie grounds for questioning the expenditure budget, we note that although, the Accounts Department have endeavoured to calculate expenditure budgets from a zero base. Our most serious reservation, however, is with respect to the revenue projections. It is apparent that these have been kept deliberately conservative. For instance, revenue projections are based on guaranteed freight. In addition, export/import freight revenues indicated in the budget have been deliberately revised downwards from the projections provided by the Commercial Department, apparently to depress projected profitability.

E22. Our final objection to the revenue budget produced is that both loan repayments and depreciation are included under expenditure. It is questionable, therefore, whether this budget should be used in any system of management accounts. Currently, SR does not produce any management accounts and responds simply to ad hoc requests for information. In the absence of any regular financial reporting, there is no way of controlling the financial performance of SR.

E23 Further, SR generates no regular information of an operational nature which can be used by management as a basis for assessing and controlling operational performance. The Chief Executive would ideally like to receive regular operational information but we are informed that the Operations Department does not appreciate the importance of generating such information.

Accounting Systems and Internal Control

E24. It is apparent from our discussion with the external auditors that the systems of accounting and internal control at Swaziland Railway are generally unsatisfactory and that these have been deteriorating over the last three years. The auditors note that: "matters have reached such a state that any further deterioration could bring about the total collapse of the systems of accounting and internal control". The auditors are of the view that the only way to avoid this situation is through the recruitment of qualified finance staff able to implement and maintain the necessary systems of accounting and financial control as they consider that none of the existing staff is suitably qualified.

Operating Performance

E25. We summarise the operating performance of SR for the last five years in Figure E2. It is evident that sugar is the most important commodity in tonnages for SR, representing between 24 and 46 per cent of tonnages hauled over the period. This commodity has replaced iron ore as the most significant freight commodity; no iron ore has been carried after 1980/81 when the mine was closed.

E26. The main conclusions which may be drawn from Figure E.2 are that:-

(a) there has been a perceptible decline in tonnages hauled over the last five years which has continued since the cessation of the iron ore traffic,

(b) "net tonne-kilometres"[1] have decline even faster than tonnages hauled, especially in 1984/85, reflecting a fall in the distances travelled; and

(c) revenues per net tonne-kilometre have increased significantly, particularly in the last three years.

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1 One net tonne-kilometre is equivalent to one tonne of freight carried over one kilometre.

E27. We recognise that the decline in tonnages hauled and revenues earned in 1984/85 reflect the impact of the Cyclone Domoina. In particular the destruction of bridges and track explains the significant reductions in tonnages hauled in respect of coal, pulp and other goods. However, the fall in fertiliser tonnage is a consequence of the closure of the fertiliser factory in Matsapa, rather than this natural disaster.

E28. Finally we note that this historical data is not a good guide to future trends since the opening of the Northern Link in January 1986. Tonnages hauled from 1986/87 onwards are expected to rise significantly with the introduction of transit traffic for at minimum the following commodities:-

* rock phosphate
* phosphoric acid
* pulp
* citrus.

Financial Performance

E29. SR has not required a Government subvention in the last three years and moreover, it is unlikely to need support in 1986/87 on the assumption that 1986/87 budget is accurate (In 1982/83 the magnitude of the subvention was E1.6 million.) However, the absence of subvention does not necessarily imply that SR's financial performance has been satisfactory. We discuss the main issues arising from our examination of the financial performance of SR under the following headings:-

* operating results
* financial ratios and indices
* working capital management
* outstanding debt.

Operating Results

E30. We summarise the operating results for the period 1979/80 to 1983/84, for which audited accounts are available, in Figure E3. SR has made an operating profit in every year since 1979/80 but the magnitude of this operating profit has fallen slightly in the last three years reaching E1.1 million in 1984/84. The existence of an operating profit explains in general why SR has not required Government subventions.

E.31. However, after taking account of depreciation and provision for track rehabilitation, SR made a small net loss in 1979/80 which had grown to E1.8 million in 1983/84. In this year SR suffered from considerable damage caused by the Cyclone Domoina and provision for this of E3.4 million appears in the accounts for this year as an "extraordinary item". As a result the final net loss in 1983/84 was in excess of E5 million.

E32. We point out that this significant deterioration in financial performance in the last three years has occurred since the closure of the iron ore mine. Therefore explanations for this recent poor performance need to be sought in other factors.

Financial Ratios and Indices

E33. In Figure E4, we record key financial ratios for SR covering the period 1980/81 - 1984/85. We point out that this analysis has been constrained by the nature and availability of financial information within SR. In particular it is not possible to identify payroll costs, a major item of expenditure, and, in addition, all expenditure categories include provision for depreciation. The main issues arising from this analysis are that:-

(a) total operating expenses have increased faster than revenues since 1981/82;
(b) "traffic and vehicle running expenses", as a percentage of revenue, have increased from 24 per cent in 1980/81 to 38 percent in 1984/85;
(c) fuel costs represent a relatively insignificant item in relation to revenues; and
(d) revenues fell to 12 per cent of net fixed assets in 1984/85 compared with 23 per cent in the previous year.

E34. The deterioration in financial performance, which has occurred since 1981/82, is explained as follows:-

(a) from 1981/82 to 1983/84 by an increase in operating expenses in excess of the growth of revenues; and
(b) in 1984/85 by the decline in revenues caused largely by the cyclone damage.

The growth of "traffic and vehicle running expenses" has been largely responsible for the escalation in operating expenditures and within this category we understand from the Accounts Department that the major increase has been in respect of the cost of hiring rolling stock from SATS. In this sense, SR's poor operating performance has been determined by external factors outside its control.

E35. The deterioration in financial performance is anticipated to be reversed in 1986/87 when a net profit of E1.3 million after depreciation, interest and loan repayments is expected. This dramatic improvement is explained by the additional revenue (estimated at E25 million in 1986/87), to be generated from the new transit traffic.

Working Capital Management

E36. In Figure E5, we examine changes in SR's balance sheet over the last five years. We note, in respect of working capital management, that SR's current ratio has been in excess of unity over the period i.e. current assets have exceeded current liabilities. This is explained by the fact that SR has had significant cash and bank balances over the period. Further, there is evidence from the 1984/85 balance sheet that SR's working capital requirement could be reduced from the debtors' side. As at 31 March 1985, outstanding debtors stood at E2.7 million, equivalent to 27 per cent of revenue, apparently the highest level for five years. Although, within the time frame of this study, it has not been possible to determine an "acceptable" level of debtors in relation to revenues, it is apparent that, at minimum, debtors' balance should be monitored and controlled more closely.

Outstanding Debt

E37. Figure E5 also shows the balance of SR's outstanding debt. As at 31 March 1985, this stood at E92 million and has increased from E38 million, the level as at 31 March 1983. As a consequence, SR's gearing ratio (the ratio of long-term debt to reserves) has increased from 3:1 to over 14:1 between 1982/83 and 1984/85. These outstanding loans, which have, inter alia, financed the development of the Golela and Northern Rail Links, are the precursor of major debt servicing in future.

E38. SR's own projections for debt servicing only cover the next financial year 1986/87 for which loan repayment and interest is estimated at E10.7 million. (This estimate is based upon exchange rates prevailing as at January 1986. Since this time we note that the Rand has strengthened against the currencies in which SR's external loans are denominated.) This amount represents over 25 per cent of projected revenues for 1986/87. Clearly, therefore, debt servicing will have a major impact on the cash flow of the Railway in the coming years and it is essential in this regard that longer term projections of loan and interest payments, on alternative exchange rate assumptions, are made.

E39. At our request the Ministry of Finance has estimated that the loan and interest payments due on SR debt in 1987/88 are E16.3 million (comprising E10.0 million principal repayment and E6.3 million interest), converting external debt at the exchange rates prevailing as at end March 1986. We point out that this estimate excludes Swaziland government loans and is much greater than SR's own estimate for the previous year of E10.7 million. This exercise should be conducted by SR, to include also local loans, on a rolling basis five years ahead, as clearly debt servicing will have a major impact on SR's financial performance in the coming years.

E40. We observe, finally, that there are a number of Swaziland government loans totalling E40 million extended to SR which are not governed by any loan agreement. In particular, these include:-

* E27 million to finance the Golela Link
* E8 million to finance the Northern Rail Link
* E4.7 million for cyclone repairs

E41. It is a matter of urgency that the terms and conditions of these outstanding Government loans are agreed and the corresponding debt servicing schedules incorporated in SR's rolling five year projection. The interest and loan repayments on this debt will have a major impact on the future overall cash flow of SR and, to the extent that these payments are not incorporated in SR's profit and loss account, net profit will be considerably and artificially overstated.

Performance Criteria

E42. The formulation of suitable performance criteria, for which achievable targets should be agreed between Government and SR, can play a key role in strengthening the relationship between Government and the Railway. These targets should be consistent with SR's corporate objectives, its medium-term plans and its budget assumptions. Clearly, therefore, a full range of performance criteria can only be developed after objectives have been clarified and a medium-term strategic plan developed.

E.43. Nevertheless, we suggest the type of performance indicators (for which targets should be subsequently negotiated) which Government should monitor to gauge the success of the Railway. These include a number of operational, manpower, financial and cash management measures as follows:-

Operations

01 Volume targets for major freight categories disaggregated by:-

* Swaziland traffic
* Transit traffic

02 Average number of traffic units per employee

03 Average number of traffic units per locomotive

04 Average number of net tonne-kilometres per wagon unit

05 Percentage of trains not to exceed two hours delay

Manpower

M1 Average number of net tonne-kilometres per employee

Financial

F1 Rate of return on capital employed

F2 Net profit/revenue

F3 Revenue/capital employed

F4 Overhead costs/revenue

F5 Variable costs/revenue

Cash Management

C1 Average working capital/total income

C2 Debtors/income

E44. The attainment of specified performance criteria needs to be backed up by internal employee incentives agreed towards individual or group performance. In this regard we note that SR is one of the few public enterprises which has a bonus system, albeit only for manual workers. The present CEO is interested in the application of incentive schemes to improve labour productivity and we would suggest that such schemes be extended to embrace non-manual employees.

Conclusions

E45. The main conclusions arising from our analysis of SR may be summarised as follows:-

(a) the commercial objectives of the Railway are not clearly defined and this has resulted in management holding questionable perceptions regarding its commercial goals, specifically that the Railway exists to benefit industry in Swaziland rather than to make a profit;

(b) SR suffers from the absence of any coherent government transportation policy which:-

(i) determines in which freight categories SR should compete with private road hauliers; and

(ii) ensures that competition takes place on an equal basis through enforcement of a rational permit system for road hauliers;

(c) management practices should be viewed in the context of the radical change in the operations of the Railway occasioned by the opening of the Northern Rail Link; it would therefore be appropriate to re-appraise the existing management practices to ensure that these are relevant to the optimisation of future performance;

(d) Planning, budgeting and management information within SR are weak in that:-

(i) there is no corporate plan;

(ii) there are no medium-term projections of debt servicing carried out beyond 1986/7;

(iii) no regular management information is produced; and

(iv) the first annual budget produced by the railway for 1986/87 has limited validity due to the apparent lack of commitment by department heads to expenditure budgeting and the explicitly conservative nature of the revenue projections;

(e) the crucial issue for SR's tariff policy in the coming years is the determination of appropriate tariffs for transit traffic. In respect of this freight carried on behalf of South African industry there is a strong case for price discrimination whereby SR sets tariffs at a level where it maximises its profitability by endeavouring to capture a share of the cost savings enjoyed by South African industry; and

(f) concerning the operational and financial performance:-

(i) the Railway has experienced an operating profit since 1979/80 which has fallen significantly in the last 3 years;

(ii) the Railway has experienced a net loss after depreciation which has grown in the last three years;

(iii) a significant decline in revenues was experienced in 1984/5 when total revenue fell to E10.0 million compared with E11.3 million in 1983/84;

(iv) there has been a significant decline in both tonnages hauled, and in particular, net tonne-kilometres since 1980/81 which has continued since the cessation of the iron ore traffic; and

(v) the future financial performance of the Railway will depend in large measure on maximising the revenues from transit to offset the impact of debt servicing.

Figure E1

SWAZILAND RAILWAY ORGANIZATIONAL CHART

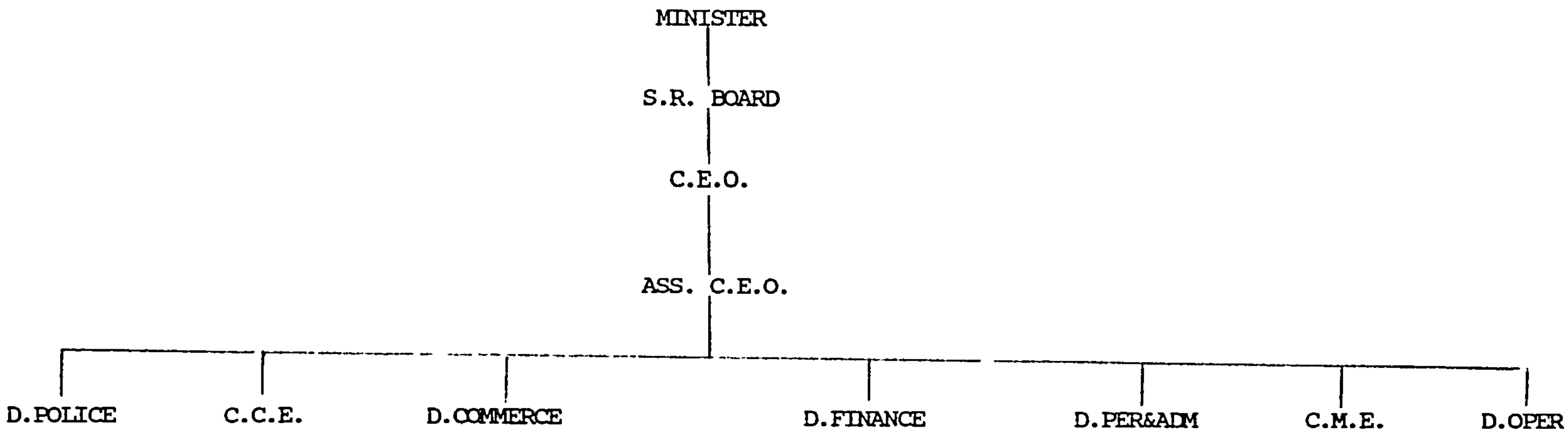

Figure E2

TONNAGES HAULED

('000 Tonnes)

	1980/81		1981/82		1982/83		1983/84		1984/85	
	N	%	N	%	N	%	N	%	N	%
Sugar	295	24	328	27	343	27	318	31	401	46
Iron ore	170	14	-	-	-	-	-	-	-	
Pulp	151	12	150	12	153	12	142	14	104	12
Coal	141	11	126	10	112	9	62	6	103	12
Molasses etc	95	8	115	9	113	10	115	11	101	12
Fertiliser	87	7	115	9	171	13	120	12	7	1
Petrol, oil etc.	67	6	59	5	70	5	72	7	57	7
Cement etc.	52	4	43	4	35	3	27	3	15	2
Other	173	14	275	23	256	20	154	15	76	9
Total	1,233	100	1,211	100	1,273	99	1,010	100	864	100
Net tonne kms ('000)	143,215		137,812		120,884		107,029		58,347	
Revenue per 1,000 net tonne kms	£56.10		£66.24		£94.00		£105.75		£168.99	
Index of tonnage (1979/80 = 100)	66		65		68		54		46	

Source: SR Annual Reports and Commercial Department, SR for 1984/85 data.

Figure E3

<u>Profit and Loss Account (1979/80-1983/84)</u>

(E'000)	1979/80	1980/81	1981/82	1982/83	1983/84
Revenue	6963	8034	9130	11368	11318
Expenditure	5376	6464	8126	10394	10236
Operating Profit	1587	1570	1004	974	1082
Depreciation	1609	1850	1913	2059	2335
Track rehabilitation provision	-	500	500	1000	500
Net profit (loss) after depreciation	(22)	(780)	(1409)	(2085)	(1753)
Profit/(loss) on sale of fixed assets	5	(6)	(25)	(24)	30
Net profit/(loss) before extraordinary item	(17)	(786)	(1434)	(2109)	(1723)
Extraordinary item	-	-	-	-	3360[1]
Net profit (loss)	(17)	(786)	(1434)	(2109)	(5083)

Note: 1 provision for cyclone damage.

Figure E4

	1980/81	1981/82	1982/83	1983/84	1984/85
<u>As percentage of Revenue</u>					
- fuel	6	12	5	9	8
- maintenance of rolling stock[1]	18	17	18	24	16
- maintenance of permanent way[1]	38	37	30	33	42
- motive power operations[1, 2]	24	29	29	22	24
- traffic and vehicle running expenses[1]	24	27	33	31	38
- total operating expenses	80	89	91	90	93
- operating profit	20	11	9	10	7
- net loss after depreciation	10	15	18	15	26
- debtors	22	21	12	23	27
<u>As percentage of Net Fixed Assets</u>					
- revenue	18	20	25	23	12
- operating profit	4	2	2	2	1
<u>Indices</u> (1979/80 = 100)					
Revenue	115	131	163	163	142
Total operating expenses	77	93	116	149	147

Note: 1 Including depreciation.
2 Including fuel.

Figure E5

BALANCE SHEET ANALYSIS (1980/81-1984/85)

(E'000)	1980/81	1981/82	1982/83	1983/84	1984/85
Fixed assets	44,265	45,393	45,312	50,248	85,602
Loans	34,803	35,710	37,789	50,861	91,805
(Gearing ratio)	(2.8)	(3.2)	(3.0)	(6.4)	(14.4)
Debtors	1,776	1,887	1,385	623	2,655
Creditors	1,459	2,345	2,682	1,869	5,631
Stocks	392	485	519	313	434
(Current ratio)	(2.6)	(1.4)	(2.8)	(4.3)	(3. 1)

LEGISLATION

F1. This appendix first sets out a summary of the present Acts governing public enterprises and points out some shortcomings of this legislation. We then present a suggested draft for a new Act which will be required to implement the recommendations on control of public enterprises contained in our main report.

Existing Legislation on Public Enterprises

F2. Figure F1 compares the Acts of 13 public enterprises, under four broad headings:-

(a) Policy: statements on general objectives and powers of the enterprise (including provisions for government to request specific services) and on financial policy;

(b) Appointments: the composition of the Board; and the authority finally responsible for the selection of the Chief Executive (and whether he is a Managing Director or just a Manager) and the external auditors;

(c) Operational decisions. the authority finally responsible for approval of tariff adjustments, investments and terms and conditions of service for staff;

(d) Reporting: provisions relating to the submission of accounts and budgets.

Where the Act gives no indication of the policy on a particular issue we have inserted "N/S" for not specified. N/A means not applicable.

F3. It is immediately clear that there are significant differences between the Acts of different public enterprises. Some enterprise Boards are able to set policy themselves whilst others are required to refer any major policy change to the Minister. And in many cases the Act is completely silent on the authorisation required to enact major policy decisions. This does not seem to have arisen as a matter of deliberate policy; rather, it would appear that there has been a lack of any formal, consistent government policy on the appropriate level of control on its public enterprises. We consider briefly below the regulations in each of the broad categories.

	POLICY		APPOINTMENTS			OPERATIONAL DECISIONS			REPORTING	
ENTERPRISE/DATE OF ACT	GENERAL OBJECTIVES/POWERS	FINANCIAL POLICY	BOARDS	CEO	AUDITORS	TARIFFS	INVESTMENTS	SALARIES/ CONDITIONS	ACCOUNTS	BUDGETS
SWAZILAND ELECTRICITY BOARD (1963)	(a) ".. secure development, extension and cheapening of supplies of electricity" (b) Minister can direct Board in "public interest" No statement on financing of non-commercial services	Revenues to cover expenses incl. larger of loan repayment or depreciation Exempt from tax/dividends	Chairman and 3-5 members, appointed by Minister	Board (GM)	Board	Board	If "substantive" - Minister	Minister	AAA to Minister	N/S
SWAZILAND RAILWAY Act 15/1962	(a) ".. secure and promote efficient and adequate system of public transport . . . with due regard to economy and safety of operation" (b) " .. supply ... rail services to the fullest possible extent consistent with the resources of the Railway" No statement on non-commercial services	Revenue to cover recurrent expenditure Exempt from tax/dividends	Minister appoints Chairman (who may be CEO) and 6 members, one to represent Swazi Nation, after consultation with Ngwenyama in Libandla. Minutes to Minister	Minister (GM or MD)	Board	CEO, general Board direction	Up to E100,000 - CEO; then Board	Minister	AAA to Minister	Revenue/ Expenditure and Cap. Exp. budget to Board. Separately list and justify all projects over R12,000
ROYAL SWAZI NATIONAL AIRWAYS CORPORATION (1978)	(a) "...provide domestic and international air transport services" (b) All powers subject to approval of Minister (c) "not to do any act. . inconsistent with government policy" Council of Ministers may direct Airline to "perform certain operations of a commercially non-viable nature" Resultant losses to be "separately mentioned" in annual report.	Revenue to cover expenditure, incl. depreciation and loan redemption. Exempt from tax/dividends	Minister appoints Chairman + 3-6 members	Minister (GM)	Minister	Board	Up to E100,000 - CEO, then Board	Board	AAA to "Government" asap. Quarterly profit and loss statement to Minister and shareholders	N/S

	POLICY		APPOINTMENTS			OPERATIONAL DECISIONS			REPORTING	
ENTERPRISE/DATE OF ACT	GENERAL OBJECTIVES/POWERS	FINANCIAL POLICY	BOARDS	CEO	AUDITORS	TARIFFS	INVESTMENTS	SALARIES/ CONDITIONS	ACCOUNTS	BUDGETS
SWAZILAND TELEVISION AUTHORITY Act 1/1983	(a) Establish and operate TV broadcasting service (b) Improve and implement controls on selling and renting TVs No statement on non-commercial services	N/S Exempt from tax/dividends	Minister appoints Chairman and 3 non Civil-Servants and 4 members from Ministries responsible for TV, Education, Finance, Commerce and GM	Board (MD)	Minister	N/S	Board	Board	AAA to Minister within 6 months, then to Parliament	N/S
SWAZILAND DAIRY BOARD (Dairy Act, No.28/1968)	"... organize efficient, orderly and stable production of dairy products..." No statement on non-commercial services	N/S	Minister appoints: 2 representatives milk producers, 1 of other dairy producers 1 of dairy distributors 1 Local authority officer 3 Govt officers, 1 nominated by Min. Health 1 non-Civ. Servant to represent consumers	PS (GM)	Minister	Minister	Minister	Board	AAA to Minister Then to Parliament	N/S
NATIONAL AGRICULTURAL MARKETING BOARD (Act 13/1985)	"... facilitate... production, processing, storage, transport, distribution and sale of scheduled products" Minister to give directions of a general nature to Board No statement on non-commercial services	N/S	Minister appoints Chairman and Representative of Min. Ag, Commerce, CCU, Rep of fruit and veg. retailers, 3 farmers reps; 2 others	Board (GM)	Minister	Board	N/S	Board	AAA to Minister within 6 months Then to Parliament	N/S

	POLICY		APPOINTMENTS			OPERATIONAL DECISIONS			REPORTING	
ENTERPRISE/DATE OF ACT	GENERAL OBJECTIVES/POWERS	FINANCIAL POLICY	BOARDS	CEO	AUDITORS	TARIFFS	INVESTMENTS	SALARIES/ CONDITIONS	ACCOUNTS	BUDGETS
NATIONAL HOUSING BOARD (Bill 21/1985)	". provide affordable housing in Swaziland" No statement on non-commercial services	Income to cover expenditure Exempt from tax/dividends	Minister appoints 9 members	Minister (GM)	Board	Board	Minister and Min Finance	Board/GM	AAA to Minister within 3 months Then to Parliament	N/S
POSTS AND TELECOMMUNICATIONS CORPORATION Act 11/1983 (Not yet in force)	".. to secure the fullest development, consistent with economy, of the Undertaking" Minister may, where he considers it in public interest to do so, after consulting Board, direct corporation to provide a particular service, "so far as this is not inconsistent with (financial provision)". PTC to draw up account of cost, Govt. to reimburse	Revenue to cover expenditure, incl. profit determined by Board Exempt from tax/dividends	Minister appoints Chairman + MD + PS (Communications Min.) + PS Finance + 3 more ([illegible] Servants) for knowledge of communications, commerce, industry, finance or administration	Minister (MD)	Minister	"Major" - Minister with Min. Finance	Up to E1m-Board Then Minister with Min. Finance	Minister	AAA to Minister within 3 months Then to Parliament	N/S
WATER AND SEWERAGE BOARD (Bill-1984)	"... secure the development, extension, improvement and reduction in cost of its services" No statement on non-commercial services	N/S	Chairman to be Director. Minister to appoint 5 members - at least one public officer	Director, appointed to Public Service (MD)	Minister	Minister	N/S	Board	AAA to Minister within 3 months Then to Parliament	N/S

	POLICY		APPOINTMENTS			OPERATIONAL DECISIONS			REPORTING	
ENTERPRISE/DATE OF ACT	GENERAL OBJECTIVES/POWERS	FINANCIAL POLICY	BOARDS	CEO	AUDITORS	TARIFFS	INVESTMENTS	SALARIES/ CONDITIONS	ACCOUNTS	BUDGETS
NATIONAL INDUSTRIAL DEVELOPMENT CORPORATION OF SWAZILAND (Act 17/1971)	"... establish or conduct any undertaking" "... to the end that economic requirements of Swaziland may be met and industrial, commercial, mining and agricultural development within Swaziland may be planned, expedited and conducted on sound business principles" No statement on non-commercial investments	All applications to be dealt with on economic merits only Revenue to cover expenditure, incl. depreciation and loan redemption Exempt from tax	5-9 members. Minister to appoint 5, incl. Chairman Private s/holders to appoint rest	Minister (MD)	2 auditors 1 Minister 1 private s/h	N/A	Minister and Min. Finance	N/S	AAA to Minister "asap" Then to Parliament	N/S
SWAZILAND DEVELOPMENT AND SAVINGS BANK (KOIC 49/1973)	"Conduct business of banking.. having regard to the needs of the individual citizen of Swaziland and of Swaziland as a whole" "take... steps .... to promote economic development of Swaziland. . ensuring the maximum possible participation of the citizens of Swaziland" "assist in the development of the commerical and industrial sectors within Swaziland" "provide improved housing and health facilities in Swaziland" No statement on financing of non-commercial investments	N/S Exempt from tax/dividends	Minister appoints Chairman and PS Agriculture, DEPS, Commerce and Co-operatives; Local Administration, Industry, Mines and Tourism. One member appointed by PM on recommendation of Swazi. National Executive; 5 members appointed by Min. Finance, o/w 3 not public officers; 2 from banking, finance or commerce, 1 farmer (NB "Minister" meant Deputy Prime Minister at this time)	PM (GM)	N/S	Rate of interest- Minister	Board	Board	Annual report on "administration of funds" to Minister	N/S

	POLICY		APPOINTMENTS			OPERATIONAL DECISIONS			REPORTING	
ENTERPRISE/DATE OF ACT	GENERAL OBJECTIVES/POWERS	FINANCIAL POLICY	BOARD	CEO	AUDITORS	TARIFFS	INVESTMENTS	SALARIES/ CONDITIONS	ACCOUNTS	BUDGETS
SWAZILAND NATIONAL PROVIDENT FUND (KDIC 23/1974)	N/S	Interest payments not to exceed net income Exempt from stamp duty	Minister Appoints 10 members - 2 public officers - 2 to rep Swazi National Council - 2 to rep employers - 2 to rep employees - the CEO - 1 nominated by Min for Local Administration	Minister (MD) (Sec to Board)	Minister	Minister sets contributions, Board sets interest rate	Committee of 2PSs, 2 private members, CEO	N/S	Annual report to Minister	N/S
SWAZILAND ROYAL INSURANCE CORPORATION (KDIC 32/1973)	"provide adequate and proper insurance business of all classes... having regard only to economic considerations"	N/S	10 members, 6 appointed by Minister, including Chairman, 4 by private shareholders	Board 1 member to be MD GM to be appointed by Board	N/S	N/S	Minister	N/S	AAA to Minister Quarterly P+L to Minister	N/S

Policy

F4. All the enterprise Acts - with the notable exception of SNPF - contain a section which sets out the objects. powers and duties of the enterprise. But as can be seen from the selected passages, these are very vague statements, primarily designed to ensure that the enterprise will never run into the charge of acting outside its legal powers, so long as it is operating in the broad area of its main line of business; for instance, the Railway Act empowers SR to run road, water and air transport services. They are not firm statements of policy which management can use as a guide to taking decisions.

F5. In particular, the stipulations on financial policy are very general, normally merely requiring revenues to cover "all those costs properly chargeable to revenue account" and then often specifying "loan redemption" as such a cost, even though standard accounting practice is not to charge loan redemption against the recurrent account, since it represents a capital repayment. Only the PTC Act stipulates a certain level of profit has to be made.

F6. Most importantly, there are few cases where the possibility of a conflict between objectives is recognised i.e. the possibility that Government may wish the enterprise to carry out a policy which "develops the Undertaking" but is not "consistent with economy". Again, only the PTC Act explicitly allows for the Corporation to be re-imbursed for carrying out such policies, though the Royal Swazi legislation at least explicitly requires the Airline to mention non-commercial activities separately in the accounts. Yet the stated objectives of many other enterprises seem inevitably to lead to instances where such conflicts will arise: the Swazibank is a particularly clear case of this.

Appointments

F7. The make-up of public enterprise Boards varies greatly. They can contain from 4 (SEB) to 12 (SDSB) members. Some are civil service - dominated, others mostly comprise private-sector personnel. Some Acts stipulate knowledge in particular areas (e.g. commerce or finance) as a prerequisite of Board membership, whilst others leave this open.

F8. Similarly, there are differences in the specification of the Chief Executive post, some CEOs being Board members and hence Managing Directors (indicated by the "MD" in brackets) whilst others only attend Boards as receivers of instruction, and are thus General Managers ("GM"), having no role to play in deciding overall policy. Some CEOs are selected by the Board, but Ministers select others. The same is true of the selection of external auditors.

Operational decisions

F9. A similar situation exists with the approval of decisions on tariffs, investments and staff terms and conditions of service; there seems no apparent reason why some enterprises are required to refer these decisions to Government whilst others may act on their own authority.

F10. It will also be noted that there are several Acts which do not stipulate the procedure for approving these policy decisions at all (i.e. where "N/S" appears). These are puzzling and worrying ommissions, for they leave the enterprise with no explicit legal mandate to enact such major policy.

Reporting

F11. The most noteworthy points here are that:

(a) only Royal Swazi National Airways and the SRIC are required to submit quarterly accounts to government;
(b) only SR is legally required to submit a budget, and that is only to the Board, not direct to government.

F12. The latter is the most serious shortcoming. We recognise that in fact several enterprises do produce budgets and there is some discussion of these budgets with Government. But as as noted in Chapter III, such discussions are only on an ad hoc basis and are generally concentrated on just a few items; the lack of a legal requirement to submit a full budget is partly the cause of the failure of enterprises to implement satisfactory budgetary systems. That said, Swaziland Railway, whose Act does require a budget to be produced, has only this year produced one, for the first time in its history.

F13. This brings up the general point, that what actually happens in practice is often very different from what the Act stipulates should happen. In particular, we have noted that:

(a) several Boards do not meet as often as is required by the legislation (usually once every three months);
(b) even where the legislation authorises the Board to approve a given policy, there is often a de facto requirement to notify and discuss the matter with government. But such discussions only take place on an ad hoc basis, leading to a lack of clarity in the enterprise as to the required procedure for obtaining approval;
(c) most enterprises are tardy in the submission of accounts to the Minister, mainly because their internal accounting is so weak that the external auditors are not able to finish their audit in the time stipulated by the Act.

F14. The Act should not be seen as the sole instrument of control of public enterprises; indeed, we have stressed throughout this report the need for "control" to be exercised through the more performance-oriented tools of corporate plans and performance targets, rather than through inflexible legal regulations. But it is important that the legal regulations give a clear statement of the government policy framework, and are consistent across the public enterprise sector; or at least where there are differences, they should exist for sound reasons. With these considerations in mind, we now turn to our suggestions for new legislation to cover the major recommendations of our report.

New Legislation

F15. New legislation would be required for two purposes:-

(a) to amend the Acts of individual enterprises, to reflect the new range of policy decisions for which we recommend government approval would be necessary and to provide for review of such decisions by the Cabinet (in adherence with the principle of collective responsibility, no Committee of Cabinet should be mentioned in the legislation);
(b) to establish the Office for Public Enterprises and set out its duties and powers.

F16. We have discussed these requirements with the Attorney-General and confirmed that, in principle, one piece of legislation - a Public Enterprises (Consolidation) Act, similar to the existing Financial Institutions (Consolidation) Act - could serve both purposes. Accordingly, we have provided a draft Bill on these lines. It is, of course, only a layman's draft and should be carefully scrutinised by the Attorney - General - assisted by the Interim Co-ordinator, as discussed in Chapter VI - to ensure its legal correctness.

F17. The regulations in the Act should apply to all those enterprises listed in Schedule 1 to the Act. These are the commercially - oriented enterprises wholly or majority-owned, and controlled, by the Government, which require the degree of control and scrutiny allowed for in the Act. Those enterprises in Schedule 2 include:

(a) enterprises in which Government has a stake but not a controlling interest;
(b) the Central Bank of Swaziland, which is a controlling Authority in its own right and should not be subject to the form of controls appropriate for the other public enterprises;
(c) organizations which, whilst quasi-autonomous from Central Government and trading on their own account, are largely subvented and not commercially-oriented, and thus do not warrant the same degree of scrutiny or analysis as the Schedule 1 enterprises.
(d) organizations such as the CTA, which, whilst having substantial trading operations, are still largely within Central Government.

The Town Councils of Mbabane and Manzini have not been included in either Schedule. They are local authorities with a mandate and a method of financing very different from the public enterprises, which are the main focus of this legislation. Control and scrutiny of them, we feel, should be effected through the existing channels of budgetary and policy review.

THE PUBLIC ENTERPRISES (CONSOLIDATION) BILL, 1986

A BILL

entitled

An Act to consolidate the provisions of Acts relating to Public Enterprises, and to establish the Office for Public Enterprises.

PART I - INTRODUCTORY PROVISIONS

Short title and commencement

1. This Act may be cited as the Public Enterprises (Consolidation) Act, 1986, and shall come into force on a date to be appointed by the Minister by notice in the Gazette.

Interpretation

2. In this Act, unless the context otherwise requires -

"Director" means the Chief Officer of the Office for Public Enterprises;

"line Minister" means a Minister responsible for the conduct of a particular public enterprise;

"Minister" means the Minister responsible for the administration of this Act;

"Office" means the Office for Public Enterprise, established under Section 3 of this Act;

"public enterprise" means any organization listed in Schedule 1 to this Act.

PART II - OFFICE FOR PUBLIC ENTERPRISES

Establishment

3.(1) There is hereby established the Office for Public Enterprises, hereinafter referred to as the Office.

(2) The Office shall be a body corporate with perpetual succession and a common seal and shall be capable of suing or being sued in its corporate name, and of doing or performing all such acts as are necessary for or incidental to the carrying out of its objects and the performance of its functions under this Act.

Director and staff

4.(1) The Chief Officer of the Office shall be the Director, who shall be appointed and may be removed from office by the Minister in consultation with the Cabinet.

(2) The Director may, with the approval of the Minister, and subject to Section 9 recruit the staff he believes are necessary for the Office to fulfill its objects under this Act.

Duties of the Office

5.(1) The Office shall, through the establishment of planning, performance review and monitoring procedures, and by conducting financial, organizational and operational analyses, endeavour to improve the performance of public enterprises in achieving the objectives set for them by Government, as interpreted in Statements of Objectives, Corporate Plans, Performance Targets or other policy statements or rulings.

(2) The Director shall inform the Cabinet, through the Prime Minister, of any action by a Public Enterprise which in the Director's opinion constitutes a material breach of any such policy statement or ruling.

(3) Without derogating from the generality of the foregoing, the Office shall, with reference to those public enterprises in the First Schedule:

(a) monitor the financial affairs of all public enterprises on a regular basis and alert Government to impending problems;

(b) review budgets of public enterprises and establish performance targets;

(c) identify problems within public enterprises in producing regular accounts or budgets and assist, or arrange and co-ordinate external assistance as necessary;

(d) advise Cabinet through the Minister on financial policies towards public enterprises, in particular regarding the granting of approval of tariffs, investments and diversifications or divestments; and the making of loans, grants or subventions;

(e) advise public enterprises on financial policy, in particular pricing policy, investment appraisal; marketing strategy; corporate planning; budget preparation; financial reporting; applications or negotiations for loans or subventions; selection of auditors;

(f) advise Cabinet, through the Minister, on the composition of all public enterprise Boards;

(g) advise Cabinet, through the Minister, on the recruitment of the Chief Executive and Financial Controller of all public enterprises;

(h) advise Cabinet, through the Minister, on the terms and conditions of service for staff in public enterprises;

(i) review from time to time the organisational structure and manpower requirements of all public enterprises;

(j) examine periodically the decision-making process within each enterprise and analyse the performance of management;

(k) instigate, periodically, for each enterprise, a detailed review of its operations, performance and relations with government, and in particular:-

  (i) review the statutory instrument establishing the enterprise to ensure its adequacy as a basis for flexible control and efficient operation;

  (ii) clarify the fundamental objectives of the enterprise and draft a formal Statement of Objectives;

  (iii) clarify general and specific government policies towards the enterprise;

  (iv) develop a medium-term financial and operational plan;

(v) establish detailed performance targets;

(vi) develop staff incentive schemes based on these targets;

(l) report to Cabinet through the Minister each quarter, providing information on the past performance and future plans of each enterprise, and the impact of and prospects for the sector as a whole;

(m) report to Cabinet annually, through the Minister, on the operations of the Office and its internal development;

(n) commission external consultants as necessary to assist with any of the above issues and liaise with the consultants on all aspects.

(4) With reference to the organizations in the Second Schedule to this Act, the Office shall receive their annual audited accounts and budgets and the Minister shall cause these to be laid before Parliament.

Powers of the Director

6. The Director shall be empowered:

(a) to obtain information on a public enterprise from the external auditors of any public enterprise or from any other consultants employed on a study of a public enterprise;

(b) to request the external auditors or other external advisers to assist any public enterprise to produce information required by the Office;

(c) to advise Cabinet, through the Minister, to authorise the Auditor-General to study any enterprise;

(d) to obtain from any member of staff of an enterprise any information or explanation he may require to perform his duties;

(e) to attend all Board meetings of public enterprises in the First Schedule as a non-voting observer.

Advisory Board

7. There shall be a Board to advise the Director in the execution of his duties. The Board shall consist of:

(a) the Secretary to the Cabinet, who shall chair the meetings of the Board;

(b) the Principal Secretaries for Finance, Economic Planning and Statistics, and Commerce, Industry and Tourism;

(c) an MP or Senator, to be appointed by the Prime Minister;

(d) a Chairman or Chief Executive of a large private-sector company, to be appointed by the Prime Minister;

(e) a Chairman of one of the public enterprises, to be appointed by the Prime Minister after consultation with all the serving Chairmen.

8. The Board shall meet as often as the Director may consider necessary to discuss issues pertaining to the public enterprise sector but not less than once in each calendar quarter.

<u>Financing</u>

9.(1) The Office shall, at least six months before the end of each financial year, draw up estimates of its expenditure for the next financial year.

(2) These estimates shall be subject to approval by the Board.

(3) On approval by the Board, a request shall be made to the Ministry of Finance to finance one half of the estimated total expenditure.

(4) The remaining half shall be raised by means of a levy on all public enterprises, such that each public enterprise shall contribute to the total in proportion to the relation its total annual turnover bears to the total annual turnover of all the public enterprises together.

<u>Accounts and audit</u>

10.(1) The Office shall cause proper books of account to be kept.

(2) The accounts shall be audited by auditors appointed annually by the Board with the approval of the Minister.

(3) The Office shall, within three months of the end of the financial year, transmit to the Cabinet, through the Minister, a copy of the annual accounts duly audited.

(4) The Minister shall cause a copy of the audited accounts, and a copy of the annual report on the operations of the public enterprises, as called for in Section 5(3) (l), and a copy of the annual report of the operations of the Office, as called for in Section 5(3) (m), to be laid before Parliament.

PART III - REGULATIONS ON PUBLIC ENTERPRISE CONTROL

11. Notwithstanding any other law in force on the date of commencement of this Act, the Regulations set out in Section 12-15 below shall apply to all public enterprises listed in the First Schedule to this Act.

12.(1) Every public enterprise and every organization listed in the Second Schedule to this Act shall submit annually to the Office and the line Minister responsible, within four months of its financial year-end, a report on its operations and a copy of its annual audited accounts, including any report by the auditors on the management practices and accounting systems within the enterprise.

(2) Every public enterprise shall submit to the Office at such time during the year as the Director may determine, estimates of the profit and loss, capital expenditure, and movements in cash balances and assets and liabilities in its next financial year.

Provided that every public enterprise and every organisation listed in the Second Schedule to this Act shall submit revised estimates to the Office and to the line Minister responsible at least one month before the beginning of its financial year.

(3) The line Minister responsible shall cause the annual audited accounts and estimates of capital expenditure and profit and loss to be laid before Parliament.

(4) Every public enterprise shall submit each quarter to the Office, in such form as the Director may determine and within times specified by him, statements of the financial and operational performance of the enterprise during the quarter.

Approval of policy decisions

13. The Chief Executive Officer and the Chief Financial Officer of a public enterprise shall be nominated by the Board of the public enterprise in consultation with the Director and shall be appointed and may be dismissed by the line Minister responsible in consultation with Cabinet.

14.(1) The auditors of a public enterprise shall be nominated by the Board of the public enterprise in consultation with the Director and shall be appointed and may be dismissed by the line Minister responsible in consultation with Cabinet.

(2) Without prejudice to sub-section (1), the line Minister responsible, on the advice of the Director, and in consultation with Cabinet, may require the Auditor-General to examine and report on the accounts or any aspects of the operations of any public enterprise.

15.(1) No public enterprise shall do any of the following without the approval of the line Minister responsible in consultation with Cabinet:

(a) make any major adjustment to the level or structure of tariffs, prices, rates or other fees or charges;
(b) undertake any major investment;
(c) open any major service, branch, outlet or other facility;
(d) close, sell, liquidate or divest any major part of the business;
(e) make any major adjustment to the level or structure of staff salaries or wages, or other terms and conditions of service of staff.

Provided that a public enterprise which has lodged an application under this sub-section and has received no reply to its request within two months may undertake the action for which it was seeking approval.

(2) For the purpose of the above sub-section 15(1) Cabinet shall, on the advice of the Director, determine for each public enterprise the interpretation of "major", and shall inform each public enterprise in writing of this interpretation.

(3) Cabinet may, on the recommendation of the Director, waive its right of approval, conferred in sub-section (1) above, with respect to any particular policy decision of any particular enterprise for any given length of time, and in so doing shall provide the relevant public enterprise with a written statement to this effect.

Provided that if, in the opinion of the Director, a policy being pursued by a public enterprise is not adequate for, or not conducive to, the achievement of the objectives of the public enterprise as interpreted in the Statement of Objectives, Corporate Plans, Performance Targets or other policy statements or rulings, the Director shall submit a recommendation to the line Minister responsible, and the line Minister may, with the approval of Cabinet, determine the policy to be adopted by the public enterprise, and shall inform the enterprise that the Government accepts responsibility for the adoption of the policy, whereupon the public enterprise shall give effect to such policy.

Regulations

16. The Minister may make regulations for the better carrying out of the purposes and provisions of this Act.

SCHEDULE 1

1. SWAZILAND ELECTRICITY BOARD
2. SWAZILAND RAILWAYS
3. ROYAL SWAZI NATIONAL AIRWAYS
4. SWAZILAND TELEVISION AUTHORITY
5. SWAZILAND DAIRY BOARD
6. SWAZILAND COTTON BOARD
7. CENTRAL CO-OPERATIVE UNION
8. NATIONAL MAIZE CORPORATION
9. NATIONAL AGRICULTURAL MARKETING BOARD
10. NATIONAL HOUSING BOARD
11. POSTS AND TELECOMMUNICATIONS CORPORATION
12. WATER AND SEWERAGE BOARD
13. NIDCS/SEDCO/COMMERCIAL BOARD
14. PIGGS PEAK HOTEL
15. SWAZILAND DEVELOPMENT AND SAVINGS BANK
16. SWAZILAND NATIONAL PROVIDENT FUND
17. SWAZILAND ROYAL INSURANCE CORPORATION

SCHEDULE 2

1. CENTRAL BANK OF SWAZILAND
2. BARCLAYS BANK OF SWAZILAND
3. STANDARD BANK SWAZILAND
4. ROYAL SWAZILAND SUGAR CORPORATION
5. CENTRAL TRANSPORT ADMINISTRATION
6. UNIVERSITY OF SWAZILAND
7. SEBENTA NATIONAL INSTITUTE
8. SWAZILAND NATIONAL TRUST COMMISSION

INDICATORS OF ACCOUNTING CAPABILITY WITHIN PUBLIC ENTERPRISES

G1. Figure G1 presents some basic information on the accounts, management information and budgets produced by each enterprise. The figure sets out:

* the name of the chief financial officer (i.e Chief Accountant, Financial Controller, Finance Director etc) and whether he has a recognised full accounting qualification;

* the date of the latest set of audited accounts, and the time taken to get these accounts signed off by the auditors (NB we recommend in our main report that audited accounts should be received by OFPEN within three months, which is also a legal requirement for many enterprises);

* the format and frequency of production of management accounts;

* the format of the budget;

* general comments on accounting capability.

G2. In preparing this information we have held brief interviews with all the public enterprises and their external auditors, and we have reviewed the accounts and budgets produced. This is, of course, not meant to be a definitive analysis of accounting strengths, but merely indicative of the general state of accountancy and where the major accountancy problems are.

G3. The following observations are noteworthy; of the 13 enterprises analysed here:

* only 5 have a qualified accountant;

* only 5 produced their latest set of audited accounts within 3 months of year-end (and 8 within 6 months);

* 4 produce no management accounts;

* 3 produce no budget;

* 5 have qualified audited accounts.

G4. There are significant accounting problems in many enterprises. Four or five of the enterprises will find it extremely difficult to produce the regular financial information and budgets which OFPEN is to request. As stressed in the main report, the early identification of accounting problems and the instigation of corrective procedures is an essential first step in improving government information on the public enterprises; and no worthwhile progress can be made towards implementing the planning, budgetary and performance review procedures until the basis accounting and management information systems within the enterprises are functioning adequately. In summary, therefore, investigation of accounting weaknesses within the enterprises should be a top priority of OFPEN and a programme should be drawn up for each enterprise setting out the changes in staff or systems required to improve the situation, with an estimate of the cost thereof.

INDICATORS OF ACCOUNTING CAPABILITY IN PUBLIC ENTERPRISES

FIGURE G1

PUBLIC ENTERPRISE	CHIEF FINANCIAL OFFICER: QUALIFIED?		LATEST AUDITED ACCOUNTS	AUDITING TIME (months)	MANAGEMENT ACCOUNTS		BUDGET FORMAT	GENERAL COMMENTS
					FREQUENCY	FORMAT		
SWAZILAND ELECTRICITY BOARD	NKABINDE	Yes	31/3/85	5	Monthly	Capital exp. reports vs budget P+L, cumulative figures vs budget	P+L, capital expenditure; some background justifications	Generally sound, but weak management accounts presentation
SWAZILAND RAILWAY	MABHUZA	No	31/3/84	12	NONE		Detailed expenditure accoun.. No break-down of revenue. No assumptions stated	Serious problems. Accounts many months in arrears. Auditors have identified numerous weaknesses; strengthening urgently required
ROYAL SWAZI NATIONAL AIRWAYS	OPONYO	No	31/3/84 (31/3/85 will be 12+ months to complete)	9	Monthly	V detailed, computerised P+L, balance sheet vs budget; variance analysis. Many operational ratios also analysed	P+L balance sheet, govt funding requirement. No background justifications given	GOING CONCERN QUALIFICATION Significant accounting backlog but new staff now in post to help clear this. "Actual" figures generally far off budget.
SWAZILAND TELEVISION AUTHORITY	MCHAKI	Yes	31/3/84	15	Monthly	P+L vs budget B/S vs budget	P+L, B/S Cap exp Extensive supporting documents	Problems with computer software. Chief Accountant qualified, but no effective understudy
SWAZILAND DAIRY BOARD	TETTEY	No	31/3/85	6	NONE	-	NONE	Manual systems-slow. Lack of management info is a serious weakness. Auditors have identified several significant accounting problems.

FIGURE G1

PUBLIC ENTERPRISE	CHIEF FINANCIAL OFFICER: QUALIFIED?	LATEST ACCOUNTS	AUDITED TIME	MANAGEMENT-ACCOUNTS FREQUENCY	FORMAT	BUDGET FORMAT	GENERAL COMMENTS
SWAZILAND COTTON BOARD	JELE No (GM)	31/3/85	2	NONE		Simple income and expenditure	Very small operation. Auditors draw up final accounts. No major problems.
CENTRAL CO-OPERATIVE UNION	LINDSAY Yes	31/5/85	2	Monthly	P+L, against previous months	NONE	CEO is secondee from auditors. Chief accountant is funded by TA. Thus accounts now in good order, but no budget.
NATIONAL HOUSING BOARD (INDUSTRIAL HOUSING COMPANY)	NKAMBULE Yes (CEO)	31/3/85	3	Monthly	Main items of income and expenditure	Main items of income; detailed expenditure breakdown. Flow of funds presentation	Some improvements in management accounts presentation to be made, but generally very good
POSTS AND TELECOMMUNICATIONS DEPARTMENT	SHONGWE No (ROBINSON temp-adviser)	31/3/84	12	Monthly	Revenue + expenditure, vs last month	P+L; "liquidity" estimate. No supporting justification	QUALIFIED (fixed asset values). Serious problems, with debtors control in particular. 6 months behind on trial balance. Management accounts weak. Accounts department understaffed.
WATER AND SEWERAGE BOARD	NKAMBULE No	31/3/85	9	NONE		P+L; Capital expenditure; cash flows. No supporting documents	GOING CONCERN QUALIFICATION Serious problems; budgetary systems unreliable; significant problems with computer

PUBLIC ENTERPRISE	CHIEF FINANCIAL OFFICER: QUALIFIED?	LATEST ACCOUNTS	AUDITED TIME	MANAGEMENT ACCOUNTS		BUDGET FORMAT	GENERAL COMMENTS
				FREQUENCY	FORMAT		
SWAZILAND DEVELOPMENT AND SAVINGS BANK	MTHANDE No	31/3/85	3	Monthly	P+L, B/S, by branch	P+L, B/S by branch. No supporting documents	GOING CONCERN QUALIFICATION Several significant problems. Management accounts of unreliable accuracy
SWAZILAND NATIONAL PROVIDENT FUND	REEVE-SMITH/ Yes/ MUCHACHE Yes	30/6/85	3	Monthly	P+L vs budget Cash flow	P+L, revised after 6 months	Generally good
SWAZILAND ROYAL INSURANCE CORPORATION	PAUL No	31/3/84	4	Quarterly	Very detailed P+L, B/S	NONE	QUALIFIED (Agents + brokers balances) Despite above, generally good. Excellent management accounts. No budget.

QUARTERLY MONITORING FORMS

H1 There are four forms to be sent to all public enterprises for quarterly submissions:-

(a) Balance Sheet;
(b) Profit and Loss (including two annexes);
(c) Cash Flow (with attachments);
(d) Capital Expenditure.

A fifth, relating to detailed performance indicators, will be added later (see main text).

H2 Ideally, the corporation should fill the forms in themselves. At the very least, they should supply all the information necessary for OFPEN to complete the forms.

H3 A general comment should be made. Whilst these forms are not complex, it must be recognised that in the early days of OFPEN's monitoring efforts, there will inevitably be mistakes, omissions and misunderstandings. There is need for both OFPEN and the enterprises to learn over time. Specifically, OFPEN must agree with each enterprise the format of that enterprise's quarterly returns; clearly, the format used should be as close as possible to the format shown here, in order to facilitate analysis and consolidation. But some enterprises - perhaps in particular the financial institutions - will have to make modifications. The important thing is to ensure that OFPEN receives, in a format it understands and can work with, all the information necessary for it adequately to analyse the enterprise's performance.

Balance Sheet

H4 A balance sheet should be produced for the end of each quarterly period, and on the form the balance sheet at the beginning and end of each quarter should be shown. Thus, for the quarter July - September, for instance, the balance sheets of 30th June and 30th September should be presented.

H5 During the budgetary process, a balance sheet forecast for the end of the year will have been produced by the corporation. If the results of the year to date are significantly different from expected, the year-end forecast should be revised accordingly and these <u>revised</u> figures entered in the final column.

<u>Profit and Loss Schedule</u>

H6 There are three forms for the profit and loss account. The first is a summary sheet, showing the major items leading to the derivation of net profit. For each item the following should be shown:-

(a) the present quarter's figures, compared to original budget;
(b) the year-to-date figure, compared to original budget;
(c) the forecast for the year as a whole. If actual figures have corresponded closely to budget, this may still be the original budget figure. But if substantial deviations from budget have occurred, this should be reflected in a revised year-end forecast

H7 The layout of the form is fairly standard, though it is recognised that some companies may define "Trading" "Operating" "Gross" and "Net " profit in slightly different ways. Nevertheless a standard is needed to assist consolidation across public enterprises. It is not necessary for each enterprise to conform to this terminology, but they must provide sufficient information, for instance, on the split between direct and indirect costs, for OFPEN to compile these forms.

H8 Other differences between companies will also occur. Some that might be expected are:-

Line 1: <u>Turnover</u>: this should be income from the main business of the corporation i.e. sales of its products or services. It should not include such things as interest on bank balances or profits on sales of fixed assets, both of which should appear in sundry income (line 6). But for the Swazibank, for instance, the major source of income <u>is</u> interest, and in its case this would be included in line 1.

Line 2: Cost of Sales: this will only be a relevant category for manufacturing or commercial companies e.g. CCU or National Maize Corporation.

Line 4: Direct Costs: these are costs incurred in the actual production of goods and services. By implication, on a strict definition, these costs should be directly proportional to the level of output, and should be zero when no output is being produced. In practice, the line between direct and indirect costs is blurred, but a broad distinction should be drawn In particular, care should be given to the division of labour costs between the two categories. Direct labour costs are those incurred on staff who are directly responsible for producing incremental output. Indirect labour costs are incurred regardless of the level of output, i.e. generally on staff in managerial or administrative posts.

Line 6: Sundry Income: this should include all income not shown as revenue, e.g. interest or profits on fixed asset sales, and, in particular, any current grants or subventions received,

Line 7: Indirect Costs: this includes all overhead costs (including "indirect labour" e g. management staff), and sundry expenditure e.g. bad debt provisions.

Line 13: Extraordinary Items: in quoting [illegible]ual figures, such items (e.g. losses on foreign exchange etc) should of course be taken "above the line" and included in the final calculation of net profit. But, in most cases, a more relevant figure for inter-enterprise or time series comparisons is net profit before extraordinary items.

ANNEX 1 - REVENUE

H9 Total turnover should be broken down into its major constituent items i.e. the revenue from each major product or service (for some corporations, there may only be one or two items of course). An arbitrary cut-off point of 10% of total revenue has been suggested as a guideline for which items should be separately shown. When necessary, further detail can be requested from the enterprise.

H10 For each item, the same format should be used as for the summary profit and loss schedule: the current quarter's figures, and the year to date figures should be shown against original budget with variances. A revised year-end forecast should be made each quarter to reflect any significant deviations from original budget that have occurred or are now expected.

H11 Where such significant deviations have arisen ("significant" is here defined as 10% in either direction) the reason for such variances must be fully explained. The variance might arise from genuinely unforseeable events - a major customer going bankrupt - or because of poor initial budgeting; it is thus not necessarily a reflection on management's performance over the quarter.

H12 Finally, to assist with preparation of the "Borrowing Requirement" from (see below), information is needed on the cash implications of revenue items e.g profit on sale of fixed assets is an item of income, included under "sundry income", but does not fully reflect the cash movement, being the difference between cash proceeds and book value. Thus all items which have been included in revenue which do not involve the movement of cash (or do not fully reflect such movement) should be separately identified.

ANNEX 2 - EXPENDITURE

H13 A similar breakdown and explanation of variances should be obtained, for both direct and indirect costs. Labour costs - both direct and indirect - must be separately identified. Again, non-cash items charged against the profit and loss account should be separately identified to assist with the preparation of the "Borrowing Requirement" form (see below).

Cash Flow Forecast

H14 For Government purposes, this is perhaps the most crucial monitoring tool, for it highlights the need for Government or other external assistance in the way of deficit financing.

H15 The format of the cash-flow schedule is accordingly geared to highlighting the excess of the cash deficit over available overdraft facilities. It requires reporting on three months past - i.e. the three months of the quarter just finished, - and forecasting forward for a year. It is thus a rolling forecast, and should be completely revised - or at least re-checked - every quarter.

H16 The individual items in the forecast are largely self-explanatory. Operating receipts, sundry receipts and loans and grants are separately identified under "inflows". Sundry receipts should include proceeds from asset sales, and a separate note should be attached on the size of such proceeds Under the "loans and grants" item, it should be stressed that only definitely-agreed sources of funds should be included in the forecast, not hoped-for, but unconfirmed, Government subventions. (An attachment should list separately each loan or grant received showing the total amount of the loan and the terms and conditions attached to it).

H17 Under "outflows", operating expenses, capital expenditure, debt repayments and overdraft interest are separately identified. The capital expenditure figures should be compatible with the figures on the capital expenditure schedule (see below). The debt repayment figures should be cash liabilities payable by the corporation; they will thus naturally exclude interest capitalisation, or loans which have been taken over by Government (i e where a definite agreement to that effect has been received)

H18 Again, however, as for "loans received", an attachment should separately identify each loan repayment making up this total figure. For each loan should be detailed: total original loan; terms (interest rate, repayment period, grace); total outstanding capital at the start of the period shown; redemption and interest in the three months to date; forecast redemption and interest over the period of the forecast (by month); and the projected total outstanding at the end of the period. Where capitalisation of interest or Government take-over of loans has occurred, this should be reflected on both the "loans received" attachment, as a new loan, and on the "loans paid" attachment as imputed payment of the interest or the loan respectively. Thus, in cash flow terms, the two transactions are seen to balance out, but the attachment makes clear what has actually happened, and correctly picks up the effective loan from the contractor or Government to the corporation.

H19 "Interest on overdraft" should be calculated wherever line 16 (the closing bank balance) is negative, up to the overdraft limit. If that limit is exceeded, the interest implications will be uncertain (since the source of balancing finance will be uncertain), and attention should be drawn to this fact.

H20 Wherever an "excess" exists - that is, when the forecast closing bank balance deficit exceeds the overdraft facility <u>at any time</u> - the corporation must be required to put forward suggestions as to how the excess can be financed; for instance, by temporarily delaying some payments or, for more fundamental crises, by loan rescheduling or new grants/loans. The cash-flow implications of each of the suggested strategies must be worked through. These calculations will form the basis for the detailed discussions/negotiations which must necessarily be held with Government whenever such a situation threatens to arise.

<u>Capital Expenditure</u>

H21 The capital expenditure form is required to keep a check on the progress of large project expenditures. Such large projects (say, over E100,000) should be separately listed on the form, and for each should be shown, the total project cost and the amount spent up to the beginning of the present quarter; the amount spent in this quarter, compared to the budget; the physical progress to date, against timetable; and the forecast (revised from the original budget if necessary) of the total year's expenditure. The source of financing for each project should also be shown, as should the available finance remaining for the project from that sources.

Summary Schedules

H22 In addition to the four reporting forms referred to above, there are two summary schedules which OFPEN should complete, drawing on information from all of the four reporting forms. These are the forms showing the "Borrowing Requirement" calculation, and a form for macro-economic indicators.

"Borrowing Requirement" (GFS - Compatible format)

H23 This form is broadly comparable to a "Source and Application of Funds" statement, but different in important ways. Most notably, all borrowing is shown "below the line", as financing of a deficit. (The deficit arises from three areas. operations, working capital movements and capital expenditure). The "balancing item" is thus the sum of internally and externally generated funds. whereas in the usual source and application statement, movements in working capital and liquid funds form is the balancing item. The form is designed to assist the Government in gauging the overall public sector borrowing requirement and hence its total impact on the economy It is thus most useful when it is used to consolidate results (or forecasts) across all public enterprises.*

H24 The derivation of each of the line items is as follows:-

Line 1 - Revenue - from Profit and Loss schedule, Line 1; "sundry income" (P & L, Line 6) should also be included here.

Line 2 - Expenditure - from P & L: Line 2 ("cost of sales") plus line 4 plus line 7.

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* Non-financial institutions only, thus excluding SDSB, and SNPF. The banking function of these enterprises renders meaningless the concept of a borrowing requirement.

Line 2a - Labour costs - from P & L schedule annex 2.

Line 3 - Gross profit - Line 1 minus line 2 = P & L, Line 8.

Line 4 - Depreciation - from P & L, Line 9.

Line 5 - Interest - from P & L, Line 11.

Line 6 - Net Profit = Line 3 minus Line 4 minus Line 5 = P&L, Line 12.

Line 7 - Increase in stocks - from Balance Sheet schedule, Line 3a.

Line 8 - Increase in debtors - from B/S, Line 3b.

Line 9 - Increase in creditors - from B/S, line 4a.

(NB. any "special" current asset/liability category can be assimilated into one of the above three for the purpose of this form e.g. "accrued interest payable" will be included in creditors etc But movements in the current portion of long-term loans should <u>not</u> be included here).

Line 10 - Increase in net current assets = line 7 plus line 8 less line 9.

Line 11 - Net profit = line 6.

Line 12 - Depreciation and other non-cash items = line 4, <u>plus</u> other net non-cash <u>debits</u> in the P&L account (as detailed in the annexes to the P&L schedule)

Line 13 - Cash from operations = line 11 plus line 12

Line 14 - Increase in net current assets = line 10.

Line 15 - Capital expenditure - from the "Total" row of the capital expenditure schedule (or the capital expenditure row of the cash flow); less capital receipts (e.g. proceeds from fixed asset sales) as found from line 2 of the cash flow).

Line 16 - Borrowing requirement = line 14 plus line 15 minus line 13.

Line 17 - Financing = line 16 = line 18 plus line 23.

Line 18 - Internal funds - from cash flow lines 15/16. (NB. financing is from "internal funds" so long as the bank balance remains in surplus, but from "domestic borrowing" to the extent of any overdraft that arises).

Line 19 - Overseas gross borrowing - from cash flow, line 3 and loan schedule.

Line 20 - Overseas repayment - from cash flow, line 9 and loan schedule.

Line 21 - Domestic gross borrowing - from cash flow lines 3 and 16, and loan schedule.

Line 22 - Domestic repayment - from cash flow, line 9, and loan schedule.

Line 23 - Net borrowing = line 19 plus line 21 less line 20 less line 22.

4.25 Each of these items can be calculated for the current quarter, and forecast for the year as a whole, so long as all the relevant information is provided by the public enterprises.

H26 This presentation of the Borrowing Requirement is on an "adjusted accruals" basis, starting with the profit and loss account, adjusting for non-cash items, and adding in other cash movements. It is more revealing than a simple cash basis, because it shows the full derivation of the borrowing requirement. However, if total compatibility with the Government's cash-based accounts is desired the lines 1 - 14 of the form could be replaced with two lines:-

(a) "Cash operating receipts" - lines 1 and 2 of the cash-flow form;
(b) "Cash operating expenses" - line 7 of the cash flow.

Line b minus line a, plus capital expenditure net of capital proceeds (i.e. line 15 of the GFS form shown here) will then equal the Borrowing Requirement.

H27 Clearly this is also a quicker and simpler presentation of the Borrowing Requirement. It is the more appropriate format where information is sparse, for instance, when calculating the Public Enterprise Borrowing Requirement (PEBR) for the purpose of the Budget Outlook Paper (see below).

H28 In consolidating the different enterprises' returns to calculate the PEBR, "below the line", i.e financing, transactions between enterprises must be netted off And similarly, to calculate the PSBR, loans between government and the enterprises must be netted off.

Macro-Economic Indicators

H29 This form generates information on the public enterprise sector for use by National Accounts statisticians, and for general macro-economic analysis Again, the most useful information is obtained when the information is consolidated across all public enterprises.

H30 Gross fixed investment is simply total capital expenditure, as derived from the Capital Expenditure Schedule

H31 Value added, or the contribution of the public enterprises to Gross Domestic Product, is the sum of gross profit (i.e. before depreciation of interest, line 8 of the P&L schedule) and compensation of employees, i.e. labour costs, line 2a of the GFS "borrowing requirement" schedule.

H32 The financial surplus of an enterprise is the difference between its savings and its investment. Saving is net profit (P&L line 12) plus depreciation (P&L, line 9). Investment is capital expenditure (as above) plus the increase in stocks (from the Balance Sheet, line 3a).

H33 The "borrowing requirement" as calculated in the GFS schedule above, is then derivable as the financial surplus less net trade credit and other accruals adjustments. These are defined as the increase in debtors less the increase in creditors (i.e. line 8 of the GFS schedule less line 9), plus adjustment for non-cash items in the P&L (as identified for line 12 of the GFS statement i.e. net debits are added back).

H34 It should be noted that:-

(a) this "borrowing requirement" is a national accounts concept and not as relevant or important to an individual corporation as the bottom line of the cash-flow forecast, which highlights the unfunded borrowing requirement. This is, clearly, the crucial figure to watch for ongoing monitoring purposes;

(b) strictly speaking, for national accounts purposes, net profit, the financial surplus and the borrowing requirement should be shown net of stock appreciation (i.e. net of the effect of price rises on the value of stocks). The effect, even for the public enterprise sector as a whole, will be minimal. National accounts statisticians will continue to obtain information separately for their detailed purposes; this form is intended to serve merely as a useful, early indication of trends.

H35 The final four consolidations are not macro-economic indicators as such, but they do give an interesting overview of the size and impact of the public enterprise sector. The figure on total government advances, for instance, is clearly particularly relevant in the budget discussions, in giving government an overall picture of the demands in its resources from the sector. There are, however, difficulties in producing forecasts of such figures. At present, the Central Government Borrowing Requirement for the coming year is forecast in the Budget Outlook paper in June/July. By this time, however, no enterprise will even have produced its initial cash-flow budget for the coming financial year. In time, however, rudimentary estimates of enterprise borrowing could be produced by OFPEN, based on its knowledge of likely trends and the company's present performance (and, eventually, on projections incorporated in the medium-run corporate plan). These estimates would be revised and improved from September with the submission of the enterprises' own cash-flow forecasts.

BALANCE SHEET

	Start of Period	End of Period	Change Over Period	Year-end Forecast
EMPLOYMENT OF CAPITAL				
1. FIXED ASSETS				
2. LOANS AND INVESTMENTS				
3. CURRENT ASSETS	____	____	____	____
3a Stocks				
3b Debtors				
3c Bank balances				
3d Other				
4. CURRENT LIABILITIES	____	____	____	____
4a Creditors				
4b Overdraft				
4c Loans, Current portion				
4d Other				
5=3-4 NET CURRENT ASSETS	____	____	____	____
TOTAL EMPLOYMENT OF CAPITAL (=1+2+5)	====	====	====	====
CAPITAL EMPLOYED				
6. SHARE CAPITAL				
7. RESERVES				
8. LONG TERM LOANS				
TOTAL CAPITAL EMPLOYED (=6+7+8)	====	====	====	====

PROFIT AND LOSS SCHEDULE

		Current (E'000)	Budget (E'000)	Var. (%)	YTD (E'000)	Budget (E'000)	Var. (%)	Forecast for Year (E'000)
1.	Turnover							
2.	Cost of Sales (if applicable)							
1-2=3.	Trading profit							
4.	Direct costs							
3-4-5.	Operating profit							
6.	Sundry income							
7.	Indirect costs (overheads)							
5+6-7=8.	Gross profit							
9.	Depreciation							
8-9=10.	Net profit before interest							
11.	Interest							
10-11=12.	Net profit							
(13).	(Extraordinary items)							

PROFIT AND LOSS SCHEDULE ANNEX I

REVENUE

(All items constituting more than 10% of total revenue, and non-cash items, to be separately identified)

Item	Current	Budget	Var	YTD	Budget	Var	Forecast for Year
A							
B							
C							
D							
Other							
TOTAL							

Notes: Reasons for variance (where greater than 10% from budget. Non-cash items need not be included.)

1) ....
2) ....
3) ....

PROFIT AND LOSS SCHEDULE

ANNEX 2

DIRECT COSTS

(All items constituting more than 10% total expenditure to be separately identified).

Item	Current	Budget	Var.	YTD	Budget	Var.	Forecast for Year
Direct Labour							
B							
C							
D							
Other							
TOTAL							

INDIRECT COSTS (Include separately items more than 10% of total; and all non-cash items)

Item	Current	Budget	Var	YTD	Budget	Var	Forecast for Year
Indirect Labour							
B							
C							
D							
Other							
TOTAL							

Notes: Reasons for variance (Non-cash items need not be included).

1) ....
2) ....
3) ......

<u>CASH FLOW FORECAST</u>

	Actual M-2	Actual M-1	Current Month(M)	Forecast M+1	M+2	M+3	M+4	M+5	M+6	-----	M+11	M+12
<u>INFLOWS</u>												
1. Cash operating receipts												
2. Sundries (incl. interest/divs)												
3. Loans/grants												
4. <u>TOTAL INFLOWS</u> (=1+2+3)	====	====	====	====	====	====	====	====	====	====	====	====
<u>OUTFLOWS</u>												
Operating												
5. Payroll												
6. Other operating												
7. <u>Total operating</u> (=5+6)												
8. <u>Capital expenditure</u>												
Debt repayment												
9. Amortisation												
10. Interest												
11. <u>Total debt</u> (=9+10)												
12. <u>Interest on overdraft</u>												
13. <u>TOTAL OUTFLOWS</u> (=7+8+11+12)	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
14. Net flow (=4-13)												
15. Opening bank balance												
16. Closing bank balance (=15+14)												
17. Overdraft facility												
18. EXCESS (=16-17)	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

CAPITAL EXPENDITURE

Project	Total Expected Cost	Expenditure To Date	- This Period -		Forecast Total Year Expenditure	FINANCING	
			Expenditure/ Physical Progress	Budget/ Timetable		Source	Remaining Finance
A							
B							
C							
D							
TOTAL	----	----	----	----	----		

PE BORROWING REQUIREMENT - GFS COMPATIBLE FORMAT

		Current	Forecast for Year
A:	PROFIT/LOSS		
1	Revenue		
2	Expenditure		
(2a)	(o/w: Labour costs)		
3	Gross Profit (=1-2)		
4	Depreciation		
5	Interest		
6	NET PROFIT (=3-4-5)	____	____
B:	WORKING CAPITAL		
7	Increase in: Stock		
8	Debtors		
9	Creditors		
10	NET CURRENT ASSETS (=7+8-9)	____	____
C:	CASH FLOW		
11=6	Net Profit		
12	Depreciation/non-cash		
13	Cash from operations (=11+12)	____	____
14=10	Increase in Net Current Assets		
15	Capital Expenditure		
16	BORROWING REQUIREMENT (=14+15-13)	====	====
17=16	FINANCING (18+23)	====	====
18	Internal funds		
19	Overseas gross borrowing		
20	Overseas repayment		
21	Domestic gross borrowing		
22	Domestic repayment		
23	Net borrowing (=19+21-20-22)	____	____

MACRO-ECONOMIC INDICATORS

			Current	Forecast for Year
	GROSS FIXED INVESTMENT			
2.	VALUE ADDED			
	a.	Gross Profit		
	b.	Labour costs		
	a+b	VALUE ADDED	____	____
3.	FINANCIAL SURPLUS/DEFICIT			
	a.	Net Profit		
	b.	Depreciation		
	c=a+b	Savings	____	____
	d.	Capital expenditure		
	e.	Increase in stocks		
	f=c-d-e	FINANCIAL SURPLUS	____	____
	g.	Net trade credit etc		
	h=f-g	BORROWING REQUIREMENT	____	____
4.	PROFIT/LOSS			
		Revenue		
		Direct Costs		
		Indirect Costs		
		Depreciation		
		Interest		
		Net Profit	____	____
5.	ASSETS/LIABILITIES			
		Fixed Assets		
		Investments/Loans		
		Current Assets		
		Current Liabilities		
		Share Capital and Reserves		
		Long-term Loans		
6.	TOTAL GOVERNMENT ADVANCES			
		Long-term loans (Capital projects)		
		Subventions (Specific Services)		
		Cash-flow support (Deficit-financing)		
		Total	____	____
7.	TOTAL STAFF EMPLOYED			

FINANCING

1. The total annual running costs of the Office, with all posts locally funded, could be approximately as follows:-

		E	
(a)	Director (up to)	50 000	
(b)	4 technically-qualified staff (B.Com + 5 years experience)	60 000	(@ 15 000 each)
(c)	1 Administrative Officer	10 000	
(d)	Messenger, Driver, Secretary etc	15 000	
(e)	Office expenses (rent, bills, etc)	25 000	
(f)	Annual charge on capital items (e.g. computer, car)	25 000	
		185 000	

2. Technical assistance

We have contacted several potential donors with regard to funding the post of Director. These are:-

* USAID
* EEC
* British High Commission (ODA)
* UNDP
* CIDA

The most positive responses were from USAID - which is, of course, the sponsor of the present study - and the EEC, which has a flexible programme especially for technical assistance; an interest was expressed in funding such a post.

In addition, there are a number of potential sources of funding for the more junior staff of the unit, at least two of which we feel initially should be expatriate staff on technical assistance.

3. Mechanism for funding the residual cost

The remaining costs will, of course, have to be locally funded. We recommend that 50% of the cost is met by government subvention and 50% is raised by means of a levy on the public enterprises, with individual payments proportional to the turnover of each enterprise.

PUBLIC ENTERPRISE CONTROL IN OTHER COUNTRIES

K1. There are a variety of different models used for controlling public enterprises around the world. In this appendix we discuss briefly some of the main models.

K2. In Malawi, control of all public enterprises is vested in the President, an extremely powerful figure. Day-to-day supervision and analysis is effected through the Department of Statutory Bodies (DSB), a department in the President's office, headed by a PS (presently an expatriate on TA) who reports to the Secretary to the President and Cabinet. All major policy decisions - tariffs, investments, salaries, recruitment and promotion in senior grades - are channelled through DSB. The line ministries' only remaining role - they were at one time responsible for such decisions - is to assist DSB in the technical issues of public enterprise operations and to co-ordinate enterprise investment plans with national development policy in their sector. DSB has so far been primarily concerned with monitoring and control, with policy advice to the enterprises generally being on an ad hoc basis during crises. Corporate planning procedures are, however, to be introduced, and steps in this direction have already been taken with selected enterprises.

K3. In The Gambia, formal control of all public enterprises is vested in line ministers, but a central body, the National Investment Board (NIB), has been set up to supervise and report on public enterprise performance. The NIB is a Statutory Body, with its own Act, under the President's office. Its Board, the Chairman of which is also the Chief Executive, consists of PSs of the key ministries. To date, the NIB's role has been effectively restricted to monitoring, its policy advice generally being disregarded by government and the enterprises alike since it was given no "teeth" to implement its recommendations. But an expanded role is now being prepared for it, as the administrator of Performance Contracts to be drawn up between government and each enterprise. This will involve the NIB as the prime technical advisor to a Cabinet Committee, which serves as the policy-making body.

K4. In Kenya, control of public enterprises is also nominally vested in the line ministries. But effective control is in the hands of the Cabinet as a whole and in particular the President, since the policy formulating body is the Parastatals Advisory Committee (PAC), which is in the Office of the President, and reports directly to the President via the Chief Secretary. The PAC consists of the main Principal Secretaries and a number of external business leaders. It is in turn served by a technical unit in the Office of the President, the Inspectorate of Statutory Boards, which performs all the technical monitoring and analysis of enterprises, and has a quasi-audit role. The Inspector is a member of the PAC.

K5. In India, the Bureau of Public Enterprises (BPE) is a part of the Ministry of Finance. It gathers information on public enterprises, reviews their performance, gives technical assistance to managers, appraises investment proposals, gives training and assists in developing training programmes, helps recruit and select managers, and sets guidelines for wage agreements and standards for various aspects of production. In conjunction with the line ministries it has developed performance targets with the CEO's of the enterprises, with accompanying action plans

K6 In Zambia, public enterprises are under a holding company, the Zambian Industrial and Mining Corporation (Zimco) which is the umbrella organisation for all the Government's holdings in those sectors. Zimco's Chairman is the President of Zambia It has been highly interventionist, setting salary, pricing and other policies for its subsidiaries, but is now delegating more decision-making power to the subsidiaries as part of a large restructuring exercise

K7. These are just five examples of countries using a central agency to effect control over public enterprises Some countries have no such central agency and a "hands off" approach (e g. the UK); and others control their enterprises through direct ministerial involvement in Board decisions (e.g. Ethiopia). There are, indeed, almost as many "models" as there are countries.

K8. In those countries favouring a central agency, however, two clear types of model are revealed by the brief summary given above: the separate Statutory Body-cum-holding company, and the government department in a central ministry, usually the President's or Prime Minister's office. The former arrangement has generally been the more flexible and the more sympathetic toward the commercial needs of the enterprises; but the latter holds the advantage of tighter control, over both the enterprises and the organisation itself.

Appendix L

PERSONS CONTACTED DURING THE ASSIGNMENT

I GOVERNMENT

MINISTRY OF FINANCE

Honourable B.S. Dlamini	Minister
Mr. K. Mbuli	Principal Secretary
Mr. G. Dlamini	Auditor-General
Mr. D. Mavimbela	Under Secretary
Mrs. D. Kingsley	Under Secretary
Mr. P. Stratford	Systems Adviser (Treasury)
Mr. T. Vilane	Assistant Secretary
Mrs. D. Dlamini	Assistant Secretary
Ms. T. van der Willigen	Assistant Secretary

DEPARTMENT OF ECONOMIC PLANNING AND STATISTICS

Mr. E. Sikhondze	Principal Secretary
Mr. D. Lukhele	Government Statistician
Mrs. I. Hlope	National Accounts Statistician

MINISTRY OF WORKS AND COMMUNICATION

Mr. G. Dlamini	Acting Principal Secretary
Mr. M. Hill	Financial Controller

MINISTRY OF COMMERCE, INDUSTRY AND TOURISM

Mr. C. Mkhonza	Principal Secretary
Mr. J. Walters	Senior Assistant Planning Officer

MINISTRY OF LAND UTILISATION, ENERGY AND NATURAL RESOURCES

Mr. A. Maseko	Under Secretary
Ms. D. Mavimbela	Assistant Secretary

MINISTRY OF AGRICULTURE

Mr. F. Buckham	Deputy Principal Secretary
Mr. R. Thwale	Under Secretary

MINISTRY OF INTERIOR

Mr. V. Dlamini	Principal Secretary
Mr. K. Owusu-Tieku	Planning Officer

MINISTRY OF LABOUR AND PUBLIC SERVICE

Mr. S. Ceko	Senior Management Services Officer

MINISTRY OF JUSTICE

Mr. D. Makanza	Attorney-General

II PUBLIC ENTERPRISES

SWAZILAND ELECTRICITY BOARD

Mr. H. Nkambule	General Manager

SWAZILAND TELEVISION AUTHORITY

Mr. D. Dlamini	Managing Director
Mr. L. Harfoot	Chief Engineer
Mr. A. Mchaki	Chief Accountant
Mr. W. Rudd	Sales Representative

SWAZILAND RAILWAY

Mr. G. Coates	Chief Executive Officer
Mr. I. Delport	Commercial Director
Mr. E. Mabuza	Finance Director
Mr. A. Simelane	Assistant Commercial Director
Mr. T. Nzima	Assistant Finance Director

ROYAL SWAZI NATIONAL AIRWAYS CORPORATION

Mr. D. Langeler	Chief Executive
Mr. W. Oponyo	Financial Accountant
Mr. M. Mcdonagh	Commercial Manager
Mr. A. Nxumalo	Assistant Commercial Manager

POSTS AND TELECOMMUNICATIONS DEPARTMENT

Mr. N. Manana	Deputy Director
Mr. G. Robinson	Finance Director
Mr. E. Shongwe	Assistant Finance Director

SWAZILAND DEVELOPMENT AND SAVINGS BANK

Mr. T. Deguefe	General Manager
Mr. J. Dlamini	Deputy General Manager
Mr. P. Doyle	Economist

INDUSTRIAL HOUSING COMPANY

Mr. D. Nkambule	General Manager

SWAZILAND DAIRY BOARD

Dr. A. Khoza	Managing Director
Dr. R. Twana	Deputy Managing Director

SWAZILAND NATIONAL PROVIDENT FUND

Mr. N. Shabangu	General Manager
Mr. J. Reeve-Smith	Chief Accountant
Mr. M. Machuche	Chief Accountant (Supernumerary)

NATIONAL MAIZE CORPORATION

Mr. J. Masson	Managing Director

SWAZILAND ROYAL INSURANCE CORPORATION

Mr. M. Mkwanazi	General Manager

NATIONAL INDUSTRIAL DEVELOPMENT CORPORATION

Mr. M. Matsebula	Acting General Manager

WATER AND SEWERAGE BOARD

Mr. D. Nkambule	Financial Controller

SWAZILAND COTTON BOARD

Mr. P. Jele	Chief Executive

CENTRAL CO-OPERATIVE UNION

Mr. W. Mhlanga	Acting Chief Executive
Mr. P. Lindsay	Acting Financial Controller

CENTRAL BANK OF SWAZILAND

Mr. H. Oliver	Governor

UNIVERSITY OF SWAZILAND

Dr. M. Matsebula	Dean. Faculty of Social Sciences

III OTHER

Mr. I. Hodgkinson	Consultant

AUDITORS

Mr. F. Lule	Akintola Williams
Mr. D. Bembridge	Aiken & Carter
Mr. J. Anderson	Coopers & Lybrand

AID AGENCIES

Mr. R. Huesmann	Director, USAID
Mr. H. Johnson	Deputy Director, USAID
Mr. N. Cohen	Regional Economist, USAID
Mr. J. Mayle	British High Commission
Mr. P. Metcalf	UNDP
Ms. I. Mathias	Canadian Embassy