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TECHNICAL ASSISTANCE TO THE SOUTH AFRICAN DEPARTMENT OF PUBLIC ENTERPRISES — PHASE 2

CLOSEOUT REPORT

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It was prepared by Emerging Markets Group, Ltd.

EMERGING
MARKETS
GROUP

TECHNICAL ASSISTANCE TO THE SOUTH AFRICAN DEPARTMENT OF PUBLIC ENTERPRISES — PHASE 2

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ACRONYMS

ACSA	Airports Company of South Africa
BEE	Black Economic Empowerment
COP	Chief of Party
CDIE	Center for Development of Information Exchange
COSATU	Congress of South African Trade Unions
CTO	Contractor's Technical Officer
DCT	Durban Container Terminal
DPE	South Africa Department of Public Enterprises
EMG	Emerging Markets Group, Ltd., formerly known as Deloitte Touche Tohmatsu Emerging Markets Ltd.
ESKOM	Electricity Supply Company of South Africa
ESP	Employee Stock Ownership Plan
DFID	(U.K.) Department for International Development
GOSA	Government of South Africa
GGI	Gillian Gamsy International
HDI	Historically disadvantaged individuals
HDP	Historically disadvantaged population
IPO	Initial Public Offering
IQC	Indefinite Quantity Contract (USAID contract instrument)
JSE	Johannesburg Stock Exchange
LOE	Level of Effort
NPA	National Port Authority
NYSE	New York Stock Exchange
PFMA	Public Financial Management Act
PSP	Private Sector Participation
SAPO	South African Port Operations
SEP	Strategic Equity Partnership
SEGIR	Support for Economic Growth and Institutional Reform
SOE	State-Owned Enterprises
SOW	Scope of Work
TRANSNET	Transportation Sector SOE Holding Company
USAID	U.S. Agency for International Development
USG	U.S. Government

I. INTRODUCTION

This report documents the activities undertaken, outputs produced, results achieved and lessons learned during the second phase of USAID assistance to the South African Department of Public Enterprises (DPE). Deloitte Touche Tohmatsu Emerging Markets Ltd. served as prime contractor for USAID assistance to DPE under two task orders of the SEGIR I Privatization Indefinite Quantity Contract, but the project was staffed differently in each phase. Phase 1 had been led by the Pretoria branch of Deloitte & Touche South Africa whereas Phase 2 was led by a U.S. Chief of Party assigned out of the Washington D.C. headquarters of Emerging Markets Group.

Phase 1 of the program had run from January 2000 through March 31, 2002, the objectives of which were to establish the policy framework for State Owned Enterprise transformation and bring the benefits of SOE restructuring to the South African population. With the help of Deloitte & Touche, the Department completed its first official statement of policy in August 2000, the "Policy Framework for the Accelerated Restructuring of State Owned Enterprises." This white paper set out the objectives and guiding principles for the restructuring of state-owned enterprises and, right from the outset, defined "restructuring" to be different from privatization. Restructuring was interpreted to mean that SOEs would be altered so as to make them operate in a more commercial manner and this could include divestiture as one of many available methodologies. Restructuring was to involve the separation of existing enterprises into components so government could withdraw from the sphere of commercial enterprise. It was to support Government's broader economic objectives like reducing the state debt and attracting foreign direct investment. Thus, some business units were to be preserved in the public domain while others were to be divested or opened to partial private equity participation. There was an emphasis on restructuring the "big four" SOEs during Phase 1, including Telkom, Eskom, Transnet and Denel.

Phase 2, the subject of the present closeout report, began on April 1, 2002 and ran through October 10, 2005. The defining characteristic of the second phase was a fundamental shift of policy away from the premise that government should withdraw from the enterprise sector. The shift was initially revealed through actions rather than policy statements but culminated in the publishing of a new DPE Strategic Plan and policy statement in mid 2005. The new Plan articulates the vision that SOEs should play a leadership role in the economy to achieve strategic public objectives where purely private sector participation would compromise these goals "given the private enterprise focus on achieving market related returns on capital."

The Phase 2 Task Order opened with a ceiling budget of $1,792,235.00 and a two year period of performance scheduled from 3/1/2002 through 3/1/2004. Due to rapid initial success on port reform, the project was extended through 10/10/2005 and the ceiling initially raised to $3,509,401. USAID/ RCSA in Botswana contributed to the higher funding level because private involvement in the port sector was expected to bring developmental benefits to the entire Southern Africa region. The U.K. Department for International Development also contributed funding, indirectly through the British Council to EMG. In the final analysis, the total cost of the project was $2,500,000 and approximately $1 million of the ceiling budget was left unfunded because the momentum for port reform was not sustained. Overall, the Phase 2 project provided 58 person months of technical assistance to the DPE. In reality, the project was highly "front loaded" and 80% of the project budget had been expended by November, 2003, half way through the life of project.

II. PROJECT OBJECTIVES AND SCOPE OF WORK

The objective of Phase 2 was to assist with the restructuring of state-owned enterprises. Efforts were to concentrate not only on the mechanics of restructuring but also on how best to achieve benefits for the South African population at large. Strong emphasis was placed on the degree of control to be exercised by the DPE in managing project resources and work plan priorities as illustrated by the following instruction in the SOW:

> "The Contractor will be responsible for the management of funding assistance granted to the Department, which shall include, but not be limited to, the supply of short and long term technical advisors, research, and training. The Department of Public Enterprises will ultimately be responsible for the management of the project."

Because of this philosophy over the division of labor between contractor and DPE, the scope of work for the project was deemed to be "illustrative". The contract SOW identified the following tasks as potential activities:

a) Assistance to the IPO office to complete the Telkom IPO

b) Assistance to the Restructuring Unit to advance the liberalization of the energy sector and the unbundling of Transnet

c) Assistance to the Alternative Service Delivery (ASD) Program

d) Assistance to the Performance Monitoring and Benchmarking Program

e) Assistance to the Communications Program

f) Workshops, Study Tours and Training.

In the end, the project did provide technical assistance in all of the above-mentioned areas though the majority of LOE was provided under tasks (a) and (b).

III. ACTIVITIES, OUTPUTS & RESULTS

The paragraphs below provide a brief narrative of the activities undertaken over the life of the project. We also identify specific project deliverables and results produced in each area of activity.

3.1. Assistance to the IPO Office to Complete the Telkom IPO

ACTIVITY DESCRIPTION

EMG provided two long term advisors to help prepare the listing of Telkom shares on the Johannesburg and New York stock exchanges. One advisor was a seasoned investment banker with Wall Street experience and the other was a public communications specialist. The former assisted the DPE to supervise Deutsche Bank and J.P. Morgan, the investment banks who advised on listing requirements at both exchanges and oversaw preparation of the offer memorandum, disclosure statements, marketing to institutional investors and pricing of the offer. The latter assisted with a nation-wide public information and communications campaign, targeted specifically at the historically disadvantaged population (HDP). A key objective of the transaction was to secure a high degree of participation by HDIs in order to deliver them the benefits from privatization and secure greater public support for SOE restructuring. A secondary objective was to raise capital for the fiscus. Both of these objectives were met.

DELIVERABLES PRODUCED

Most deliverables produced under this component were the joint work product of DPE, EMG and its investment bankers and were characterized by a high degree of confidentiality. Therefore, most are not appropriate to catalog with the Center for Development of Information Exchange (CDIE). However, significant outcomes were achieved as described below and the technical assistance team produced a post-IPO paper on lessons learned during the IPO.

"Final IPO Analysis and Summary Report: Support to the Department of Public Enterprises for the Planning and Implementation of an Initial Public Offering of Telkom S.A. Limited." Prepared by Robert O'Brien, Alan Smith and Andy Dijkerman, March 31 2003.

RESULTS ACHIEVED

Although it took longer to achieve than initially predicted, the IPO was largely successful. It certainly achieved the primary objective of distributing shares into a wider span of ownership. The listing began on March 4, 2003 on the Johannesburg Stock Exchange and concluded on March 7th with listing on the New York Stock Exchange. Upon listing, 27.7% of Telkom shares were sold of which 92.5% were purchased by institutions at R28 per share. An additional 4.4% (6,127,350 shares) went to South African individuals at R26.8 per share under the general retail offer and 3.1% (4,316,997) went to HDIs at a 20% discount to the institutional price. In total, 168 institutions purchased shares, of which 51.5% were South African institutions. Foreign investors took up 41% of the total share allocation. A most significant result was that 127,000 historically disadvantaged individuals purchased Telkom shares, thus delivering on the project's objective to achieve benefits for the South African public at large.

The results with respect to share pricing were not as encouraging. The offering prospectus, published on January 24, 2003, indicated an expected IPO price of between R33.50 and R40.90 per share. This price range was reduced to R27.30 on the night before the listing in response to apparent lack-lustre demand by domestic institutions. In our view, this "apparent" situation simply reflected a bargaining stance by South African financial institutions reflecting their effective cartel power in a financial sector largely closed to foreign competition. Naturally, however, investors and analysts greeted the lower price positively and, in the end, shares at the strike price were over-subscribed by two to one. Total proceeds of R4.2 billion were generated for government coffers.

Although we are not able to track how the extent to which the original HDI participants have retained their investment, Telkom stock has done very well since the time of listing. Chart 1 presented below illustrates that Telkom shares have appreciated by approximately 500% in the 30 months since their listing, far out-performing the S&P 500 index and an African stock index. While this may have provided a good windfall for HDI investors and created some public goodwill towards privatization, the degree of subsequent price escalation suggests that the price range identified in the prospectus would have been fair and there was effectively an opportunity loss to the government.

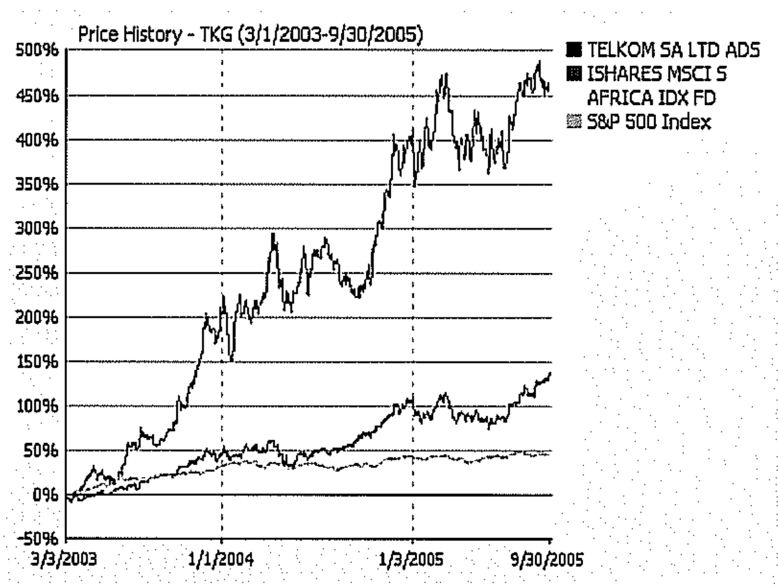

Chart 1: Price Escalation of Telkom S.A. Shares Since Listing

3.2. Assistance to the Restructuring Unit

ACTIVITY DESCRIPTION

During Phase 1, Deloitte & Touche Pretoria placed a long term advisor in the DPE to oversee the Restructuring Unit. While this was helpful to DPE at the outset, it was not an effective way to build DPE's internal capacity, and Phase 2 took a different approach of seeking task by task short term assistance to the restructuring unit.

In the illustrative task list under the contract SOW, it was envisaged that the EMG team would possibly work in the energy and transport sectors. As it turned out, DPE preferred that DFID fund a contractor to assist them in the energy sector and they requested that USAID devote its restructuring support to port sector reform. We complied with this orientation and approximately 40% of total project resources were expended on this sphere of assistance. Our interventions in port sector reform went through three phases:

1. Selection and oversight of an international subcontractor of high repute to conduct the Economic Impact and Port Asset Packaging Study (EIAPPS) and prepare a concession for Durban Container Terminal. This phase of work benefited from the joint financial sponsorship of USAID/RCSA and the UK Department for International Development.

2. Retention of South African and US advisors to review and comment on the draft National Port Authority bill with a specific focus on assessing the adequacy of the proposed regulatory framework.

3. Retention of a team of South African advisors to revisit the findings of the EIAPPS and re-cast a strategy to promote inter and intra port competition and PSP in light of revised policy favoring public sector leadership in the creation of basic economic transport infrastructure.

In many respects the work done at each stage responded to the prevailing public policy perspective with respect to private participation in the South African economy.

Phase 1. The first phase of work was cast in terms of the National Commercial Ports Policy which envisaged that South African SOEs would, over time, exit altogether from delivery of port operations services and be replaced by private operators and concessionaires. This vision took as a starting premise that the division of Transnet providing this service-- South African Port Operations (SAPO)-- would ultimately go out of business. Opposition to this premise mounted throughout the course of the study, not only by labor, but also by Transnet, National Port Authority and ultimately the DPE. By the end of 2003 it was becoming clear that many in the public sector were against the concessioning of Durban container terminal in particular. There was a belief that this would place a crown jewel and cash cow in the hands of the private sector thereby depriving Transnet of a vital source of financing for its own broad-ranging restructuring.

Phase 2. Meanwhile, the "landlord" model of public sector involvement in the port sector was being cast into the National Ports Authority legislation and this assumed that NPA would be carved out of Transnet to serve as the granter of concessions to private providers of port operations services. Because the legislation envisaged that the separation of NPA from Transnet was imminent, it was felt that NPA could serve both as landlord and regulator of private operators. While this notion had some conceptual flaws of its own, EMG observed that the interests of DPE, Transnet and NPA were beginning to diverge and it became increasingly evident that the NPA bill would be passed but NPA's separation from Transnet would not occur until far in the future. Our concern with this development was that NPA could end up exercising the role of port sector regulator while still under the authority of Transnet, effectively leading to capture of the regulator by an SOE. For this reason we agreed with DPE to initiate a second modest phase of work to review and comment on the draft NPA bill. With this study, we helped DPE articulate the need for an independent ports regulator and to advocate this position to the policy ministry, Ministry of Transport and Communications.

Phase 3. The third phase of ports reform work was undertaken in late 2004, early 2005 at the request of DPE to revisit the voluminous information generated under the EIAPPS study and re-cast it into a new strategy under revised policy assumptions. These included:

1. The new premise that the public sector is to take a lead role in supplying economic infrastructure in the transport and energy sectors;

2. National Ports Authority is to be established with landlord functions and powers but will be located in the Transnet Group until a decision is taken to remove it. For the period that NPA is located within Transnet, NPA's objective is to help the SOE rebuild the group balance sheet and facilitate integrated infrastructure investment and planning;

3. SOE involvement in port operations will not be phased out and private sector participation will be introduced in a manner that presumes a "mixed model" of collaboration between SAPO and the private sector;

4. A port regulator will be established with responsibility for economic regulation of port services as a whole.

DELIVERABLES PRODUCED

Phase 1: EIAPPS Study Deliverables:

1. **Inception Report**
2. **Concession Strategy Paper**
3. **DCT Concession Plan**
4. **Economic Impact Analysis**
5. **Transaction Strategy Report**
6. **Final Report**

Phase 2: **South Africa Ports Regulatory Review**

Phase 3: **Private Sector Participation in South African Ports**

RESULTS ACHIEVED

EIAPPS Stage. At the stage of submitting our DPE Phase 2 proposal, EMG assumed that it would fill a direct advisory role in the implementation of port reform and we had planned to do this with Nathan Associates as subcontractors. However, when DPE identified the planned scope for the EIAPPS study, they made clear their preference instead was for EMG to manage a procurement process to secure international competition from the best sources of port expertise available in the world. Moreover, it was clear that the study would be extensive and would require funding beyond what was readily available in the USAID-EMG contract. The EMG COP and USAID CTO, legal and contracts offices worked proactively and collaboratively to respond to DPE's request. DFID was requested to provide a 50% increase over USAID funding and they agreed. This was arranged through a side agreement between the British Council and EMG backed up by an MOU between DFID and USAID. Because DFID's procurement policies required un-tied aid, it was agreed that an international tender would be launched and the resulting winner would be subcontracted by EMG regardless of US Source and Origin requirements in the SEGIR 1 Privatization IQC. USAID/South Africa provided a waiver through a modification to the contract to enable EMG to carry out the EIAPPS study along these lines and the mission was pleased to engage in a bona fide collaboration with DFID in this arena. In addition, USAID/RCSA contributed funding into the Task Order to sponsor the EIAPPS on the expectation that the concessioning of Durban container terminal would provide a boost to regional trade by reducing congestion and transaction costs of freight movement.

The EIAPPS contract was awarded to CPCS Transcom Ltd. of Canada with a U.S. firm Cornell Group as concession strategy consultants and Pathani Consulting as South African BEE subcontractors. Numerous deliverables were produced under this study, all of which are identified below. The study included 6 milestones with deliverables, perhaps the most significant of which were the sector-wide concession strategy and the design of a container terminal concession for Durban. While much information was developed under the EIAPPS study and it remains relevant to DPE and its counterpart agencies today, it was a disappointment to USAID and DFID that the Durban container terminal concession transaction was never launched. While it is the prerogative of government to set and change policy, few would dispute the fact that South Africa lost some credibility with the private sector from repeatedly announcing and then retreating from the stated intention to invite private participation in Durban container operations.

NPA Bill Review Stage: The NPA bill has been amended to provide for an autonomous and independent regulator of the port sector writ large. This is a highly positive result: it will reduce the risk of regulatory "capture" by any given SOE and renders the investment climate for eventual PSP more attractive. The bill has been passed and is due to take effect towards the first quarter of 2006 when the regulations have actually been written and the regulator is able to commence operations.

Strategy Revision Stage: Our consulting team developed a new set of recommendations on how the DPE could structure and sequence a series of "mixed-model" transactions between SAPO and the private sector to secure private participation and promote competition and efficiency within the ports sector. While EMG would still have favored a first transaction that aims to de-congest DCT, it now appears that the first port sector opportunity that DPE will truly open for PSP is one related to the Eastern Cape port of Coega. The success of this effort will likely depend on the degree to which the private operator is expected to invest in quay-side infrastructure and the economic parameters of inland rail freight transport.

In a project close-out exit interview with a DPE professional involved in port sector restructuring, the view was expressed that USAID-funded assistance had been helpful in providing vital analysis and information to the Department at all stages in their decision-making even though DPE has not always chosen to implement the recommendations as formulated. In addition, they expressed satisfaction with the quality of advice that EMG provided.

3.3. Assistance to the Alternative Service Delivery (ASD) Program

Activity Description

The ASD directorate in DPE initially wanted assistance in developing procurement models that would favor participation by historically disadvantaged individuals in government procurements. EMG referred the team to a great deal of literature on this topic and through this they discovered a Canadian initiative that greatly interested them as a relevant preferential procurement model. They carried on subsequent stages of their work without further assistance.

We were subsequently asked by the Strategic Analysis division to help them research the applicability of Employee Stock Ownership Plans for SOEs in the context of the South African Companies Act and the tax regime. The rationale for this assignment was that the policy framework-- "An Accelerated Agenda Towards the Restructuring of State Owned Enterprises"-- stated that one objective of restructuring was to address imbalances in the economy through empowerment, specifically Black Economic Empowerment (BEE), by making BEE an integral element of the restructuring process. DPE had observed that employee participation in the ACSA restructuring had favored the predominantly white management. Our research confirmed that employee stock participation under the South African tax regime would likely always produce this result unless stock ownership schemes were consciously designed to produce more equitable results. Our brief was to review international best practices of ESOPs and then develop a concrete operational model capable of structuring ESOPS successfully in the South African context. Our study provided recommendations on the following design elements:

- Percentage of government shares to be divested and allocation to each employee;
- Administration and management of shares by a trust on behalf of employees;
- Pricing of shares;
- Funding e.g. credit and/or discounting of shares to ensure affordability;
- Eligibility and allocation criteria for inclusion of employees;
- The vesting period for full ownership of shares;
- Effective participation of employees in the management of an enterprise once they have shares;
- Taxation issues
- Conditions for sale of shares, including incentives favoring retention and ensuring liquidity.

DPE utilized our research to produce a white paper on ESOPs as a means to promote black employee share ownership. This was adopted by Cabinet in late 2002 and fed into Government's overall agenda for design and implementation of Empowerment Charters in the Mining sector and other sectors.

DELIVERABLES PRODUCED

"The Use of Employee Share Ownership Plans in Restructuring State-Owned Enterprises: Policy Recommendations," May 31, 2002.

RESULTS ACHIEVED

Policy endorsement and inclusion into Government-wide models of black economic empowerment which now forms an important background framework for BEE deals.

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3.4. Assistance to the Performance Monitoring and Benchmarking Program

ACTIVITY DESCRIPTION

The business plan of the Department of Public enterprises incorporated Performance Monitoring and Benchmarking. When launched, the overall aim of the PMB program was to "serve as the vehicle to manage government shareholding interests through monitoring and evaluating the financial, socioeconomic and non-financial performance of State Owned Enterprises (SOEs). In addition the Program engages in the promotion and advocacy of best performance management practices contributing to enhanced shareholder value, within an improved corporate governance environment".

Among the efforts to achieve this objective was the design and population of an SOE statistical database. During a period of high staff turnover at DPE, the maintenance of the database fell away and decisions relating to the access and outputs were not made. The activity under this task was to assist the DPE's PMB unit to integrate and link the various existing components of the monitoring 'platform' including:

- SOE database
- Investment Map
- Procurement System
- Benchmarking and Evaluation System
- Governance Protocol
- PFMA
- Treasury regulations

DELIVERABLES PRODUCED

- A reporting calendar with an annual schedule of reports due from SOEs on a periodic basis;
- Terms of Reference for upgrades to the database divided into interventions required in:
  - IT platform
  - Data entry (in-house or out-sourced)
  - Report design (MS Access)

- Software development (non-MS database or programs), and
- Training for Company Secretaries and Directors

Results Achieved

The database was reviewed and recommendations made concerning the linking of the various elements for ease of use and non-duplication of entries. Terms of reference were developed for upgrades to the database. DPE, using the services of its government IT staff, developed upgrades to the database. A training manual was developed and one training session was conducted for company Secretaries.

3.5. Assistance to the Communications Program

Activity Description

Aside from the public communications dimension of EMG support to the Telkom IPO, we secured communications assistance from two South African subcontractors to help with DPE's wider public communications program.

The first task was handled by Sasani Consulting. Their SOW was to assist the DPE with its public communications campaign in advance of the May 2002 budget speech for Fiscal Year 2003. The purpose was to address the Department's shortcomings heretofore in effectively communicating the Department's role. There was a need to explain what was meant by "restructuring", what impacts the DPE was striving to achieve for the benefit of all South Africans and to communicate the successes achieved vis-à-vis DPE's mandate. The strategy was to disseminate key messages in the manner of a political campaign so as to win the hearts and minds of the Minister's key constituents. Sasani conducted an attitude survey to help inform the crafting and targeting of key messages in this respect.

The second task was a long term contract awarded to Gillian Gamsy International to develop a comprehensive public communications program, provide time sensitive communications assistance with respect to "issues management" and assist specifically with communications vis-à-vis port sector reform.

Deliverables Produced

A multitude of internal strategy statements and public press releases were produced by EMG's communications contractors, but these are not the type of deliverable that are suitable for filing with the CDIE.

Results Achieved

The most significant results generated by the EMG communications sub-contractors were with respect to the handling of specific crises with the potential to generate significant negative press for the Department. For example, GGI helped contain the damage to DPE as an organization when allegations of bribery involving DPE's Chief Director of Restructuring arose. Though a disciplinary enquiry was opened by the Public Service Commission, GGI advised the Director General to take immediate disciplinary responses within DPE and pro-actively manage stakeholder perceptions on DPE's approach to infusing integrity in transaction management. This advice was taken and while the incident was shameful, DPE managed to portray it (correctly) as an isolated incident. They then took GGI's advice and instituted an indoctrination seminar for all DPE employees relating to ethical procurement practices.

GGI was also called upon to advise the Minister on a communication strategy and media action plan related to the COSATU anti-privatisation strike which took place in the first days of October 2002. Shortly before the strike, Cabinet decided to coordinate communications through the Government

Communication and Information Services but GGI continued to advise DPE on how to minimize negative exposure to the department during the course of the strike. In retrospect, Government messages released during and after the COSATU strike came across with a clear commitment to staying the course on SOE restructuring.

While EMG and USAID believe that the communications assistance provided to the DPE was effective and valuable in various times of need, continual turnover in the Communications division of the Department meant that it was impossible to build internal capacity for the Department to sustain their own effective PR program.

3.6. Workshops, Study Tours and Training

Activity Description

EMG sponsored the participation of a number of DPE employees at training courses and international seminars over the life of the project. These included:

- Attendance by Makhensa Mabunda of the Performance Monitoring and Benchmarking unit at the "Private Finance of Infrastructure" course provided by International Law Institute 29 April – May 12, 2002.
- Attendance by Vusi Mkhonta of the Restructuring Directorate at the "Port Planning & Management" seminar provided by ILI in fall of 2002.
- Attendance by Jabulani Mzaliya of the Strategic Analysis unit at the "Post Privatisation: Managing the Challenge" course provided by ILI from 14 to 27 July, 2002.
- Attendance by Ajay Makan, Director of Energy Restructuring team within DPE at the Africa Energy Forum on Promoting Investment in Power, Gas and Water Sectors held in London from 1 through 4 July, 2002.

We were also planning to sponsor the enrollment of Andile Nkhulu, Chief Director of Restructuring in the July 10 – August 11, 2002 Executive Development Program at WITS. However, it was discovered at the last minute that Mr. Nkhulu was relieved of his duties at DPE due to his involvement in irregularities connected with the award of the Komatiland forest concessions. We therefore declined to carry through with sponsorship. Although USAID had approved an initial non refundable deposit for course participation, the parties agreed to treat this as a sunk (unrecoverable) cost and refrain from incurring the remaining costs of participation.

EMG also prepared and sponsored a number of workshops for DPE and its stakeholder community on a number of topics. These included:

- A Director Training seminar to prepare newly appointed SOE directors for their role in corporate governance. This included a review of the roles, responsibility and accountability associated with each corporate office (Directors, Company Secretary, etc.) and a detailed introduction into the Public Finance Management Act as well as the Protocal on Corporate Governance for SOEs. This seminar was held on two occasions at which 25 participants attended, of which 10 were women. Subsequent to the Director Training interventions, our subcontractor Jeff Jackson of Privatization Group International produced a comprehensive Director's Toolkit on Compact Disc to serve as a ready reference guide for SOE directors. The project purchased 20 copies of this CD and provided it to DPE for use by its own staff and for distribution to SOE governance teams. This product is particularly tailored to the South African legal environment but also draws upon the King reports and global best practice for corporate governance.

- A stakeholder workshop on port sector reform attended by 70+ attendees from DPE, Transnet, National Port Authority, South African Port Operations and a multitude of private sector transport sector companies. Topics included World Trends and Best Practices in Port Reform as well as Political Perspectives on Effecting Reform in the Transport Sector.
- A change management workshop with 50+ members of management from the South African Port Operations SOE to prepare them for the eventual introduction of private participation in container terminal operations in Durban.

DELIVERABLES PRODUCED

SOE Director Training Slides—Power Point format.

RESULTS ACHIEVED

A minimum of 160 South Africans participated in training and workshop events sponsored by the project.

IV. LESSONS LEARNED

In this chapter we reflect on the insights EMG has gained from involvement in this project. In some instances these can be characterized as lessons learned, but in others they are lessons "yet to learn" though that depends on one's perspective. It is best, therefore, to portray our lessons as insights that help interpret legitimate differences in perspective held by the three main participants in the project—DPE, USAID and EMG. These are described for the purpose of stimulating further dialogue and reflection by our two clients—USG donor and DPE implementing partner-- with the intent of enriching their joint or respective programs as they move forward.

Project "Success" is Best Achieved when Defined the Same Way by All Parties. Like all long term development projects, the "Support to DPE" projects (including phases 1 and 2) involved three-way collaboration between Emerging Markets Group as contractor and two sponsoring clients—USAID as funding partner (including both USAID/SA and USAID/RCSA) and DPE as implementing partner. From our perspective, a contractor is best able to meet or exceed the expectations of its clients when both sponsors share the same vision of project. In this instance, the two project sponsors' objectives began to diverge over the life of the project for reasons discussed below and this makes it difficult to declare the project a success on all fronts. Who's definition of success would be applied? Certainly all parties can congratulate themselves on the results of our collaboration on the Telkom IPO. Yet, EMG's involvement in the port sector offers a different example. At project outset, all three participants would have viewed the selection of a private concessionaire for Durban container terminal as a successful outcome. At project completion, the parties see things differently. USAID is disappointed that the DCT transaction was never launched and congestion in the Durban port remains a severe impediment to trade. DPE is pleased that they did not push SAPO out of the business and deprive Transnet of an important cash cow to finance its own restructuring. EMG believes that a private operator in DCT could have generated concession income for Transnet and demonstrated that investment capital for heavy infrastructure can successfully emanate from the private sector.

In the final analysis, however, it must be noted that USAID and EMG stuck to the collaboration principles laid out in the SOW: we managed project funding and resources, but left DPE to manage the direction of the project. The unwavering commitment to this process, for its own merits, deserves recognition: it is testimony to USAID's earnest desire to be a partner in support of a South African-led development agenda. It is EMG's hope that USAID and DPE take the opportunity to reflect on the fruit of their long term collaboration in the SOE sector. There is no doubt that joint commitment to economic transformation is inherently complex and continued dialogue is the best means of enriching a vision shared in a development partnership. When Phase 2 began there was a shared vision between DPE and USAID, but as elections approached fear mounted that labor might not adequately support the ANC, the commitment of the Minister and the Government of South Africa to its prior vision of reform dissipated. The agreement on objectives established through numerous meetings between USAID and DPE over the first few years changed due to politics. Thus, USAID might wish to draw from this experience the conclusion that it is essential to make restructuring changes early in an administration and not close to elections.

Political Realities Steer Public Policy. Over the span of USAID's collaboration with DPE, GOSA policies regarding private participation in the economy changed. The first Support to DPE project began in the context of a clear vision for national economic transformation whereby the GOSA aimed to foster private sector led economic growth. In this context, there was a declared intent to shrink the public sector footprint in the enterprise sector. The Office of Public Enterprises was elevated to departmental status, DPE was given the specific mandate to accelerate SOE restructuring and private investment was viewed in a positive light. Broadly speaking, the private sector was expected to rapidly generate growth, create jobs (that would off-set those lost from SOE restructuring) and expand national wealth. But this was a very tall order—one that was difficult to fill at sufficient speed. The fact is that private sector growth was not generating jobs at the rate required, particularly among the HD population, so the pendulum of public policy swung to a more palatable political vision where job creation through government investment became paramount. By the end of the project, emphasis had shifted to favoring job creation and preservation through public sector investment in key economic infrastructure and there is now greater emphasis on wealth redistribution over generation. In this context the vision for SOE participation in the economy changed substantially. DPE has now made it clear that SOEs are expected to play a leadership role in the economy to undertake investments that achieve strategic public objectives. This orientation is very much a reflection of South Africa's present-day political economy and outside the sphere of influence of a contractor or donor partner.

Consequently, the question that arises for the funding agent is whether the returns from project investments have been worthwhile and whether a re-direction of project activity could have had a greater effect. For instance, we have been asked to consider whether a switch to working on divestiture of non-core SOE assets and away from port sector reform might have resulted in more completed transactions. We think not. DPE is fully capable of executing non-core transactions, both in terms of mobilizing domestic consulting and finance expertise and tapping resources to compensate them. In our view, the correct shift in the circumstances was one that we did take. As opposition to the DCT transaction began to mount and vested interests became more apparent, it was clear to EMG that it was imperative to avoid a legislative outcome in the draft NPA bill whereby the port sector regulatory function was captured by an SOE with conflicting interests. We therefore went to work at helping DPE articulate the potential problems and exercising their advocacy role with the policy ministry. It was a stretch beyond the original SOW to venture into the legislative arena, but our ability to assist in this domain was attributable to the collaboration principles in effect and the quality of our relationship with key drivers in DPE. Ironically, this was one of the best results of EMG's work in the port sector, though it consumed the least amount of project resources. That, however, is not an unusual phenomenon when promoting change.

Finally, the implementation of economic policy change almost always produces some winners and some losers and resistance from the latter constituency can and should be expected. For that reason, the need for public outreach to convince the public of the need for change is a vital function, not a luxury. With respect to SOE restructuring, our observation is that DPE and the Government writ large communicated to the public when there was an emergency, but not in the regular course of events. It should remain a priority of DPE to build and nurture its capacity for proactive communications about SOE transformation, even in the context of its revised policy.

Bringing Down the Costs of Doing Business in South Africa. All participants in the project clearly understand that modern transport infrastructure is vital to trade, both within South Africa and the region, and that increased trade will contribute to regional economic growth. As noted earlier, DPE's new vision is that SOEs should play a leadership role in making strategic investments in transport infrastructure, including the movement of freight via rail and the handling of cargo through ports. The rationale is that purely private sector participation in these functions could compromise the state's strategic goals "given the private enterprise focus on achieving market related returns on capital." While we understand this perspective, we do not agree with it. The embedded assumptions behind this rationale are two-fold: (1) that public enterprises reliably deliver the same degree of efficiency as private enterprise, and (2) that the public sector can afford to forego market returns to capital, thereby delivering the same output to the public at lower total cost. We would challenge both assumptions. A good body of empirical evidence exists from around the globe to indicate that efficiency is the hallmark of private enterprise and the public sector has rarely been able to achieve the same standards. Moreover, the best efficiencies are achieved when both operations and investment emanate from private sources and "white elephant" capital projects are more frequently spawned in the public sector than private enterprise. Investment capital should always be treated as a scarce commodity. While it is indeed the prerogative of government to allocate capital at lower returns to sectors deemed to be most "strategic", this shifts responsibility for capital rationing into the realm of political rationale and away from market discipline. Furthermore, the South African public would benefit from greater competition in the economy at large and this is also applicable to the SOE sector. At present, there is not sufficient regulatory capacity in the country to ensure rational competitive behavior by SOE giants and the State Enterprise sector writ large would greatly benefit from greater contestability whether by regulators or by competition. In our view, the costs of doing business in South Africa would be reduced lower, more quickly and with sustained pressure for efficiency through a strategy of robust private participation in strategic infrastructure.

Lessons Regarding Donor coordination. The EIAPPS port sector study offered an excellent laboratory in which to enhance donor collaboration. Surprisingly, there were a number of bureaucratic and procedural hurdles that had to be overcome in order for USAID and DFID to carry out their intent to co-fund the latter study. For example, USAID had to capitulate and waive their source and origin requirements vis-a-vis sub-contractors carrying out the study. DFID had to make the case that they could live with USAID's competition process which had already resulted in the selection of EMG as supervising contractor. With these conditions in place it was still impossible for USAID to accept a direct contribution from DFID due to prohibitions on co-mingling of USG funds with other external sources. Inasmuch, EMG assumed some risk and offered itself as the vessel into which DFID funding would be placed, but this only occurred after we had concluded a contract for services with the selected sub-consultants. In short, there was a need for solid commitment to collaboration between all parties and a determined attitude to surmount all possible bureaucratic obstacles was required. It is testimony to the high quality relationship between USAID and DFID in South Africa that this outcome was achieved. Once the EMG Chief of Party and the Technical Officers from each donor had established a shared objective, we were all grateful to have Contracting Officers in both organizations willing to focus on the development objectives and permit those to prevail over normal constraints and procedures. We recommend that mission management of USAID/South Africa replicate this constructive experiment in other projects and programs in their portfolio.

At a later stage in the project, there was a degree of overlap between the USAID and DFID projects supporting DPE insofar as the DFID contractor provided negotiation assistance to the unions with respect to concessioning out operations of Durban Container Terminal. Our only regret at this overlap was that there was a resulting imbalance of emphasis placed on giving voice to this stakeholder group affected by port privatization, when an equivalent amount should have gone to promoting the private sector as a critical stakeholder favoring de-congestion of Durban container terminal.

Greenfield PPPs are Likely to be a More Successful Form of Private Participation in South Africa. We have been asked to comment on whether PPPs are a more successful means of promoting private sector participation in the economy as compared to restructuring approaches that include divestiture or selection of strategic equity partners. Our insight on this topic is that the likelihood of success correlates more with whether the project is a start-up versus a going concern than it does with approach to packaging the transaction. Concessions are a classic form of PPP, for example, but they have had dismal uptake so far for the management of legacy infrastructure such as ports or rail services. In contrast, PPPs involving the creation of new infrastructure from scratch (such as the DTI building or the Gautrain project) generate less resistance and are therefore more palatable to those who are their champions. Our observation is that unions have a strong voice in South Africa and they are quick to resist any type of transaction where a public sector employer is predominantly replaced by a private one. This perspective is often shared by politicians, civil servants and SOE management and explains why the vast majority of "restructuring" transactions planned or executed to date provided for a minority ownership stake by the private sector. The reasoning seems to be that minority strategic equity partnerships (SEPs) achieve the best of both worlds: jobs and pension rights are preserved, but company modernization and industry competition are promoted. The down-side of this approach is that minority private stakes can lead to anemic participation by the private sector where, due to a lack of control, they minimize investment risk and maximize short term rewards from operational efficiency. This can lead to a self-fulfilling prophecy about a risk-avoiding, self-interested private sector.

In conclusion, we believe that start-up PPPs offer a stark contrast to going-concern PPPs (leases and concessions) as well as the SEP approach to SOE restructuring. Not only are they more palatable to the public and therefore politicians, they offer the prospect of better demonstrating the efficiency gains that can result when a private partner assumes risk and participates in both investment and operating decisions. This is most likely to be the case where a PPPs sponsors the creation of a new enterprise or generates new employment that did not exist before.

Factors Favoring Successful PPPs. Following on from the insight above, we believe that USAID can make a substantial contribution to South Africa by continuing to support private investment in South African infrastructure projects. In that context, we offer the following observations about factors that have a material impact on transaction success. Firstly, there is need for a more inclusive approach to stakeholder outreach and inclusion. To date, most transactions in South Africa have included media campaigns designed to appeal to those who might be a source of resistance, ie. unions, SOE employees and the like. It would help a project gain and maintain momentum if the private sector were also viewed as an explicit stakeholder group and their views were given voice during the promotion stages of a transaction. EMG attempted to do this with GGI when preparing the DCT concession. On behalf of DPE, we prepared a letter to 500 private sector business leaders in the transport sector identifying the goals, objectives and processes proposed for port sector privatization. That letter was never sent and in our view that was an unfortunate missed opportunity. Secondly, it is critical to have host country project champions throughout the life of the project, preferably one with a high degree of political clout and another within the civil service who is the operational driver of a given transaction and the master of its details. The difference between a poor vs. successful transaction is embedded in the details. Once a project gains political traction, it is important to move it along at the highest speed possible, without compromising attention to detail. Speed will demonstrate public commitment to a project, avoid second-guessing in the political sphere and heighten the interest and investment appetite of the private sector.

It has been a tremendous pleasure and privilege for EMG to work on behalf of USAID and the Department of Public Enterprises to advance the agenda of SOE reform and economic growth in South Africa. We look forward to the opportunity to serve both clients again.