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DUMA GQUBULE: Restructuring the balance sheet the starting point for saving Eskom

BL PREMIUM
21 December 2018 - 07:00 Duma Gqubule

Pravin Gordhan, Minister of Public Enterprises briefs the Media. Picture: FREDDY MAVUNDA

After an hour listening to public enterprises minister Pravin Gordhan and Eskom chair Jabu Mabuza evading questions about Eskom's balance sheet and its R419bn debt at a recent media conference, Financial Mail deputy editor Sikonathi Mantshantsha hit the nail on the head.

"Jabu Mabuza told us in June that there would be a plan for this debt that you now say we should not talk about," said Mantshantsha. "He gave us a deadline of September. Let us now just admit that there is no plan. We are bumbling along from day to day. We do not know how to fix this organisation."

Mabuza replied that there was a plan. But there had been delays in Eskom's processes to procure the services of two international companies — Lazard and Boston Consulting Group (BCG), which will advise on the balance sheet and the organisational design respectively — to "stress test and validate our own hypotheses".

On Friday, in response to public outrage in the wake of the latest round of nationwide load shedding, President Cyril

Ramaphosa decided to kick the can down the road. He announced another task team with an unrealistic timeframe to develop yet another plan to fix Eskom. Lest we forget, in December 2014, after the previous episode of load shedding, the government established a "technical-team war room" headed by Ramaphosa to implement a five-point plan to fix Eskom. In 2011, former president Jacob Zuma established a presidential review committee on state-owned companies (SOCs), which presented a report to cabinet in 2013. In 2014 Zuma appointed Ramaphosa to head an inter-ministerial committee on SOCs that would oversee the implementation of the review committee's 21-point plan. In August 2016, cabinet announced the establishment of a presidential SOC co-ordinating council.

The Eskom sustainability task team includes members who have different ideologies. They include Frans Baleni, a veteran trade unionist, and Mick Davis, the CEO of British Prime Minister Theresa May's Conservative Party. "They will probably deadlock, like we did," a former member of the war room says. The task team has no legal standing and undermines the role of the board. If Lazard and BCG are already checking the board's work, why is there a need for another odd appendage to also review the board's strategy? More important, Eskom is a macroeconomic policy issue. The government must make critical political decisions about economic policy that neither the board nor any task team can make.

But we must first understand how we got into this mess. It has little to do with the midnight contracts the previous board awarded to Tegeta, the Gupta company. During the decade from 2009 to 2018 Eskom spent R537.5bn on its capital investment programme. This was equivalent to an average of 43% of the company's revenues of R1.2-trillion over the same period. The capital investment accounted for an average of 1.6% of GDP between 2009 and 2018. The economy grew by 1.6% a year over the same period.

A report by Trade and Industry Policy Strategies economist Neva Makgetla says Eskom's capital expenditure rose to a high of 11% of gross fixed capital formation in 2010 and then fell back to 7% in 2016. "At the start of the century, Eskom accounted for 1.5% of SA's total fixed capital. By 2016, the figure had risen to over 5%." Therefore, a decision to decommission power stations and implement deep cuts in capital spending to trade back to financial health would have an impact on the growth of the economy, the public debt to GDP ratio and employment.

The 2008 Budget Review said the construction of the Medupi (R85.6bn) and Kusile (R84.8bn) power stations would cost R170bn. Two years later the document said the project would cost R266.4bn. Between 2009 and 2017 Eskom invested R200bn into the two power stations. This was equivalent to 41% of Eskom's total capital spending over the same period. The remaining cost to completion is about R93bn, according to a report by Meridian Economics. Although there have been numerous accounts of waste and corruption in delivering the project, cost overruns are normal in such large contracts. Eskom's other major cost driver over the past decade has included increases in primary energy (coal and renewable energy) costs.

Between 2009 and 2018, primary energy costs soared 235.6% to R85.2bn. But their share of revenues remained at about 48% as Nersa, the regulator, allowed Eskom to pass on the costs increases to consumers. Between 2009 and 2018 employee costs rose 93.4% to R29.4bn from R15.2bn as employee numbers increased 9.1% to 41,316 from 37,857. Employee costs as a percentage of revenues declined to 16.6% from 28.2%. The increase in the employee costs and the headcount does not seem excessive for an organisation whose assets soared 270% to R739.1bn over the same period.

In its 2009 annual report, former Eskom chair Bobby Godsell said: "It is not possible to fund the first major expansion of our electricity grid for several decades through revenue generated from tariffs alone. The growth of a business is normally funded by a sensible balance between owner's equity, accumulated reserves and debt. We need to mobilise greater equity resources to fund the build programme." Eskom had no reserves, since a normal company would never spend 43% of its revenues on capital investment.

Over the next decade, Eskom's average selling price of electricity increased 240.1% to 85.1c/kWh, which resulted in a 229.7% increase in revenues to R177.4bn as production declined slightly due to the price increases. However, with rising depreciation and finance costs — they increased to 26% of revenues from 9% — due to capital investment, Eskom made large losses. The company's debt soared to R419bn from about R41bn. Since 2009, the government has invested equity of R83bn in Eskom and provided guarantees of R350bn. There has been no sensible balance between owner's equity and debt.

Eskom can reduce some of its costs. It can also sell some smaller assets. But it cannot trade itself back into large profits that will make a big dent in its R419bn debt. Also, as Mabuza explained, privatisation cannot happen any time in the near future. The planned functional and legal separation of the company into distribution, transmission and generation could take years to conclude. The time has come to restructure the company's balance sheet. This must happen within the context of a restructuring of the country's balance sheet after a lost decade in terms of economic development with 9.8-million unemployed people.

There can be a large reduction of the R2.1-trillion of assets within the Public Investment Corporation. There is no need to have a fully funded pension fund for government employees. In rich countries, the majority are not fully funded. However, the Government Employees Pension Fund has an excessive level of funding for a country with such high levels of poverty, even if one accepts the need for full funding. The PIC can write off R400bn of government debt and R200bn of SOC debt, of which Eskom accounts for almost half.

The PIC and the government can also make an equity injection into Eskom. The company is too big to fail. With a further injection of funds into the economy as part of a monetary and fiscal stimulus, the resulting higher levels of economic growth would make it impossible to decommission Eskom assets.

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