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SOEs and Development in Africa: Lessons and Policy Implications

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Introduction

Why do state-owned enterprises (SOEs) matter, and what is the rationale for their role in economic development? Does ownership matter for firm performance? What are the challenges and lessons in building a vibrant SOE sector? These are strategic issues that concern policymakers and require pragmatic responses rather than dogmatic prescriptions. SOEs administer an enormous public resource, with significant economic growth and accountability implications. Over 1 000 national-level SOEs in Africa are deploying about US$ 1 trillion in assets, accounting for 5% to 35% of the GDP to national economies, and employing nearly 1.5 million people across sectors in 2020. Worldwide, the role of SOEs increased in the 2010s, particularly in emerging and developing economies, and they currently account for US$45 trillion worth of assets and 20% of the world's largest Fortune 2000 corporations. SOEs have increasingly expanded operations internationally since the 2010s.

However, the significant heterogeneity across African SOEs is shaped by historical factors, national contexts, ownership structures and firm size, sector features, and government policies. The performance of SEOs has been mixed, and empirical evidence suggests that SOEs have lower financial performance in aspects such as profitability and revenues. Nonetheless, this evidence does not acknowledge the conflicting policy goals set for SOEs and the political environment in which they operate. The mixed and inadequate performance of the SOE sector, and the limited outcomes of reforms, have brought the agenda to the forefront. In some cases, the crisis in giant SOEs in public utilities has become a

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dominant political concern. The 'state capture' report of systemic corruption in SOEs in South Africa has magnified the vulnerability of the SOEs' governance system and the risks of 'political' intervention. Hence, the necessity of SOEs in African economic transformation and the underperformance and political risks put significant pressure on governments to address this fundamental concern.

A widely held view is that SOEs are disastrous for economic development on conceptual and empirical grounds. And indeed, there are prominent examples that confirm how bad they are. However, this paper argues that, despite obvious evidence that many are awful, there are good reasons and sound evidence to support a very different argument. With a focus on the challenges and lessons of the governance of SOEs in Africa, this paper shows, first and foremost, that ownership *per se* does not tie up firmly to corporate performance as much as universally supposed. But, more than this, SOEs are at the heart of transformation and economic catch-up, as they have been in many places. This is a perspective underpinned by the developmental role of the state in accelerating capitalist development. SOEs are playing increasingly prominent roles worldwide in the early twenty-first century. Moreover, developing productive and high-performance SOEs requires a more disciplined state that promotes the constructive political conditions for the productive role of SOEs, restrains harmful political interventions, and articulates the public policy purpose of the SOEs.

Furthermore, a vibrant SOE sector necessitates enhancing the governance system – both the supervision and administration of SOEs – and developing corporate governance within each SOE that constantly evolves with the best international experience. In addition, firms' performance requires a complex and painstaking effort to build capabilities and strategies specific to the industry in an increasingly intense global competitive force. However, this undertaking is more complex than often thought, and the governance of SOEs and a disciplined state are necessary but inadequate.

SOEs and development: Empirical evidence from diverse sectors

The paper examines the performance of SOEs in diverse priority sectors, including energy, aviation, telecommunications, banking and logistics. Ethiopia and South Africa stand among African countries with a long tradition of SOEs in diverse sectors. A comparative research approach was used, supported by multiple cases. Considering the availability of data and the author's access, Ethiopia and South Africa were used as national case studies where SOEs have a legacy extending over a century. They have also gone through diverse political systems, and have been involved in multiple sectors. A few sectors were selected as case studies. The paper's methodology draws from extensive document reviews and official records of the SOEs or relevant government bodies. It also uses an observer-participant method to benefit from the author's experience. Moreover, qualitative interviews and consultations were conducted with appropriate experts and board members.

The case of South Africa's Eskom and the Ethiopian Electric Power Corporation (EEPCO) in the energy sector illustrates how the government's policy decisions could potentially affect – positively or negatively – the SOE's performance. It also shows that the energy sector is one of the most challenging sectors for most African governments, given the scale of required financial resources, the organisational and technological capability needed, the need for long-term strategies, and the transition to a carbon-neutral economy. Again, this case shows that the problem is not 'ownership', but instead the pursuit of appropriate strategy and the development of capabilities.

The story of SAA, EAL and other African carriers highlights several insights into SOEs and development. First, the cases show starkly that ownership did not remotely matter for the performance of the SOEs. Second, the cases show that understanding the industry's trends, having a long-term direction, and developing a clear national strategy are essential for a thriving SOE sector. Third, capability development and technological learning are critical to boosting dynamic and competitive SOEs. As the aviation industry shows, an economy of scale and scope are essential in a globally competitive industry. Lastly, SOEs can play a prominent role in supporting development strategies in export industries.

While the policy purpose has made an essential developmental contribution in the banking industry, the impact has been undermined by the banks' weak capitalisation and bureaucratic procedures, and the unwarranted restriction of the central bank that aggravated its foreign exchange position. There is enormous space to modernise the SOE banks and for them to play developmental roles, and the rationalisation of assets and focus is necessary. Making banks provide loans to the industry would require specialised knowledge about the sectors, as international experience shows. Examples are Brazil's Bundes Bank, Latin America's largest development bank and Netherland's Rado Bank financing the horticulture sector. The China Development Bank and the other policy banks have played a prominent role in China's transformation and economic catch-up. The Development Bank of Singapore is the world's most highly ranked bank in terms of performance and corporate governance, and is central to Singapore's international finance centre.

The five case studies provide a few insights. First, SOEs played an essential developmental role in the rise of the three industries, and the governments continue to play a dominant role despite the changing environment. Second, the performance among the SOEs has been uneven, and variations remain an essential feature of firms' performance. Third, there is no evidence that ownership matters and that private ownership is superior to public ownership. Fourth, an economy of scale and international operations are essential drivers of building competitive SOEs, and government strategies for the specifics of each sector and the SOEs continue to be necessary.

Table 1: Classification of SOEs based on characteristics

Sector	Key characteristics
Development finance (development and trade finance)	(a) This category includes policy banks such as development financing and trade financing (Exim banks), and development financing may specialise in industrial development, infrastructure development, and agriculture, as in South Africa's IDS, DBSA, and Land Bank. (b) It requires financial prudence, ensuring scale, a balanced portfolio, high ratings, and sustainable financing. (c) Requires an industrial policy targeting and selecting growth sectors, a specific bank policy for each industry, and involves targeted subsidy and performance requirements developed with the responsible government agencies (d) The involvement of the bank's representative in the management of firms may be relevant, depending on the specific industry and national context. (e) Carbon neutrality and ensuring environmental and social safeguards are complied with.

	(f) Close coordination with central banks, the Ministry of Finance and focal policy agencies, and placing development banks under a single government agency is helpful. (g) Best examples that can be emulated include the Development Bank of Singapore (DBS), the Brazilian Development Bank (BNDES), and the China Development Bank (CDB).
Utilities, infrastructure, logistics	(a) Managing multiple stakeholders becomes critical, and interacting with dense provincial and local governments, individual customers – firms and households – becomes vital. (b) Equity and inclusiveness become critical drivers in settling prices and ensuring profitability and maximum cost recovery. (c) Large workforce and decentralised service delivery. (d) The need for extensive capital investment for expanding infrastructure, and upgrading and protecting infrastructure. (e) Ensuring environmental sustainability in infrastructure development and operation. (f) Managing conflicts between commercial goals, policy goals and inclusiveness is a constant challenge.
Manufacturing and technology	(a) Economies of scale, scope and international competitiveness are essential drivers. (b) Productive and technological capability are of paramount importance. (c) The increasing requirement to invest in innovation and research. (d) Organisation along sectoral specialisation and diversification in relation to related industries, and business partnerships with international companies are critical. (e) Industrial policy outcomes and long-term competitiveness override short-term profitability.

Developmental mission and productive politics

The paper explores the lessons from the continent by providing multiple case studies drawn from several industries. First, the review shows that SOEs can play a strategic role in a country's development strategy and industrial policy. However, this demands building a thriving SOE sector and requires painstaking effort and a strategic approach. In South Africa and Ethiopia, many SOEs play such a role. In situations where this is not the case, such as the energy sector or Eskom, the price for failing to develop a productive and competitive firm is enormous. But there is no substitute, and 'privatisation' or 'independent power providers' is not an answer. Second, the paper shows that the governance of SOEs – both governing the SOE sector and corporate governance at the firm level – is critical. SOEs must respect legislation and practices; failing to improve governance can paralyse their performance. Third, effective SOEs surpass the government's political commitment and industrial policy. For firms to be competitive, significant investment should be made in organisational, operational, and technological capabilities, in line with industry trends.

Furthermore, through multiple cases, the paper shows that heterogeneity and diversity among SOEs are significantly influenced by issues related to the national context, sectoral features, the developmental and political nature of governments, and legacy issues. Mixed outcomes and unevenness are critical features of SOEs' performance. While many SOEs are in deep crisis, entailing formidable development challenges and political risks, there are also many that not only operate profitably, but also excel like private firms. The ownership structure is neither the primary nor the sole driver of performance, and a strategic direction should look beyond ownership or privatisation. However, heterogeneity and unevenness can be a source of learning – policy learning for government and technological learning for firms. International experience and best practices are a source of learning when purposeful and targeted.

The policy and commercial goals can complement each other and help ensure virtuous growth . The key lesson is that without a *disciplined* developmental state, no SOE can emerge as a 'national champion' or 'national leader'. SOEs must receive 'intermediate assets', but the reciprocity principle should be strictly and consistently pursued to ensure that internationally competitive, productive SOEs are developed. This is possible, but is not a necessary outcome. As a policy direction, the government must focus on a few strategic SOEs that can play a catalytic role in the broader economy and set an example, rather than have a more significant number of SOEs that are not productive.

The government should enact a legislative framework that reflects the complexity of the SOE sector and international practices of administering and coordinating the SOE sector. Three crucial levers should be considered: ensuring developmental goals and public policies are achieved effectively, providing public assets and resources must generate maximum returns and value, and internationally applicable management systems and requirements must be benchmarked and implemented. Maximising the achievement and delivery of this system is not a one-time task, but rather an ongoing process that involves learning and research.

Why SOEs matter, and the imperative for SOEs

SOEs are broadly defined as companies wholly or partly owned and controlled by the government, with policy goals but operating under the country's commercial law. SOEs are distinct from non-commercial government entities such as agencies or statutory boards. Two marked features of SOEs are that they are owned by the state and constituted as commercial entities per the country's commercial or corporate law. Empirical evidence suggests that African SOEs have the potential (prospect) to drive transformation and economic catch-up, playing specific roles to serve the state's development strategy. The extent and type of role evolves with the level of economic development and diverges across sectors and the particular context – the capacity of the private sector and political landscape favouring public investment. The roles of SOEs can be classified into four categories: stimulating investment, managing natural resources and a nation's wealth, providing monopoly utility services like water and electricity, and building innovation and technological capability.

Table 2: Roles of SOEs in economic development

Purpose	Strategic roles
Inducing investment	SOEs play a role as industrial policy instruments to generate investment through two channels. The first is making a direct investment for demonstration effect or filling a gap in industrial capacity as a primary mechanism, and ownership may gradually change to private hands. A second channel is providing development finance to industrial actors to stimulate investment in key priority sectors or firms aligning with the government's industrial policy. This is done through development financing to priority sectors. Development banks have been considered flagships of developmental states and conduits of subsidised loans for industrialists. Governments build these SOEs as 'national champions' (or global champions) operating within domestic and international markets.

Natural resources	Governments establish SOEs to administer natural resources (such as mining resources and gas and oil) as national sovereign wealth as instated in the country's constitution and to maximise the commercial return of the asset. Examples are Morocco's OCP, the Saudi ORAMCO and Norway's Statoil.
Natural monopolies, public utilities	Governments apply SOEs to cope with the complexity of dealing with natural monopolies such as electricity transformation and distribution networks, where competition and market laws are constrained. Power utilities and public transport are examples. In most cases, consumer bills are closely regulated by governments.
Stimulating innovation and technological capability	Governments may also establish SOEs to stimulate innovations in frontier technologies in which scientific breakthrough is required, and socialising risks and managing uncertainty are vital. The forms may be diverse, depending on the scope and direction of technological, such as space technology, the defence industry, and new chip technologies.

Lessons on the governance of SOEs

A productive SOE sector necessitates designing, implementing and continuously improving the governance system, which has two dimensions – governing the SOE sector, which focuses on the bridge between government and the SOEs, and corporate governance within SOEs, which is essential for firms' high performance. In several African countries, governments apply different governance approaches with limited effectiveness. Eskom is a notable example of how governance systems can further aggravate crises rather than help in their turnaround strategy, leading to the creation of fertile conditions for corruption. International experience in the governance of the SOE sector shows that many governments have moved toward the decentralised governance of SOEs under various government ministries for centralised management through specialised agencies. The decentralised governance allows various ministries to administer SOEs in terms of their sectoral nature. This was a dominant feature in many African countries until the 1990s. Ministries are compelled to combine regulatory and SOE responsibility, which does not allow them to ensure that SOEs deliver policy missions and commercial goals. It also undermines the quality of regulating the sector.

In the African context, there is enormous scope for improving the corporate governance of SOEs, and the following recommendations are acknowledged as improving governance and performance positively. The corporate governance within SOEs affects firm performance and ensures that the public asset effectively generates wealth and is utilised for its intended purposes. The effective corporate governance of SOEs has to underpin the national legislation, such as commercial or tax laws, to ensure that SOEs adhere to the existing rules and emerge as the best corporate citizens. Corporate governance should pursue its ultimate purpose by enabling an improvement in and maintenance of high performance. There are various international lessons to improve corporate governance, which can be a source of learning, such as the OECD's research and publications on SOEs. The focus on *corporate governance* in the internal functioning of SOEs is to ensure that their mission is achieved, the expectations of key stakeholders are met, that their performance levels are improved and a growth strategy is pursued. It also requires that SOEs continuously upgrade their management systems and adhere to the principles of transparency (and disclosure of information) and accountability. Reviews of advances in corporate governance are a critical source of emulation and indicator, and specific international industrial practices play a crucial role in corporate governance. SOEs should be obliged to strictly follow the national laws and international standards applicable to business entities as the minimum requirement, and be encouraged to adopt international corporate governance practices on a constant basis.

Governance structure

A key priority relates to the type of coordination mechanism and structure used to monitor the SOEs. In several African countries, SOEs are administered mainly by multiple ministries, to some extent linked to a past legacy. In this system, the SOE sector is fragmented under various government agencies, making it challenging to lead the sector effectively. Practically, it is less productive when SOEs are placed under the regulator ministry as a supervisory agency (the owner). There is an unavoidable conflict that cannot be resolved, which damages both the commercial and operational performance of the SOE and compromises the regulatory mandates. Governments should be able to prevent this weakness.

A logical advance is to bring SOEs under a single government body such as an agency or ministry (such as the Ministry of Public Enterprises in South Africa or the Ministry of Finance in Ethiopia). Moreover, maximum and continuous efforts should be put into identifying and improving the conflicts in the government's multiple roles as an owner (supervisory agency), regulator (competition law and sectoral regulation), and as a purchaser through public procurement methods. Nonetheless, this has to be an ongoing effort, and the conflict is not necessarily negative; what is critical is understanding the nature and underlying drivers (see Table 1, 2,3).

Table 3 Principles and practices of SOE governance framework

State ownership	Define the purpose, policy goals, prioritisation Ensure that the state is an 'informed and active owner' Ownership policy that specifies the rationale for state ownership, the government's role in the governance of SOEs, and the respective mandates of government bodies Ensure operational autonomy of SOEs and their regular review Oversight review by parliament sub-committees and cabinet
Board of directors and CEO	Provide strategic direction on behalf of the owner with the necessary authority The board must be independent, with separation of the roles of board chair and CEO, and avoidance of conflict of interest Worker representation on boards and members with diverse competence The board should not interfere with the CEO's mandate Merit-based selection and appointment of CEO One-tier board system Internal auditor (under the executive management and board) and independent external auditor
Public policy and principles	Subsidies related to policies should be financed by the state and made public Disclosure of SOE performance and assets Strict adherence to stakeholder value (shareholder, labour, creditors, community) rather than shareholder value No exemption from the application of government laws (such as tax or other standards) and access to financing

Source: Own compilation.

Firm capability, performance, and competitiveness

SOEs are commercial operators competing with other firms in their industry and in related sectors. Building highly productive and internationally competitive SOEs requires investing in strategies, operational and productive capability, technological capability, and organisational capability, prioritising economies of scale and scope. Such a process demands constant learning, internalising new capabilities and competitive assets, and understanding the changing environment. First, as the cases show, African governments and SOEs do not focus adequately on building firm capability. SOEs are, first and foremost, firms that compete in the market – not just in domestic markets, but also internationally in a constantly changing competitive landscape. Even so, the firm-level capability determines the ultimate success and performance.

The number of globally competitive SOEs is limited in the African context, and the primary lessons should be that building vibrant and productive SOEs entails, first and foremost, developing the capabilities of firms, which will require a strategy for competitive assets specific to the sector and international in scope. The 'small is beautiful' view is unlikely to work in global markets, and rationalisation and mergers are essential to operate at scale. However, the issue is not about size *per se*, but rather the failure to focus on developing organisational and technological capability. Another puzzle for SOEs operating in 'natural monopoly' industries such as utilities is that competitive forces are insufficient to drive firm performance. However, various mechanisms are available to complement their competitive intensity, including contrasting performance with the best performers in the industry globally, thereby compelling the SOE to have an international operation to use as a channel for international learning and performance comparison, and forming a strategic partnership with leading firms in the industry worldwide.

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