RESOURCE DOCUMENT: ANNEXURE B

Developing and implementing municipal electricity and energy business turnaround strategies

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1 Context and purpose

Many of South Africa's municipal trading service businesses are in trouble. The National Treasury is working with national departments, municipalities and other stakeholders to address this situation . The National Treasury's Cities Support Programme (NT CSP) has been supporting metropolitan municipalities since 2019, on request, to turnaround their water business. Several metro municipalities have also requested support on their electricity and energy business, which are also facing serious challenges.

This, plus the overall awareness of the parlous state of essential services in metros, resulted in the Metro Trading Services Reform Programme (MTSRP) being initiated, covering three trading services: water and sanitation, electricity and energy, and solid waste management.

The electricity trading business faces complex challenges characterized by poor financial and revenue management, operational inefficiencies, ageing infrastructure, vandalism, and insufficient technical (and in some cases, leadership) capacity. These challenges are further exacerbated by the changing municipal electricity business model including availability of alternative energy and subsequent decentralization, impacting the demand and energy requirements of the municipalities.

One of the core challenges is the inadequacy of current tariff structures and designs, which are often not cost reflective. This leads to a revenue shortfall which is compounded by poor billing practices and ineffective debt management, resulting in significant financial leakages. Revenues and expenditures are not ringfenced, further exacerbating underinvestment in the maintenance and expansion of the distribution network.

Thus, it is recognised that part of turning around the municipal electricity business will require significant investments in improved business practices and infrastructure. It is clear that municipalities alone will not be able to meet the investment needs to have significant impact, while failure to provide a solution to this glaring challenge may collapse the economy of the cities and the country.

To mitigate this imminent threat, national government needs to work with municipalities to develop a long-term sustainable solution to address underinvestment. With increasing pressure on the national fiscus, the traditional approach of providing more money, through increased transfers (e.g., grant funding with relaxed conditions) to fund the under-investment in trading services is not viable or desirable. Also see Annexure A.

National Treasury, together with national departments, is establishing a performance-based finance incentive requiring cities to develop and implement a turnaround strategy that sets out clear goals, with time-bound targets and includes a practical pathway to develop or secure the necessary capability to implement the strategy effectively.

The NT CSP is using a theory of change[1] which recognises that municipalities have the constitutional responsibility to provide basic services, and that it is ultimately a political decision on the part of municipalities as to how these services are provided. It is against this background that each municipality needs to develop a reform strategy that is designed to respond to its context.

[1] "Building water resilience in South Africa's cities" (National Treasury, 2022).

Change is much more likely to be successful if it is guided by a clear strategy that includes the following components:

- A clear identification of the challenges to be addressed, together with an understanding of the underlying causes of these challenges.
- Clear prioritised goals related to key outcomes, with time-bound targets so that progress can be easily tracked.
- Clear identification of solutions (*how to address the challenges*) paying attention to organisational form (structure), processes and capability (particularly managerial and technical capability).
- A process that builds a stable and strong coalition to support the changes, understanding that any significant change will inevitably meet some form of resistance.
- Draws on relevant experience and expertise to assist the process, both from South Africa and elsewhere. South Africa's challenges are not unique and experience in the provision of well managed municipal trading services is both relevant and available to support within South Africa and beyond.

This document has been developed as a resource document to support metropolitan municipalities to turnaround and improve their electricity businesses. It is based on a similar document developed to support institutional turnarounds in the metro water businesses. This resource document is not static and will be enhanced over time, based on experience and learnings implementing the reforms.

2 The case for change

Implementing significant change in an organisation is both difficult and risky. There needs to be a compelling case for change, although this is not the only criterion for initiating successful change. Key stakeholders need to understand the need for change. It is particularly important that political and administrative leadership within a municipality understands the need for change and provides the leadership required to implement a Council-approved strategy that effectively addresses the challenges.

National Treasury acknowledges that a compelling case has been made to implement trading services reforms in municipalities. In summary:

- **Financial performance is very poor**, and many cities are not able to collect the cash necessary to manage the business effectively. A turnaround in the financial performance of the business is critical to improve services.
- **Cities have been under-investing in the maintenance and rehabilitation of infrastructure over many years,** resulting in a compromised service with an ongoing decline in service outcomes.
- **Tariff structures, setting and approval** are problematic resulting in tariffs that are not cost-reflective with negative impacts on revenue.
- **Cities' trading services are not run as a business**. This has a direct impact on all aspects of the performance of the service. There is no single point of accountability for performance.

Corporate finance blames the technical department for poor performance. The technical department blames the corporate and finance functions (IT, fleet, metering, billing, debt management, procurement, HR and Customer services) for poor performance. The reasons why trading services should be run as a business are set out elsewhere in the document.

- **Most cities do not have the necessary technical capability to manage and run an effective trading services business**. Some municipalities do not have a single registered professional engineer, technologist or scientist in the employ of the service function at a senior level.
- **The electricity operation is highly inefficient** in most cities with high percentage of losses and theft, well above benchmarks for acceptable performance. This results in a massive wastage of scarce resources.
- **Procurement of essential support services is compromised**. Cities appear unable to procure the services of competent service providers in a timely way to support the performance of its functions. The compliance focus of centralised procurement processes often results in disabling interpretation of applicable legislation and regulations, leading to unacceptable delays and questionable value for money.
- **Cities suffer a lack of legitimacy and credibility** and are unable to win the trust of customers.
- **Additionally, both national and international energy markets have changed with decentralization of the energy system**. The electricity bulk purchasing regime of municipalities has fundamentally changed with the introduction of multiple generators and prosumers. This has profound implications for the business models of the municipal energy function.

Service delivery performance is negatively impacted by a combination of the above inter-related factors, where long-term underinvestment leads to declining services which result in declining cash revenues, which leads to inefficient and under-resourced municipal service providers resulting in even less funding to maintain and invest in infrastructure. Without attending to the overall management and governance of the electricity business, improvements in any of the above factors are likely to be only temporary.

3 Strategic focus areas

Based on National Treasury's engagement over the last two years with municipal trading service challenges, an effective and responsive turnaround/improvement strategy for cities should address the following key areas: (*with associated goals, indicative and illustrative*).

- **Organisational structure**

The organizational structure within which the service is delivered should be designed to effectively manage the core functions of the business—such as customer services, finances, human resources, procurement, asset management, and operations. This management structure must have a degree of autonomy, with clear accountability for performance, while operating within a framework of robust governance practices.

- **Management and technical capability**

To ensure the effective management and operation of the service, it is essential to secure the following capabilities:

- *Management Capability: Recruit or contract skilled professionals with the requisite management expertise to oversee and guide the service's operations effectively. This includes individuals with strong leadership skills, strategic planning abilities, and experience in managing core business functions.*
- *Professional Engineering and Technical Capability: Engage or contract qualified engineering and technical experts who possess the specialized knowledge and skills necessary for the technical aspects of the service.*

Human resources talent management must identify and develop a pipeline of competent employees in these critical skills areas.

- **Financial viability and performance**

This encompasses key functions such as revenue metering, billing performance, cash collection, credit control, budgeting, budget execution, and tariff management. Specific targets may include achieving 100% metering coverage, 98% monthly meter reading rate, improved cash collection rate and publishing annual financial statements for the business unit.

Effective management and sustainable revenue from electricity sales require enabling systems that are both technologically advanced and integrated with tariff mechanisms. This allows for efficient operation, better performance tracking, and dynamic tariff adjustments, enabling utilities to meet performance targets and manage the electricity business more effectively. Ring fencing of electricity accounts is a step towards cost-reflective tariffs and identifying the level of subsidisation of either the electricity service or the rates account.

- **Customer service, responsiveness, and communications**

A key principle is recognizing that the service exists to meet customer needs, which can be demonstrated through a fully operational customer call centre, ensuring for example that 80% of calls are answered within 60 seconds (to be progressively improved), and setting clear standards for resolving different types of customer queries. These actions promote responsiveness, efficiency, and accountability in service delivery.

- **Technical performance metrics**

The CAIDI[2], SAIFI[3], and SAIDI[4] measure service reliability and interruption durations. These metrics, along with consumption and demand growth, network management, and asset maintenance, are used to ensure effective and efficient operations, including infrastructure upkeep, replacement, and expansion. For example:

- *Technical and non-technical losses x%*
- *Investment in network replacement (1 to 2% of network, annually)*

[2] CAIDI — customer average interruption duration index, which is the average duration that a customer is without power when affected by an interruption to supply

[3] SAIFI — system average interruption frequency index, which represents the average number of interruptions that a customer experiences each year

[4] SAIDI — system average interruption duration index, which is the average duration that customers are without power each year

- *Investment in network expansion to accommodate growing demand*
- *Technical systems and technologies to remotely monitor, control, and optimize the network (i.e. Supervisory Control and Data Acquisition (SCADA) and related technologies)*
- *Demand side management, anti-theft technologies and accurate metering systems*
- *Renewable energy /embedded generation integration*

(Also see Annexure B).

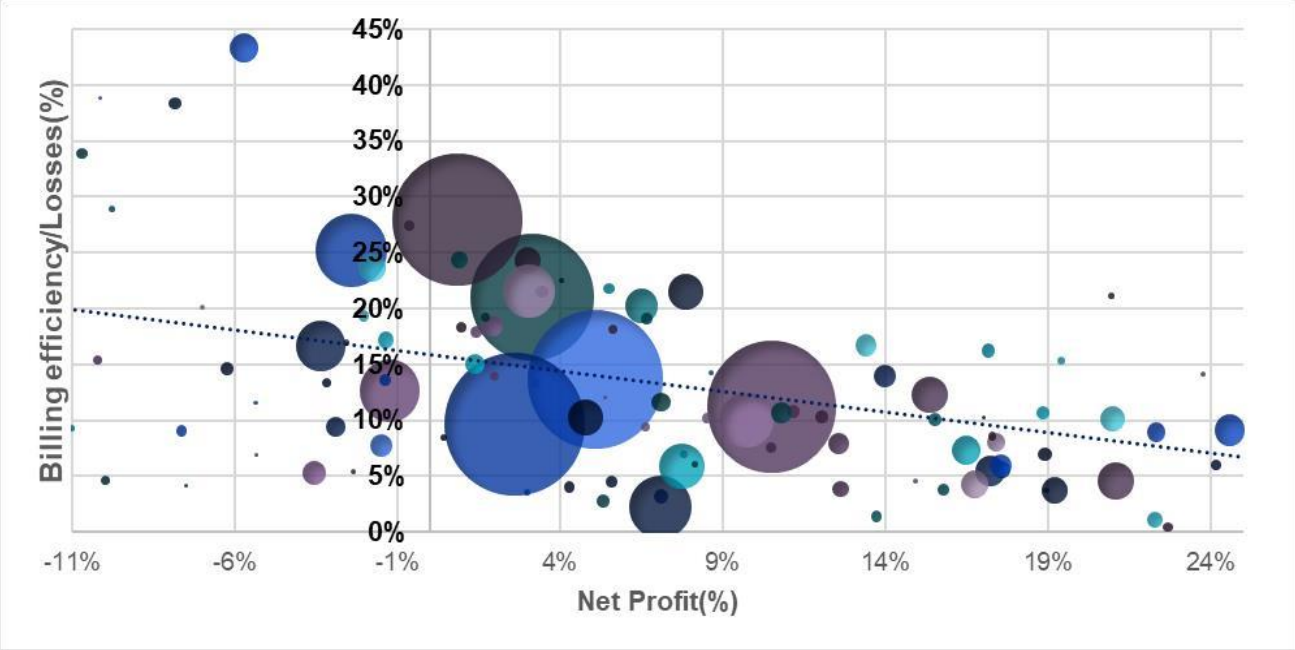
In addition to the above, the following could be addressed as part of this strategy or in supplementary strategies:

- **Strategies to Mitigate Losses, Electricity Theft, and Infrastructure Vandalism**

Addressing the issue of losses due to electricity theft and infrastructure vandalism is crucial for maintaining the financial sustainability of municipal services. These losses pose a substantial threat, significantly impacting municipalities' capacity to sustain essential services and fulfil their financial commitments.

As depicted in Figure 1, the magnitude of these losses, when compared to net profit, underscores the urgent need for the implementation of effective measures. Developing and enforcing comprehensive strategies to combat electricity theft and infrastructure vandalism is essential. These strategies should include enhanced surveillance and monitoring systems, improved asset protection measures, and community engagement initiatives to reduce the occurrence of such incidents and safeguard municipal resources.

Figure 1: Comparison of Utility size against Losses and Net Profit[5]



*Vertical axis shows the percentage losses *Horizontal axis shows the percentage net profit *The size of the bubble indicates the total sales volume of the utility.

[5] https://www.sagen.org.za/all-publications/197-an-updated-assessment-on-the-status-quo-and-current-performance-of-the-south-african-edi?category_access=1.

- **Comprehensive Planning and Management for Effective Electricity Supply**

Develop comprehensive plans and processes that are both effective and accountable for managing the electricity supply. This includes investigating, evaluating, planning, deciding, implementing, and monitoring measures to secure and expand electricity supply in the medium and long-term. The strategy should adopt a broad system perspective and involve collaboration with key stakeholders. Where applicable, the strategy should align with the city's plans for supply augmentation, focusing on enhancing and strengthening existing infrastructure.

- **Build Resilience in the Electricity and Energy System**

To build resilience in the electricity and energy system, implement a risk-based and scenario planning approach that addresses changes in the electricity market, demand, supply constraints and climate change. This involves identifying and evaluating potential risks and vulnerabilities, preparing for various future conditions through scenario analysis, upgrading infrastructure to ensure reliable power distribution, and collaborating with stakeholders to develop and implement robust strategies. Such a comprehensive approach ensures effective and adaptive management of the electricity system, maintaining reliability and resilience amidst changing conditions.

4 Managing an electricity and energy business

4.1 Sound management as a foundation of resilience

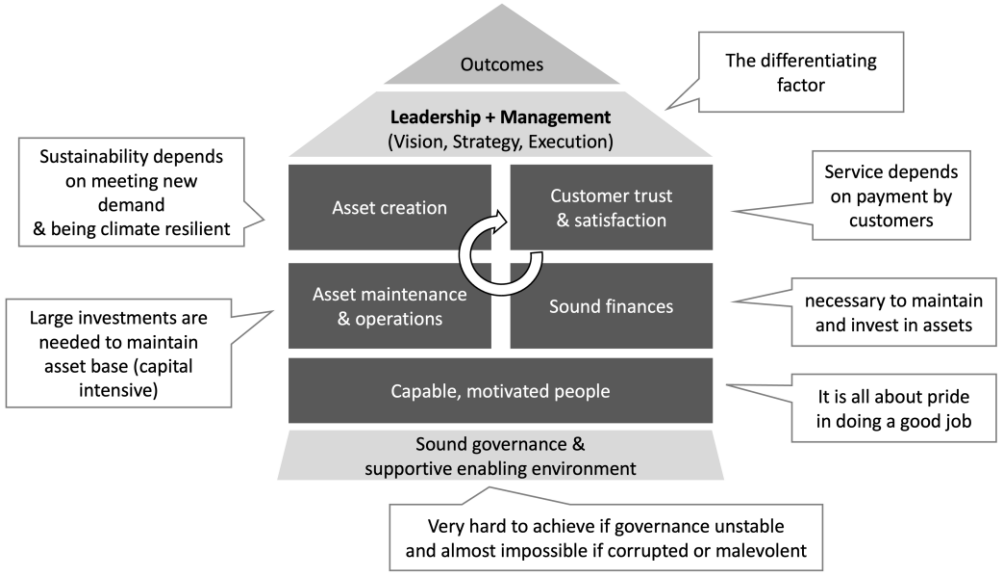
To provide reliable and safe electricity and energy services, these services and associated infrastructure needs to be resilient to shocks, including climate-related shocks and anticipated changes arising from climate change and adaptation. Systems that are poorly managed and financially weak are inherently fragile, and the impacts of shocks on these systems are much more severe.

The focus of this document is to provide a resource document that will guide metros to craft their agenda for creating soundly managed businesses because these will be much more resilient to the inevitable shocks that will arise through climate-related and other events. Soundly managed businesses plan for, and anticipate shocks, reducing their impact. These businesses have the management capability and the resources to effectively manage shocks as and when they arise.

4.2 Essential characteristics of soundly-managed trading service businesses

Providing effective trading services is not just a technical function but requires a "whole of business" approach. All of the functions necessary to manage an effective trading service must be addressed (see figure 2); this includes customer services (communications, metering etc.), financial performance (including billing, credit control etc), human resources (ensuring staff capability and performance), support services (procurement, contract management, IT, fleet management etc.) as well as the more 'technical' aspects of the business (planning, asset creation, asset management, operations and maintenance etc.). Also see Annexure C.

Figure 2: 7-box model of successful trading service



International experience shows that soundly-managed trading service businesses share the following five common characteristics:[6]

- **Customer-oriented and customer-responsive**, recognising that the purpose of the business is to serve customers, that customers experience and perceptions matter, and that happy customers are paying customers.
- **Sound finances**, as a result of effective **financial management,** accompanied by financial **transparency** and **appropriate tariffs** with good revenue management (**metering**, **billing** and **cash collection, debt management**), low levels of losses and good controls on expenditure, with cost-effective and efficient procurement.
- **Care of asset maintenance, operations and asset creation** to maintain the asset base, meet new demand, respond to a changing business landscape and be climate resilient.
- **Professionalised-management** with a suitable degree of managerial autonomy, incentivised to perform and with accountability for performance.
- **Sound governance**, with a clear distinction and separation of oversight and management/operational roles, and with clear processes and mechanisms that promote and protect probity, particularly with respect to finances, procurement and appointments.[7]

Effective utility operations also have two further important requirements (i.e. seven in total):

- a supportive enabling environment; and
- leadership and management with the vision, strategy and execution capacity required to achieve the outcomes required.

[6] See, for example, Baietti A. Kingdom, W. & Van Ginneken M. 2006. Characteristics of well performing Public Water Utilities: World Bank Water Supply and Sanitation working Note No. 9. and Kingdom Bill. Building Utility Resilience. Presentation to DWS Workshop on Water resilience, August 2022, Bill Kingdom

[7] Probity *definition*. Having strong moral principles; honesty and decency. (Oxford English Dictionary)

5 Governance

5.1 Why sound governance is important

Weak governance is a fundamental cause of poor performance in municipalities. Elected political office bearers hold ultimate responsibility for the performance of the municipal administration due to their oversight role and they have significant influence on governance and operational outcomes, including the provision of key services such as electricity and energy. Variations in performance within municipalities and among those in similar conditions underscore the critical impact of political governance on municipal effectiveness.

Without robust governance structures, there is limited confidence that scarce resources—such as grants, commercial finance, and user payments—will be utilized efficiently and effectively.

5.2 Options to improve governance

Improving governance in municipal trading services involves two complementary approaches:,(i) protecting against poor or corrupt practices, and (ii) creating a trading service structure that promotes better governance through clear rules and norms. These strategies are not mutually exclusive but work together to strengthen governance and improve service delivery.

The core ingredients of sound governance and effective management contributing to good performance of a municipal trading service are set out in Table 1.

Table 1: Core ingredients of sound governance and effective management

Area	Core ingredients of sound governance and effective management
Leadership	• Public commitment by political leadership • Dashboard on performance published and regularly updated (see strategy & business plan below) • Regular engagement and communications on progress
Strategy & plans	• Council-approved Turnaround Strategy with priorities, targets & milestones (ten-year horizon, updated periodically) • Approved business plan in place covering all aspects of the business, with agreed KPI's (three-year horizon, updated annually) • Council-approved & funded investment plan aligned to strategy & business plan, (updated annually) • Plans and programmes fully embedded /included in / supported by MTREF
Revenue & tariffs	• Council-approved tariff generates sufficient revenue (with available grants) to meet efficient operating costs and necessary investment costs. • Processes and methods for setting tariffs and pricing well-defined and transparent, and based on accepted economic regulation methodologies for public infrastructure • Municipalities must conduct Cost of Supply studies and submit to NERSA for approval of cost reflective unbundled tariffs.
Governance & oversight	• Oversight committee (“Board”) suitably skilled, experienced and trained • Separate reporting on financial performance for electricity and energy business (with full set of financial statements (income statement, balance sheet and cash flow) within metro AFS, audited by A/G)

Area	Core ingredients of sound governance and effective management
	• Clear separation of governance role from day-to-day operations and management • Zero tolerance of corruption and patronage
Management	• Appointment of capable management team with mandate and autonomy to manage • Accountability for performance with incentives (annual performance review linked to remuneration)

Source: Summary Concept: Incentives to support municipal water service turnarounds. Draft: 27 April 2022. Prepared for National Treasury. Prepared by Cities Support Programme.

Strong leadership is essential at both the political level (the Executive Mayor and the Mayoral Executive Committee), and within the senior administration, (the City Manager and the Executive Management Team), to ensure that all governance elements are in place and functioning effectively. However, several risks can undermine effective governance of trading services in municipalities, including:

- **An absence of leadership at the political level (trading services not considered a priority).** This could be because of failure of communication – politicians are not made aware of the full extent of the problem or because short-term considerations trump the decisions, actions and investment priorities (often long-term or repairs and maintenance) necessary to make a significant difference (and to turnaround a business).

  The nature of infrastructure investment requires a long-term approach while political terms are short. This is compounded by much infrastructure being buried underground or far away from households and therefore difficult to use in political campaigns compared to other services such as housing.

- **Oversight exercised without the necessary knowledge and skills to oversee a large, complex infrastructure-intensive business.** Many elected representatives are inexperienced and without appropriate qualifications.[8]

- **A failure to appoint a capable management team with the necessary management and technical skills.** For large urban trading services, it is essential that professional qualified engineers are part of the management team. In addition, the lead executive needs to be suitably skilled to implement a business approach.

- **Inappropriate interference in the day-to-day management of the business, including in staff appointment and procurement decisions**, leading to poor decision-making and inefficient use of scarce resources.

The remedy depends on well-informed political leadership is willing to take a longer-term view (term of office and beyond), and a capable executive management team (city manager, chief financial officer and the executive lead for electricity).

[8] Former SALGA CEO, Xolile George, noted that, while councillors did not require any particular qualification, their lack of skills had become a problem. "With almost 69% of councillors with either matric or less in the picture, and this is not to say the standard measure is above matric, but there's a need to have a multi-pronged strategy that recognises leadership competencies political leadership and maybe a degree of academic qualifications." (Eyewitness news, 16 April 2021; ewn.co.za/2021/04/16/salga-raises-concerns-over-councillors-lack-of-skills).

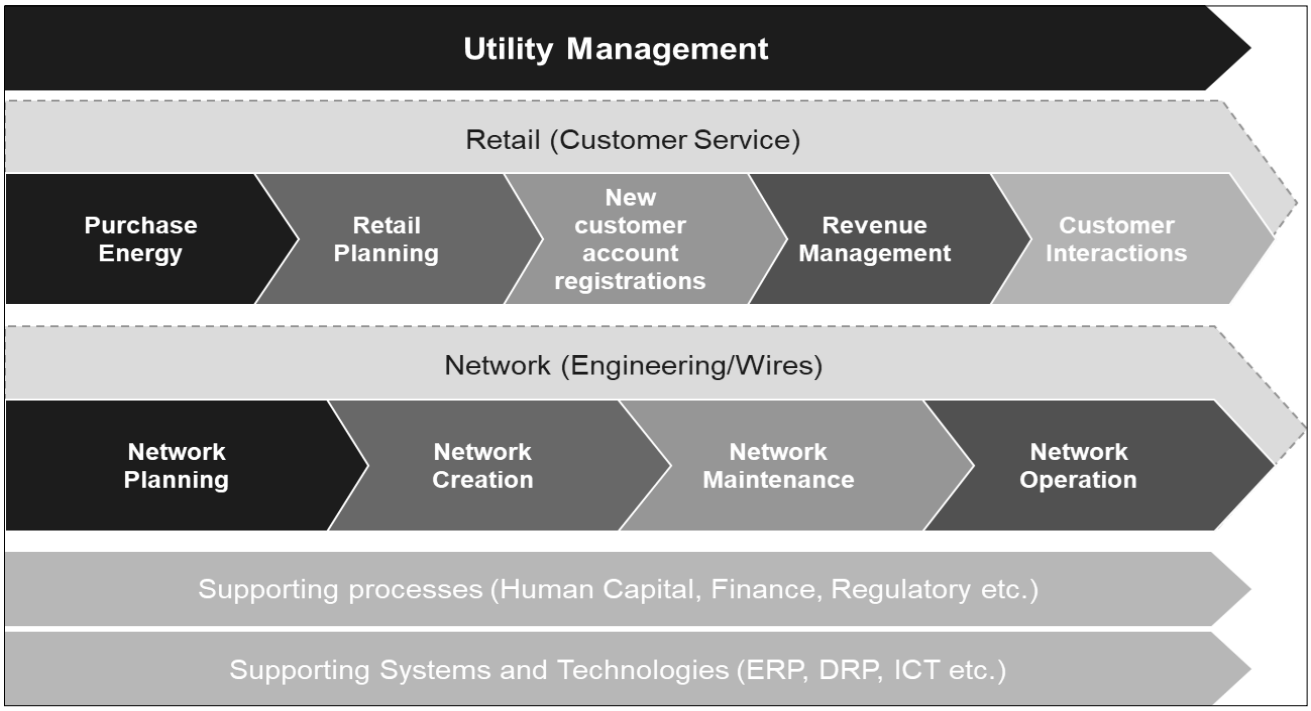
6 Structuring the electricity and energy service as a business

6.1 Benefits of structuring electricity as a business

Metro electricity businesses play a significant role in municipal finances; electricity is the largest revenue stream for most municipalities. In the first six months of 2023, municipal expenditure on bulk electricity purchases was R50.2 billion, while total sales amounted to R60 billion[9]. This resulted in a trading margin of 16%, despite challenges such as electricity theft, non-payment, and poor collection rate. This surplus is a crucial source of revenue for municipalities, supporting various essential services and operations.

In this larger context, the needs and imperatives of the trading service are seldom fully appreciated, and do not receive the necessary management attention. Therefore, providing effective trading services is not just a technical function. All of the functions necessary to manage an effective trading service need to be addressed (see figure 3); this includes customer services (communications, metering etc.), financial performance (including billing, credit control etc), human resources (ensuring staff capability and performance), support services (procurement, contract management, IT, fleet management etc.) as well as the more 'technical' aspects of the business (planning, asset creation, asset management, operations and maintenance etc.).

Figure 3: Holistic approach to Utility Management[10]



Of the 167 municipalities holding electricity distribution licenses, only two metros – Mangaung's Centlec and Johannesburg Metro's City Power – are organised as registered corporations. The majority, of electricity departments or business units including City Power, operate with a fragmented

[9] https://www.statssa.gov.za/?p=16721

[10] https://www.sagen.org.za/all-publications/197-an-updated-assessment-on-the-status-quo-and-current-performance-of-the-south-african-edi?category_access=1

structure where some essential functions such as retail services, revenue management, network operation, and support functions and technologies are managed separately from core electricity distribution activities.

6.2 Implications of not treating trading services as a business

To significantly improve the operational and financial efficiency of electricity trading services, it is crucial to dedicate considerable and focused management attention to the business. Treating the electricity trading service merely as a technical department can obscure the comprehensive view of the business, which is essential for effective management.

A narrow focus on technical aspects alone often results in overlooking the broader business context, including the intricate interplay of various functions and objectives within the municipality. The implications of not treating trading services as a business typically include the following:

- No clear picture of the true financial position (balance sheet) and financial performance (income statement and cash flow) of the business and hence an inability to assess financial performance of the business as a whole. Instead, the key metrics measured are revenue and expenditure against budget.
- A failure to adequately resource the service in relation to its needs, that is, the capital and operating budgets, which are typically a product of an annual determination of a maximum increment rather than based on actual business needs.
- An inability to make appropriate trade-offs between capital and operational spending.
- A failure to recognize the specific technical and other competence requirements of the business in recruitment processes.
- Lack of transparency in inter-business costs and performance within the municipality, and absence and/or lack of enforceability of inter-business contracts.
- Decisions based on short-term considerations rather than the long-term sustainability of the business.
- Decisions based on corporate considerations rather than trading services' needs.
- Low flexibility in deployment of resources as a result of strong rules against moving money between budget items within year and a lack of flexibility in how people are deployed. This makes it difficult to respond to unplanned challenges or changes during a financial year.
- An organizational culture that is risk averse and that penalises mistakes whereas innovative business cultures actively encourage experimentation and expect failures as part of this process.
- The absence of clear performance and shareholder (financing) agreements between the shareholder and the business entity.

6.3 Trading service restructuring options

An analysis of the current electricity distribution industry within municipal departments and state-owned enterprises has led to the following observations:

- **Municipal departments (status quo)**. The outcomes from over 20 years of implementing this structure are overwhelmingly poor and not well capacitated. Alternative options to the current dominant mode of provision are explored in this resource document.

- **State-owned enterprises**. The provision of trading services by **state-owned enterprises** does not address accountability and governance risks in a context where local governments retain constitutional responsibility for service provision.
- **Lease, concession and full private options** are assumed to be politically unacceptable. In addition, where they exist, they may remove public accountability by locking the government in the long-term contracts while the private sector is under-investing and profiteering.

It is evident that the current structure of the Electricity Distribution Industry (EDI), whether organized as a corporation or a business unit, faces significant challenges. These challenges encompass issues related to management inefficiencies, accountability, and operational performance. The persistence of these issues underscores the urgent need for structural reform. To address these challenges effectively and improve service delivery, a comprehensive review and redesign of the existing EDI framework are essential. The example of restructuring the EDI in Namibia is included in Annexure D.

Based on an overview of international examples for structuring the business (Annexure E), there are four options that could be considered:

- **Municipal business units**. Corporatization of the service but within the existing municipal legal structure (previously successful eThekwini model for the water & electricity trading services).
- **Municipal entities**. Municipal-owned companies as defined in the Municipal Systems Act (the City Power model).
- **Cooperative ownership models**, with community ownership.
- **Mixed-ownership companies** (Empresa Mixta[11]), that are majority-owned by the municipality (or municipalities). This is a new model not yet used in South Africa and it may require amendments to the legislative framework to implement.

When evaluating these four options, several key factors must be considered. First, the involvement of the private sector could significantly enhance management capabilities within the sector, bringing in specialized expertise and efficiency. Additionally, given the constrained availability of funding (own revenue and grant funding), and the significant infrastructure needs (existing and new) it is crucial for trading services in urban areas to secure commercial finance to support necessary investments.

6.4 The differences between department, business unit and company structure

When providing trading services through a department within the municipality (the dominant status quo model in South Africa), the ownership, oversight and provider roles are all combined in a single organisation. In theory, Council fulfils the ownership and oversight roles, and the administration and provider role. This blurring of the roles is a significant risk that can result in inadequate oversight and inefficient operations.

When a ring-fenced business unit is created, there is an opportunity to establish management autonomy and to structure the business unit as a business within the administrative structure of the city.

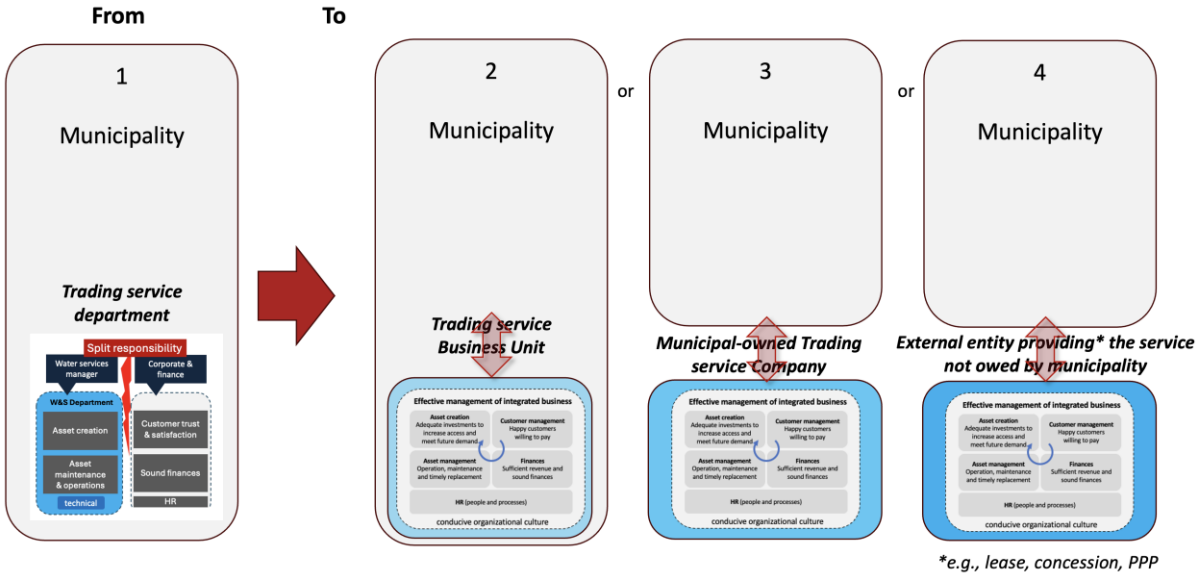
The establishment of a company structure formally separates the ownership, corporate oversight and management functions. There are two main forms of company structure: (i) a statutory body (formed

[11] https://ppp.worldbank.org/public-private-partnership/library/mixed-private-public-ownership-companies-empresa-mixta.

in terms of specific legislation), or (ii) a company established in terms of private company law. This is an ideal model, however, it is not protected from an erosion of autonomy and the penetration of corrupt interests and requires strong governance norms to uphold autonomy and professionalism (Annexure F).

The progression of restructuring options is shown in Figure 4.

Figure 4: Direction of travel



The evidence also shows that corporatization on its own is not a sufficient condition for good performance. City Power (also set up as a corporate municipal-owned entity) and other municipal entities set up without management contracts have not performed well. The performance of Johannesburg Water after the management contract also declined, showing the need for a more prolonged approach to build internal capacity and to strengthen incentives to create a structure that is more robust and is able to protect and extend performance improvements. Also see Annexure G.

7 Management and technical capability

As already noted, there has been a significant decline in the necessary management and technical staffing capabilities within municipalities to manage trading services effectively, and these are now in short supply in most municipalities. Two options for strengthening this are considered.

7.1 Internal capacity building, with external support (keeping the existing delivery model intact)

Municipalities could build their own capacity, through recruitment and training, with external support, while maintaining the existing service delivery model. Various municipal support initiatives have been attempted and some are ongoing.[12]

[12] For example, Project Consolidate (2004-2006**),** Siyenza Manje (2006-2011), Local Government Turnaround Strategy (2009-13); Back-to-basics initiative (2014-18), Municipal Infrastructure Support Agency (MISA) (established in 2012), Cities Support Programme (established in 2011).

Success in turning around the performance of municipal trading services as a result of these initiatives is, in general, not apparent.[13] For example, a review of the Siyenza Manje support initiative, specifically focused at increasing technical capacity in the municipal water sector, through deployment of engineers, concluded that the majority of the problems at municipalities are structural, organisational and political in nature, with high municipal vacancy rate in key technical and senior management posts, and that the support requests tended to focus on addressing a short-term crisis rather than capacity development in municipalities.[14]

In light of the above, the strategy of internal capacity building (at least on its own) may not be sufficient to result in the necessary turnarounds of the municipal trading service business.

7.2 Creating a business unit or municipal entity, supported by a management contract

An alternative route to building capability is to professionalize the service through setting up a sufficiently autonomous business unit or a company structure, and to build capacity through recruitment into the business unit or company structure, supplemented with training initiatives. A management contract offers a possible vehicle to fast-track the creation of both management and technical capacity in this company structure.

The benefits of this approach are two-fold:

- Service conditions within a company structure are likely to be more favourable and it will be more possible to attract the necessary expertise into this structure (MFMA/PFMA prescripts will still exist); and
- Management contracts are much more likely to be successful when applied to a company rather than a department within a municipality.[15]

There is precedent in South Africa for the use of a management contract to support the setting up of a company structure and to build the capacity of this structure for the provision of water and sanitation. The example of Joburg Water is useful as it can be applied to electricity entities as well (see Annexure G). City Power on the other hand was established without the use of a management contract, with less favourable results.

Another way to provide capacity is to contract the service out, either to a private or public entity that has this capacity. There are no known public entities that have the technical capacity or experience to be considered.

Contracting out the service to a private operator, through a lease, affermage[16] or concession contract is also possible.

[13] A review of the successes and failures of these initiatives is beyond the scope of this report.
[14] pmg.org.za/committee-meeting/12999/
[15] A legal opinion commissioned by National Treasury concluded that "As a legal matter, the creation of a municipal entity undoubtably makes the conclusion of an effective management contract easier for the reasons discussed in this section and the previous section of the Report." (Legal Report on the use of Management Contracts as a mechanism to turnaround municipal water businesses (29 November 2021, World Bank).
[16] https://ppp.worldbank.org/public-private-partnership/agreements/leases-and-affermage-contracts.

8 Process considerations

8.1 Foundational conditions for successful reform

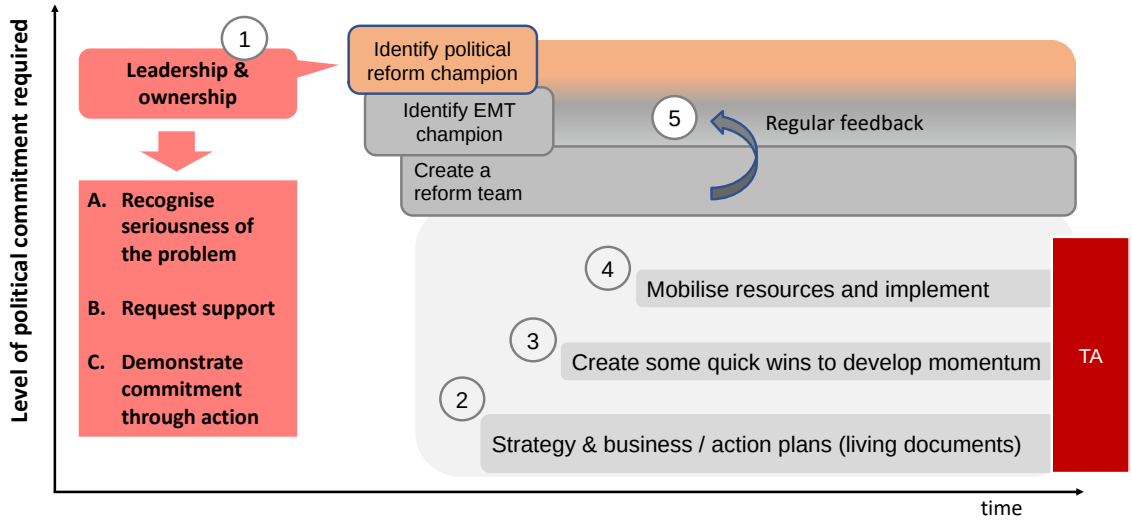
Empirical evidence strongly suggests that specific factors need to be present to start a turnaround process for a trading service business[17]. While these do not ensure success, they are an important starting point:

- A **catalytic event** that triggers a need to change (a crisis);
- **Committed and capable leadership** to guide the utility through the process;
- The possibility of establishing sufficient **managerial autonomy** over key aspects of the business, including operations, finances and contracts;
- A **political champion** committed to making the necessary changes in the governance environment to support good performance.

8.2 Political and administrative leadership of the process at municipal level

National Treasury emphasises the importance of leadership (as shown in Figure 5) in leading the turnaround of the municipal trading service business. CSP's approach has been to offer technical assistance and other support where this leadership is evident and requests the required support in writing.

Figure 5: A leadership first model



The requests needed to identify a political and administrative reform champion as well as a municipal reform team. The municipality needs to demonstrate its commitment through action. In response to the request, the CSP provides technical assistance to:

- Support the development of a turnaround strategy and business plan.
- Advise on the implementation of the strategy and business plan, with a focus on quick wins to gain momentum.

[17] Heymans, Chris. Fixing NMBM Water Business. Presentation to DWS Workshop on Water resilience, August 2022, Chris Heymans

- Assist with the mobilisation of further resources to help with implementing the turnaround strategy.

9 Additional resources & references:

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15. U.S. Department of Energy, "Grid Modernization and the Smart Grid," 2014 https://www.energy.gov
16. U.S. Energy Information Administration (EIA), "Electricity Data Browser," 2020 https://www.eia.gov/electricity/data/browser/
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18. World Bank, "Reducing Technical and Non-Technical Losses in the Power Sector," 2009 https://openknowledge.worldbank.org
19. World Bank, "Electricity Tariffs, Power Outages, and Firm Performance: A Comparative Analysis," 2016 https://openknowledge.worldbank.org
20. World Bank, "Electricity Governance Initiative," 2008 https://openknowledge.worldbank.org
21. World Bank, "Improving Revenue Collection in Power Distribution Utilities," 2014 https://openknowledge.worldbank.org

Annexure A: Increasing the level of investment

There is strong evidence that current investment levels and their implementation are insufficient to meet the needs of South Africa's electricity grid. The required investment for grid maintenance and upgrades across municipalities is estimated at R120 to 150 billion in the short to medium term. The DBSA Infrastructure Investment Report highlights an immediate need for R 70 billion to address maintenance backlogs and upgrade municipal distribution infrastructure, with long-term needs potentially exceeding R120 billion. At a sector level it is estimated that the investment need to maintain, expand and implement the transition in a just manner is R1,033.2 trillion (Table 2) for the period of 5 years and R 319.1 billion will be allocated to municipalities (South Africa's Just Energy Transition Investment Plan - JET IP report).[18]

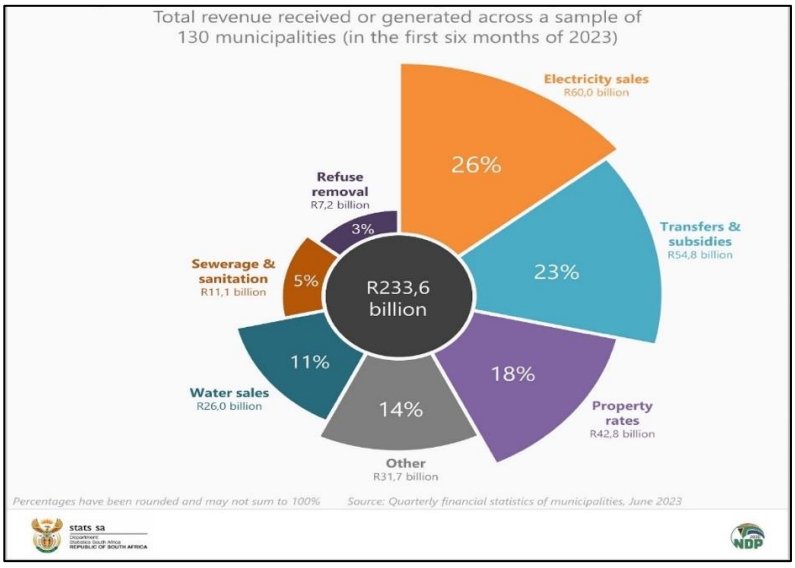
Table 2: Just Energy Transition Investment requirement

JET IP funding requirements 2023-2027	ZAR billion	USD billion
Electricity sector	711.4	47.2
Skills development	2.7	0.18
Municipal capacity	319.1	21.3
Total	1,033.2	68.68

Sources of revenue

Figure 6 illustrates the municipal revenue streams which can be broadly classified into two categories: internally generated revenue and financial transfers from government. Internally generated revenue refers to the funds that municipalities generate through their own operations. This category includes income derived from service charges, such as electricity sales, water sales, refuse removal, and sewerage and sanitation services, as well as revenue from property rates. These sources are critical for the financial health and autonomy of municipalities, enabling them to fund essential services and infrastructure projects directly.

Figure 6: A breakdown of Municipalities revenue

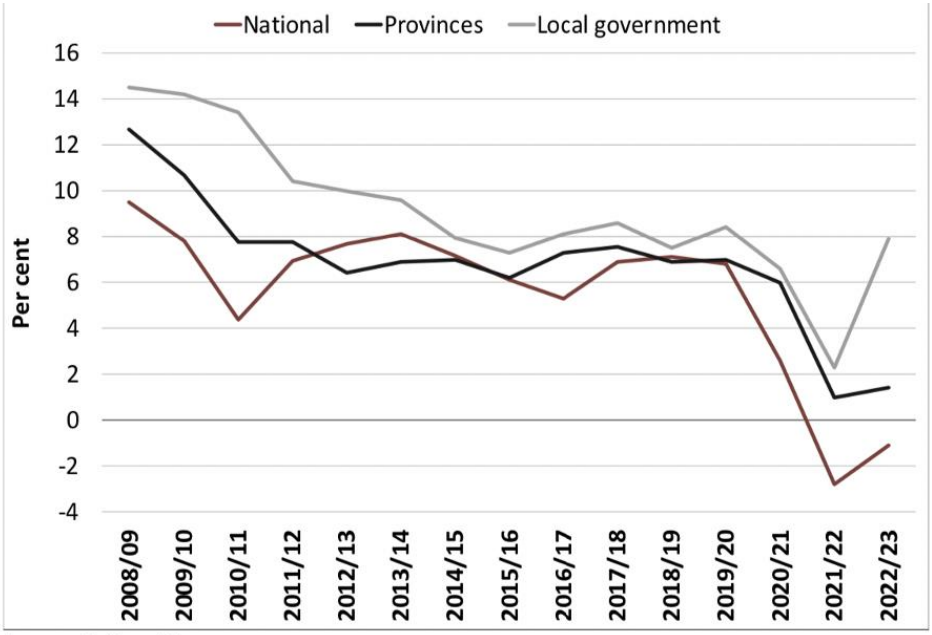


[18] https://www.climatecommission.org.za/publications/sa-jet-ip.

Grants trends

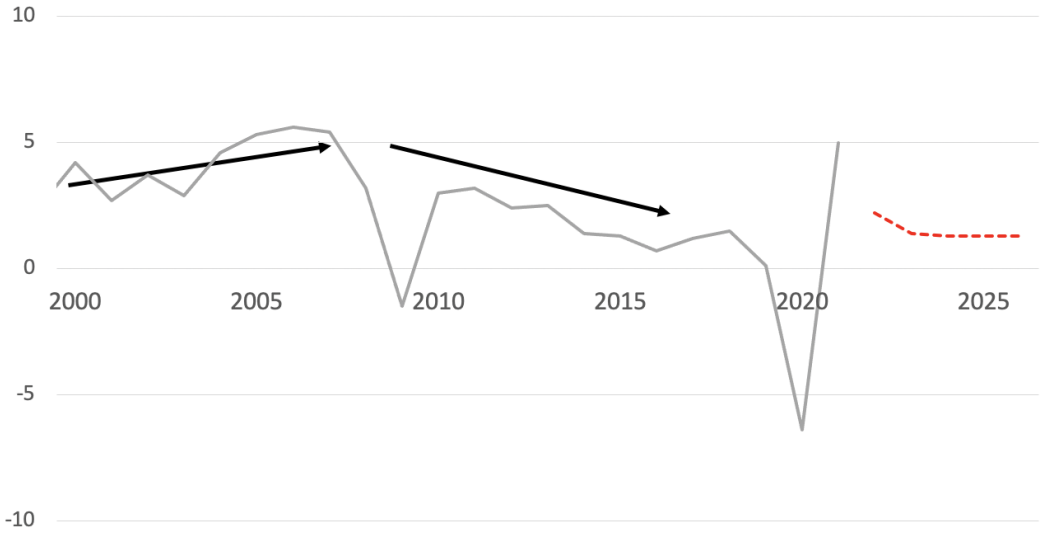
While grants to local government have increased significantly above inflation in the past, the rate of increase has been declining (Figure 7). The scope for increasing grants significantly in real terms (at rates above inflation) is limited unless and until government finances improve on the back of economic growth and growing tax revenues (Figure 8).

Figure 7: Average annual rate of growth in budget allocations to local government, compared to other spheres



Source: National Treasury

Figure 8: Annual real growth in GDP from 2000, with forecast for 2022 to 2025 (% per year)



Source: IMF (2022)[19]

[19] https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/ZAF.

Making better use of grant funding

The current grant conditions in the Division of Revenue Act (DORA) offer limited incentives for better outcomes. Resources are typically allocated to municipalities based on the ability to spend rather than spending that leads to improved service outcomes. In addition, grant spending suffers from the following inter-connected challenges:

- Municipalities lack the technical capability and capacity to spend grants effectively. This often means that allocated grants remain unspent at the end of a financial year.
- Projects are chosen for the wrong reasons, and capital allocations are not optimized.
- Procurement processes are captured for corrupt purposes, leading to inflated prices and poor project outcomes.
- Supply chain management processes are overly onerous and risk pursuing form and compliance over value for money.

The result is poor value for money from the significant grant spend in the sector overall.

This problem cannot be solved by throwing more good money after bad. It is imperative that existing grants are used more effectively and efficiently.

More commercial funding is needed to fill the funding gap. Commercial funding is entirely feasible to support infrastructure investments in South Africa's main economic hubs, but *only where* trading services are effectively and efficiently managed.

Annexure B: Technical performance trends

SALGA, in collaboration with GIZ, commissioned a study[20] to evaluate the performance of all 167 municipalities licensed to distribute electricity in South Africa. Pervasive problems are evident in most municipalities with widespread negative yields and sustainability challenges. High losses, inadequate tariff structures, inadequate infrastructure spending, and manpower constraints further impact on service delivery.

The municipal electricity distribution industry (EDI) is facing significant operational inefficiencies that threaten its sustainability and ability to deliver reliable services. Table 3 compares Eskom's annual municipal tariff increases from 2010 to 2021 with the average Consumer Price Index (CPI) increases for each financial year. It highlights that electricity tariff hikes have consistently surpassed inflation, except for the 2017-2021 financial year.

Table 3: Eskom Tariff Increase, CPI inflation, and municipal purchases and sale of electricity

Municipal financial year (1 July to 30 June)	Nersa/Eskom municipal tariff increase	Average CPI inflation	Average increase in municipal electricity purchases	Average increase in municipal electricity sales
2010–2011	28,9%	3,8%	30,5%	25,0%
2011–2012	25,3%	5,8%	26,1%	20,2%
2012–2013	13,5%	5,6%	11,5%	8,6%
2013–2014	6,1%	6,0%	5,8%	5,0%
2014–2015	8,1%	5,2%	6,2%	5,7%
2015–2016	14,2%	5,6%	12,8%	10,6%
2016–2017	7,9%	6,1%	7,9%	6,5%
2017–2018	0,3%	4,5%	-1,8%	-1,1%
2018–2019	7,3%	4,6%	7,4%	6,2%
2019–2020	15,6%	3,7%	11,7%	6,7%
2020–2021	6,9%	3,5%	6,7%	4,0%

Sources: (1) Eskom tariff books, (2) *Consumer Price Index (CPI)*, and (3) *Financial census of municipalities, for the year ended 30 June 2021*

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The decline in bulk purchases and sales (Figure 9) can be attributed to a range of factors, encompassing structural, operational, and governance challenges, as well as regulatory and market changes. Table 4 illustrates key performance indicators of a well-managed trading business. These benchmarks are essential for assessing the effectiveness of management practices and identifying areas for improvement in mitigating losses and optimizing overall business performance.

[20] https://www.sagen.org.za/all-publications/197-an-updated-assessment-on-the-status-quo-and-current-performance-of-the-south-african-edi?category_access=1

Figure 9: Five metros recorded a decline in electricity sales in the first six-month of 2022, percentage change in sales of electricity

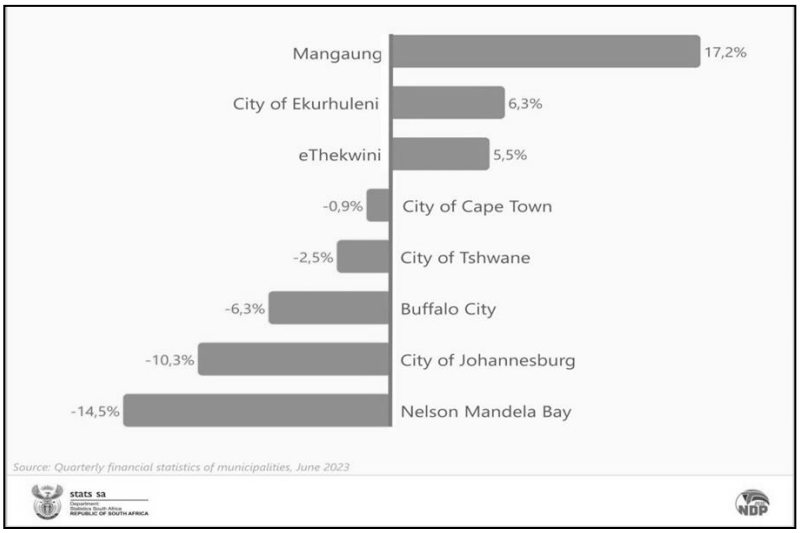

Table 4: Performance Metrics and Indicators for an efficiently managed utility.

Performance Metrics	**Indicators**
Reliability	Low power outage rates and minimal service interruption times. (IEEE Std 1366-2012) Designed to prevent widespread outages and recover quickly through grid modernization. (U.S. Department of Energy, 2014)
Operational Efficiency	Minimizes technical and non-technical losses. (World Bank, 2009) Maintains system stability and prevents overloads. [IEA, 2018) Uses advanced systems for real-time monitoring and fault detection. (EPRI, 2014)
Economic Efficiency	Cost-Effective Operations: Low operational costs lead to lower tariffs. (IRENA, 2016) Tariff Rationalization: Cost reflective tariff World Bank, 2016) Ongoing Investment and maintenance of Infrastructure (IEA, 2020)
Customer Service	High Customer Satisfaction: Reliable service, complaint resolution/ transparent billing. Smart meters ensure accurate billing and improved revenue collection. (FERC, 2018)
Environmental Sustainability	Reduces consumption through efficiency measures. (IEA, 2019) Incorporates renewable sources and reduces fossil fuel reliance. (REN21, 2020)
Regulatory Compliance/ Governance	Compliance with safety, reliability, and environmental standards. (IEC, 2009) Ensures management practices are transparent and compliant. (World Bank, 2008)
Financial Viability	Ensures profitability through sound management. (IEA, 2019) High collection efficiency with minimal arrears. (World Bank, 2014)
Adaptability and Innovation	Seeks to improve processes and adopt new technologies. (IEA, 2017) Adapts to regulatory and market changes. (European Commission, 2019)
Safety	Maintains safety protocols for employees and public. (OSHA, 2021) Prevents and manages hazards effectively. (ILO, 2013)
Stakeholder Engagement	Engages with stakeholders to meet needs and expectations. Builds trust through social and environmental commitments. (UN Global Compact, 2014)

Energy systems are evolving rapidly in many countries, particularly at the municipal level. Key drivers include the growth of distributed energy resources, shifts in regulatory frameworks, increased

electrification, the push toward carbon neutrality, the rise of new market players, and greater customer involvement. These trends are transforming the market landscape and may challenge the traditional business models of established entities like municipal utilities[21].

Given the rapidly changing energy sector, the proposed structure must take into account the current developments shaping the energy sector. These include the ongoing shift towards competitive market reforms, the decentralization of the energy system, and the push towards decarbonization. Additionally, the structure must prioritize overall business efficiency to remain viable while maintaining the core objectives of reliability, affordability, and sustainability.

Annexure E presents a comparative analysis of key attributes of Municipal Energy Company (MEC) models from three different countries, highlighting how various functions and responsibilities are managed by municipalities. These case studies offer valuable insights into effective practices and structural arrangements. However, it is crucial to tailor these examples to the local context, recognizing and addressing specific characteristics and challenges unique to the region or country. For an electricity trading business to achieve efficiency, several critical elements must be considered:

- **Delineation of Services:** Clearly separate retail and network services to ensure that each area can be managed with a focus on its specific operational and strategic requirements.
- **Ring-Fencing Practices:** Implement financial ring-fencing to enhance transparency and accountability. This practice involves isolating financial operations to prevent cross-subsidization and ensure clear financial reporting, meeting regulatory requirements.
- **Strategic Flexibility:** Maintain strategic flexibility in budgeting and investment decisions to adapt to changing market conditions and evolving needs. This flexibility allows for responsive and proactive management.
- **Operational Control:** Ensure effective operational control over support functions. This includes managing administrative, logistical, and technical support functions to optimize overall performance and efficiency.
- **Regulation and Tracking:** Establish robust mechanisms for regulating and tracking infrastructure investments. This involves setting clear guidelines and monitoring systems to oversee the allocation and utilization of resources, ensuring that investments are aligned with strategic objectives and deliver expected outcomes.

By incorporating these attributes and adapting them to the local context, municipalities can enhance the efficiency and effectiveness of their electricity trading businesses, ultimately leading to improved service delivery and financial performance.

[21] Kühne, S., Scheller, F., Kondziella, H., Reichelt, D. G., & Bruckner, T. (2019). Decision Support System for Municipal Energy Utilities: Approach, Architecture, and Implementation. Chemical Engineering & Technology, 42(9), 1914–1922. https://doi.org/10.1002/ceat.201800665

Annexure C: A business approach

The following are defining elements of a business approach to the provision of trading services:

1. **Leadership and management**: The service is led by a business-oriented single executive lead ("Chief Executive Officer") and managed by a multi-disciplinary management team reporting to, and including, the executive team lead. This team has a dedicated focus on business performance and outcomes, and with individual and collective responsibility for outputs and outcomes, suitably incentivised.
2. **Time horizon**: Investment and management decisions are taken on the basis of a multi-year and long-term outlook in light of the fact that trading service business is infrastructure intensive.
3. **Financial accounting**: The business entity has a separate income statement, balance sheet and cash flow so that the financial status and performance of the business can be assessed. The financial statements record the assets and liabilities of the business and are audited separately from the municipality's primary accounts.
4. **Performance reporting**: There is a suitable set of integrated performance metrics for the business (financial and technical) that is measured and reported at least annually, along with appropriate benchmarks.
5. **Business integration**: The core functions of the business (human resources, finance, information technology, supply chain management, project management, communications, call centre, fleet management, meter reading, billing, cash collection etc.) are tightly integrated into the business. Where these functions are performed by an external entity to the business, these are performed in terms of well-structured and enforceable service level agreements.
6. **People**: The business has the responsibility to recruit (and dismiss or retrench if necessary) and to set pay and incentive structures subject to relevant legislation.
7. **Trade-offs between operational and capital spending** are routinely taken into account in decision making.
8. **Flexible deployment of resources**: The entity is able to flexibly deploy staff and capital so as to optimise outcomes.
9. **Mandate, performance agreement and managerial autonomy**: The entity operates within an appropriate mandate of the owner/shareholder, in terms of a performance agreement, and with appropriate managerial autonomy related to the day-to-day operations of the business.
10. **Shareholder financial agreement:** there is an agreement with the owner/shareholders on how inter-business costs are treated and the contribution provided to and/or from the municipality, and how investments are financed. In general, this is expected to comprise two components: (a) An expectation that the business will earn a profit that provides a reasonable return on capital invested, and (b) social goals are addressed through explicit Community Service Obligations for which the government pays by way of operational costs and through explicit grant-financing for capital projects that are not expected to earn a return.

Annexure D: Principles of EDI reform in Namibia

In Namibia, the reform of the electricity distribution industry (EDI) is guided by several key principles. The reform is designed to address regional needs while aligning with local conditions and government electrification priorities. Recommendations include establishing REDs in Northern Namibia and the Erongo Region, with a structured process for expanding to other areas. It is essential to tailor these principles to our local context to identify solutions that enhance operational efficiency, adaptability, and resilience. The principle are as follows:

- **Restructuring Focus:** Proposals address various aspects such as customer base, network characteristics, and geographic areas to optimize the distribution framework.
- **Establishment of REDs:** The reform aims to transition towards Regional Electricity Distributors (REDs) as the central structure for electricity distribution.
- **Financial Viability:** The reform ensures that licensed distributors maintain financial viability while supporting ongoing electrification efforts.
- **Local Authority Revenue Protection:** Mechanisms are put in place to safeguard local authority revenue throughout the restructuring process.
- **Private Sector Participation:** The reform facilitates private sector involvement under transparent and well-defined terms.
- **Single Supplier Model:** Initially, each distribution area will have a single supplier until the development of retail competition.
- **Customer Supply:** Most customers will receive electricity from the licensed distributor in their area, with exceptions for a few large users.
- **Voluntary Rationalisation:** Changes in the distribution industry are intended to be voluntary but will be guided by government policy and the rulings of the Electricity Control Board (ECB).

Annexure E: Business models in Germany, California & Great Britain

Business model Overview	**Germany**	**Great Britain**	**California**
Business activities	Energy retailers/ gen-tailers and some integrated with distribution network operations (Electricity, gas, heat	Energy retailers without networks	Community Choice Aggregators (CCA) without networks and a vertically integrated MEC
Ring-Fencing Practices	Stadtwerke manages various utilities like electricity, gas, and water under one organization, with finances for each service often ring-fenced for transparency and accountability.	MECs must keep separate financial accounts for energy and municipal services to ensure independence and transparency, preventing cross-subsidization and aiding accurate reporting and accountability.	CCAs typically handle only electricity procurement, not gas or district heating, so they generally do not require complex financial ring-fencing.
Regulatory Requirement	Each utility service (e.g., electricity, gas, heating) must have separate accounts to comply with legal and regulatory standards. This prevents cross-subsidization and allows for individual financial assessment.	Regulated entities need distinct accounts for regulated and non-regulated activities, with separate financial statements to differentiate income and expenses related to each service	CCAs must follow CPUC regulations for transparent accounting. If they offered multiple services, separate financial management would be required to ensure accountability and compliance.
Strategic Flexibility	Flexibility to allocate surplus revenues from one service can support investments in another if it aligns with municipal goals and regulations. I.e., electricity profits might fund renewable projects or district heating expansion.	While there is flexibility to use surplus funds, regulations prevent cross-subsidization between regulated and non-regulated activities. This ensures that funds are used appropriately within the energy sector.	Financial arrangements between CCAs and existing utilities are governed by agreements that ensure clear financial separation for infrastructure use.
Operational Independence	Separate governance structures allowing independent decision-making free from municipal priorities and distinct management, staff and corporate support separate from municipal functions.	Energy management teams are separate from municipal management to prevent conflicts and ensure regulatory compliance.	CCAs and traditional utilities maintain separate management and staff for energy operations, ensuring independence from municipal responsibilities

Business model Overview	**Germany**	**Great Britain**	**California**
Investment and Revenue Tracking	Investments and revenue from energy services are tracked separately from municipal finances to ensure transparency and proper fund use.	Regulated entities must separately track infrastructure investments from competitive activities to ensure proper funding and avoid cross-subsidization.	Track regulated infrastructure investments (transmission and distribution networks) separately from competitive areas (Generation) to ensure regulatory compliance and transparency.

Annexure F: A governance-protected municipal company

Improving governance through a company structure or business unit

Establishing a corporate structure (particularly in the form of a legally separate company)[22] has several advantages that support a sound governance agenda. A corporate structure:

- Introduces the possibility of independent oversight by a suitable skilled and experienced Board of Directors[23]; (Municipalities must rely on elected representatives[24] to play this role when providing the service themselves through a municipal department).
- Creates financial transparency through the generation of a separately audited set of financial statements comprising a balance sheet, income statement and cash flow; (These have been lacking when a trading service is provided through a departmental structure within a municipality, although *m*SCOA makes more financial transparency possible).
- Creates clearer accountabilities for performance through a dedicated management team with a clear mandate and performance agreement with the Board; (Accountability is much more diffuse when a service is provided by a department within a municipality, with poorly specified and often unenforceable dependencies on other departments. It is easy to shift blame in this context).
- Creates a clearer separation between the ownership/shareholder and management roles, making inappropriate interference in the day-to-day operations more obvious and easier to manage. (In direct municipal provision there is no separation between ownership/shareholder and management roles).

Creating a purpose-built governance-protect municipal company

The need for commercial finance combined with the imperative of sound governance creates an opportunity to create a corporate structure with protected governance that would be attractive to commercial lenders.

The proposal is to create a *purpose-built* "South African company" structure and template with *built-in features* that would ensure and protect sound governance.

This company structure could be offered by National Treasury to be used as a vehicle to provide municipal trading services, together with incentives of financing through grants, facilitated access to commercial finance and with technical assistance to establish the company.

The company template would need to go beyond a tick-box exercise to ensure that there is sound governance in substance, not only in form.[25] Special care is needed because public companies, "by their very nature as publicly-funded entities, are not subject to the same market discipline or shareholder oversight as other entities".

Protecting governance

The development of this *company template* (and the associated processes to form and govern the company) could learn from practical experience gained in South Africa. A review of governance

[22] Or at least a business unit within a municipality (see later discussion).
[23] This applies in the municipal owned entity such as Centlec and City Power.
[24] This refers to the portfolio committee which is made up of political representatives.
[25] See "SOE Governance Unmasked: A learning journey" (Future Growth, 2018).

failures in South Africa's state-owned entities identified four areas where governance can be improved, noting that "corporate governance is better understood as a "web" of oversight by stakeholders (for example, shareholders, directors, employees, regulators, suppliers, financiers, auditors, corporate secretaries) as well as a range of policies, practices, protections and disclosures":[26]

1. **People.** The review noted that "an organisation can have all the trappings of governance such as a board, committees and policies - but if it has corrupt or ill-intentioned shareholders or leaders then policies and practices are all at risk. In the first instance, improving governance means improving the selection and appointment process of individuals on boards, board sub-committees, and executive management." In the case of public companies, this also implies improving the selection process of shareholder representatives.
2. **Processes.** Three key processes need to be given careful attention**:**
    - **Board of directors and board committees**: The review noted that "all corporate governance begins with the board of directors, so its composition and operations must be appropriate."
    - **Governance policies**: Governance policies need to cover all major business areas (e.g., procurement, recruitment, financing) as well as key risk areas (e.g., remuneration, dealing with politically exposed persons and conflicts of interest), be fit-for-purpose and protective of sound governance.
    - **Internal watchdogs**: The review noted that "even the best governance arrangements will degrade without active oversight. There are always witnesses to poor governance – such as executives, auditors, employees, and suppliers – who almost universally fail to speak up. Insiders invariably know the truth and it is self-evident that confidential whistleblowing mechanisms should always be in place, with suitable processes and protection."
3. **External oversight through transparency and reporting**. The review noted that "investors, bankers, ratings agents, regulators and the public are 'always the last to know' when governance goes wrong. External parties need complete and timely reporting of details about the membership and operations of boards, committees and executives, as well as the governance policies and practices." These detailed requirements need to be built into the governance processes above, as explicit reporting requirements.
4. **Shareholder role**. The executive authority is the owner (municipality, or municipalities) and the owner bears the primary responsibility for appropriate oversight and accountability. The review notes that "the layer of governance that exists between the board of the company and its executive authority is embodied in the *shareholder compact*" and that "the shareholder compact should enable the shareholder to monitor 'the extent to which the board as a whole and individual directors achieve the objectives and any specific performance targets set, and where necessary, effect any remedial action'". The review notes that the shareholder compact is in essence "a performance contract, agreed between the executive authority and the board, and designed to hold the board accountable for delivery of the mandate." They note that "the terms and key performance indicators (KPIs), and measurements against set targets" should be disclosed as part of the annual public reporting by the company.

[26] "SOE Governance Unmasked: A learning journey" (Future Growth, 2018: 5-8).

In much the same way that Johannesburg Water was created, a purpose-built and governance-protected municipal trading service company owned by a Municipality could be capacitated through a management contract.

A company structure does not guarantee good governance

While a company structure can support good governance, it does not guarantee it. In the South African municipal environment, where elected representatives often lack the necessary skills to manage large, infrastructure-intensive services, a company structure may be considered a necessary condition for improving governance. However, it is not a sufficient condition. There are numerous examples of failed or poorly governed state-owned and municipal-owned companies. A typical example is City Power, which faces challenges similar to those affecting other municipal distributors, despite its corporate structure.

The City of Cape Town provides an example of a partially ring-fenced business unit operating within a municipality. While such units can be successful, they are more susceptible to shifts in leadership, which undermines their autonomy compared to a company structure. Although oversight remains the responsibility of the Council, financial transparency can be ensured through the creation of separate financial statements and a transparent, well-defined relationship with the city's corporate finance department. Additionally, the business unit should have clear accountability for all aspects of managing the trading service. While partially ringfenced, Cape Town’s electricity directorate does not conform to a fully ringfenced business unit with autonomy over all critical services supporting its business. This example demonstrates that municipalities should not be fixated on a company structure but rather advocate for an effective governance structure which suites the context.

Annexure G: Using a management contract to reorganize the water utility in Johannesburg[27]

Before 2000, responsibilities for water and sanitation services in Johannesburg were spread across six separate municipal departments: four geographical departments were in charge of water distribution and sewerage networks (answering to four local councils); one department was in charge of the operation of wastewater treatment plants; and the central level of the municipality directly handled all matters related to customer relationships, revenue management, procurement, and finance. This fragmented structure had generated a “silo mentality” among the staff, with a dilution of responsibility and accountability, and customer service was notoriously poor. To remedy this situation, Johannesburg Water was established in 2000 as a new corporatized public utility responsible for water and sanitation services. The main rationale for bringing in a private operator under a five-year management contract was to establish Johannesburg Water as a viable and efficient water utility.

A major part of the job of the private operator was to organize the newly consolidated utility, putting the proper work procedures in place and training employees. The goal was not just to design a new organization chart; it was, most important, to instil a new corporate culture focused on service and efficiency. This was a major challenge with employees who had previously operated under an old-fashioned bureaucratic culture. Implementing such a change was a long and gradual process, in which the daily coaching by the operator staff played a major role. One example of the many measures taken to foster change was empowering line managers to take more initiative in their daily job, as long as this would benefit the quality of service to customers or result in efficiency savings. The average salary per employee went up by 23 percent in real terms during the management contract.

A major effort to promote a new generation of managers and professionals was carried out in parallel with this cultural change. The 693 promotions that occurred during the management contract mostly benefited staff members belonging to groups that previously had faced discrimination in the apartheid era. Although the total number of staff members remained fairly stable (rising from 2,500 in 1999 to 2,600 in 2006).

945 skilled employees were recruited during the management contract, again largely from previously disadvantaged groups.

[27] Marin, Mas, and Palmer 2009, as presented in Concept Note: The importance of management contracts as an intervention to improve the management of water services in South Africa (February 2021, National Treasury)