

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing March 2015

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#### South Africa Summary 26 March 2015

*Finance minister Nhlanelhla Nene and public sector unions clash over the public sector wage increase. The treasury offers a 4.8% raise but unions demand an increase of 10%. Internal divisions within the Congress of South African Trade Unions (COSATU) lessen union threats of strike action. Eskom chairman Zola Tsotsi suspends four members of the power utility's senior management team. The board votes to reject an internal inquiry proposed by President Jacob Zuma (2007-present) and asks public enterprises minister Lynne Brown to support Tsotsi's removal. Eskom also faces a cash-flow problem and strike action at the crucial Medupi plant. Ratings agency Standard & Poor's gives South Africa two years to sort out its economic growth. It will not downgrade the debt rating during this period.*

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#### Nene faces down increasingly fractured unions

Finance minister **Nhlanelhla Nene** is facing opposition and possible disruption from public sector unions over wage negotiations. Seven public sector affiliates of the **Congress of South African Trade Unions (COSATU)** are demanding a 15% wage increase for 2015/2016. However, Nene has granted them a 4.8% wage increase, in line with inflation.<sup>1</sup>

COSATU affiliates represent 58% of the 1.3m public sector workers. The public sector wage bill accounts for 40% of non-interest government spending (i.e. all money not spent on paying off debt). The COSATU affiliates oppose the 4.8% wage increase. The government dropped its planned increase from 5.8% to 4.8% in February in line with the falling rate of inflation. The finance ministry insists that the government cannot afford a higher pay rise. International confidence in the economy is low. With ratings agencies and other observers watching closely, a high increase in public sector wages could have serious implications:

*"The ratings agencies, investors, the currency and bond markets....everyone is looking at South Africa to see if it can pick itself up....giving in to demands for high public sector wages sends a message that it isn't going to."*<sup>2</sup>

In response to the government's plea, the unions reduced their demands from 15% to 10% on 5 March but insist that the government can afford a double digit pay increase.<sup>3</sup> COSATU president **Sdumo Dlamini** said that the government was negotiating in bad faith as inflation could rise in the following months leaving public sector workers out of pocket. Union leaders insist that the government could afford the increase if it cut the positions and salaries of top tier public servants including directors-general and their deputies.<sup>4</sup>

COSATU's public sector unions have threatened to strike if the 4.8% increase comes into effect on 1 April.<sup>5</sup>

*"A strike is quite likely to happen, but given COSATU's internal divisions, the ANC may be able force them to back down....but it also needs union support for the 2017 municipal elections."*<sup>6</sup>

Increased divisions within the unions have left them in their weakest position in years. The tripartite, or revolutionary, alliance formed of the ruling **African National Congress (ANC)**, COSATU and the **South**

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<sup>1</sup> Financial Mail, 12 Mar 2015

<sup>2</sup> Source: macroeconomics professor, Johannesburg

<sup>3</sup> Business Day, 11 Mar 2015

<sup>4</sup> Mail and Guardian, 13 Mar 2015

<sup>5</sup> Mail and Guardian, 13 Mar 2015

<sup>6</sup> Source: political journalist, Johannesburg

**African Communist Party (SACP)** has in the past been the forum for settling public wage negotiations.<sup>7</sup> COSATU is a weaker partner in the alliance. This may affect the outcome which has usually been in the umbrella union's favour. COSATU voted to expel the **National Union of Metalworkers of South Africa (Numsa)** in November (see *ARC South Africa November Briefing 2014*). Seven COSATU affiliates sided with the expelled union against COSATU leadership. Four of them – **South African Municipal Workers' Union (SAMWU)**, **Democratic Nursing Organisation of South Africa (DENOSA)**, the **South African State & Allied Workers Union (SASAWU)**, and the **Public & Allied Workers Union of South Africa (PAWUSA)** – are public sector unions. Numsa has gone on to form a left-wing workers party, **United Front**, as a direct challenge to the tripartite alliance.

COSATU general secretary, **Zwelinzima Vavi** is also involved in a struggle with Dlamini and his allies. Dlamini is a **Zulu** and a supporter of President **Jacob Zuma** (2007-present). He has sought to oust Vavi who has been an outspoken critic of the Zuma administration since 2013. COSATU's executive committee suspended Vavi prior to the 2014 general election for encouraging members not to vote ANC (see *ARC South Africa March 2014 Briefing*). Dlamini commissioned independent audit, advisory and forensic services firm **SizweNtsalubaGobodo** to investigate whether Vavi and his assistant, **Nonhlanhla Hlomuka**, complied with official tendering processes. SizweNtsalubaGobodo published a report on 9 March alleging that Vavi and Hlomuka had not complied with these processes. The report claimed that the executive committee was not informed when Vavi and Hlomuka awarded contracts to office equipment provider **VMS Technologies**.<sup>8</sup> Vavi and seven pro-Numsa unions that support him boycotted COSATU's 2 March central executive committee meeting. The other two public sector unions within COSATU, the **Police and Prisons Civil Rights Union (POPCRU)** and the **SA Democratic Teachers Union (Sadtu)**, are divided over support for Dlamini and Vavi.<sup>9</sup>

Dlamini has considerable power following the expulsion of Numsa, as the public sector unions that back him now dominate COSATU. However, he is a close ally of the Zuma administration and the ANC. He faces criticism from other factions within COSATU both for expelling Numsa and suspending Vavi, and his closeness to the current regime. If COSATU is seen to have failed in the public sector wage negotiations, it stands to lose further credibility in the eyes of its constituents and may face another exodus of support from the public sector. Breakaway **SA Public Service Union (Sapsu)** is actively trying to take workers from COSATU's public sector affiliates.<sup>10</sup> Former members of Sadtu, under former Sadtu president **Thobile Ntola**, formed Sapsu in December 2014.<sup>11</sup>

*"If COSATU fails to increase the public sector wage rise to an adequate extent then members will move out....and COSATU loses more legitimacy as the workers' representative."<sup>12</sup>*

### Board calls for Tsotsi's resignation following executive suspensions

**Eskom** chairman **Zola Tsotsi** has suspended CEO **Tshediso Matona** and three other executives at the state-owned power utility. Behind the move is political interference from President Zuma, public enterprises minister **Lynne Brown**, and deputy-president **Cyril Ramaphosa**.<sup>13</sup>

Brown told shareholders of her *"concerns, fears and frustration about the state of affairs"* at Eskom at a meeting on 10 March. Following this meeting Tsotsi suspended Matona, finance director **Tsholofelo Molefe**, group capital executive **Dan Marokane**, and head of commercial and technology **Matshela Koko**. Eskom's board voted to appoint **Zethembe Khoza**, a non-executive director, acting CEO.<sup>14</sup> The executive team has been unable to address either the power crisis or Eskom's ongoing financial difficulties. However,

<sup>7</sup> Business Day, 11 Mar 2015

<sup>8</sup> Business Day, 4 Mar 2015

<sup>9</sup> Financial Mail, 12 Mar 2015

<sup>10</sup> Financial Mail, 12 Mar 2015

<sup>11</sup> Independent Online, 14 Dec 2014

<sup>12</sup> Source: political journalist, Johannesburg

<sup>13</sup> Business Day, 13 March 2015

<sup>14</sup> Mail and Guardian, 13 Mar 2015

the four executives have been in their posts for seven months at the most (with Matona and Molefe appointed in September 2014), raising questions over why they would be suspended so soon.

*"I understand the government's frustration with Eskom....but the causes of the power crisis go back years, suspending a relatively new executive team isn't going to fix the structural problems."*<sup>15</sup>

Tsotsi's suspensions may not be in line with company regulations as he has been unable to demonstrate the executives did anything wrong. Brown maintains that she did not initiate the suspensions, but supported them as she was not getting accurate information from the management team.

When Zuma told Tsotsi to start an internal inquiry into Eskom's management, Tsotsi brought this to the board on 12 March. Tsotsi also told them that Zuma's preferred candidate, consultant **Nick Linell**, would carry out the inquiry.<sup>16</sup> However, the board voted to reject the proposal, going against both Tsotsi and the president. They also passed a vote of no confidence in Tsotsi and have formally requested that Brown support a further vote to remove him. The **National Union of Mineworkers (NUM)** also passed a no confidence vote in Tsotsi and called on Brown to fire him.<sup>17</sup>

The board has moved to block further moves by Tsotsi to start an inquiry, placing pressure on Brown to intervene directly. Brown has not said whether she would support a request to start proceedings to remove Tsotsi. She has asked for a legal opinion on how the **Department of Public Enterprises (DPE)** can intervene without breaching the **Companies Act** or Eskom's memorandum of incorporation.<sup>18</sup>

There are political reasons why Tsotsi has remained in post at Eskom. Brown pulled her weight against Zuma's preferred candidate **Ben Ngubane** replacing Tsotsi in December 2014 (see *ARC South Africa December 2014 Briefing*) and sources with links to the ANC claim that this has made Tsotsi a valuable stopgap:

*"Brown can't remove Tsotsi now that she's vouched for him to remain, no matter what concerns there are over his competence."*<sup>19</sup>

If the board passes a resolution to remove Tsotsi it will put Brown in a difficult position. A chair opening will be another opportunity for Zuma to put in place one of his preferred candidates. However, not agreeing with the board would contradict her efforts to prevent political interference in SOEs.

It is a difficult time for Eskom to be without leadership. New government figures have revealed the true cost of the power crisis and Eskom faces a fight with the unions over tariff increases and retrenchments. The DPE estimates that the ongoing power crisis costs the country between \$1.7 billion and \$6.8 billion a month. Additionally, in response to the suspension of the management team and announcement of the inquiry, ratings agency **Standard and Poor's (S&P)** downgraded the company's debt rating from BBB- to BB+, one notch below investment grade.<sup>20</sup>

The power situation will not improve in the near term. The DPE estimates that load shedding will continue for at least the next two years and that the grid will not be secure until 2020 when it adds an extra 10,000 megawatts (MW) of power through new power installations.<sup>21</sup> The company has a cash flow shortage and will run out of money to pay staff and subcontractors by the end of April if it does not raise further funds through asset sales or tariff increases. It is receiving an \$876m bailout from the government and has been given permission to raise its tariffs by 12.69% for direct customers and 14.25% for municipalities from July. However, these measures are not enough to cover the immediate shortfall. COSATU has said that it will oppose an increase in tariffs through strike action if necessary.<sup>22</sup>

<sup>15</sup> Source: political journalist, Johannesburg

<sup>16</sup> Moneyweb, 26 Mar 2015

<sup>17</sup> Financial Mail, 23 Mar 2015

<sup>18</sup> Business Day, 24 Mar 2015

<sup>19</sup> Source: financial journalist, Johannesburg

<sup>20</sup> Mail and Guardian, 23 Mar 2015

<sup>21</sup> Moneyweb, 24 Mar 2015

<sup>22</sup> Business Day, 21 Mar 2015

Compounding Eskom's woes, a Numsa strike has halted work at the **Medupi** power plant. The union is threatening further strikes if Eskom does not meet their demands, including an end to all retrenchments. Completing Medupi is the first step in bringing more power online to end the ongoing load shedding.<sup>23</sup>

*"Eskom needs both a CEO and a chairman with real experience and political weight to see Eskom through the next two years....no candidates come to mind."*<sup>24</sup>

### Ratings agencies give South Africa time to sort out economic problems

Ratings agency Standard and Poor's (S&P) will not downgrade South Africa's economic rating to junk despite continued economic troubles. The agency gave the economy a stable outlook and a two-year period to turn the economy around. S&P Africa managing director **Konrad Ruess** said that the country should take advantage of the opportunity to implement economic reforms without the risk of further downgrades. It forecasted economic growth at 2.1% across 2015, and said the ongoing power crisis would reduce growth by 0.3%. Other threats to investment include the proposed land ownership reforms, a high current account gap of 6% of GDP, and ongoing labour issues. S&P cited these as reasons the country retained its current status. S&P downgraded the debt rating to BBB-, one notch above junk, in June 2014.<sup>25</sup>

*"S&P's decision to spare South Africa a junk rating is a recognition of the desire of the national treasury to turn the country around....but the ratings agency is less convinced of the treasury's ability to do this."*<sup>26</sup>

Fellow ratings agency **Moody's** has highlighted infrastructure deficiencies, an inflexible and strike prone labour market, and a large unskilled labour force as major threats to economic stability. Moody's cut its rating to BBB (two notches above junk) in November 2014.<sup>27</sup> **Fitch** downgraded the economy to BBB in June 2014 (at the same time as S&P) but, unlike S&P, has said it is prepared to junk the debt rating in June this year unless there is significant improvement.<sup>28</sup>

A few short-term figures point to some economic recovery. The current account deficit was 5.1% in the last quarter of 2014, down from a forecasted 5.8%. The decrease in the deficit was due to an increase in export volumes over the period.<sup>29</sup> However, the rand has been steadily falling against the **United States (US)** dollar across March, from R11.66 on 1 March to R12.51 on 26 March. This is an 18% decrease year-on-year (R10.56 to the dollar in March 2014), and a 70% decrease over 5 years (R7.48 to the dollar in March 2010). Businesses fear that unless the government takes action the rand could reach 14 or 15 against the dollar, although it has performed better than other emerging currencies across the first quarter of 2015.<sup>30</sup>

The vital manufacturing sector also remains shaky. In the **Bureau for Economic Research (BER)**'s manufacturing survey, the thinktank's measure of sector confidence fell 12 index points (on a scale of 1-100) between the last quarter of 2014 and the first quarter of 2015. BER said continued concerns over strike action and the ongoing effects of the power crisis were major contributing factors to the drop in confidence, which has translated into a drop in domestic and international sales.<sup>31</sup>

### Implications

The treasury's tough line on public sector wage increases is a pushback against public sector unions for the first time. Until now the ANC has accepted above inflation wage increases for the public sector to keep the

<sup>23</sup> Business Day, 26 Mar 2015

<sup>24</sup> Source: businessman with ANC connections, Johannesburg

<sup>25</sup> Financial Mail, 12 Mar 2015

<sup>26</sup> Source: macroeconomics professor, Johannesburg

<sup>27</sup> Moneyweb, 11 Mar 2015

<sup>28</sup> Mail and Guardian, 10 Mar 2015

<sup>29</sup> Business Day, 17 Mar 2015

<sup>30</sup> XE.com

<sup>31</sup> Business Day, 16 Mar 2015

unions on-side and voting for the party. The unions use public sector wage negotiations to demonstrate their power to their members. This year they will not get what they want: the economy is precarious and unions are split. This makes a 10% increase unlikely. The government may increase its offer before the 1 April deadline. In response public sector unions' membership may push for a strike, but it will have little effect if only half the unions support it. This is the first test of the strength of the tripartite alliance since COSATU expelled Numsa. If the privileged link that COSATU shared with the ANC in the alliance doesn't deliver, then public sector unions that are already at odds with Dlamini may leave. This will diminish COSATU's legitimacy as the voice of South Africa's workers and may break the tacit agreement that the ANC grants high wage increases in return for union loyalty.

Lynne Brown has repeatedly said that she does not support political interference in state-owned enterprises. The ongoing problems at Eskom have caused her to go back on this and revealed that, yet again, Zuma is pulling strings behind the scenes. If Zuma had got his inquiry, he would most likely have been able to replace the management team with loyalists. The fact that the board is willing to vote openly against the president shows the limits of his power. However, it puts Brown in the position where she and Ramaphosa will either have to take direct control of Eskom or fight Zuma on another chairperson appointment. None of this helps Eskom tackle its financial shortfalls, mounting union issues or fixing the power crisis. By getting involved with the decision to suspend Matona and the others, Brown may have made things worse. Only a quick restoration of order can set the utility back on track. That track, however, still includes years of load-shedding that is costing businesses and the economy billions of dollars per month.

The ratings agencies, and the markets that follow them, are watching to see if Nene and his team will be able to rein in spending and encourage investment back to the country. His handling of the public sector wage bill is a key test of his strength and influence and keeping it down will provide the agencies and the markets with proof of his abilities. However, the ongoing problems of difficult labour regulations and poor infrastructure will take longer to rectify. S&P has given a two-year reprieve but Fitch may not follow suit when it reviews the country's rating in June. A junk rating will harm South Africa's standing in the bonds and currency markets and further hinder its recovery.

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