Wage increases could sink Eskom

By Maarten Ackerman

7 Aug 2018

Above-inflation wage increases for Eskom workers are simply not sustainable in the long-term, especially if South Africa is to avoid further credit ratings downgrades.

Maarten Ackerman, chief economist, Citadel

Following weeks of negotiations with unions, Eskom has tabled wage increases of 7.5% in 2018 and 7% in 2019 and 2020. This is in addition to inflation-linked increases in housing allowances and once-off cash payments of R10,000 for workers.

However, global ratings agencies have identified poor governance and high levels of debt at the troubled state-owned enterprise (SOE) as a key risk to government's balance sheet, placing the country at heightened risk of further credit rating downgrades and impairing its drive to attract foreign investment to stimulate the economy.

Eskom's revenue has remained fairly flat since the 2008 recession, as demand for electricity has been subdued by a stagnating economy since then. Meanwhile, staff costs have increased some 200% and primary energy costs around 600%, with the result that debt levels have spiked nearly 800%.

According to data compiled by Bloomberg, Eskom now has debt totalling R399bn, after reporting a loss of R2.3bn for the year to 30 March 2018.

These numbers not only show the extent to which the previous board failed to perform, but are also the signs of a bankrupt enterprise which cannot afford to reward employees with above-inflation salary increases.

The way forward

Much hard work now lies ahead for the new board and Public Enterprises Minister, Pravin Gordhan, if they are to right the company's balance sheet and reduce Eskom's risk to the fiscus.

The main problem is that, as an SOE, there is no profit incentive. Around the world we've seen that any company that is nationalised begins to struggle over time – there are very few examples where nationalisation has been successful. SOEs don't need to compete like those in the private sector do as the government is always there to support them, meaning that there's less incentive to make the tough decisions such as cutting wages to reduce costs and make profits.

Eskom needs to enter into a public private partnership (PPP), similar to what was set up for the Zambia copper mines.When Zambia nationalised its copper mines in 1969, employment and output plummeted for nearly 30 years, and by 1984 the country was plunged into recession. By the late 1990s, most operating units had been privatised again, creating the incentive for mines to get out of debt and return to profitability.

However, a partial (or full) privatisation will require Eskom to reduce its costs, beginning with the bloated staff component.

A recent report by the World Bank suggested that the utility is overstaffed by as much as 66%, or that of the 47,000 staff currently employed, just 14,000 are needed for the SOE to operate efficiently.

But given that South Africa is currently entering an election cycle, management will find it especially difficult to garner the political support needed to push through wage cuts or reduce headcount.

However, Eskom is simply not generating sufficient revenue to fund its current staff costs, let alone wage increases, which means that it is relying on debt. And with its anaemic financial condition, the market is less open to new lending, requiring a premium over market interest rates to compensate for the additional risk.

With this in mind, the question is which private company would be happy to buy into this type of business with this kind of debt?

If Eskom is to achieve a turnaround, the board and government will need to demonstrate that they have the political will needed to stand up to unreasonable union demands, reduce costs and address corruption.

ABOUT THE AUTHOR

Maarten Ackerman is the chief economist at Citadel