Productivity in South Africa: is reward management part of the problem or part of the solution?

SARA Conference – 12 October 2012
Q: Productivity in South Africa: is reward management part of the problem or part of the solution?

A: Both
Introduction

- Why is productivity important?
- How is South Africa doing in the labour productivity stakes?
- Historic pay increases and inflation
- Addressing labour productivity
- What can the reward profession do to meet the productivity challenge
Why is productivity important?

- “Productivity is a ratio of production output to what is required to produce it (inputs). The measure of productivity is defined as a total output per one unit of a total input.” (Wikipedia)

- Economic well-being is created in a production process. The greater the productivity in the economic process, the greater the economic well-being

- So, the more productive we are as a country the greater the economic well-being of the people
Why is productivity important?

<table>
<thead>
<tr>
<th>Country</th>
<th>Organisation</th>
<th>Individual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upgrading the infrastructure</td>
<td>Creating employment</td>
<td>Job security</td>
</tr>
<tr>
<td>Cleaning up the environment</td>
<td>Investing in advanced technology</td>
<td>Better opportunities</td>
</tr>
<tr>
<td>Providing more and better social services</td>
<td>Providing better pay and working environments</td>
<td>Better wages</td>
</tr>
<tr>
<td>Providing better care for the poor, disabled and others</td>
<td>Increasing contributions to society with a higher tax quantum</td>
<td>Greater social mobility</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Better quality of life</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Do not waste scarce resources</td>
</tr>
</tbody>
</table>

Source: Productivity SA
Why is productivity important?

- This presentation focuses specifically on labour productivity.

- Poor productivity is holding back business in South Africa with the problem much worse than official estimates, according to a report released on Monday. Prophet Analytics analyst Peter Aling said labour productivity had declined since the 1980s, contrary to an SA Reserve Bank estimate that it had risen 2% a year since the 1960s.

  These findings support other data which show that labour productivity for the South African economy as a whole has fallen to a 40-year low.

  (fin24.com 20 August 2012)
How is South Africa doing in the productivity stakes?

- In The Global Competitiveness Index 2012-2013: *Strengthening Recovery by Raising Productivity*, the WEF “define[s] competitiveness as the set of institutions, policies, and factors that determine the level of productivity of a country”.

- South Africa ranked 52 out of 144 (down from 50 in the previous survey). Kazakhstan is at 51

The most problematic factors for doing business:

- Inadequately educated workforce: 19.7
- Restrictive labor regulations: 18.5
- Inefficient government bureaucracy: 16.4
- Inadequate supply of Infrastructure: 10.8
- Corruption: 9.0
- Policy Instability: 6.1
- Access to financing: 4.4
- Crime and theft: 4.1
- Poor work ethic In national labor force: 3.7
- Insufficient capacity to Innovate: 3.4
- Foreign currency regulations: 1.3
- Tax rates: 0.7
- Tax regulations: 0.7
- Inflation: 0.6
- Poor public health: 0.3
- Government Instability/coups: 0.0
How is South Africa doing in the productivity stakes?

- The problem seems to be that the cost of producing goods and services in South Africa has risen too quickly.
  
  *2012 UASA South African Employment Report*

- “SA formal sector salaries are by many standards in the top 20% of countries around the world (sometimes even in nominal terms.)” *Mike Schüssler*
Gross wages in PPP dollars
SA compared to the rich world - 2010.

Mexico
Chile
Slovak
Estonia
Hungary
Turkey
Poland
Czech
Greece
Slovenia
Portugal
SA Private
SA All
NZ
Israel
Iceland
Spain
OECD
Italy
Canada
SA Gov
France
Sweden
Australia
Finland
USA
Korea
Japan
Ireland
Denmark
Austria
Belgium
Norway
Swiss
Germany
Netherlands
Lux
UK

Ave Gross wages USD PPP

Mike Schüssler - 2012 UASA South African Employment Report
Real unit labour costs. SA has relatively increased twice as fast as OECD.

One can increase pay but when pay and productivity do not match up the cost of labour makes competing more and more difficult. This is the critical part of the SA employment question as we embark on a new world where costs may not be the only thing that counts, one must remember that most other countries have, as they developed, started on a lower cost route. SA can not be that different.
Historic pay increases and inflation

The labour productivity gap
Historic pay increases and inflation

- If CPI is a proxy for the price increases that a company can secure, then pay increases above CPI indicates that there is a decrease in productivity of the labour unit.

- The labour unit cost has increased above the rate that the output price has increased.

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour cost</td>
<td>55</td>
<td>60</td>
<td>9.1%</td>
</tr>
<tr>
<td>Output value</td>
<td>100</td>
<td>104</td>
<td>4.0%</td>
</tr>
<tr>
<td>Profit</td>
<td>45</td>
<td>44</td>
<td>-2.2%</td>
</tr>
</tbody>
</table>
Addressing labour productivity

- What are companies doing to deal with the productivity problem?
  - Head count reduction
  - Cutting costs in areas such as procurement
  - Outsourcing
  - Greater use of technology
  - Off-shore production and services

- These may not always be ideal for the well-being of the overall economy
Labour productivity and the reward profession

- Should we be following market increases blindly? Market increases typically are higher than inflation and not aligned to the specific circumstances that prevail in your organisation.
Labour productivity and the reward profession

- Market increases are a percentage, not an absolute value. They do not factor in the level of pay that the percentage is based on.

<table>
<thead>
<tr>
<th></th>
<th>Company A</th>
<th>Company B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base pay</td>
<td>10 000</td>
<td>11 000</td>
</tr>
<tr>
<td>% increase</td>
<td>8.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>New base pay</td>
<td>10 800</td>
<td>11 880</td>
</tr>
</tbody>
</table>
Labour productivity and the reward profession

- What opportunities are there to change the mix of pay to better reflect reward for value adding performance
  - Slowing of guaranteed increases to better reflect inflation and the business reality
  - Increase in size and participation of self-funding STI programmes that are aligned to key performance indicators. Productivity gains will therefore = higher pay
  - Robust STI scheme rules that are upheld even when times are tough
  - Review of LTI programmes to determine true retention value and alignment to key performance indicators
The “four seasons” of reward in South Africa

Illustrative pay mix values for Middle to Senior Management

Cautious management of fixed costs due to productivity challenges

Well designed variable pay will give productivity gains
Labour productivity and the reward profession

- What role does reward play in attracting and retaining employees?
  - Experience indicates that pay levels rank about 3rd or 4th in the most important reasons for joining or leaving an organisation.
  - Are we not over emphasising the importance of pay levels and neglecting other items of importance such as leadership, work-life balance, culture…?
  - Pay levels need to be reasonable, with key skill and performance differentiation, but are we not over emphasising high guaranteed pay levels?
Moderate Pay Raises on Tap for U.S. Workers

As the global economy continues to waver, U.S. employers are projecting moderate pay raises for employees next year as part of an ongoing effort to closely manage costs, according to survey data from Towers Watson.

"Most U.S. companies continue to keep their salary budgets relatively tight, especially since they are having little difficulty attracting and retaining employees, in general, reflecting the soft labor market," said WorldatWork member Laura Sejen, global practice leader for rewards at Towers Watson. "At the same time, most organizations are having as much trouble attracting and retaining critical-skill employees as they did during the economic expansion from 2002 to 2007."

WorldatWork Practice Leader Kerry Chou, CCP, agreed with Sejen, asserting that pay for performance should be more heavily underscored given modest salary budgets. "You need to effectively allocate available salary dollars, which could mean low or no raises for marginal performers," he said. "And while this isn't a pleasant conversation for managers to have, in the long run it's easier than losing your stars to the competition and then spending far greater sums to find replacements."

According to the Towers Watson survey, exempt workers who receive the highest performance ratings will be in store for an average salary increase of 4.7% this year, which is roughly 50% more than workers with average ratings will receive (3.2%). Workers with below-average performance ratings will receive average merit increases of 1.3%.
In summary

- Think carefully about market increase levels and what that means for your organisation. Are all skills equal when it comes to increases? Which skills are important to your business strategy – where is the greatest return on investment?

- Be clear on your organisation’s current position in the market and what an increase will mean in absolute terms, not just in percentage terms. Remuneration is ultimately a business decision involving hundreds of millions of Rands.
In summary

- Review the pay mix of your organisation so that the “reward levers” are being used to gain maximum output through optimum input. Increases in guaranteed pay are permanent, variable pay is well….variable. The level of control is greater when it comes to variable pay.

- Establish the true (not emotional) importance of pay levels in the your organisation and act accordingly.
In summary

- The key challenge for the reward profession in the next 2-3 years will be the effective management of the pay mix, especially the fixed cost component.

- The economy does not need fewer jobs due to high fixed costs. The economy needs appropriate guaranteed pay that ensures that the job cost is commensurate to the output that is produced, thereby making SA more competitive and ensuring greater economic well being.
Thank you