ARTICLE/ OPINION PIECE

Price decline exposing productivity flaws in mining

South Africa's mining industry is facing rising employment costs and a crucial question regarding sustainability. The average employee's earnings have increased almost 200% since 2005, or 11% every year. Even with the fall in commodity prices since 2011, wages since then have still grown by 43% over that period.

Graham Schwikkard, Manager at Datta Burton & Associates, says that this wouldn't be a problem if prices were rising as they were until 2008, if other input prices were declining, or if there was a tie-in to increases in productivity.

Decreasing output despite increasing wages

The most overlooked and poorly executed response to improve labour productivity is to offset higher employee costs.

Unfortunately, data shows that it just hasn't happened. There has been a steady decline in output per employee for the past decade. On average, weighted output per mining employee has declined 21% since 2001. None of South Africa's major commodities have been exempt from this downward bearing.

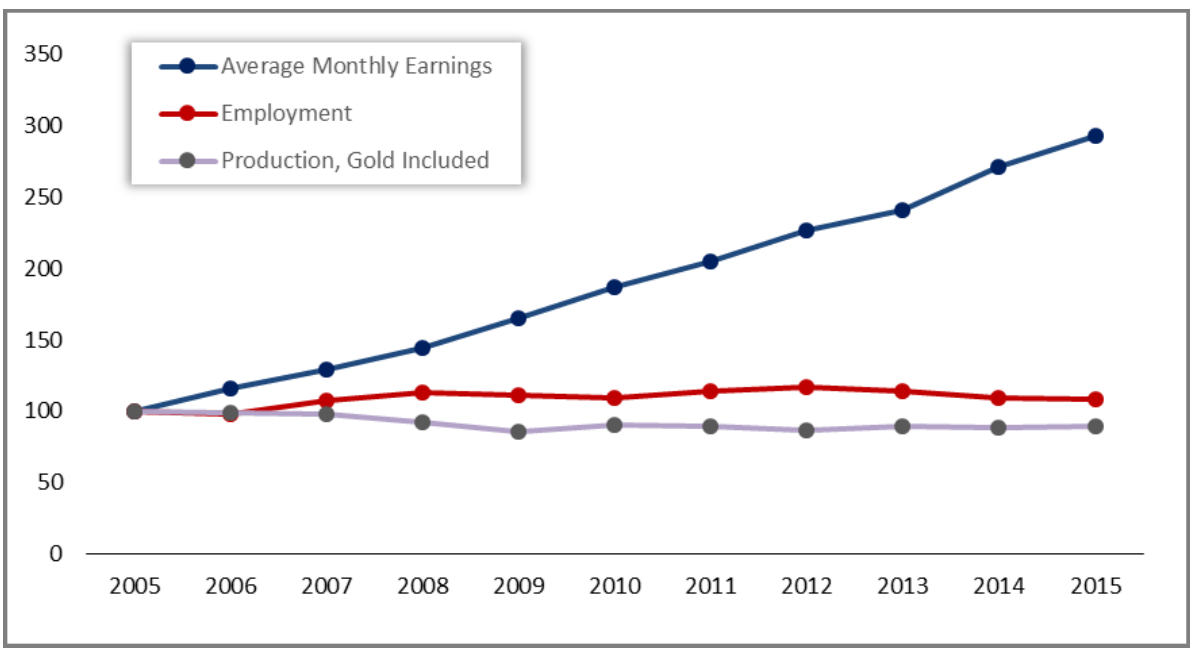

Figure 1 - Index of Production, Employment and Average Monthly Earnings (nominal) based on data from StatsSA and the Department of Mineral Resources

Some factors that contributed to this decline have been the strikes themselves, HIV, the inability of the education system to create higher-skilled employees, and possibly, the lack of innovation and investment from mines to relook at operations.

Capital investment on strike

Since 2008 real capital investment has declined 3% every year. Capital expenditure now only matches depreciation, showing a motivation of investors to just stay in business. This is likely due to a lack of available funds, or appetite for South Africa's risk profile. According to the Fraser Institute Mining Survey, South Africa placed 64th out of 122 global investment destinations in terms of attractiveness, and only 11th in Africa.

This, combined with newer militant strike action, makes South Africa a difficult and risky investment. Since 2008, it has been as though investors have also been on strike. Rather, investors have likely been putting their money elsewhere.

Productivity changes is the answer

South Africa is in a difficult situation - prices are low, input costs continue to rise, and there is minimal capital. If wages continue to rise, the only way forward to avoid shut downs, is for step change productivity improvements.

Miners need a frank diagnosis of their enterprises and must investigate new ways of operating. In some cases, this will include mechanisation, but it is not viable everywhere and other solutions will be needed. From Datta Burton & Associates' experience, this often requires a redesign of the mine's entire management operating system, and leveraging of advances in technology to break through the structural constraints of the way the mine currently operates.

Furthermore, mines and unions need to find a way to tie growing employment costs to improvements in productivity. Mr. Schwikkard advises that mines should tie in future profit as incentive. Many unions are upset about the margins made during the boom. A good solution to avoid unrealistic compensation when it is unaffordable is to offer sharing schemes for when prices and costs improve.

Miners can also consider scenario planning and how they respond to depressed markets. Situations such as these should be planned for to avoid costly knee jerk reactions.

Government's role in the future of mining

Government has a critical role to play as well. Firstly, by creating policy certainty that managers and investors crave, and secondly, to improve education and build a greater skills base that new initiatives in productivity need.

Hopefully, when all combined, these changes could reverse the decline in productivity and encourage investment into South Africa's mining industry once again.

For more in-depth insight and solutions, visit the full analysis here

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