Contract mining in South Africa
Are current models supporting business sustainability?
Contract mining in the current business environment

“A common theory of excellence is to stick to doing what you do best and get help where knowledge gaps exist.”
*Bulk Mining Explosives (BME) marketing manager Charles Hurly*

South African mining companies have used contractors and other forms of atypical employment to complement their current labour models for a number of years. This kind of employment, particularly the use of contractors, has historically been viewed as a more flexible, more highly skilled and more cost-effective alternative to permanent labour.

In recent years, contractors have been one of the mechanisms used to reduce business plan costs and to add flexibility to labour plans. Pressure to cut full-time employee numbers in annual business plans resulted in functions having to be performed with fewer permanent employees. This results in the “unintended” consequence of contractors being used to fulfil these key functions in the core value chain, doing work that was previously executed in-house.
Impact on sustainability

Dependencies in the core mining value chain where a mix of contractor and mine employees operate within the same area distort accountability and eventually reduce productivity.

The mining value chain has significant interdependencies that need to be managed and the use of contractors adds complexity to the process. Dependencies in the core mining value chain where a mix of contractor and mine employees operate within the same area distort accountability and eventually reduce productivity. The negative impact is amplified when the operational objectives and incentives of the different role players are not aligned. This practice ultimately has a negative impact on business sustainability.

Sustainability in the mining context can be defined as the ability to ensure a stable labour force, having the processes, resources, planning capability and controls in place to ensure that adequate mineable face length be opened in good time and that these faces can be mined safely over the longer term.

In view of this, it is apparent that an employment model that involves a mix of own and atypical forms of labour would have a negative impact on business sustainability. Such a model introduces unnecessary interdependencies and complexity in the core mining operation, and these affect the ability of the mine to achieve its business objectives.

Most mining companies have very specific strategic objectives. However, these objectives are often not operationalised to create alignment and focus in all areas of the business. Typically, where contractors are employed, they are not managed as a strategic asset, as the contracting companies do not necessarily complement the current business model or processes but are rather utilised where current resources and capabilities are inadequate.

Even so, contracting companies have become an increasingly important part of the DNA of the South African mining environment, as in-house skill levels have deteriorated over the last two decades and the demand for certain specialist functions have increased. It is, therefore, critical that these contracting companies be enabled and supported to drive the strategic objectives of the business and that they be used only in areas where knowledge gaps exist. The increasing employment of contractors for functions that form part of the core mining value chain rather than specialist skills (often required in areas such as the commissioning of new mining operations) has diluted the focus of mining companies on their core operations. Mining companies are not sticking to what they do best, namely the core mining functions of developing, equipping, constructing and stoping. This results in declining efficiencies and declining overall business performance.

In its most recent strategic plan, the Department of Mineral Resources (DMR) highlighted – as one of its biggest challenges over the next five years – the increased propensity among employers to switch from permanent labour towards atypical forms of employment. It is estimated that 28% of total employment in the mining industry is made up of atypical forms of employment. The DMR goes further to state that the increased use of these forms of employment has contributed to the instability in the labour market and in some cases could potentially violate labour standards and fair labour practices.
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Are current models supporting business sustainability?

Typical contractor models

Contracting companies have traditionally followed a very specific remuneration and benefit model to operate at a lower cost base and to remain profitable. Based on this model, employees in lower job grades are paid significantly lower salaries than permanent mine employees of the same grade and they do not receive the additional benefits of housing, training, medical aid and death benefits that permanent employees receive. Senior-level contractor employees, who form a smaller portion of the employment base, are often compensated more favourably than the mine’s senior-level permanent employees, which is done to attract the best management skills in the industry.

In recent years, many mining contractors have been struggling to make ends meet.

The increasing cost pressure on mining companies is transferred to the contracting relationship.

These companies also employ a different remuneration structure, whereby the variable portion of employee salaries is significantly larger, so as to motivate and incentivise exceptional operational productivity, which enables them to meet their contractually agreed targets.

Contracting companies have indeed been able to operate at acceptable levels and to remain profitable; however, only until recently. In recent years, many mining contractors have been struggling to make ends meet. The increasing cost pressure on mining companies is transferred to the contracting relationship, where contracts are often awarded primarily on the lowest cost tendered for the required service. The result has been a price war among contracting companies with ever-diminishing margins. In many cases, these companies are making losses on certain contracts in order to retain market share.
Top labour mediator and Bowman Gilfillan director, John Brand, has attempted to illustrate the lessons of the Marikana mine disaster to corporate South Africa, where the lower-paid contractor and labour broker employees were highlighted as one of the underlying causes. “Very serious, is a feeling on the part of those workers that nobody cares, and one of the mistakes we have made is to think that this is a money problem. We grossly underestimate the extent to which human dignity is wrapped up in this,” Brand told the Bowman Gilfillan seminar.

The increase in Industrial Relations (IR)-related incidents among lower-level contractor employees is evidence that this model is not sustainable. The poor living conditions of contractor employees (compared with permanent employees who generally have favourable accommodation models and options supported and funded by the mining companies) are another contributing factor to the recent violent strike action in the South African mining industry. After spending ten hours working underground, many of these workers go home to shacks made of plastic, metal and wood, without any electricity.

Contracting companies are also not conforming to the labour demographic goals of mining houses, which complicates stakeholder management (i.e. managing the expectation from organised labour and employees around issues such as the employment of workers from the local community and women in mining). The DMR’s strategic plans highlight the fact that targets for employment of local labour and women in mining are not aligned to the business, which indicates that women remain marginalised in terms of meaningful and influential participation in the economy, along with the increased social challenges related to domestic and cross-border labour migration. The tension caused by migrant workers in local communities was also raised as an underlying contributor to the Marikana tragedy.
Contractor management as a sustainability tool

There needs to be a change in the paradigm for sustainable mining, and the way in which companies employ and manage contractors will have an impact on the future sustainability.

The sustainability of the contractor model in the South African mining environment is in jeopardy, which is due to the way in which contractors are managed and the way in which contractors manage themselves.

Companies have to ensure that their contractor strategy and model support business objectives. They also need to take ownership of issues such as the following, which cannot be transferred to contractors:

- Accountability for increased IR incidents
- Declining efficiencies
- Safety-related incidents as a result of contractors working in high-risk areas
- The lack of skills among contractor employees
- The misalignment of operational targets and objectives between contractors and mining companies

In a recent interview at the 2013 Mining Indaba, former Gold Fields chairperson Mamphela Ramphele highlighted the fact that the traditional way of mining in South Africa, with its reliance on cheap labour, is not sustainable. The cost of atypical forms of labour will inevitably increase, and failure to anticipate this increase could result in a sudden spike in costs. There needs to be a change in the paradigm for sustainable mining, and the way in which companies employ and manage contractors will have an impact on the future sustainability. An understanding of how contractors can support the strategic objectives of the business will ensure that these companies be only utilised for functions where knowledge gaps exist.
The changing business environment, inclusive of the factors mentioned on the previous page, will require that companies critically review the current and future role of contractors in their business. If the situation remains unchanged, it could potentially lead to a tipping point for mining companies where the repercussions will be significantly worse than adopting a proactive approach. A number of possible scenarios of not taking action are shown below. The potential impact of the outcomes further supports the case for change.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Outcome</th>
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<tr>
<td>Contractors will struggle to sustain their businesses in the current model, as many of the contracting companies are already struggling with profitability.</td>
<td>The unforeseen failure of contracting companies that perform critical functions and the subsequent cancellation of the contract by the contractor.</td>
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<td>Stakeholder expectations with regard to equal rights, demographics and broader employee benefits will not be addressed adequately in the short-to-medium term.</td>
<td>Disruptions in production will remain a reality in the mining industry as a result of IR-related incidents related to the dissatisfaction among contractor employees.</td>
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<td>Imminent changes in the labour legislation related to contractor employees will affect mining companies. The most common mistake made in independent contracting relationships is to contract out of employment law and tax provisions and regard the relationship as a legitimate exclusion of such provisions.</td>
<td>An equalisation in remuneration levels and employee benefits to bring contract labour on par with the mining company’s own labour (Failure to anticipate this will result in a spike in costs, without the required productivity increase to offset these costs.)</td>
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<tr>
<td>Legal complications in ending certain contracts where the relationship between mining companies and certain contractor employees are viewed as a labour-broking relationship (These employees may be deemed to be employed by the mine if the employee is reporting into the organisational structures of the mine, employed for longer than six months and is not rendering temporary work for the company. This will inevitably lead to the enforcement of Section 197 of the Labour Relations Act being enforced where mining companies take accountability for the contractor employees with all their existing benefits.)</td>
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The graph below illustrates the potential impact of the realisation of one or more of these “tipping point” scenarios. The compounding impact of a drop in production and a sudden increase in costs will severely impact the bottom line of the company as illustrated.

**Figure 1: Impact of a potential “tipping point”**

A review of the current contractor model is therefore imperative, and companies need to ensure that business models be aligned to the rapid changes in the South African mining environment.
Developing a contracting model for improved business sustainability

A contractor classification framework can be used to categorise all the current contracting functions performed. If the contracting decision is not based on a clearly defined framework, it might result in an increased contractor base and resultant inefficiencies in the operation’s value chain.

Contractor creep at mining companies is mostly a result of:

• The greater ease of employing a contractor, compared with the ease of employing a permanent employee, due to increased cost pressure (fulltime labour component) on annual business plans and the general bureaucracy in most recruitment processes
• The lack of an integrated functional work planning, management and control system at a business level, which can be negated by using contractors
• Open-ended contracts or poorly defined and managed contract scope, resulting in contractors being used for functions outside the initial intended scope

The classification process can create internal business alignment and understanding about the position of contractors in the business. The outcome of the classification can, in turn, be used as the primary input for a more sustainable contractor model. Different business functions can be classified by using the following criteria:

• Core capability, continuous work
• Unique capability, continuous work
• Core capability, ad hoc work
• Unique capability, ad hoc work

The business can then follow a specific diagnostic and implementation approach for each of the criteria and for the contractor landscape as a whole. The matrix on the right is an example of a classification model, with the number of people as a function of the annual cost for a specific contracting activity.

Figure 2: Contractor classification framework
The current trends in the industry point to the need for companies to take back control of their core mining functions and only employ contractors where knowledge gaps exist.

This approach of mapping contractor annual cost for a specific contracting activity will give strategic direction to the existing contractor model and could potentially form the basis of any contracting decisions. The transition from contractor to fulltime employees in certain business functions could result in a higher cost profile in the short-to-medium term. However, it is expected that increased costs will be offset by increased production (in the short-to-medium term, depending on the specific contractor functions being insourced), i.e. the cost per tonne will not be negatively impacted. The major benefit to mining companies will be a sustainable contractor model with better control over business performance and stakeholder expectations. This will also address the DMR’s concerns about the unnecessary use of atypical employment, misaligned demographics and cross-border labour migration.

Certain functions that will remain outsourced need to be managed in line with strategic business objectives (i.e. unique capability and ad hoc functions). For these functions, the focus should be on identifying opportunities to improve the contractor management lifecycle. The suboptimal execution of the contractor management process throughout the lifecycle (from contract initiation to performance management to exit) could result in contractor creep and ineffective performance management. Areas of consideration in the contractor management lifecycle include:

- During the contract clarification the contract structures and contract policies should be linked to business strategic objectives. The “rules of engagement” should stipulate the business expectation in terms of employment demographic profiles, general employee benefits, etc.
- Contractor rates should be linked to a balanced set of KPIs, managed through the correct structures and forums. This will ensure that contractor operational performance is actively tracked and managed and that social and human resource metrics are also adhered to.

**Conclusion**

Companies that develop a contractor model which is aligned to the strategic objectives of the business will prevent the likely scenario of an inevitable spike in costs without the required production benefit to offset the increased cost of insourcing. A more sustainable business model will require agility in adapting to the rapid changes in the South African mining environment. The current trends in the industry point to the need for companies to take back control of their core mining functions and only employ contractors where knowledge gaps exist.

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