Debating productivity

BY GIDEON SKHOSANA, GENERAL MANAGER, PRODUCTIVITY AWARENESS, NPI

Management's task is to meet the profit demands of the owners of capital – those individuals who provide the company with the capital which is the life-blood of the organisation. Owners of capital usually demand a return which is commensurate with the risk they are exposed to If management cannot meet the owners of capital's profit expectations, they can and probably will be fired.

It is therefore important that management understands how productivity links up with profits.

Productivity is simply measured as the quantity of goods and services produced divided by the quantity used to produce these outputs. This can be written as follows:

$$\text{Productivity} = \frac{Qu}{Q1}$$

The sales (Qu) of the organisation are calculated by multiplying the number or quantity of goods and services produced by the price per unit, written as:

$$\text{Sales} = Qu \times Pu$$

Costs are calculated by multiplying the quantity of resources used by the price that is paid per unit – for example, the cost of labour is equal to the personhours hired multiplied by the price per personhour or wage. This can be written as:

$$\text{Cost} = Q1 \times P1$$

The accountants in the organisation and the owners of capital subtract costs from sales to determine profits. In our formula the sales are divided by the cost to get the profit ratio. This looks as follows:

$$\frac{\text{Sales}}{\text{Cost}} = \frac{Qu}{Q1} \times \frac{Pu}{P1}$$

Profit is derived from the left hand side of the formula, while the right hand side indicates which factors determine profit and it is

$$\frac{Qu}{Q1}$$

or productivity, and

$$\frac{Pu}{P1}$$

or price recovery.

If an organisation's profit ratio goes up from one year to the next and productivity did not change at all, this profit ratio could only have increased because selling prices (Pu) of the company's products increased faster than purchase prices (P1) of the resources used. This makes the organisation vulnerable and subject to competition.

Similarly, if prices relative to each other remained constant, and the profit ratio goes up, it could only have been because productivity of labour, capital and materials individually and/or collectively went up

Competitiveness

Our organisations need to be competitive in world markets and the first requirement for competitiveness is productivity. It is easy to see that profits cannot be fed by increasing the selling price of products and services in the international market beyond the going prices in these markets. Already South Africa finds it difficult to compete on a price basis. At the same time the organisation is subjected to increases in the prices of energy, labour, capital, etc. This unquestionably forces the company to focus on productivity improvement as the only means of competing internationally.

This shows why management is interested in ongoing productivity improvement in the company

What about labour?

Labour obviously has two fundamental objectives. The first is that the standard of living of every employee should go up, ie that wages and salaries increase at a faster rate than inflation. The law of economics is fairly simple: it says that the consumption per person (standard of living) cannot increase beyond the production per person (productivity). Unless wealth is created it cannot be distributed. If wages and salaries are increased at a high rate, the only way in which the organisation can recover this increase is by increasing prices, which could make it uncompetitive internationally and locally. Alternatively, it could increase productivity.

Consensus

What is important is that labour and management should agree on how labour will benefit from an increase in productivity. It is important that the additional wealth flowing from productivity improvement must be distributed in three ways:

- the owners of capital must get a higher return on their investment;
- customers must pay a lower price for the product or service;
- workers must get a higher wage or salary.

Only if all the parties in an organisation agree on the basic principles of how wealth created through productivity improvements will be distributed, will wealth be created. It certainly will not help if management tries to keep all the additional wealth for distribution to the owners of capital, nor would it help if everything goes to the customer or the employees. It must be an equitable and acceptable split.

Job security

The second fundamental objective of labour is job security. No employee in his or her right mind will improve productivity if this could lead to workers being dismissed. It is therefore essential that employment should be guaranteed when productivity is improved. In the long run, more and more people will be employed, because productivity is the seed bed of growth and development – the ultimate prerequisite for more job opportunities.

The argument for productivity could be expanded, but what we have set out here is sufficient to demonstrate the stake management and workers have in the improvement of productivity. It is for this reason that the basic principles outlined here should be agreed upon prior to starting the productivity improvement process, to ensure that every participant will freely and enthusiastically contribute to the creation of wealth. ★