Responding to externalisation: Part I

Jan Theron's first part of a two-part article explores 'atypical' work and how companies are implementing it.

The Loots family run a taxi business in Atlantis. It comprises a fleet of eight taxis owned by a close corporation. The members of the corporation are Mrs Loots, Mr Loots, and their eldest son. The other son Percy is not. He is regarded as the manager of the fleet, but is not paid a salary. He operates in the same way as all the drivers working for Loots' taxis. He has the use of a mini-bus for the working day. That is as long as the hours he chooses to work. What he takes in fares he keeps for himself.

But unlike the other drivers, Percy does not pay for use of the mini-bus. That is his equivalent of a manager's salary. It amounts to R1 100 a week. R1 100 a week is what each of the other drivers pays for the use of a mini-bus. Their other important obligation toward the corporation is to ensure that the vehicle is parked in a safe place at night. The corporation in turn is responsible for servicing and maintaining the vehicle. Mr Loots senior is the mechanic who does so.

One of the drivers was Percy's friend Apollus. He was once counted as a friend of the family. The terms on which Apollus was engaged were no different from any other driver, except insofar as he was responsible for fulfilling certain contracts the corporation had with local factories, transporting workers to and from work. Apollus was paid 30% of the corporation's fee each month for doing so.

According to Apollus, the cause of his problems with the Loots was the vehicle they provided him with. It was mechanically unsound. As a result, he was not able to make the target of R1 100 for two months in a row. The next thing he knew, Percy had engaged a driver to replace him. Percy had a different version. The only reason he engaged a new driver was because Apolllus had told him he was resigning.

Apollus then referred a dispute to the CCMA, alleging he had been dismissed. But was he dismissed by the Loots? Was he indeed ever employed? An employee, as defined in the LRA, is differentiated from an independent contractor. But the proposed amendments to both LRA and the BCEA provide that someone who is 'economically dependant' on the person for whom he or she works or provides services is presumed to be an employee. So too is someone who is provided with his or her tools of trade or work equipment by another person.

What can the CCMA do about it, should it find that Appolus was unfairly dismissed?

The CCMA has powers in terms of the LRA to reinstate or compensate dismissed workers. Could it ever be practicable to 'reinstate' him as a taxi driver? Suppose the CCMA considered it was, on the grounds that the relationship between a driver and owner is not close. What will then happen, if Apollus is again not able to make his monthly payment of R1 100? Can he continue to be a driver without doing so? Is the owner, or employer, precluded from terminating the relationship for this reason?

The other remedy for unfair dismissal is compensation. Suppose that the CCMA were to order the Loots to compensate him. How would compensation be calculated if he did not earn a salary? Some would argue compensation must be calculated according to the average 'earned' over the period 'employed.' But no one apart from Apollus is likely to know how much this was. Whatever it was, it is a virtual certainty he did not pay tax on it. It would be ironic if a body funded by the South African taxpayer were to come to his relief in these circumstances.

But there is a more fundamental question at issue. Is it appropriate to use labour legislation to regulate this kind of relationship? Are we not straining the notion of 'employment' by seeking to extend legislative protection to persons it was not intended to cover? To address this question, it is first necessary to place the relationship between Apollus and the Loots' family business in a broader context.

Survey of 'atypical work'

Earlier this year the Labour and Enterprise Project at the University of Cape Town was asked to undertake a study of the extent of 'atypical employment' in South Africa for the Department of Labour. Interviews were conducted with some 45 individuals associated with nine different sectors. The sectors chosen were those in which it was believed atypical 'employment' was significant. These were as follows: retail, mining, manufacturing (food, clothing, metal and engineering), agriculture (deciduous fruit), catering and accommodation, construction and transport. Where possible, both employer and union parties in a sector were interviewed, as well as representatives of any significant bargaining councils, as well as researchers.

The object of the interviews was to obtain an overview of changes in each sector since 1990 in two respects. Firstly, to what extent economic or business restructuring had resulted in a decrease in permanent jobs, and an increase in the number of persons who depended on the sector, but who were not in employment. Secondly, to what extent the make-up of the workforce in each sector had changed or was changing, resulting in the increased employment of part-time and temporary workers. The object was also to determine how unions, employers and bargaining councils were responding to these changes, if at all.

More detailed studies of specific sectors and specific businesses are needed than could be undertaken in the time available. Even so, there have clearly been profound changes in each sector. This is especially so since 1995, and even more so over the past few years. There are now fewer workers in formal employment (and in sectors such as mining and metal far fewer). The make-up of the workforce in each sector has also changed. There are now proportionally more part-time and temporary workers employed.

The proportional increase of part-time and temporary workers in employment is regarded here as casualisation. However, it is only in the retail sector that casualisation in the workplace can be said to have been dramatic.The extent of casualisation in the retail sector can be gauged from the example of a major chain store.Ten years ago 70% of its workforce were permanent and 30% 'casual'.Today the ratio is reversed.A range of part-time workers, some of whom are so-called 'permanent casuals', account for 70% of the workforce. It is therefore noteworthy that retail is the sector in which overall employment (permanent and non-permanent) has diminished least.

Casualisation has been dramatic in the retail sector.

In sectors other than retail, the dramatic change has not been as a result of casualisation as much as restructuring.This was most evident in the number of goods and services that had been outsourced.The rationale for outsourcing is that a business should concentrate on its core functions, namely those operations or activities where it has expertise, or where it has established a competitive advantage. Cleaning, security, canteens or catering and maintenance are readily identifiable as non-core operations, even though their content varies considerably from sector to sector. In all sectors they had generally been outsourced.

However, one cannot explain the extent of outsourcing in terms of this rationale. It has included operations that cannot be construed as non-core on any sensible application of this doctrine: the production line in a food factory, for example, or core mining operations. One can also not explain the extent of restructuring in terms of outsourcing alone. Outsourcing occurs when an employer retrenches workers and engages a contractor to do their job. However, the same outcome, characterised here as externalisation, can be achieved in less obvious ways.A new business can elect to engage outside contractors from the outset, rather than employ. Existing businesses can do so, without having to make their decision to do so explicit.A retrenchment may be separated in space and time from the decision to externalise. In which event the extent of externalisation may only be apparent in a reduction in the numbers employed and a growing number of contractors supplying goods and services in a sector.The construction sector is one such example. It has long been the practice to 'outsource' painting, joinery, installation of ceilings, and so on, because these are functions best performed by persons with specialist skills.This, by the way, goes to show that neither outsourcing nor the rationale in terms of which it is justified is new. Now functions that do not require persons with specialist skills are increasingly being subcontracted. As a result the industry now differentiates between specialist sub-contracting and the 'labour-only' contractors.

The 'labour-only' contractor is paid per completed task, does not supply any materials, has no specialist skills, and exercises no discretion in how the job is carried out. Although estimates vary, it seems safe to say that between 40 and 50% of labour employed in the industry is now being performed by 'labour only' contractors. It has been relatively easy to make this change, because workers are employed on specific projects.

The growth of 'labour only' contractors in construction is matched by a proliferation of labour brokers, sub-contractors and small enterprises that perform essentially the same function in all other sectors. Some may be new or existing enterprises responding to a perceived gap in the market and be more or less viable. But some are no more than satellite enterprises, existing only to service the core business that set them up in the first place.

What has changed?

The terms in which a phenomenon or trend is described is not just a matter for academic debate. It concerns how we respond to it. The point of departure in the above study was that what 'atypical employment' seeks to describe encompasses a spectrum of relationships. Some of these are not new, such as part-time or casual employment. To the extent that these forms of employment are increasingly prevalent, 'atypical' seems an inappropriate term to describe them. If 'typical' employment refers in essence to employment in a permanent job, the converse increasingly applies.

More importantly, it is misleading to characterise the outcome of restructuring as 'employment'. To do so narrows our focus to changes in the arena of employment, the workplace. It also invites us to regard these new relationships as a form of disguised employment.

It is perhaps appropriate to speak of disguised employment, where workers have entered into agreements in which they are described as 'independent contractors'. But the matter is not simple. In the case of clothing manufacturers in Durban, one could say they have done so under duress, for fear of being retrenched. But in metal and engineering skilled workers have done so in droves, for short-term material gain. As 'independent contractors' they do not have to contribute to benefit funds or bargaining councils. Probably they are also hoping not to pay tax.

It is also not only changes in the workplace that are contributing to externalisation. In food manufacturing, for example, hawkers and street vendors have become an important distribution channel for certain foodstuffs. The same is true of flea markets in the clothing sector. Many things have contributed to the growth of these informal enterprises, amongst them government policy. The role of government's development policy in restructuring is most apparent in the transport sector. It was the apartheid government that sponsored the growth of taxis, while at the same time cutting back on subsidies for other forms of transport. This was not only because it regarded taxis as a viable means of transport. It was consistent with its promotion of small business and entrepreneurship to do so.

The case of a taxi driver such as Apollus is relevant, not simply because there are thousands or tens of thousands in his position. Notwithstanding attempts to organise taxi drivers, it is through government and its enterprise development policy that the relative imbalance of power between Apollus and the Loots can best be addressed.

Given the range of forms it can take, is externalisation a coherent concept? The trend that seems to drive all forms of externalisation, is for businesses to focus on the marketing of their product. Functions formerly fulfilled by employees within the enterprise are now being fulfilled by contractors (or entrepreneurs), external to the enterprise. What is significant about externalisation, is the flight from the employment relationship it represents. In its stead, a new contractual relationship is constituted between the core business and the contractors who serve it.

The difference between casualisation and externalisation needs to be highlighted. In the case of casualisation, although the status of employees in the enterprise changes, their status as employees does not change. While regulation of the employment relationship may be made more difficult, it nevertheless remains susceptible to regulation. In the case of externalisation, goods or services are supplied in terms of a commercial contract rather than in terms of an employment relationship. The scope for all forms of regulation premised on an employment relationship is correspondingly reduced.

The consequences of the two processes are also different. Externalisation is creating a new layer of entrepreneurs. Some of these will be employers. Some of them are drawn from the ranks of those who were formerly employed, and from the unions. At the same time externalisation is generating casualisation. Although one of the effects of externalisation is that the conditions of employment of the workers of the enterprise supplying the service become opaque, all indications are that they are in the most casualised form of employment possible. As a rule of thumb (according to one employer) an outsourced operation employs two-thirds of the workers at two-thirds of the rate permanents were once paid. Needless to say this has far-reaching consequences for the cause of workers' organisation. It is therefore significant that trade unions have been party to externalisation, under the umbrella of 'empowerment'.

Externalisation and empowerment

A leading hotel chain provides one instance of how externalisation has been effected under the umbrella of empowerment. It did not introduce externalisation in the hospitality sector. A competitor did. This competitor did not have to do so through outsourcing. It was a new business to start with. From the outset, it chose to employ as few people as possible, through what is referred to as the limited services concept. To the extent that this gave the newcomer competitive advantage, it constrained its competitors to match its cost structure.

Functions such as garden services and security were soon identified as not part of the core business, and outsourced. Then it decided food and beverages were not part of its core business as well. It defined its core business as taking a booking and providing accommodation. Providing accommodation, one might suppose, must make the function of keeping the accommodation clean and presentable a core one. Yet housekeeping has also been outsourced. The reasons for outsourcing this function really have no relation to the distinction between core and non-core functions. Rather they concern how work is structured, and the introduction of what is in effect a task-based system of payment instead of a wage. This is done by setting up the workers involved in housekeeping as an external enterprise. The hotel chain then contracts the enterprise to do the job on a task basis.

By contracting an enterprise to do the job, the company has contracted out of its obligations as an employer. This is not only the obligation to pay a wage that bears some relation to the cost of living, but also to provide social benefits such as a pension and medical scheme.

There are still workers employed, but they are employed by the newly-created enterprise. The form of enterprise the company has chosen to establish is a close corporation. The members of the close corporation were once employees of the hotel chain. If they did not occupy leadership positions then, they do so now. They are now responsible for managing and directing their former colleagues. In effect they are their employers, although the company speaks of the employees as associates of the corporation.

The company has thus achieved a triple objective. First, it has cut its labour costs, in the form of wages and benefit fund contributions. This it has done by outsourcing to the newly established enterprise. But the term outsourcing does not describe all that it has achieved. A new system of payment is provided for in the agreement between the company and the enterprise.

If the rooms are occupied, there is work for the close corporation. The company then pays the agreed rate per room. If not, the company pays nothing, and the workers of the enterprise are also not paid. The second objective is achieved thus. Its labour costs (which have now been converted to service fees) are no longer fixed, but variable. Third, it has effected a transformation of social relations in the workplace, in terms of which certain ex-employees are elevated to the status of employers of the other employees.

Transfer of assets

The enterprises established by the hotel chain are economically wholly dependent on the core business, and exist to service the enterprise. Accordingly they are characterised here as satellite enterprises. Even more radical forms of externalisation have been attempted, where assets have been transferred to satellite enterprises established by its employees. The best known example is where truck drivers buy their trucks from the employer, and employ their own crew to do deliveries.

The pattern at one major food company is probably typical. The truck driver borrows from the bank to buy his truck. The employer stands surety for the loan. To all and intents and purposes it is an ordinary agreement of purchase and sale. The employer and the company in turn enter into an agreement whereby the driver undertakes to deliver for the company, and is paid for tonnage delivered. In effect this is a productivity payment, akin to payment on a piece-work or task work system, but cast in the form of a commercial contract. The driver is also beholden to the company for the duration of the agreement. Ten years is probably a typical period. After all, the truck he drives bears the company logo.

Before the trucks were sold two or three workers were employed on each to assist the driver. After buying the truck, the driver will make do with one assistant, usually a family member, or none at all. Through this arrangement the company achieves the same objectives as the hotel chain. Not only are labour costs cut, but the costs of delivery now vary according to sales. As a result the company claims significant increases in productivity. The reason productivity increases, as articulated by the company, is that the driver is 'incentivised'. In contrast to a driver who is paid an hourly rate, who will spin out a delivery for as long as possible, he (it is not likely to be she) is working for his own profit. As a result the tonnage moved at some plants tripled. Overall it is 20 to 30% higher than it was.

The transfer of physical assets to an enterprise is significant for a number of reasons. For one thing, it is difficult to see how a transfer of physical assets could not also constitute a transfer of a whole or part of the business. This is precisely the kind of transfer the LRA seeks to regulate, yet in a unionised workplace the LRA was not invoked. When the trucks were sold, workers that could not be accommodated elsewhere in the company were retrenched. The union did not contest the retrenchments.

This must surely be because the owner-drivers perceive they have benefited from their new status. But the benefits may be of a short-term kind. It is therefore probably too soon to assess the extent to which this is really so. Such an assessment will have to include an appraisal of the assets they have acquired, and an appraisal of the benefits they have forfeited, including pension and medical benefits. The extent to which owner-drivers are able to provide for the depreciation of their trucks will in many cases determine whether their enterprise is sustainable in the longer term.

The case of the owner-drivers is not unique. There were instances of assets being transferred to satellite enterprises in construction, engineering and food manufacturing. However, the category of persons most often 'empowered' is former managers. It is management or someone with management support that is most likely to be aware of an opportunity to outsource, and to have the resources to tender.

A food manufacturing company sold 13 poultry farms to its employees, including the management. Each lot of employees, through companies they had formed, entered into a 20-year agreement with the parent company. In terms of this agreement, they undertake to supply the parent company with 80% of what they produce. The balance they may sell as they like. The objective, again, is to 'incentivise' the employees. The mundane and repetitive nature of this particular farming operation makes it all the more desirable to do so.

A parallel objective is to transform this part of the company's business from manufacturing to marketing. There is an incentive for it to do so. By disposing of assets, it is presumably also diminishing risk. At the same time it is improving its ratio of the return on investments to assets, making it a more attractive investment. Yet it is also not all the farms that have been sold. The parent company will retain the 'high-tech' breeding farm. It also retains the right to enforce hygiene and quality standards.

Through its ownership and control of technology that is essential to the operation, it retains control. When all is said and done what is core may be no more than the right to certain brand names, by virtue of franchise agreements, or by virtue of the law of intellectual property. Provided the rights to those intellectual property rights or franchises are not compromised, virtually every operation can be outsourced. ★

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