ABSTRACT

The purpose of this study is to propose a financial assessment model for use in preparation for salary and wage negotiations.

Media reports covering recent salary and wage negotiations, as well as industrial action, were studied to identify financial factors that could have an impact on the negotiation process. The financial factors were grouped according to external, internal and personal financial factors. Of note is the fact that the majority of financial factors were found to be of an internal nature, that is, concerning the internal organizational environment. This group could be further divided into pure financial factors and financial factors relating to the relationship between management and the employees.

The principles and calculations used in value based management were considered. Particularly the balance between direct and indirect cost, in relation to the return that is generated, as the return creates value for the owners and shareholders, but return requires input cost, which includes labour cost and should be closely managed to optimize the balance between the two.

A study of negotiation preparation methodologies and practical preparations for negotiations identified financial assessment and preparation as an area that is relatively neglected when preparing for salary and wage negotiations. Although the reasons for this were not particularly researched, it can be deduced that time plays a role, as well as ready access to models and tools to assist negotiators in this area. The findings of the theoretical research were confirmed by the empirical study, which consisted of structured interviews with persons normally involved in salary and wage negotiations. Of note is the fact that several of the interviewees indicated that they are not particularly financially literate and that they therefore battle to assess the finances attached to salary and wage negotiations.
A financial assessment model is proposed which incorporates the identified financial factors and the principles of value based management. The model has been designed to be simple to use and applicable to any industry or organization. It still needs to be extensively tested and developed into a software product that is interactive, simple to use and automates the calculations contained in the model.
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### TERMS AND ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AA</td>
<td>Affirmative Action</td>
</tr>
<tr>
<td>BATNA</td>
<td>Best Alternative to a Negotiated Agreement</td>
</tr>
<tr>
<td>BEE</td>
<td>Black Economic Empowerment</td>
</tr>
<tr>
<td>CAPM</td>
<td>Capital Asset Pricing Model</td>
</tr>
<tr>
<td>CF</td>
<td>Cash Flow</td>
</tr>
<tr>
<td>COMP</td>
<td>Competitive</td>
</tr>
<tr>
<td>COSATU</td>
<td>Confederation of South African Trade Unions</td>
</tr>
<tr>
<td>CPIX</td>
<td>Consumer price index less the mortgage rate</td>
</tr>
<tr>
<td>EBIT</td>
<td>Earnings before Interest and Tax</td>
</tr>
<tr>
<td>EE</td>
<td>Employment Equity</td>
</tr>
<tr>
<td>Est</td>
<td>Estimated</td>
</tr>
<tr>
<td>EVA</td>
<td>Economic Value Added</td>
</tr>
<tr>
<td>Exp</td>
<td>Expected</td>
</tr>
<tr>
<td>FCF</td>
<td>Free Cash Flow</td>
</tr>
<tr>
<td>GAAP</td>
<td>Generally Accepted Accounting Practise</td>
</tr>
<tr>
<td>I</td>
<td>Investment(s)</td>
</tr>
<tr>
<td>ICE</td>
<td>Interests, Concerns and Emotions</td>
</tr>
<tr>
<td>Inc</td>
<td>Incorporated</td>
</tr>
<tr>
<td>MVA</td>
<td>Market Value Added</td>
</tr>
<tr>
<td>Neg</td>
<td>Negotiations</td>
</tr>
<tr>
<td>NEHAWU</td>
<td>National Education, Health and Allied Workers Union</td>
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<tr>
<td>NOPAT</td>
<td>Net Operating Profit after Tax</td>
</tr>
<tr>
<td>NPV</td>
<td>Net Present Value</td>
</tr>
<tr>
<td>OE</td>
<td>Operating Expenses</td>
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<td>Org</td>
<td>Organization</td>
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<td>PP</td>
<td>Preferential Procurement</td>
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<td>Prob</td>
<td>Probability</td>
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<td>ROI</td>
<td>Return on Investment</td>
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<td>Acronym</td>
<td>Description</td>
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<td>--------------------------------------------</td>
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<tr>
<td>ROIC</td>
<td>Return on Invested Capital</td>
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<td>SA</td>
<td>South Africa</td>
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<tr>
<td>SAA</td>
<td>South African Airways</td>
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<td>SARS</td>
<td>South African Revenue Services</td>
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<tr>
<td>T</td>
<td>Tax</td>
</tr>
<tr>
<td>TOC</td>
<td>Theory of Constraints</td>
</tr>
<tr>
<td>TP</td>
<td>Throughput or sales</td>
</tr>
<tr>
<td>UASA</td>
<td>United Association of South Africa</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>VBM</td>
<td>Value Based Management</td>
</tr>
<tr>
<td>VW</td>
<td>Volkswagen</td>
</tr>
<tr>
<td>WACC</td>
<td>Weighted Average Cost of Capital</td>
</tr>
<tr>
<td>WITS</td>
<td>University of the Witwatersrand</td>
</tr>
</tbody>
</table>
CHAPTER 1

INTRODUCTION

1.1 Background

There are different reasons and circumstances that lead to the incidence of a strike. According to Bendix (2005:592), "The majority of strikes are supposedly instituted for economic reasons; ... of significance is the large number of strikes where the cause is apparently unknown".

Media research suggests a host of factors, including, but not limited to, amongst other, the relationship between company profit and pay, the disparity that exists between directors and shop-floor workers' pay, unstable inflation and fuel prices, the rising cost of healthcare and the financial effects of restructuring.

This study intends to identify those financial factors from the external environment, the internal environment and personal circumstances that could influence the outcome of wage negotiations. The principles of Value Based Management are investigated and in particular, the role of each of the identified financial factors as it relates to Value Based Management. Negotiation preparation methodologies are analysed to evaluate how the identified financial factors and the principles of value based management are incorporated into preparations for wage negotiations. The study concludes by proposing a financial assessment model that management could use when preparing for wage negotiations.

According to Catalano (2005:8), a purchasing consultant for Roche Molecular Systems Inc, "One of the most important skills to develop is negotiation ... And when it comes to negotiation, the most important thing for anybody is the preparation you put into it." Catalano maintains that the negotiation brief should be deemed a critical tool in
preparation, providing information regarding the history, the current situation and the objectives of the forthcoming negotiations. Although these comments relate to the purchasing environment, it does hold true for wage negotiations too.

The Huthwaite Research Group has spent some time researching and analysing the behaviour of "skilled negotiators" in comparison to that of "average negotiators". According to Rackham of the Research Group (1978:2), the research concluded that planning was the definitive characteristic that determined the measure of success achieved and that it "was not the amount of planning time which makes for success, but how that time is used". The Research Group does propose models and tables to assist negotiators with the preparation phase, covering various elements of the negotiation process and content, but do not propose a specific model for evaluating financial factors that could influence the outcome of wage negotiations.

1.2 Research Statement

There are several methodologies available to follow when preparing for wage negotiations. Methodologies generally emphasize one or some aspects relevant to the negotiations, but do not specifically relate the negotiations to the strategic intent of the organization. This study proposes to assess wage negotiations from a financial perspective within the context of Value Based Management and to propose a financial assessment model for preparation.

1.3 Study objective

1.3.1 Main objective

The objective of this study is to develop a financial assessment model, which can be used during preparations for salary and wage negotiations.
1.3.2 Sub-objectives

- To identify financial factors that might impact on the outcome of wage negotiations.

- To indicate how these financial factors relate to the principles of value based management.

- To assess how the identified financial factors and principles of value based management are incorporated into existing preparation methodologies.

- To propose a financial assessment model that incorporates identified financial factors and relates these financial factors to the principles of Value Based Management.

1.4 Research Design and Methodology

This dissertation includes a media study. The media study will focus on press coverage of recent wage negotiations and strike actions to identify financial factors that had an influence on the negotiation process and strike action in the past. These factors will be grouped together in three categories, namely financial factors from the external environment, the internal environment and the personal financial circumstances of employees.

The financial factors that have been identified will be related to the principles of Value Based Management, to indicate how management can assess the impact of the financial factors on the Economic Value of the organization. Examples are quoted of companies that have successfully integrated compensation practices and value based management.
Wage negotiation preparation methodologies are evaluated to ascertain how identified financial factors and principles of value based management are currently being incorporated into preparation for wage negotiations.

The empirical research will consist of structured interviews based on a qualitative questionnaire. The purpose of the questionnaire is to determine the consideration currently given to financial assessment of wage negotiations, as well as the potential use of a financial assessment model.

Finally the financial assessment model will be presented and further research proposed in this regard.

1.5 Limitations

There are specific limitations to this study and hence also to the application of the proposed financial assessment model:

- The focus of this study is salary/wage negotiations and unrelated negotiations and strikes are disregarded. Preparation methodologies and research regarding other commercial negotiations are included for completeness, only where appropriate to salary/wage negotiations.

- This study assumes that all parties to the negotiations are engaged in non-cooperative bargaining and acting rationally, that is, aiming to maximize the financial benefit of the outcome.

- Only financial factors influencing salary/wage negotiations are considered in the study and non-financial factors are excluded.

- The media research component is restricted to South African salary/wage negotiations and strikes in the recent past.
1.6 Exposition of chapters

Chapter 2:

This chapter contains the information gathered in the theoretical research. It identifies prominent financial factors from recent salary/wage negotiations and strikes. The identified financial factors are grouped and summarised.

The principles of Value Based Management are discussed, with specific reference to the remuneration component and the impact that this has on the value of an organization. The identified financial factors are related to the principles of value based management.

Above financial factors and value based management principles are compared to various negotiation preparation methodologies, to determine how these are currently considered during preparation for wage negotiations.

Chapter 3:

The third chapter is devoted to the empirical research, the process followed, the results obtained and an analysis and discussion of the results.

Chapter 4:

The information obtained from the theoretical and empirical studies are used to compile a financial assessment model, for use in preparation for salary/wage negotiations.

The use of the proposed model will be covered in this chapter, as it will be explained to negotiators before they use it. Future application, refinement and research regarding the financial assessment model conclude the discussion.
CHAPTER 2

THEORETICAL RESEARCH

2.1 Background

There is a distinction between bargaining and negotiations. Volkema (2001:2) states that bargaining is merely a facet of negotiation, namely deciding on the final price of an item, whereas negotiation is ongoing dialogue between two or more parties to determine the nature of the future relationship. Thus stated, it would make sense to skill and prepare oneself for such engagements. Yet, Fisher and Shapiro (2005:5) maintain that "a lot of negotiators come to the table without preparation, because they don't have a structured way to prepare".

2.2 Financial factors from recent industrial action

The South African Constitution, section 23, recognises the right of employees to strike: "Everyone has the right to fair labour practices; every worker has the right: (c) to ... strike", however, the equivalent right, or the right to lock out employees, is not afforded employers, either in the Constitution or the Labour Relations Act. The website of the National Department of Labour reports that the number of workdays lost per annum per 1 000 workers due to strike action, increased from 107 in 2004 to 221 in 2005.

Though not all financial by nature, Patricio (2005) lists what employees might want, and accordingly should create motivation and contentment:

- A friendly and caring environment.
- A secure job.
• To be paid a fair wage.

• Recognition.

• Fair management practices.

• To participate in decisions that affect employees.

• Interesting and challenging work.

• Opportunities for growth and promotion; and

• Clear expectations.

A media study revealed financial factors that impact wage negotiations/strike action. These factors are divided into three broad categories, namely the external environment in which the organization operates; financial factors within the organization; and personal financial factors, that is, the financial position of the individual employee.

2.2.1 The external environment

The external financial factors impacting wage negotiations are derived mainly from government policy and the results of implementing this policy. Two issues in particular, the reduction in the number of personnel employed by the government and the severe restrictions imposed on personnel costs at all levels of government, impact wage negotiations. Barchiesi (1999:16) quotes the Public Services Minister as having said that the government intends to retrench at least 50 000 more public servants in a drive to drastically reduce the size of an allegedly "bloated" public sector.

Discussing the financial factors within the broader context of a changing political landscape, Barchiesi further claims that "the budget constraints behind the
government's negotiating stance are part of the ANC's macro-economic program - which calls for tight limitations on budget deficits, increasing privatization, and public spending cuts for the sake of fiscal discipline.” Further, with the current backlog in service delivery, the government is persisting in following a policy of reducing its own commitments and transferring its responsibility to the private sector, which has not succeeded in reducing the existing levels of poverty and social exclusion yet. The employed workers or privileged layer of society are expected to make increasing sacrifices whilst the government is “letting the capitalist market have its way to balance the demographic composition of capital”. The emphasis of transforming business by way of affirmative action and employment equity has merely created a new bourgeoisie and resulted in economic development that is unlikely to benefit the majority.

The South African Business Guidebook 2002/03 provides a synopsis of the South African labour market – “an over supply of unskilled workers and a shortage of skilled ones; a population growth that exceeds the growth in employment demand; and a consistent loss of jobs in the formal sector.” Government strategies to eliminate the labour inequalities of the past and improve working conditions in general, have yielded mixed results and seen unemployment marginally decrease from 26.4% in February 2000 to 23% in 2007, according to the Presidency Annual Report 2007/ 2008.

Ueckermann (2005:1), interviewing Jaco Kleynhans of Solidariteit, reports that whilst the government’s economic policy should be benefitting all, it seems that it is only the case for a privileged few and the masses at the lower end of the scale. The middle levels, such as skilled artisans, are neglected and increasingly frustrated. This frustration could lead to strike action. Ntuli (2005) supports this notion and states that, whilst macro-economic indicators are favourable, that is a stabilized public deficit and a balanced growth rate, few jobs have been created and many workers are still employed as temporary staff and casuals.

According to the Merrill Lynch World Wealth Report, ministers currently earn 15 times more than the average public servant and the gap increases in local authorities and the
private sector. The Independent Commission for the Remuneration of Public Office Bearers recently recommended an 11% increase for public office bearers, in contrast to the 8% that public servants received, reported by Sapa (2008:21). The National Education, Health and Allied Worker’s Union (NEHAWU) ascribes the rise in government spending directly to increases in pay and benefits for management whilst the Congress of South African Trade Unions (COSATU) claims that the wage gaps are legacies of apartheid and that this, together with rising costs caused by the privatization of services, are the major financial factors impacting wage negotiations.

The recent public sector strike, whilst not handled well by either the unions or the employer, has cost the country dearly, that is according to Mkhabela (2007:13). This point of view is supported by Ntuli (2007), who goes on to say that the loss of production in the private sector can be recouped, but this is not the case with the public sector. Whilst the final wage settlement will have minimal impact on medium range inflation, it will serve as benchmark for other industries’ negotiations and the average annual wage growth could end somewhere between 7% and 8%. Although public sector unions traditionally receive the lower end increases, they set a benchmark for other industries in the country. The militant approach of public sector employees could also increase the propensity to strike in the other sectors of the economy. Chauke (2007) reports that the recovery plan for education in Gauteng alone after the 28 day public sector strike is estimated to cost R10 million, whilst the damage in terms of exam results is incalculable.

Sapa (2007:11) draws attention to the contribution of foreign companies, which, though very briefly reported, should not be overlooked. In a German wage deal, Volkswagen (VW) pledged to shift production of VW models, possibly impacting 6 600 employees at the Uitenhage plant. Mass action and higher labour costs send negative signals to investors, creating situations where the country as a whole and employees in particular, emerge as losers. Ntuli (2007) reports that COSATU did propose legislation compelling retailers to stock 75% local goods and cut back on imports, in an effort to save jobs, but this proposal did not elicit much reaction.
According to COSATU, the cost of basic services, particularly water, electricity and refuse removal, is rising due to the privatization of services at municipal level. The struggle for a living wage for all workers represents its efforts aimed at meeting the costs of basic necessities and services, as well as paying for arrear debts inherited from the era of anti-apartheid boycotts for which the new government is now demanding payment. The government is adhering to economic policies that support its growth and inflation targets, whilst international influences, national domestic spending levels and an increasing current account deficit force interest rate increases and translate to inflation rate instability.

2.2.2 The internal organizational environment

Jack and Suzy Welch (2007:2) are of the opinion that “with good management, unions aren’t really necessary. When managers operate transparently and fairly – and workers know it – there is no need for a third party to broker the conversation between them”. “Transparently and fairly” are explained as an understanding that workers are employers’ own people and they need to be given a voice and a sense of dignity. Workers should know that their ideas are important and there should be open communication between employers and employees. Workers should know what the costs are, the competitive situation, growth plans and economic projections. They should also know what issues are negotiable and which are not.

In contrast to this opinion, is the South African Airways (SAA) strike of 2005. Makings (2005) blames the relationship with management, bad management of staff issues, appointment of unsuitable staff, management extravagance and re-interpreting of signed agreements as the contributing factors. Piliso (2005:10) quotes Koos Bezuidenhout (2005:5), Chief Executive Officer of the United Association of South Africa (UASA), "If you lie to your opponent around the negotiating table, you do so at your own peril". The negotiators painted a gloomy picture of the company’s financial position and refused to provide the financial statements to the union to substantiate this. Whilst negotiating, management announced a healthy profit, and unions immediately
reverted to strike action, claiming that the employer was negotiating in bad faith. "Workers demanded a share of the fruit of their labour, while management refused to move." The strike affected the bottom line and the reputation of the organization, for whilst SAA had declared a profit of R966 million for the previous year, the strike is estimated to have cost R1 billion.

Although inflation is reported to surface in many negotiations and strikes on both sides of the negotiation table, Ntuli (2006) tries to put it into the correct perspective, namely that employers cannot readily increase prices above the consumer price index less the mortgage rate (CPIX) and so have to restrict the increase of salaries and wages to the same level, or balance the equation by reducing the number of jobs. Unions on the other hand, are of the opinion that business has been profiteering at the expense of employees, and are disregarding issues such as job security, living standards and basic rights of workers. The opinion is that real inflation for the lower level employee is above CPIX due to the influence of transport cost and that a fixed percentage increase across the board, offers more to management than to a lower level employee.

Bain (2007) reports that employees in the Metal Engineering Industries have agreed to a three year deal, with increases above inflation, but marginally decreasing as job levels increase. This has motivated employees in the mining industry to request increases substantially above the inflation rate too. However, Ueckermann (2005) quotes Kleynhans as saying that the practise of diminishing increase as post levels rise is one of the reasons for dissatisfaction in the middle employment levels. Barron (2007:10) interviewed Elize Strydom, Chief negotiator for the Chamber of Mines, who firmly believes that if unions get what they demand, the mines would not survive financially. She continues by saying that whilst the unions understand economics and particularly the total cost of their demands, the expectations of members were unrealistically high. She includes remuneration as a portion of total cost to the industry and the cyclical nature of the business in her arguments. However, she does add that employers should be more socially conscious when addressing labour issues, particularly regarding job
categories that no one wants due to the particular working conditions attached to the job.

The threat by South African Revenue Services (SARS) officials to strike over pay reveals several financial factors worth considering. According to Naidoo (2007), SARS employees are of the opinion that their remuneration should not be benchmarked against that of public service workers, as they are not public servants. There is a demand for improved fringe benefits (housing and medical aid contributions), citing the excellent financial performance of the organization and the contribution of the employees to the financial position of the government in justification of the claims.

Clark (1997:645) contends that there is a direct relationship between the level of inventory within an organization, the wages paid and the propensity to embark on industrial action. The correlation was demonstrated during the United Kingdom coal miners' strike in 1984-85. Failure to prevent delivery of coal to power stations rendered the strike futile. The author further postulates the findings as follows: "...the higher are the firm's inventories at the outset of the period, the lower will be the union's perception of the probability of acceptance of any given offer. Thus, higher inventories will induce the union to make a lower offer, which will be less likely to be accepted, causing a tendency to decumulation. This would show up as a positive association between wages and inventory change. In addition, a strike in one period makes one in the next period less likely." This contribution suggests that management can prepare for industrial action in order to minimise the probability and impact thereof.

2.2.3 Personal financial circumstances

Harris (2007:7) weighs devotion, morale and remuneration in an emotionally charged article after the strike by public servants. The author claims that "if all teachers and all doctors were concerned only about money, there would be no one to run government schools or hospitals". It is explained that a 9% increase translates to approximately R250 per month in the pocket of government employed teachers. On the other hand,
the working conditions are less than ideal and accordingly outweigh the actual pay when decisions regarding industrial action are taken. Teachers do not own cars or houses, having limited opportunities for advancement, they do not benefit from share options like executives do, and experience large pupil to teacher ratio's whilst minimal resources and teaching aids are available.

Ntuli (2007) looks at the personal circumstances of particularly mineworkers and concludes the following: Mineworkers earn very low wages considering the dangerous and hard manual labour that is performed; the working conditions of mineworkers are bad; the living conditions within the mining enclosures are squalid; and these circumstances are perpetuated despite successive mining bosses and the new democracy. Although wage increases will contribute towards alleviating these, a concerted effort is required to improve the living conditions.

There seems sufficient reason to believe that industrial action is not merely focussed on an increase in wages and salaries, but that there are other financial factors involved. Venter (2008) reckons that managements' commitment to their employees plays a role, mentioning the disparity between management remuneration and that of lower level employees, as well as the fact that management seems to be getting higher percentage increases than lower level employees, exacerbating the wage gap. Fringe benefits, particularly housing and medical aid schemes are high on the agenda of employees. Venter maintains that benchmarking increases against the inflation rate is a fallacy as the actual cost of living, for the lower level employee, increases more than the inflation rate. Employees also consider the financial position of the country and expect to prosper when the country does. This, however, is not the case for the lower level majority.

2.2.4 Summary of financial factors reported by the media

The website of COSATU mentions a host of financial factors impacting on salary and wage negotiations, ranging from sharing in the profits of the organization, improved
wages and working conditions to job security and disparity in earnings. These, as well as the research documented above, can be summarised as follows:

**Table 1: Financial factors impacting negotiations**

<table>
<thead>
<tr>
<th>EXTERNAL</th>
<th>INTERNAL</th>
<th>PERSONAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>International economic conditions, policies and decisions that might impact local conditions.</td>
<td>Organization history, including financial position, production cost, profit levels, prices, suppliers, contracts, current and future market position and strategy for the future.</td>
<td>Job security, continuation of the working relationship, position relative to temporary workers.</td>
</tr>
<tr>
<td>General financial position of the country, government’s economic and financial policy, and rising aspirations of employees in general.</td>
<td>Relationship between employee costs (including fringe benefits) and production cost/ profit for the organization, the industry and related industries.</td>
<td>Individual objectives of the negotiations, relating to wants, needs and priorities.</td>
</tr>
<tr>
<td>Social and financial history, as well as government policy to address/ correct it.</td>
<td>Transparent and fair management, including finances of the organization, cyclical nature of business and costs of industrial</td>
<td>Fair wages for the contribution made, acceptable working and living conditions.</td>
</tr>
<tr>
<td>Availability and cost of basic services, food, fuel, transport and health care.</td>
<td>Disparity between the management and shop floor employees’ remuneration, scaled increases in the past and performance bonuses.</td>
<td>Availability and cost of fringe benefits such as housing and medical aid schemes.</td>
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<tr>
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</tr>
<tr>
<td>Inflation and interest rates.</td>
<td>Inventory levels, estimated cost to prepare for a strike in comparison to estimated loss due to a strike.</td>
<td>Opportunities for advancement and access to higher levels of remuneration.</td>
</tr>
<tr>
<td>National and international trends relating to the industry, overview of the market and strategies for the future.</td>
<td>Organizational objectives of the negotiations; goals and outcome of the negotiations; and wants and needs of the participants.</td>
<td>Changing family structures, increasing numbers of dependants and limited access to social services.</td>
</tr>
<tr>
<td>Benchmarking against related industries or comparable organizations.</td>
<td>The maximum financial impact of associated risk, the tolerable residual risk and mitigation costs.</td>
<td>Increasing cost of basic services, food and transport.</td>
</tr>
<tr>
<td>Loss of jobs in the formal sector and a decline in</td>
<td>Cost and nature of resources controlled by the</td>
<td>The monetary value of the demand and the individual’s</td>
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<tr>
<td>Creation of new job opportunities.</td>
<td>Parties to the negotiations, relative scarcity of resources and impact on their price.</td>
<td>Interest in the results of the negotiations.</td>
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<tr>
<td>Financial value of the demand and offer on the table, cost of alternative offers, long and short term consequences of the positions and the Best Alternative to a Negotiated Agreement (BATNA).</td>
<td></td>
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<tr>
<td>Target compensation levels, cost of concessions and cost of trade-offs.</td>
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<tr>
<td>Financial impact of reorganising/ restructuring the organization, reducing number of employees and employing alternative production methods.</td>
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<td>Cost to use casual, contract or scab labour; consideration of future use</td>
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The above table summarises financial factors that impact wage negotiations. These factors will be included in the further analysis and the proposed financial assessment model. The number of financial factors identified, the variety and the complexity, emphasise the necessity to have a database available to assist negotiators to quickly and accurately calculate the value of positions, offers and demands as they change during the negotiation process.

2.3 Value Based Management

The Oxford Dictionary (1987:950) defines value as: “worth of something in terms of money or other goods for which it can be exchanged”. Chase (2004:6) reckons that metaphorically, it is quality divided by price. Klassen (2006:26) concludes that “value is the most sought after currency in business today. Creating value for stakeholders is truly what successful business is all about and value management is a measurement of how much value is created in a business”.

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<tr>
<td>Financial and other implications of unilateral implementation of last offer.</td>
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<tr>
<td>Financial interests and position of the negotiating counterpart.</td>
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Lew and Barnard (2005:20) are of the opinion that Value Based Management (VBM) is a tool that can assist an organization to implement strategy. It requires all levels of the organization to base daily decisions and activities on creation of shareholder value. The annual performance targets are aligned with the business unit profitability and tracked through regular reporting. This implies that from an employee perspective, VBM is a reward system that is aligned to the creation of shareholder value. From a management point of view, performance scorecards quantify the relationship between employee commitment, economic profit and customer satisfaction.

Investors require a return on the investment that they have made. Because of that requirement, Stern (2007: 3) believes that growth rates, margins and the use of invested capital are as important as trademarks, future products and scale effects. The author further believes that “if investors do not receive an appropriate interest yield, they will take their money elsewhere”. The value that has been added through the endeavours of the organization can be calculated, using the accounting formulae Capital Asset Pricing Model (CAPM), Weighted Average Cost of Capital (WACC) and Net Operating Profit after Tax (NOPAT). This provides a very narrow view of shareholder value and adding the customer and employee perspectives on value form the basis for VBM practices.

Stern and Shiely (2001: 1) explain that Economic Value Added (EVA) provides a more accurate evaluation of the financial position and shareholder value than pure financial figures do. “Generally Accepted Accounting Practise (GAAP) delivers results that are designed to satisfy lenders... GAAP figures can be very misleading.” However EVA denotes the profit that remains for shareholders after the cost of the invested capital, used to generate the profit, has been deducted. Maximizing shareholder value, results in maximized value across the entire spectrum of the economy, that is, labour, the community, shareholders and the organization itself.

Young and O’Byrne (2000: 1) explain that EVA is a measure of economic profit, as opposed to a financial measure and that the calculation shows the difference between the cost of capital and the return that the capital has generated. According to the
authors a simple calculation of EVA would be to subtract capital charges represented by the invested capital multiplied by WACC, from NOPAT. The authors then continue by suggesting how EVA can be improved in the organization, providing a link between the calculations and the efforts of management and employees alike:

i) Increase NOPAT.

ii) Lower WACC; or

iii) Reduce the amount of invested capital.

Finally, suggestions are made to link compensation to EVA, committing management and employees to actually taking responsibility for the financial calculations:

i) Align management performance to shareholder value.

ii) Create strong wealth leverage so that employees work harder.

iii) Manage employee retention risk in low performance periods; and

iv) Manage the cost of the compensation plan to shareholders.

Brigham & Ehrhardt (2005: 3-2) provide insight into the various financial calculations required to arrive at EVA and Market Value Added (MVA), both indications of the interest that shareholders take in the performance of the organization:

"The income statement summarizes the firm's revenues and expenses over a period of time."
Income statement for the period ended ... 

Sales  
Less: Cost of sales  
Gross profit  

Less: Operating expenses  
Earnings before Interest and Tax (EBIT)  

Less: Interest paid  
Less: Tax  
Net Operating Profit after Tax (NOPAT)  

"The balance sheet shows the firm's assets and the claims against those assets at a point in time."

Balance sheet as at... 

Assets  
Fixed assets  
Operating assets  

Shareholders Equity  
Ordinary shares issued  
Other shares issued  
Retained earnings  

Liabilities  
Long term liabilities  
Short term liabilities  


Shareholders interests are represented in the shares that are owned, the dividends that are earned on the shares and the ability of the organization to deliver a return on the investment that has been made. Hence, maximizing the value of the organization's ordinary/ common stock is the most important goal for shareholders and organizations. Consumers benefit from this approach because maximizing the value of the shares requires efficient, low cost business practices that produce high quality goods and services at the lowest possible price.

Brigham and Ehrhardt further state that "the traditional financial statements are designed more for use by creditors and tax collectors than for managers and equity analysts. Certain modifications are used for corporate decision making and stock valuation. To judge managerial performance one needs to compare managers' abilities to generate operating income, Earnings before Interest and Tax (EBIT), with the operating assets which are controlled."

The author continues by stating that earnings are not always a clear indication of company performance and that Net Operating Profit after Tax (NOPAT) should be used, which is the profit that a company would generate if it was debt free and owned no financial assets:

\[
\text{NOPAT} = \text{EBIT} (1 - T)
\]

The Return on Invested Capital (ROIC) can be explained as the return that the organization is generating on the capital that is invested in the organization, calculated as follows, where capital represents the total operating capital:

\[
\text{ROIC} = \frac{\text{NOPAT}}{\text{Capital}}
\]

WACC is the average return required by the shareholders and the creditors who have invested in the organization and is determined by the capital structure (debt to asset
ratio), the current interest rates, the risk that the organization takes and the market attitude towards risk:

\[
WACC = w_d r_d (1-T) + w_s r_s
\]

- \(w_d\) = weight of debt
- \(r_d\) = cost of debt to be raised
- \(T\) = tax
- \((1-T)\) = adjustment for tax savings as interest is tax deductible
- \(w_s\) = weight of shares (disregard different types of shares for this explanation)
- \(r_s\) = cost of common equity raised by reinvesting earnings

Free Cash Flow (FCF) indicates the cash that is available for distribution to shareholders and creditors after expenses and tax have been paid, and a portion has been invested for future growth. FCF has five uses, namely:

i) Pay net after-tax interest to creditors.

ii) Pay redemption of debt.

iii) Pay dividends to shareholders.

iv) Repurchase shares from shareholders; or

v) Purchase marketable securities or other non-operating assets.

\[
FCF = NOPAT - \text{Net investment in operating capital}
\]

The formula indicates that FCF is affected by sales revenue, operating expenses and required investments in operations. Operating expenses include both direct – and
indirect labour costs and sales revenue is affected by the productivity of the labour force. Whilst FCF could be utilized for distribution to shareholders in the form of dividends, it does not address the actual value of the shares. Neither do any of the other financial calculations that have been provided. Two measures available to evaluate shareholders' wealth are MVA and EVA.

MVA represents the difference between the market value of an organization's equity and the amount of equity capital that was invested by shareholders. It measures the effects of managerial effort from the establishment of the organization to date that is for a period of time in excess of one financial period, and can be calculated as follows:

\[
MVA = \text{Total market value of the organization} - \text{Total capital invested}
\]

\[
= [(\text{Outstanding shares})(\text{Current share price}) + \text{Value of debt}] - [\text{Total common equity} + \text{Debt}]
\]

EVA is a measure of the extent to which an organization has added to shareholder value in a given period, usually one financial year, and represents the residual income after the cost of capital has been deducted:

\[
EVA = \text{EBIT} (1-T) - [(\text{After tax percentage cost of capital})(\text{Total operating capital})]
\]

\[
= \text{NOPAT} - \text{After tax cost of total operating capital multiplied by total operating capital}
\]

\[
= (\text{ROIC} - \text{WACC}) \text{Total operating capital}
\]

Beneda (2003: 248) offers guidance when evaluating rapid growth organizations and start-ups, as opposed to established organizations with constant growth. “Financial analysts should be primarily concerned about the operating performance of a firm when considering whether to invest in a company... financial managers are reviewing and evaluating valuation techniques and procedures.” The author proposes that VBM could be used to:
i) Evaluate the effects of alternative strategies on an organization’s value.

ii) Provide guidance in strategic decision making.

iii) Indicate future financial needs; and

iv) Contribute towards corporate governance.

Beneda then continues by providing formulae and a worked example of applicable calculations to determine FCF and the value of operations:

\[
FCF = \text{EBIT} \times (1 - T) + \text{Depreciation and amortization} - \text{Net investment in total operating capital}
\]

The current value of operations, assuming a constant growth, could be calculated as:

\[
\text{Current value of operations} = \frac{\text{Current FCF} \times (1 + g_{FCF})}{(WACC - g_{FCF})}
\]

\[
g_{FCF} = \text{Expected future growth in free cash flow}
\]

\[
\text{Current value to shareholders} = \text{Current value of operations} + \text{Current value of non-operating assets} - \text{Interest bearing liabilities} - \text{Preferred stock}
\]

The use of these valuation techniques sheds light on the degree of success of the strategic direction and management efforts, and together with qualitative evaluation and judgement could guide investment decisions. Once again, the calculations are determined by the success of the management, and the effort of the employees associated with the organization.
Ray (2001: 65) regards the evidence concerning the efficacy of EVA as mixed and provides a different definition of value, suggesting that what is really required to improve value is productivity. Organizations that have experienced improvements due to the implementation of EVA, have not distinguished the improvements due to the "measurement" taking place and the productivity increases due to continuous learning and development of employees, from those brought about by the EVA implementation per se, argues the author.

Value in this instance is defined as quality / price which is perceived / paid by the customer and the arguments of the author are supported by the making the following calculations:

Change in earnings = Accounting value – Value added by the organization.

Economic value = Residual income after suppliers of capital have been compensated.

The author proposes to calculate EVA using the following formulae:

\[
EVA = \text{NOPAT} - (\text{Cost of capital required to create the profit multiplied by the capital used to create the profit}). \\
= \text{NOPAT} - (r - k) \text{Total operating capital}.
\]

In this formula, \(k\) represents the cost of capital, or WACC, which is largely determined by market forces and a perception of the organization's risk profile, whilst \(r\) is the return on capital, ROIC, which can be increased by increased productivity, which should be linked to consumer demand, and innovation, technology and human capital investment. Innovation, improved technology and investment in human capital should lead to increased output per worker, improved quality of the products and services, decreased costs and a reduction in errors, defects and wastage.
Ray concludes that this is the actual improvement that is sought by shareholders. As return outstrips cost, the market bids up the price of the shares and that equals MVA.

VBM is regarded as a financial management and incentive compensation system that guides decision making in an organization, Beneda (2004: 56). In this instance, EVA, ROIC and MVA are used for calculations:

\[
\text{EVA} = \text{income from operations less the risk adjusted cost of investments} = \text{NOPAT} - (\text{ROIC} - \text{WACC})(\text{Total operating capital}).
\]

In the above formula, the author suggests that assets should be considered at their replacement value and not book value, to account for the opportunity cost of the investment made by shareholders and possible changes to the value since the transaction was recorded.

\[
\text{Total value of operations} = \text{Replacement value of operating assets} + \text{Expected future EVA from existing operating assets} + \text{Expected future EVA from growth}
\]

\[
= \text{Book value of operating assets} + \text{Excess replacement value over book value of operating assets} + \text{Expected future EVA from operating assets} + \text{Expected future EVA from growth}
\]

Expected future EVA from existing operating assets assuming zero growth and then growth is added in the following formula:

\[
\text{Exp. future EVA from operating assets} = \frac{\text{Beginning replacement value of operating assets} \ast [\text{Marginal ROIC} - \text{WACC}]}{\text{WACC}}
\]
Expected future EVA from growth = Expected annual EVA from future reinvestments / Current WACC

= \frac{[\text{Expected annual future reinvestment} \times (\text{Marginal ROIC} - \text{WACC})]}{\text{WACC}} / \text{WACC}

MVA = \text{Total value of the organization, calculated as the number of shares outstanding multiplied by the market price of the shares, plus debt} - \text{Book value of the organization}

In this case, MVA is an indication of what the market expects in future regarding the performance of the organization, as well as the value from the existing total assets and claims against these assets.

Smith and Pretorius (2002: 69) apply the Theory of Constraints (TOC) to illustrate how economic value can be increased within an organization. The relationship between TOC and EVA are indicated, as well as advice offered for improvements which would enhance shareholder value:

TOC is a system approach to business management, originating in operational management. It views an organization as a system and measures the success of the system against pre-determined goals, in the case of a business, making money for the owners (shareholders) of the business, now and in the future. The system (organization) can only achieve these goals within a set of conditions, conducive to the achievement of the goal, that is, a secure and satisfying environment for employees now and in future, and only if the organization satisfies the market demand now and in the future (quality and price of the services and products). These conditions link the success of the organization to management intervention and employee effort.
TOC defines productivity as every action that brings the organization closer to its goal of shareholder value maximization and non-productivity as every action that does not contribute to the achievement of the goal.

To measure the achievement of the goal, an organization is likened to a money making machine and the determinant of success is the rate at which the organization generates money (throughput), faster being better than slower. There is an amount of money captured within the machine, without which it would not be able to operate, namely, the initial investment to purchase the machine and the money required to sustain operations. These are the investment that was made, capital outlay, and the ongoing operating expenses. The authors define the return on the investment in the machine as:

\[ \text{ROI} = \frac{(\text{TP} - \text{OE})}{\text{I}} \]

\( TP = \) Throughput or sales
\( OE = \) Operating expenses, that is direct – and indirect expenses, interest and tax
\( I = \) Investment in the organization, or total investment in operating capital

The Cash Flow (CF), also FCF as previously defined, that is being produced can be calculated:

\[ \text{CF} = (\text{TP} - \text{OE}) - \text{I}, \text{ which is the same as} \]
\[ = \text{NOPAT} - \text{Net investment in operating capital} \]

From a management perspective, the CF or FCF can be improved by reducing the total cost (OE), increasing the throughput (TP) or reducing the investment (I). The easier options are to reduce the cost, amongst other the total amount spent on labour which forms a part of the cost, and the reduction in investment, which could be achieved by a decrease in inventories (just-in-time inventory management) or an increase in creditors (longer payment terms). An increased throughput (sales) requires innovation, improved
and efficient use of technology, and continuous training and development of employees. These need to be creatively managed and measured to achieve the desired results.

From a practical point of view, it is impossible to generate CF or FCF without the concomitant investment and operating expenses, hence the focus should be on increasing TP (sales) rather than on reducing OE and I.

The authors calculate EVA similar to the previous formulae, and add comments on areas for improvement through management intervention:

\[
EVA = (TP - OE) - (\text{Rate of return} - \text{Cost of capital}) \times \text{Capital employed}
\]
\[
= \text{NOPAT} - (\text{ROIC} - \text{WACC}) \times \text{Total operating capital}
\]

To increase EVA, management could either increase the net profit, which roughly equates to increasing the TP and/or reducing the OE, or increase the rate of return by increasing total asset turnover (associated with increased TP), or decrease the cost of the capital employed. As the cost of capital or interest charged is determined by external market forces, management should review the organizational risk as perceived by the market:

i) Operating risk, which is determined by variations in pre-tax returns, after tax returns, total gross returns, operating cash flow and capital growth, can be managed by diversification into segmented markets and not segmenting resources in the process. This will contribute towards increased TP and stabilize returns, even when certain segments of the market experience a downturn in demand.

ii) Strategic risk, which relates to the profitability and growth rate of the organization, requires increased TP, leading to increased return. Together with a reduction in cost, this would improve profitability and contribute towards a sustained growth rate.
iii) Asset risk is derived from a perception of the way in which working capital and fixed capital are managed. Asset management is tracked by measurements such as amount of working capital needed, inventory turnover, average economic life of assets, plant and equipment, and state of the plant and equipment (newness and continued maintenance) and are all within the control of management and the employees.

iv) Size and diversity risk refer to the size of operations (small organizations taking big decisions could increase the perceived risk), geographic dispersion and product/market diversification. A strategy of market segmentation, without resource segmentation, whilst expanding the market offering and TP, would result in an increased size of operations and diversification of offerings, reducing the impact of size and diversity risk on the organization.

The relationship between the principles of Theory of Constraints (TOC), Shareholder Value and Economic Value Added (EVA) can be explained as follows:

Improved CF → Increased availability of internal funds for investment → Opportunity to create new market offerings → Increased TP → Reduced dependence on externally determined cost of capital → Growth in shareholder value.

Principles of TOC → Improved NOPAT, ROI, CF → Reduction in the perceived levels of the four risk categories → Reduction in the externally determined cost of capital → Improved EVA.

Manning (2003: 35) contributes to the discussion of creating shareholder value by stating that value depends on the perception of the beholder:

i) Customers: quality or performance at an acceptable price.

ii) Shareholders: real financial return.
iii) Employees: secure job, income, training and development, respect, social contact, and the prospect of doing something worthwhile.

iv) Suppliers: regular orders, satisfied buyers, ideas for improvement, few hassles, payment without delay.

v) Society: clean environment, jobs, support for healthcare, welfare, education, the arts and sport; and

vi) Government: taxes, job creation, training, social services and support.

Although the ultimate aim of business is to “do business”, in its creation of value for shareholders, it should also create value for other stakeholders.

**Figure 1:** The “value creation” chain, Manning (2003: 37)

Manning (2003: 39) continues the discussion by quoting Drucker who believes that organizations should focus on wealth creation and not on saving costs. In an effort to improve ROI, there is a finite limit to the amount of cost that can be saved, as there would be no production without incurring costs. In contrast, increasing the revenue of an organization has no limit, as management could follow a strategy of selling more, raising
the price of the existing products and services or increase the stock turn, to achieve increased revenue.

In an effort to increase shareholder value or create new value for shareholders, management could either change the direction that the organization is taking (strategic decision), or they could improve the current processes (operational decision). This decision would be determined by the focus of the organization, namely what is the purpose of the organization and the core competence of the organization, what are the few things that we excel at and that distinguish us from our competitors?

Manning (2003: 75) provides guidelines for the implementation of above decision and then proposes measuring the progress, but cautions that "financial performance is a result of many activities... you have to make assumptions about cause and effect linkages... whose targets should you go for?" The author proposes a combination of subjective and objective measures, summarized in a Value Plan, and including as a minimum for consideration of this plan,

- People.
- Sales.
- Services and support.
- Manufacturing.
- Quality.
- Innovation.
- Safety, health and environment; and
• Social responsibility.

The value of shares is not determined by what happened in the past, but by the perception of what might happen in the future, as well as “the gaps between what investors hope for and what actually happens”, Manning (2003:77). Future changes in performance can be the result of changes in the macro environment, industry dynamics, stakeholder dynamics or organization strategy, culture, assets and capabilities.

Investors make money from the increased value of their shares and the stream of dividends that flow from owning the shares. Dividends are paid from CF, so shareholders track CF when evaluating a firm’s value. The increased value of shares refers to the requirement that capital should be earning more than it costs. Metrics suggested include ROI, ROE and ROIC, as discussed above.

Manning introduces a Du Pont chart to indicate how value is created and destroyed in an organization.
Figure 2: The Du Pont chart, Manning (2003: 98)
It should be noted that in the Du Pont chart, the “Cost of goods sold” includes direct labour cost and “Operating expenses” includes indirect labour cost. The endeavours of the management team and the employees are represented by the “Earnings”, “Sales” and “Assets”, in the case of assets, the management and use of the assets to create a profit.

Manning (2003: 105) is of the opinion that every box in the Du Pont chart offers the opportunity to change something, but that the chart clearly indicates that there are only two boxes that could make a difference to financial performance, namely profit margin and asset turnover.

The chart clearly indicates that there are only four ways in which to improve these two boxes, namely:

i) Sell more products or services.

ii) Increase the price of the product or service.

iii) Sell more of the product or service (increase stock turn); or

iv) Reduce the costs.
Figure 3: Improving profits illustrated by the Du Pont chart, Manning (2003: 106)
“Value management is first and foremost about people. Its purpose is to focus their energies, enable them to achieve extraordinary things, and inspire them to stretch towards their potential. People must see the process as fair and transparent. Trust is a critical factor in performance management. It is hard to build and easy to kill. Be careful what information you hide”, Manning (2003: 137).

2.4 Negotiation preparation methodology

Several negotiation preparation methodologies were studied and compared to identify how financial factors that have an impact on salary/wage negotiations are incorporated and considered during preparation for wage negotiations. The preparation methodologies were found to cover mainly three areas, namely the position of the negotiator, the position of the opposing negotiator and the process of negotiation. The financial factors that are included in the preparation methodologies are those relevant to the positions of the negotiators and not the negotiation process itself.

An amended version of the Harvard Preparation Methodology proposes eight distinct categories or topics to be covered when preparing for negotiations. These categories or topics are:

i) Stakeholder analysis, referring to individual stakeholders as well as the groupings or organizations that are represented, the negotiator and principles of the negotiator, included.

ii) The sources of influence that these stakeholders possess.

iii) The interests and positions of each of the stakeholders.

iv) The different negotiation scenarios that exist.

v) Identification of risks and possible mitigation strategies therefore.
vi) The communication strategy, covering the content, process and the styles that will be utilized.

vii) The formal and informal relationships that exist, separating the people involved from the problem/situation at hand; and

viii) The commitment that will be made to conclude the negotiation.

The categories or topics are further developed through a set of questions, designed to assist the negotiator in preparation. Although not one of these refers directly to cash or finance, some of the questions could be interpreted that way.

i) Stakeholder analysis

- What are the substantive issues for the stakeholders, including what is the monetary value of the demand from the opposing party and the offer that the negotiator can make?

- Can the counterpart's case be accurately articulated, which would include calculating the total cost of the demand, should it be granted; and

- Can your own case be accurately articulated, which would include calculating the total cost of the different offers that could be made?

ii) Sources of influence

- The sources of influence could include, amongst other, money or the lack thereof. In this category one should also include the monetary value of resources, which are costly from a business perspective.
• Scarcity is considered a source of influence in negotiations. Scarcity increases monetary value and this relationship should be stated as accurately as possible when preparing for negotiations; and

• The “Best Alternative to a Negotiated Agreement” (BATNA) should be calculated in monetary terms to determine the total cost of agreement at that point. Improving a BATNA, or reducing the total cost of this position, is one of the aims of the preparation for negotiations.

iii) Interests and positions

• When considering the interests and positions of the negotiating parties, time is spent on the financial interests of each participant. Although this might not be quantifiable, consider the different approaches: a shareholder is interested in maximising the value of shareholding (EVA and MVA), amongst other by limiting cost. Management might be interested in earning performance bonuses for achieving financial targets, but could personally benefit from a substantial salary increase on lower levels of the organization. Union representatives are dependant on the ongoing support of union members to ensure their financial sustainability and lower level employees are eager to maximize their immediate financial gain.

v) Risk and possible mitigation strategies

• Risk and mitigating strategies are stated in monetary terms, to rate the risk and determine tolerance levels. The negotiation principles set parameters for the negotiators within which risk should be contained and which serves to guide the settlement to be reached.
Heald (2008:58) from the WITS Business School proposes a preparation methodology similar to the Harvard Methodology. The initial step should consist of a basic due diligence or forensic evaluation to determine if the negotiation counterpart is in trouble and the extent of the trouble. Although only one question directly deals with the financial position of the counterpart, all the themes covered are from a business environment and have financial implications of themselves:

i) What is the public perception?

ii) Has a sudden market shift occurred or do you foresee one in the near future?

iii) Has the product or service failed in some way? What are the limitations of the products and services?

iv) Do executable top management succession plans exist?

v) What is the cash position of the business?

vi) Are the industrial relations and management practices embedded in the organization and healthy?

vii) Is there a hostile take-over on the cards?

viii) Have any adverse national or international events recently occurred?

ix) What role does regulation and deregulation play?

The methodology then continues to cover the position of the negotiator. It considers the desired outcome or goal of the negotiations, as well as rating the goals of the negotiations in order of preference. The preferences are packaged and the financial implication of the different packages calculated.
Distinction is made between individual and organizational preparation. Whilst the individual preparation is focussed on the human side and personal styles of counterparts, organizational preparation considers the system and stakeholders within the system, as well as interaction between the stakeholders and the systems. Financial aspects are restricted to the content of the negotiations, the different mandates that exist, risk and mitigation thereof and positioning. This preparation methodology introduces the consequences of different positions, which could be quantified for financial analysis purposes.

The Huthwaite Research Group (1978:2) has observed, analysed and documented the difference in behaviour between "skilled and average negotiators". The research concludes that, amongst other, thorough planning lays the foundation for successful negotiations. Rackham (1978:2), from the Research Group, expands on this statement by saying that "it is not the amount of planning time which makes for success, but how that time is used".

The planning methodology that is covered in this research includes:

i) Exploration of a variety of options, understood to include financial and non-financial options.

ii) Consideration of common ground around areas of anticipated agreement.

iii) Long and short term implications of the different positions.

iv) Setting upper and lower limits, within which negotiators can manoeuvre and engineer an agreement, keeping in mind that higher aspiration levels lead to higher outcomes when setting the limits within which to negotiate; and

v) Sequence and Issue planning.
The research concludes that negotiation training should include the theory and administration of negotiations, together with practical “here-and-now” negotiation interaction. A Venn-diagram is provided to record the areas of overlap between the negotiating parties, as well as a pay off matrix which assists when considering the opportunity cost of different proposals and a consequences matrix to clarify the long and short term consequences of accepting or rejecting a proposal. These planning forms are useful but do not offer any assistance in consideration of financial factors that might impact the negotiations.

The notion that preparation for negotiations and the outcome thereof are directly related is widely supported in literature. Pressman (2000:12) maintains that negotiators often enter negotiations without supporting data. The research suggests developing a comprehensive contracting plan, the result of data collection, evaluation and ranking. Catalano (2005:8) uses the negotiation brief extensively when preparing for negotiations, citing information such as historic prices, and distinguishing between wants and needs to assist the negotiator.

Martinez (2004:6) agrees that “even if you're not the best negotiator, you can still win by being the best prepared negotiator”. This author's methodology includes preparing for the people side, conditioning the opposition to want to continue the business relationship, building a people strategy, understanding the counterparts' culture and using body language to your advantage. It is mentioned that value should be assigned to everything and that issues should be negotiated individually or in packages, concluding that “a deal” is sometimes better than “the best deal”. No proposal regarding how the values should be calculated is offered, or how these values can be utilized during preparations for negotiations or during the actual negotiations.

Reardon (2004:2) offers concrete suggestions to negotiators on preparing: “to expose false assumptions, prepare for your negotiation by researching all the elements involved, including people, issues and history. When preparing, focus your research on
interests, concerns and emotions (ICE), as these factors determine the course of negotiations." The proposed stepped approach includes:

i) Clarification of one's own position, which includes the financial position, the authority to make binding decisions, BATNA and the minimum and maximum parameters within which the negotiation process should ideally be concluded.

ii) Study the counterpart (s) in person, as well as the position that is likely to be presented. Calculate the value of demands that can be anticipated; and

iii) Set the agenda for the negotiations.

In comparison, the three step approach to planning negotiation positions for a firm contemplating a joint venture, proposed by Contractor (1984:31), offers some insight into financial factors one could consider when planning for salary/ wage negotiations too. The author suggests targeting an acceptable compensation level and then working backwards to identify different offers, composed of the various elements of a compensation package, of a similar total value as the target level. The preparation steps include a market analysis, defining quantifiable benchmarks to guide negotiators and calculating trade offs.

Fells (1996: 50) studied negotiators preparing for a simulated negotiation exercise and then observed how the preparation was applied during negotiations. This research led to the conclusion that negotiators emphasize establishing a negotiation position over process preparation. Negotiators prepare a minimum position and a target position, using the difference between the two to move about during the process. Having specific objectives provides structure and focus, but could limit negotiators when developing a case and considering alternatives which could be equally satisfying. This research does not introduce additional financial factors.
Peterson and Lucas (2001:38) extensively researched pre-negotiation planning, particularly the means negotiators employ to plan and prepare for the negotiations. Planning is defined, for the purpose of the research, as "information collection and option development; and preparation is confined to activities related to the development and rehearsal of the presentation of the planned components to the other side(s) of the negotiation table". The planning methodology collects data from the past, makes assumptions regarding the future and plans a course of action accordingly. A preparation framework, consisting of data collection, formulation, strategizing and preparation is proposed:

**Table 2: Pre-negotiation preparation phases**

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<tr>
<th>Intelligenee Gathering</th>
<th>The act of collecting, processing, analyzing and evaluating available data concerning the other party and relevant environmental factors. Identify strengths, weaknesses and battle plans. Predict wants, needs and possible actions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formulation</td>
<td>Entails developing goals, specific objectives, and setting the parameters for each issue to be negotiated. Set level limits for a pessimistic, realistic and optimistic outcome. Know the opponent’s authority to settle and the level at which the negotiation process will break down, the respective BATNA’s. Set the agenda for the meeting.</td>
</tr>
<tr>
<td>Strategy</td>
<td>Strategy is a plan that integrates a person’s goals and action sequences into a cohesive whole. Offensive and defensive moves, a trade-off strategy, concession and reciprocation strategies.</td>
</tr>
</tbody>
</table>
Preparation involves rehearsing verbal communication, arranging and creating support material, and attention to logistic concerns. Script certain critical points in the negotiation process.

Stepped approaches to negotiation preparation assist particularly the lesser experienced negotiators. Thomas and Wisdom (2001: 34), Lewicki et al (1993: 189) and Cronin-Harris (2004: 44), provide such models consisting of five steps each, to assist with preparations. In the case of Thomas and Wisdom (2001: 34), the five step approach offers concrete examples of financial calculations and factors to consider. The five steps broadly entail:

i) Regard preparation as an investment, emphasising that preparation for negotiations is important and continuous, and yield a return on the investment made.

ii) Identify organizational objectives, as negotiation positions are determined by organizational goals and objectives, rather than opposing demands.

iii) Anticipate the union needs by studying grievances and arbitration awards, negotiation history, union politics, recently settled contracts and calculate the financial cost of union demands and settlements.

iv) Develop a computerized database to capture internal and external data, as well as calculate the offers and options proposed; and

v) Prepare for a potential strike.
In comparison to the above, Cronin-Harris (2004: 44) proposes the following five steps:

i) Decide on priority interests and rank them accordingly.

ii) Assess the other side’s priorities.

iii) Money represents other needs as well, which need to be explored.

iv) Plan factual inquiries carefully to probe opponents’ interests and priorities; and

v) Plan money moves based on principles.

On the other hand, Lewicki et al., (1993: 189) recommends the following steps for preparation:

i) I see/ hear – the data.

ii) I assume – interpreting the data.

iii) I feel – the cost or impact.

iv) I need – the alternative desired results or conditions; and

v) I want/ will – the plan of action.

Benoliel (2006: 2) cautions that pre-investigation and preparation could cause a negotiator to experience frozen perceptions, that is, blinding the negotiator to other acceptable offers. It is proposed to distinguish between elements that are “must haves” and “nice to have”. The model includes a bottom line or maximum willing to spend, and
a BATNA, cautioning the negotiator against a settlement because it is “believed that this deal is the only one possible” or due to time and effort invested in the process.

2.5 Discussion

The metrics quoted by researchers for consideration in VBM can be summarised to include the following formulae:

(1) NOPAT \[= [(\text{Sales} - \text{Cost of sales}) - \text{Operating expenses}] - \text{Interest} - \text{Taxes} \]
\[= \text{EBIT} (1 - \text{T}) \]

(2) CF or FCF \[= (\text{Throughput} - \text{Operating expenses}) - \text{Investment} \]
\[= \text{NOPAT} - \text{Net investment in total operating capital} \]
\[= \text{EBIT} (1-\text{Tax}) + \text{Depreciation and amortization} - \text{Net investment in total operating capital} \]

(3) ROI or ROIC \[= (\text{Throughput} - \text{Operating expenses}) / \text{Investment} \]
\[= \text{NOPAT} / \text{Total operating capital} \]

(4) WACC \[= w_d r_d (1-\text{T}) + w_s r_s \]

(5) EV \[= \text{Residual income after suppliers of capital have been compensated} \]

(6) EVA \[= \text{Accounting value} - \text{Value added by the organization} \]
\[= \text{NOPAT} - (\text{Cost of capital required to create the profit multiplied by the capital used to create the profit}) \]
\[= \text{NOPAT} - [(\text{ROIC} - \text{WACC}) \times \text{Total operating capital}] \]
(7) MVA = Total market value of the organization – Total capital invested

= [(Outstanding shares) * (Current share price) + Value of debt] – (Total common equity + Debt)

The literature offers various solutions to improve the value for the shareholders, which can be grouped together:

i) Improve the productivity, stock turn or sales, which will result in an increase in NOPAT. This implementation should be aligned to market demand and include an improvement of the quality of services and products.

ii) Increase the price of the services and products that are offered.

iii) Reduce the operating expense or costs incurred to produce the products and services. This could include a reduction of direct - and indirect labour costs, which are included in cost of sales and operating expenses.

iv) Reduce the capital employed, the total investment or the cost of the capital (WACC). This suggestion assumes that the optimal debt leverage ratio has not been achieved and that there is room for improvement in that ratio, as there is a finite limit to the amount of capital reduction before it has a negative impact on the overall operations of the organization. The discussion of risk and risk management addresses the reduction in the cost of capital; and

v) The research further suggests that efficient management of human resources, including the associated costs, could contribute towards shareholder value. The first proposal in this group is that an investment in training and development will contribute towards improved productivity, simultaneously supporting item (i) above.
The second proposal is associated with the first, namely that a retention strategy should be followed, rather than a retrenchment strategy. An organization would not like to see the investment that it has made in human capital development, disappear, and it would like to reap the benefits of the productivity improvement that is associated with this type of investment.

Organizations should create strong wealth leverage opportunities for employees to motivate them, to retain their services and to contribute towards shareholder value. This proposal can be achieved through carefully considered metrics attached to fair compensation schemes, which cater both for economic booms and declines.

Finally, management performance should be aligned to shareholder value creation. The metrics that are used to measure management performance should be similar to those that are used to measure the creation of shareholder value and management compensation should be at least partially derived from increased value, to add meaning to performance.

The financial factors impacting salary and wage negotiations were grouped according to external factors, internal factors and the personal financial circumstances of the employee.

The organization has limited control over the external financial factors and to some extent, is subject to the same financial factors that have been identified to impact salary and wage negotiations. As correctly stated by Ntuli (2006), organizations cannot merely increase prices of services and products above the inflation rate, without market demand to support this step and without increased return, it would be challenging to justify increased operating expenses in the form of direct and indirect labour cost, from salary and wage hikes.
The discussion of VBM and TOC indicated how the cost of capital or interest rates offered by the market can be influenced by the efforts of the organization. Similarly, benefits are available to employees that few know about or have access to. The organization could investigate financial literacy training and group benefit schemes for employees in an effort to assist. These interventions do not add to the cost of the organization as they are provided by external service providers on behalf of the organization, but do engender loyalty towards the employer and offer financial relief to individuals. Examples of group schemes include short term insurance at preferential rates, motor car loans at reduced interest rates, various life cover and funeral benefits and study loans for employees' dependants.

The personal financial circumstances of the individual employee could be improved by the above interventions, but the recent spate of increases in the interest rate, in an effort to restrict consumer spending and so manage the rising inflation rate, have proved that financial equations offer limited explanation for individual behaviour. Barron (2007:10) rightly quotes Elize Strydom, Chief negotiator for the Chamber of Mines, who firmly believes that if unions get what they demand, the mines would not survive financially. The same holds true for individuals, if each receives the pay that they demand, the organization would not survive and the individual would probably still not be satisfied.

Organizations cannot merely dismiss their social responsibility and particularly their responsibility towards their employees with the above argument. It has been mentioned that it is in the interest of the organization to retain employees and in particular, that it would benefit both the employee and the organization if an investment is made towards the training and development of employees. Employees have indicated that a fair wage is desired for the contribution that has been made. If this “fair wage for contribution” is linked to the interest of shareholders, that is value creation, and if wealth creation is leveraged correctly, the organization could create a win-win result around the negotiation table.
Whilst the management of an organization has to answer to the owners or shareholders regarding the financial results that are achieved, they also have to achieve those results with the employees who work for the organization. It has clearly been indicated that management could focus on cost reduction to achieve the desired financial results, or they could employ a strategy to increase the return through improved operational efficiency, implementing VBM. This strategy can only be achieved if management can “sell” the strategy to the employees, if employees can be convinced that they will share in the fruits of their labour and if management has not previously deceived the workforce regarding the financial position of the organization or around the negotiating table.

Lastly, as Volkema (2001:2) points out, negotiation is an ongoing dialogue between two or more parties to determine the nature of the future relationship. If the relationship between management and the employees has been damaged in the past, there is no better time to start healing the relationship, than now. Transparency, fairness, open communication and an opportunity to participate in meaningful decisions could contribute towards the healing process, without major cost implications to the organization.

The literature research has confirmed that limited attention is given to financial factors that might impact salary and wage negotiations, other than a calculation of the offers and demands that are being tabled. The preparation methodologies include some financial aspects but there is limited consideration for the integration of these with the strategy of the organization and the principles of VBM in particular.

The proposed financial assessment model will attempt to integrate the identified financial factors from the media review and the study of current preparation methodologies with the principles of VBM.
CHAPTER 3

EMPIRICAL RESEARCH

3.1 Research methodology

The empirical research was conducted in the form of structured interviews involving 45 respondents, using the questionnaire that has been attached as Annexure B. The qualitative research was analyzed, using descriptive statistics and is summarised and graphically presented herewith.

The sample was small and consisted of a large portion of public servants. The private sector was mainly represented by small business owners. Although valuable input was gathered and the results are valid for the purpose that it was intended, similar research in a bigger geographic area and including particularly a strong representation from the mining and industrial sectors, could result in different findings. The results that are specifically affected by the composition of the sample are pointed out as such in the ensuing discussion.
3.2 Analysis of research results

Graph 1: The nature of the industries represented by the respondents

COMPETITIVE: If someone from this industry is on strike, customers would use another provider from the same industry (retail, airlines, building contractors).

NON-COMPETITIVE: If someone from this industry is on strike, customers are not able to revert to another provider although providers could make use of scab labour (municipality, police, and correctional services).

The respondents were provided with the above explanation of the nature of the industries and selected the appropriate response, based on this information. The respondents from the non-competitive industries are mainly public servants and the respondents from the competitive industries represent a variety of services and production organizations, mainly small businesses.
Graph 2: Gender representation

There were more female (28) respondents than male (17) respondents due mainly due to the fact that females are well represented in the public service and other organizations that were approached to participate in the research.

Graph 3: Years working experience
The majority of respondents have more than 2 years working experience. This was specifically planned that way due to the fact that mainly senior employees and business owners were interviewed, who normally take an active role in wage negotiations. The lower level and less experienced employees seldom actively participate in negotiations and rarely in the role of negotiator, which is the focus of this research.

**Graph 4: Role during negotiations**

A: Employee/ Other, with no direct or active role during negotiations, other than supporting the representative, attending meetings and participating in action.

B: Union representative/ Shop steward/ Represent the employees during negotiations; and

C: Manager/ Business Owner/ Represent the employer during negotiations.
The distribution of responses to the question regarding the role played during negotiations correlates with the findings represented in graph 3, namely years working experience. As more senior employees were interviewed, group C is well represented and the other two groups, slightly less.

**Graph 5: Time spent preparing for negotiations**

The graph is distorted by the respondents who do not take an active role in negotiations and thus do not prepare for it. All the respondents who actively participate in the negotiation process indicated that they do prepare. The graph with the responses from this group resembles the form of a normal distribution curve (columns B, C and D).

The responses from the group who do not actively participate in the negotiation process have been disregarded for the remainder of the analysis.
The majority of respondents indicated that they either use an own developed methodology or a company specific methodology, but could not clearly state if this methodology was adapted from an existing and acknowledged formal methodology. In the case of own developed methodology, some of the respondents indicated that it was an adaption of a methodology learnt during their formal tertiary education.

The majority of the respondents who use a methodology that they learnt during training indicated WITS University and University of Pretoria as the source of the methodology. This is merely interpreted as an indication of the geographic area in which the research was conducted.

The preferred formal preparation methodology is the Harvard method and adaptations thereof. Once again, this could refer to the geographic area covered in the research and the major academic institutions in that area.
Most of the respondents indicated that they are provided with a maximum settlement target, which is what was expected from this question. Of particular interest is the number of respondents who are not supplied with a target at all. Probing of this matter revealed that in most cases, the respondents were the owners of the organizations that they were representing in the negotiations.

The group of respondents, who are provided with detailed guidelines, including a maximum, minimum and target settlement level, indicate a strictly regulated working environment, which could be expected with a strong representation from the public sector.
The majority of respondents indicated that they do consider financial factors during preparations, but that they do not embark on a detailed evaluation thereof. Financial factors that were mentioned during the discussion include the economy of the country, some industry benchmarks and recently reported settlements, as well as what the organization can afford. The current interest rate and inflation were mentioned during most of the discussions.
Graph 9: Inclusion of strategy, policy and procedures when preparing

The responses to this question are as expected, with the majority considering strategy, policy and procedures only where applicable to the negotiations. This finding correlates with the findings of graph 5, where limited time is spent on preparations, so only applicable information is considered.

The number of respondents who indicated that it formed a key element of their preparations was surprising. Several of these respondents were the business owners, mentioned in the discussion of graph 7.
The results obtained from this question are similar to the results obtained for the previous question and are what was expected. Most of the respondents who claimed to use modelling tools mentioned spreadsheets, which assist in calculating the total impact of demands and offers, as well as to do “what if” analysis. Several of the respondents commented that they prepare as a team, including someone who can assist with calculations or modelling, sometimes using a computer, but with no specific modelling tools being named or preferred by a significant group of the respondents.
Graph 11: Use of a financial assessment model during preparations

Only two respondents were not interested in a financial analysis model, but did qualify the response by adding that the financial calculations were done by financial analysts.

The majority of the respondents agreed that it would be helpful and that use of the financial assessment model would be considered, subject to, amongst other, the following conditions:

- Ease of use.
- Simple to complete and understand.
- Not very time consuming; and
- Generally applicable and not meant for a specific industry/organization only.
The responses indicate a broad interest in the financial factors that could impact wage negotiations and a model to analyze these factors.

The use and application of the financial assessment model, as well as the fact that the negotiator, or the individual preparing for the negotiations would be populating the model, was not explained during the research. This could at least partially account for the high scores in all areas of the question. Based on the responses regarding the time and effort spent on preparation, as well as the inclusion of financial analysis during preparation, it is assumed that there would be less enthusiasm if it was know that the preparation is not done on behalf of the negotiator.
The response to this question should not be interpreted without cognisance of the response illustrated in graph 1, as it is largely determined by the background, experience and industry type represented by the respondents. Value based management is unfamiliar to the public sector representatives and not yet broadly implemented by the private sector in this geographic area.

The responses to this question will have an impact on the responses obtained for the following question too.
Considering the fact that the majority of respondents indicated only a brief consideration of financial factors impacting the negotiations during preparations as represented in graph 8, the response to this question was unexpected. It could be explained by the fact that the discussion in general and the foregoing questions in particular, have caused the respondents to consider the matter and that the response is what is deemed to be correct, rather than what actually happens in practise.

The group that indicated that the impact on the value of the organization was a major consideration, once again strongly corresponds to the group of business owners, identified in the discussion of graph 7.
The responses that were received for this question are similar to the responses that are represented in graph 11. The respondents are willing to use the financial assessment model, but with conditions similar to those mentioned in the discussion following graph 11. It is clear from the discussion in both cases that time is a factor when preparing for negotiations and that the negotiators are not necessarily the financially literate representatives.

The exception to the above comment regarding financial literacy seems to be the business owners, who once again have shown an interest in the model which correlates with the findings of graphs 7, 9 and 14.
3.3 Discussion

It is clear from the findings of the empirical research, and supported by the analysis of the preparation methodologies, that there is limited attention to financial assessment during preparations for wage negotiations. The preparation methodologies do cover some of the financial factors that were identified during the review of reported salary and wage negotiations and strikes, but there is no one methodology that covers the external, internal and personal factors and incorporates the principles of VBM and TOC as discussed.

On the other hand, the respondents to the empirical research have indicated a need for and an interest in a financial assessment model that could be used during preparations. It should be noted that there was great emphasis on the fact that it should be simple and quick to use. The respondents stated their requirements for a financial assessment model s being:

- Ease of use.
- Simple to complete and understand.
- Not very time consuming; and
- Generally applicable and not meant for a specific industry/organization only.

These requirements are what could be expected from a bigger sample, as well as from a group of respondents representing a different composition of industries and indicates that this particular sample did not negatively affect the research results.

Financial analysis in preparation for wage negotiations is neither simple, nor quick if all the identified financial factors and VBM principles need to be incorporated. As stated by
Martinez (2004:6), “even if you’re not the best negotiator, you can still win by being the best prepared negotiator”.
CHAPTER 4

FINANCIAL ASSESSMENT MODEL

4.1 Financial assessment model

The proposed financial assessment model is to be completed by the individual or group whilst preparing for the intended negotiations. Some examples are provided of information that could be used, from the theoretical research that was done. However, one of the stated requirements was that the model should be generally applicable and not meant for a specific industry/organization only. To achieve this requirement, it is imperative that financial factors and information relevant to the organization and the specific forthcoming negotiation scenario be completed, rather than a general and vague content be supplied.

4.1.1 External financial factors

Consider INTERNATIONAL economic trends, conditions, policies and decisions that might impact on the wage negotiations at hand. List these in column A of the table and a description of the possible impact thereof in column B, before completing the remainder of the table:

<table>
<thead>
<tr>
<th>(A) External financial factor</th>
<th>(B) International impact of financial factor</th>
<th>(C) Estimated impact on the organization</th>
<th>(D) Probability of the impact occurring</th>
<th>(E) Mitigation measures in place</th>
<th>(F) (Impact * Probability) - Mitigation</th>
<th>(G) Calculated impact on the organization</th>
<th>(H) Impact on the wage negotiations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub prime</td>
<td>Closure of</td>
<td>Limited</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>loan crisis</td>
<td>financial institutions, insurers and manufacturers</td>
<td>exposure to foreign investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------------------</td>
<td>---------------------------------------------------</td>
<td>----------------------------------</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decreasing value of the rand</td>
<td>Investment opportunity, ideal for export and inbound travel</td>
<td>Consider increasing export of products or production for foreign companies at reduced real labour cost</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

i) Column C: The possible impact on the organization should be stated in monetary terms, that is, the rand value of the impact should be determined and inserted in the table. If the impact on the organization is zero, the identified financial factor can be disregarded for the remainder of the analysis.

ii) Column D: The probability of something occurring is expressed by a figure ranging from 0 to 1, with 0 meaning that it will not happen at all and 1 representing an absolute certainty that it will happen. 0.5 indicates a 50% probability that something will impact the organization.
iii) Column E: The mitigating measures are firstly described in words, and then a rand value is allocated, similar to what was done for the impact on the organization. The rand value of the mitigating measure should always be equal to or less than the impact that the financial factor would have on the organization.

iv) Column F: The formula for completing column F is supplied, namely the rand value in column C, multiplied by the probability in column D, from which is subtracted the rand value in column E. The result provides a monetary indication of the impact that the financial factor could have on the organization.

v) Column G: A brief description of the effect that the residual value would have on the organization, qualitatively and quantitatively, referring to the calculated residual value.

vi) Column H: A brief description of the relevance to the negotiation process, qualitatively and quantitatively, referring to the calculated value.

Consider **NATIONAL** economic trends, conditions, policies and decisions that might impact on the wage negotiations at hand. (Interest rate changes will be dealt with separately and need not be considered here.) List these in column A of the table and a description of the impact thereof in column B, before completing the remainder of the table:

<table>
<thead>
<tr>
<th>(A)</th>
<th>(B)</th>
<th>(C)</th>
<th>(D)</th>
<th>(E)</th>
<th>(F)</th>
<th>(G)</th>
<th>(H)</th>
</tr>
</thead>
<tbody>
<tr>
<td>External financial factor</td>
<td>National impact of financial factor</td>
<td>Estimated impact on the organization</td>
<td>Probability of the impact occurring</td>
<td>Mitigation measures in place</td>
<td>(Impact * Probability) - Mitigation</td>
<td>Calculated impact on the organization</td>
<td>Impact on the wage negotiations</td>
</tr>
<tr>
<td>Increasing cost of basic</td>
<td>Increased cost of OE, small businesses</td>
<td>Investigate alternative sources</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

79
<table>
<thead>
<tr>
<th>services and consumer goods</th>
<th>forced to close down operations due to financial problems</th>
<th>and recycling</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing cost of transport</td>
<td>Price increases transferred to consumers</td>
<td>Investigate own fleet, including busses to transport employees</td>
</tr>
</tbody>
</table>

i) Column C: The possible impact on the organization should be stated in monetary terms, that is, the rand value of the impact should be determined and inserted in the table. If the impact on the organization is zero, the identified financial factor can be disregarded for the remainder of the analysis.

ii) Column D: The probability of something occurring is expressed by a figure ranging from 0 to 1, with 0 meaning that it will not happen at all and 1 representing an absolute certainty that it will happen. 0.5 indicates a 50% probability that something will impact the organization.

iii) Column E: The mitigating measures are firstly described in words, and then a rand value is allocated, similar to what was done for the impact on the organization. The rand
value of the mitigating measure should always be equal to or less than the impact that the financial factor would have on the organization.

iv) Column F: The formula for completing column F is supplied, namely the rand value in column C, multiplied by the probability in column D, from which is subtracted the rand value in column E. The result provides a monetary indication of the impact that the financial factor could have on the organization.

v) Column G: A brief description of the effect that the residual value would have on the organization, qualitatively and quantitatively, referring to the calculated residual value.

vi) Column H: A brief description of the relevance to the negotiation process, qualitatively and quantitatively, referring to the calculated value.

Consider **INDUSTRY** specific economic trends, conditions, policies and decisions that might impact on the wage negotiations at hand. (Include sector determinations and recent wage settlements for consideration.) List these in column A of the table and a description of the impact in column B, before completing the remainder of the table:

<table>
<thead>
<tr>
<th>(A)</th>
<th>(B)</th>
<th>(C)</th>
<th>(D)</th>
<th>(E)</th>
<th>(F)</th>
<th>(G)</th>
<th>(H)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company A has agreed to a 5.5% wage increase across the board</td>
<td>Pressure to approve similar increases, increased OE due to</td>
<td>Consider market demand for products/services, price elasticity, alternatives of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

81
| Company B is currently implementing VBM | Perceived as fair wage for contribution incentive scheme, wealth creation opportunity for employees | Investigate possibility to do the same, invite employees to participate in investigation and possible future implementation |

i) Column C: The possible impact on the organization should be stated in monetary terms, that is, the rand value of the impact should be determined and inserted in the table. If the impact on the organization is zero, the identified financial factor can be disregarded for the remainder of the analysis.

ii) Column D: The probability of something occurring is expressed by a figure ranging from 0 to 1, with 0 meaning that it will not happen at all and 1 representing an absolute certainty that it will happen. 0.5 indicates a 50% probability that something will impact the organization.

iii) Column E: The mitigating measures are firstly described in words, and then a rand value is allocated, similar to what was done for the impact on the organization. The rand
value of the mitigating measure should always be equal to or less than the impact that the financial factor would have on the organization.

iv) Column F: The formula for completing column F is supplied, namely the rand value in column C, multiplied by the probability in column D, from which is subtracted the rand value in column E. The result provides a monetary indication of the impact that the financial factor could have on the organization.

v) Column G: A brief description of the effect that the residual value would have on the organization, qualitatively and quantitatively, referring to the calculated residual value.

vi) Column H: A brief description of the relevance to the negotiation process, qualitatively and quantitatively, referring to the calculated value.

Consider changes to the INTEREST RATE.

<table>
<thead>
<tr>
<th>(A) External financial factor</th>
<th>(B) Areas of impact to the organization</th>
<th>(C) Total impact on the organization</th>
<th>(D) Probability of the impact occurring</th>
<th>(E) Mitigation measures in place</th>
<th>(F) (Impact * Probability) - Mitigation</th>
<th>(G) Calculated impact on the org.</th>
<th>(H) Impact on the wage neg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in the interest rate</td>
<td>Interest bearing debt, bank overdraft, return that owners/shareholders expect, NOPAT, FCF, ROIC,</td>
<td>Management of strategic -, operational -, asset -, size and diversity risk, other mitigating measures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

83
i) Column C: The possible total monetary impact on the organization, as calculated during the analysis for column B.

ii) Column D: The probability of an increase in interest rate is determined by the quarterly announcements of the governor of the Reserve Bank. It would be either 1 if an increase has been announced, or 0 if the rate remains unchanged or decreases. During the quarter, or whilst awaiting the announcement, the probability is stated as 0.5.

iii) Column E: Some risk reducing mitigating measures have been discussed. These can be supplemented by any measures that the organization has implemented.

iv) Column F: The formula for completing column F is supplied, namely the rand value in column C, multiplied by the probability in column D, from which is subtracted the rand value in column E. The result provides a monetary indication of the impact that the financial factor could have on the organization.

v) Column G: A brief description of the effect that this would have on the organization, qualitatively and quantitatively, referring to the calculated residual value and the analysis completed in column B.

vi) Column H: A brief description of the relevance to the negotiation process, qualitatively and quantitatively, referring to the calculated residual value and the analysis completed in column B.
4.1.2 Internal financial factors

Using the latest financial statements of the organization and other relevant financial information, do the following calculations. Only one of the formulae for every metric needs to be used, reducing the number of calculations to 12.

(1) NOPAT

\[ \text{NOPAT} = [(\text{Sales} - \text{Cost of sales}) - \text{Operating expenses}] - \text{Interest} - \text{Taxes} \]
\[ = \text{EBIT} (1 - T) \]

This profitability of the organization provides an indication of the affordability of an increase in labour cost. Labour costs increase the cost of sales (direct labour) and the OE (indirect labour).

(2) FCF

\[ \text{FCF} = (\text{Throughput} - \text{Operating expenses}) - \text{Investment} \]
\[ = \text{NOPAT} - \text{Net investment in operating capital} \]
\[ = \text{EBIT} (1-\text{Tax}) + \text{Depreciation and amortization} - \text{Net investment in total operating capital} \]

FCF is an indication of the ability of the organization to pay the employees the agreed remuneration. Labour costs decrease NOPAT and EBIT.

(3) ROIC

\[ \text{ROIC} = (\text{Throughput} - \text{Operating expenses}) / \text{Investment} \]
\[ = \text{NOPAT} / \text{Total operating capital} \]

ROIC provides an indication of the impact that labour cost has on the return on invested capital as labour costs decrease NOPAT.

(4) WACC

\[ \text{WACC} = w_d r_d (1-T) + w_s r_s \]
EVA = Accounting value – Value added by the organization
= NOPAT – (Cost of capital required to create the profit multiplied by the capital used to create the profit)
= NOPAT – (ROIC - WACC) * Total operating capital

EVA provides a numeric value to describe how management, through their contribution and management of the organization have added value in a financial period. The impact that labour costs have on NOPAT, EBIT and ROIC have been explained above.

MVA = Total market value of the organization – Total capital invested
= [(Outstanding shares) * (Current share price) + Value of debt] – (Total common equity + Debt)

Total financial value of the last demand and offer, as well as alternatives that could have the same perceived value.

Total financial value of the target compensation level, maximum and minimum positions and the BATNA.

The current total labour cost as a percentage of total production cost, OE and NOPAT. Benchmark these calculations against the industry or comparable organizations if the figures are available.

Calculate the ratio of each of the employment levels total average remuneration package to that of the lowest paid employee and plot the results in the form of a graph. The increment should preferably follow a linear pattern, as opposed to an exponential pattern.
(11) Evaluate the current inventory levels and the number of days inventory on hand (applicable to production type organizations). Calculate the direct and indirect cost required to prepare for a possible strike by increasing production and compare these costs to the expected cost of the strike.

(12) Estimate the relative scarcity of critical resources, particularly human resources, and calculate what it would cost to find and employ alternatives.

4.1.3 Personal financial factors

A sample of PERSONAL financial factors which were identified during the theoretical research, have been included in column A of the table below. Consider any additional personal financial factors that might be applicable and complete column A of the table, before proceeding to the remainder of the columns:

<table>
<thead>
<tr>
<th>(A) Personal financial factor</th>
<th>(B) Management approach to the financial factor</th>
<th>(C) Proposed intervention</th>
<th>(D) Total cost of intervention</th>
<th>(E) Impact on the organization</th>
<th>(F) Impact on the wage negotiations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Job security and continuation of the working relationship</td>
<td>Intend to retain the current workforce</td>
<td></td>
<td>Current total labour cost plus any settlement reached</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fair wages for the contribution made</td>
<td>Consider a new incentive scheme</td>
<td>Direct intervention: Implement</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

87
<table>
<thead>
<tr>
<th>Scorecards using VBM</th>
<th>Acceptable working conditions</th>
<th>Acceptable living conditions</th>
<th>Opportunities for advancement and access to higher levels of remuneration</th>
<th>Changing family structures and increasing numbers of dependants</th>
<th>Limited access to social services</th>
<th>Increasing cost of basic</th>
</tr>
</thead>
</table>

88
<table>
<thead>
<tr>
<th>services and necessities</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing cost of transport</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

i) Column B: Management states their intention regarding the specific financial factor, which could either be to maintain the status quo, or to address the identified financial factor in some way. In this case, the following columns should be completed.

ii) Column C: Management could either consider a direct intervention or an indirect intervention. This column can be completed with high level suggestions of appropriate interventions.

iii) Column D: Calculate the total cost of each of the suggested interventions and enter the respective costs into this column.

iv) Column E: Consider the impact that the proposals and the concomitant cost thereof might have on the organization. Complete column E with the relevant information.

v) Column F: Consider the impact that the proposals might have on the negotiation process and how the proposals can best be included in the offer that is presented. Complete column F accordingly.
4.2 Conclusion

The theoretical research revealed a wide range of financial factors that have influenced salary and wage negotiations, as well as industrial action in the recent past in the country. The financial factors were grouped into three groups, external financial factors, internal financial factors and personal financial factors. Of particular importance is the fact that the majority of the financial factors that were identified relate to the internal environment, or the organization itself. The internal financial factors could be further divided into two groups, namely those that are purely related to finance and those that have an element of the relationship between management and the employees incorporated. The financial assessment model concentrates on the purely financial factors, but does take cognisance of the relationship issue when assessing and addressing the financial factors.

It could be argued that the personal financial circumstances of the employees are of no concern to the employer. However, when compiling an offer, the total cost of the offer, as well as the cost of concessions and trade-offs should be considered. It has been mentioned that indirect assistance to the employees could be perceived to have a high value, at a limited cost to the employer. The compilation of these interventions, perceived value in relation to the actual cost and implementation as part of an agreed settlement, could present a topic for future further study.

The principles of VBM present an opportunity to align the interests of the business owners and shareholders to those of the management and employees of the organization, whilst addressing one of the identified personal financial factors, namely a fair wage for the contribution made. VBM was found to be relatively unknown, particularly amongst the public servants and smaller businesses participating in the research. A study of the successful local implementations to design a recommended implementation methodology, could contribute to the local body of knowledge regarding VBM.
Limited attention is given to financial assessment in preparation for wage negotiations. This was confirmed by the theoretical, as well as the empirical research. Although the sample was limited in numbers and geographic area, similar results to those obtained, can be expected from a large sample across an extended geographic area. Two of the reasons that could be offered to explain this finding, are the time available to prepare for negotiations and a readily available financial assessment model, particularly to assist non-financial negotiators with the assessment. The proposed financial assessment model could assist in addressing the need.

The proposed financial assessment model should be tested, refined and validated in a range of salary and wage negotiations. It could be further developed into an interactive software product that is simple to use and automates the calculations that were included in the model. This poses an opportunity for future further study.
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APPENDIX A

RESEARCH QUESTIONNAIRE

FINANCIAL FACTORS IMPACTING SALARY/ WAGE NEGOTIATIONS.

This questionnaire forms part of an academic research project for completion of a MBA dissertation and is for academic purposes only. The questionnaire should be completed honestly and anonymously, that is, you will not be identified and it will in no way be made available to your current employer. Individual answers will not be referenced, other than to illustrate the view of the group that is represented by the findings of this study.

YOUR PARTICIPATION IS GREATLY APPRECIATED.

BACKGROUND:

This questionnaire deals with financial factors that might have an influence on your decisions and actions during salary/ wage negotiations.

RESEARCH QUESTIONS:

1. INDUSTRY:

Do you work within a competitive or non-competitive industry?

COMPETITIVE: If someone from this industry is on strike, customers would use another provider from the same industry (retail, airlines, building contractors).
NON-COMPETITIVE: If someone from this industry is on strike, customers are not able to revert to another provider although providers could make use of scab labour (municipality, police, and correctional services).

| Comp. | Non-comp. |

2. DEMOGRAPHIC INFORMATION:

2.1 Gender:

| Male | Female |

2.2 Years working experience:

| Less than 2 | Between 2 and 10 | Between 10 and 20 | More than 20 |

2.3 Role during negotiations:

A: Employee/ Other, with no direct or active role during negotiations, other than supporting the representative, attending meetings and participating in action.

B: Union representative/ Shop steward/ Represent the employees during negotiations.

C: Manager/ Business Owner/ Represent the employer during negotiations.

A  
B  
C
3. PREPARATION METHODOLOGY:

3.1 How much time do you spend preparing for negotiations?

A: Not at all
B: A few hours, less than one day
C: More than one day but less than a week
D: More than a week

3.2 Do you use a specific preparation methodology?

A: Not really, some reading, recent media reports and gut feel
B: Yes, company methodology, own methodology
C: Yes, learnt at university/ short course

Name of institution: ________________________________________________

D: Yes, formal methodology

Methodology: ______________________________________________________

A
B
C
D
3.3 Are you provided with settlement guidelines or targets for the outcome of the negotiations?

A: Not at all
B: A maximum target only
C: A maximum and minimum target
D: A maximum, minimum and desired target

3.4 Do your preparations/ the methodology you use, include financial aspects?

A: Not at all
B: Very briefly, inflation, previous settlements and industry benchmarks
C: A detailed overview of the company financial position, what can be afforded, previous settlements, an overview of the market including industry benchmarks
D: Detailed research covering the international financial position, the financial position of the company and the financial position of the workforce
3.5 Do you include aspects such as the company strategy, policy and procedures in your preparations?

A: Not at all
B: Only if I think that it is applicable
C: It is a key consideration during preparations

4. FINANCIAL ASSESSMENT MODEL:

4.1 Do you use specific modelling tools during preparations for negotiations?

A: Not at all
B: Yes, sometimes

Specify: __________________________________________________________

C: Always, it is a key element of the preparations

Specify: __________________________________________________________
4.2 Would you consider using a financial assessment model if it was readily available?

A: Not at all
B: Perhaps, on condition that:

Specify: ________________________________________________________________

C: Definitely

4.3 What would you like included in the financial assessment model? (Mark all the applicable items)

A: Financial factors specific to the external environment, particularly the international economic conditions
B: Financial factors specific to the industry and competitors
C: Financial factors regarding the company itself
D: Financial factors impacting the individual employees
4.4 Do you have any knowledge or experience of Value Based Management?

A: Not at all
B: Have heard about it before, read about it
C: Know about it but have no practical first hand experience
D: Have implemented VBM and use it at our company

A
B
C
D

4.5 Do you consider the impact that a proposed settlement would have on the value of the company as perceived by the owners, shareholders or market in general?

A: Not at all
B: Very briefly
C: Yes, but that is the nature of business
D: Yes, it is a major determinant of the outcome

A
B
C
D
4.6 Would you consider using a financial assessment model if it assisted you to analyse the impact of the outcome of the negotiations on the value of the company, as perceived by the owners, shareholders or market in general?

A: Not at all
B: Perhaps, on condition that:

Specify: ________________________________________________

C: Definitely

5. CONCLUDING REMARKS:

You are welcome to add any other remarks that you would like to be noted:

____________________________________________________________________

____________________________________________________________________

____________________________________________________________________

Once again I would like to thank you for your participation in the research!