Remuneration Perspectives
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VENCON
Research International

SALARY TRENDS - 2009

"Prediction is very difficult, especially if it's about the future" **Niels Bohr**

In numerous conversations with clients from, inter alia, Boston, Chicago, New York, Buenos Aires, London, Paris, Moscow, Dubai, Mumbai, Hong Kong and Sydney we have been repeatedly asked what we see happening to consulting salaries over the coming year. At Vencon Research International we have always been hesitant to predict, extrapolate or forecast, restricting ourselves to reporting and analysing current data. However, such has been the demand from clients around the world in the light of the current economic turmoil that we have decided to set out our observations, thoughts and a synthesis of the views of the consulting practitioners around the world with whom we have spoken. We may well be proven wrong by the time this article arrives in your in-box, but with that caveat established we respond, as ever, to our clients' request …

"Toto, I've a feeling we're not in Kansas anymore" **Dorothy Gale**

Once upon a time (about a year ago, actually), when banks were places you deposited money in the full expectation of getting it back, the Dow Jones was hovering around 13,000 and the phrase 'as safe as houses' could be used without irony. Consulting industry journals were reporting that although we should be nearing the end of the current upward cycle, there were no clear signs that an end was in sight, and our clients were asking about salary inflation in emerging markets and new market opportunities. Meanwhile at Vencon we were making some observations regarding the predictability of consultant compensation. Back then, before words like subprime, quantitative easing and Ponzi scheme had entered everyday vocabulary, we noted the strong correlation between a country's GDP per capita and the starting salary of a recent graduate Analyst into consulting – better than 90%. We also observed that senior Principal earnings in virtually all countries tended toward the marker level of the US, illustrating the international mobility of such experienced consultants. Therefore, we concluded, variations in pay-scales between markets were primarily a function of the slope of the earnings graph in a given country, and transient market perturbations in exchange rates.

Then came September 15th, 2008, the day on which Lehman Brothers filed for bankruptcy. Since then currencies have crashed, the governments of the Czech Republic, Hungary, Iceland and Latvia have fallen, AIG has reported a loss greater than the GDP of Egypt and the IMF, World Bank, WTO and OECD are all forecasting the worst global outlook for generations.

"There are known knowns. These are things we know that we know" **Donald Rumsfeld**

We also observed, in an earlier issue of 'Perspectives', that GDP growth is a prime driver for management consulting growth.

Figure 1 illustrates the relationship between global GDP growth, and revenue growth of the global management consulting industry since 1990. For 10 years, as the world recovered from the 1990 recession through to the next major downturn in 2001, consulting grew strongly by a compound rate of 17.5% per annum, and more importantly closely tracked the global GDP line. But the 2001 recession resulted in a dramatic disconnect - firms had recruited in expectation of continued high growth, only to find that consulting experienced its worst ever downturn.

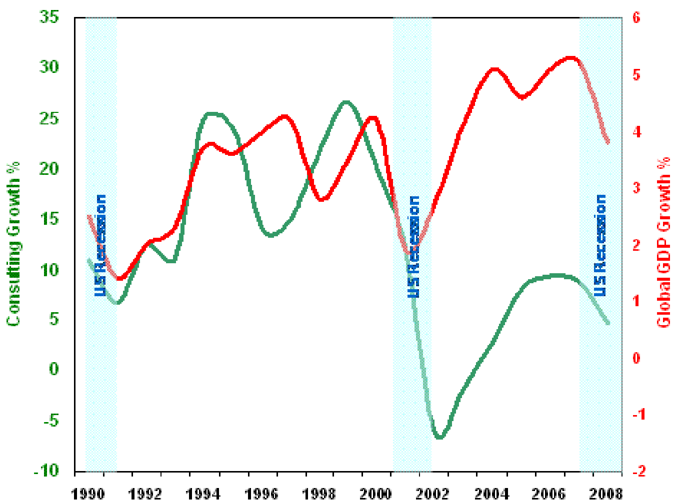

Figure 1: Global GDP and Management Consulting growth

Some firms posted revenue declines of 30%; some well known names disappeared altogether.

Now we have entered an even deeper and more widespread recession. The IMF is forecasting global growth will go negative this year for the first time in 60 years, whilst the WTO expects world trade to drop by 9%, again the worst performance since the Second World War.

Some service lines within consulting actually benefit from economic downturn (e.g. restructuring, outsourcing and business process re-engineering). However, the overall picture remains one of reduced discretionary spend by clients. It would be foolish to imagine that consulting can do any better than remain static in this climate. As one client partner put it to us "Flat is the new Up."

"Those who cannot remember the past are condemned to repeat it" George Santayana

Following the 2001 recession, it appears consulting firms have been far more cautious in their recruitment and growth plans, with the industry's CAGR since then averaging only 3.5%. Bizarrely, as shown in Figure 3, MBA recruitment peaked in 2001, as many first year offers came to fruition right in the middle of the downturn. Thereafter it dropped dramatically through 2002 and 2003, only recovering to its pre-2001 level several years later. It appears that many firms have refrained from over-recruiting (having been burned in the 2001 downturn), preferring to await confirmed assignments before staffing up. This more conservative approach may be why many firms are able to say they are not (yet) cutting back on planned recruitment.

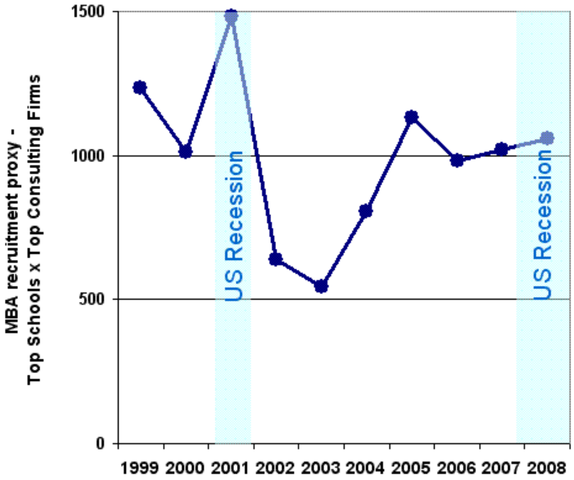

Figure 2: MBAs into consulting – Top 25 Schools x Top 10 Employers

Add to this the fact that the other major business and undergraduate school recruiter, Investment Banking, is not going to be a major player this year, and we can conclude that this year the traditional upward drift of salaries at the career entry points is improbable.

The other traditional upward driver of salaries, across the board, is price inflation, and the impact is probably more dramatic than we realise. While consulting may not adopt a classic public sector approach of directly linking salary review to inflation, the connection is unmistakable over time. Figure 3 takes data over a 3 year time period for a number of major consulting markets, showing compound consumer price inflation over the period 2005-2008, and plots this against Vencon's record of consulting earnings (base salary plus actual bonus) for the same period. For this purpose we have used primarily strategy consulting data, as the career structures and roles are completely consistent across markets.

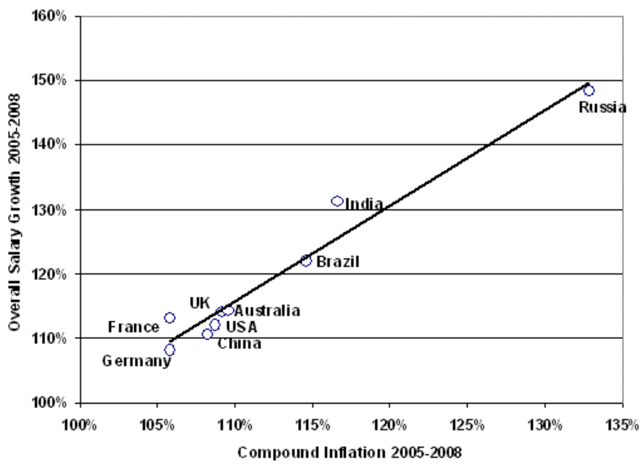

Figure 3: Consulting salary growth vs. consumer price inflation

The correlation is almost 98%, and would be higher but for a lag in India's inflation figures; CPI for India has risen in the first quarter of this year, as a sharp currency decline has caused food prices to rise. Overall, the trends and the messages are clear: (a) Although the recession will cause inflation to drop, in countries such as Russia, India and much of Eastern Europe, it will still be high, and we can expect some measure of consequent salary inflation; (b) But in most of the major consulting markets CPI will drop to near zero, and we can anticipate zero or even negative earnings growth.

In the current financial chaos, there is a further major factor at play. Figure 4 illustrates the magnitude of the changes in currency exchange rates, particularly over the 6 months following the demise of Lehman Brothers. Tracking the growth of several major currencies against the US Dollar since January 2006, the Euro had gained nearly 35% compared to the USD, whilst the British Pound, Chinese Yuan, Indian Rupee and Canadian Dollar had all posted relative growth of between 15-20%. Since the middle of last year, and especially since August 15th, most of those 2½ years of growth have been not just eliminated, but for the pound, rupee and Canadian dollar, completely reversed. The pound is currently down 40% against its previous high, the others, except for the Yuan, posting 20-25% declines.

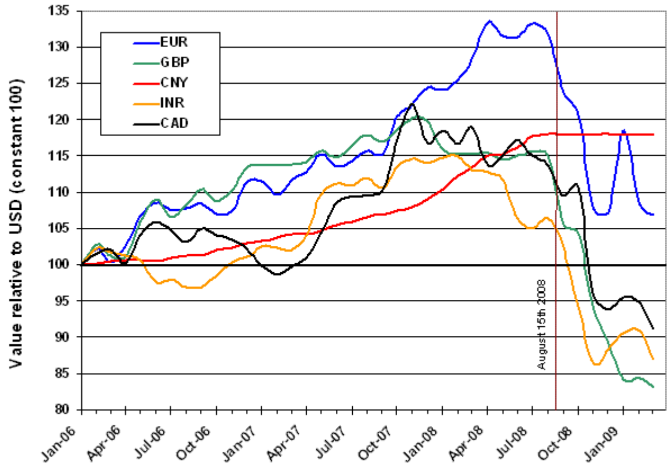

Figure 4: Movement of leading currencies against US Dollar

This alone has radically changed the landscape for consulting salaries.

This time last year, as a direct result of US Dollar weakness, the US had become one of the lowest cost markets for consulting in the developed world.

Figure 5 shows an average salary (base plus bonus) figure for the USA using Vencon's 2008 data, compared against a weighted average for 12 other countries, designated on the graph as "Rest of World" (RoW), comprising Australia, Belgium, Canada, China, France, Germany, India, the Netherlands, Russia, Spain, Switzerland and the UK. Together with the USA these represent over 60% of the world's GDP, and over 80% of the world's management consulting revenues.

Two data sets are presented: we have taken the 31st May 2008 data, using exchange rates as at the middle of the year, and the September update data, using exchange rates for 1st February 2009. The US data are reasonably constant, as only minor salary and bonus revisions implemented during that 4 month period are involved; the line is, for this purpose, fixed.

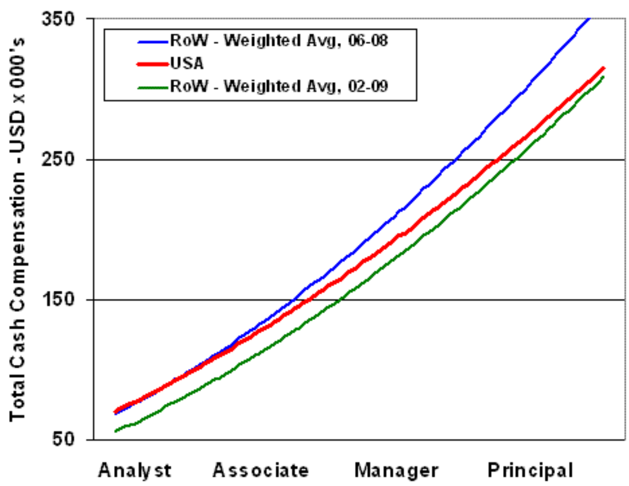

Figure 5: Impact of Exchange Rate on US salary positioning

Compare this to the weighted average of the 12 other countries: using the mid-2008 data, the 'other countries' average earnings were 7.5% above that of the USA. Barely 6 months later, the February 2009 average had dropped to fully 10% below the USA, and suddenly the USA had resumed its traditional status as one of the highest cost markets for management consulting.

If we look at this trend in more detail, Figure 6 allows us to identify three bands of relative compensation movement:

(1) At the extreme end, with relative decline of ca. 30%, are those countries that have experienced the most dramatic currency decline, such as the UK – formerly one of the highest paying countries – and Australia;

(2) Euro-zone countries, along with Canada, have seen declines of around 15%, and finally

(3) China and India have remained relatively stable, as a consequence their continued economic growth outstripping the effects of inflation. Russian consultants meanwhile benefited from a widespread practice of having their salary set in US Dollars, rather than roubles.

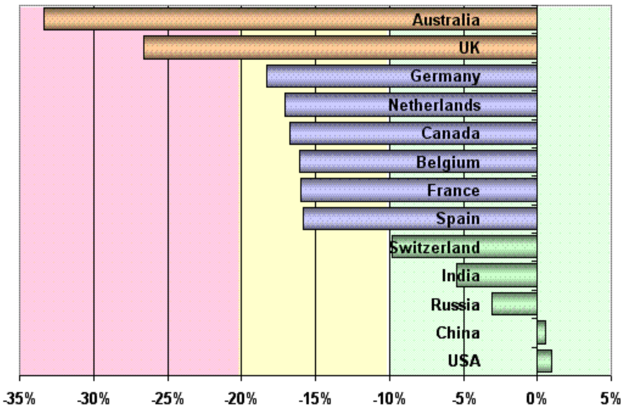

Figure 6: Exchange Rate Impact (selected countries vs. USA)

"Ask five economists and you'll get five different answers - six if one went to Harvard" Edgar R. Fiedler

We have now identified a range of factors that will influence salary movement in the coming year: an economic cycle that has entered a major downturn, and will take consulting revenues with it; decreased recruitment, with reduced demand from both consulting firms and investment banking, a unique "double whammy" for prospective hires; consumer price inflation, which is a primary determinant of salary growth over the medium term, is falling, although currency fluctuation may cause CPI to rise in countries with high import levels, such as the UK; and finally currency fluctuations, which have been more extreme in the last six months than in the preceding three years.

Armed with this knowledge, added to the early data we have received from client firms and anecdotal input from around the world we shall now set out our thoughts on salary trends for the coming year.

- At the end of 2008 bonus levels appear to have been up, probably the result of the personnel adjustments made by the firms during 2008 while job booking was still high. Many firms raised the performance bar, and hence 'let go' staff who, in better times, might have been retained. Those who remained therefore found themselves working harder, but were able to share in the consequent higher profits and thus higher bonuses.

- 2009 bonuses will depend on each firm's financial and personnel cost structure. Firms that have staff performance bonuses in their financial plan as a fixed cost (e.g. force-fit the staff performance curve to achieve 70% of target bonus payment) will continue to pay their performers a good bonus. Those that have the bonus payment as a variable cost will only pay their performers a good bonus if the firm does well against plan.

- Sign-on bonuses are down across the board, as competition for candidates is well down.

- Base salary increases are restricted to the dynamically growing regions of the world, e.g. India, China and those of the 'Asian Tiger' economies, which usually also have higher inflationary pressures.

- Both Eastern Europe - other than countries within the Euro-zone - and South America are caught between the downward pressure of economic decline, and upward pressure of currency inflation.

Here we anticipate salary increases in local currency terms, but in effect a decrease against international comparisons.

- In Europe we saw salary stagnation in 2008, but are now seeing a decrease for most countries during 2009. This is being implemented by means of adjusting the "salary grid" downward for new entrants and promotions. Existing staff are facing pay freezes almost across the board.

- We have also seen a decrease in salaries for both the USA and Canada, with adjustments of over 5% in certain sectors. Again, a combination of salary grid adjustment and pay-freeze are being utilized.

This is an unprecedented situation, and much depends on decisions being made at the highest levels of government around the world. At Vencon Research International we will be monitoring the position constantly, and advising clients as soon as any further compensation trends become clear.