Asking the Audience …

Vencon's previous 'Perspectives' responded to client requests to pass on our thoughts on likely compensation movements over the next review cycle, in the light of the global economic downturn. Whilst giving our best estimates, we indicated then that we would continue to monitor the situation and advise clients, as soon as, further hard data were available. Here we present an overview of the trends apparent from the June 2009 Vencon Research International consultant "Salary Surveys".

As before, we have consolidated data from a representative sample of countries we benchmarked, ranging from mature to emerging consulting markets, and covering both strategy, IT- and operations-based firms, to determine general trends, and hopefully aggregate the collective wisdom of our clients.

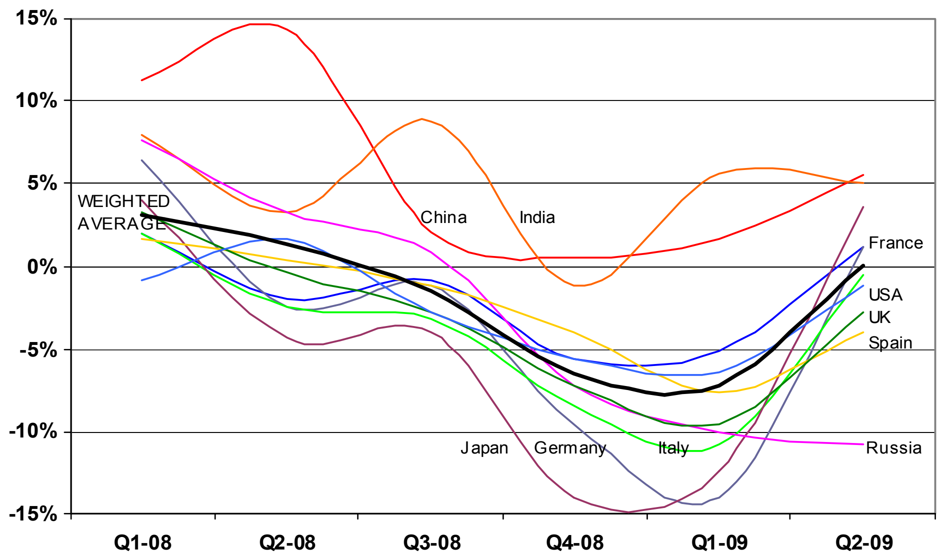
> ***"Ask the Audience"***
> *The TV studio audience of "Who Wants to Be a Millionaire" guesses correctly 91% of the time.*

Overall, June 2009 data show a modest reduction in base salaries which averaged only around -1.5%; more significantly, bonus payments were reduced by an average -5.5% of base salary when averaged across all career levels; the so-called 'pure' strategy, the full-service IT- and the full-service operations-based management consulting firms have all seen broadly the same result.

However, since the percentage of base salary paid as bonus by operations-based firms is typically only half that paid by strategy firms, a reduction of 5.5% has proportionately greater impact on the operations-based staff. Conversely, as base salaries for strategy firms are typically 30% higher than the equivalent position in operations, the cash impact has been greater for strategy consultants – though, of course, the higher base and bonus payments in strategy may mitigate the pain.

As forecast in the previous 'Perspectives', there is considerable variation from these general trends, dependant upon an individual country's economic growth or decline, market maturity and exchange rates and we should thus look at the results in more detail. Therefore, we have taken a sample of consulting economies, representing the Euro-zone (France, Germany, Italy and Spain), the non-Euro mature consulting economies (Japan, UK and USA) and the emerging consulting markets (China, India, and Russia) to illustrate our findings (refer to Figure 1.).

Figure 1: GDP Growth (Q-on-Q, annualised)



We had already established the strong relationship between a country's GDP and growth in management consulting. Using the latest GDP data for the 10 countries mentioned (which collectively represent 64% of the global economy) we may conclude **the worst is over**; the nadir was around December '08 / January '09, with weighted average GDP growth now passing through the 'zero' point. (Please bear in mind 'zero growth' only indicates that things aren't getting any worse, not that they're back to where they were: if GDP - or any important indicator for that matter – falls by 50%, it subsequently needs to rise again by 100% to get back to where it started!):

- China and India were never technically in recession (though note that official Chinese figures quote only Quarter growth against the same Quarter in the previous year: Hence in a downturn, growth appears much higher than it would when using comparable Q-on-Q data, as presented in figure 1).
- The countries who experienced the greatest decline were Japan, Germany and Italy, all with annualized Q-on-Q declines of 11% or more at the end of 2008.
- Officially Japan and Germany (as well as France) have now emerged from recession. Both Japan and Germany experienced dramatic turnarounds, from an annualized -14% to positive growth in just one quarter (which was particularly fortuitous, given their coming general elections).
- The USA is on the cusp of a return to growth and a 2% growth rate is forecast for next year.
- Based on latest data, the UK and Spain are still suffering, posting Quarter 2 declines of in excess of 3% annualized, though the rate of decline has eased for both.
- The rate of decline in Russia, however, continues to get worse.

That said, in the near term using GDP data to forecast is like looking in a distorting rear-view mirror: the data are historical, subject to statistical (and political) massage and time-lag. Furthermore current data (i.e. June 2009) are also likely to be revised and are therefore even less help when forecasting business activity over the critical next few months. Simply put, another measure is needed.

The stock market as an alternative measure of economic activity

Clearly a great many measures are potentially available to gauge forward economic activity – house price indices, commodity futures, forward exchange rates, purchase managers' index etc, but strangely none of these seemed of use in forecasting the recent unpleasantness.

As an alternative proxy for a real-time indication of the state of any country's economic well-being we have chosen to look at the performance of the local stock market – the collective opinion of lots of local people (and well-read institutions) choosing to put their money where their collective mouths are.

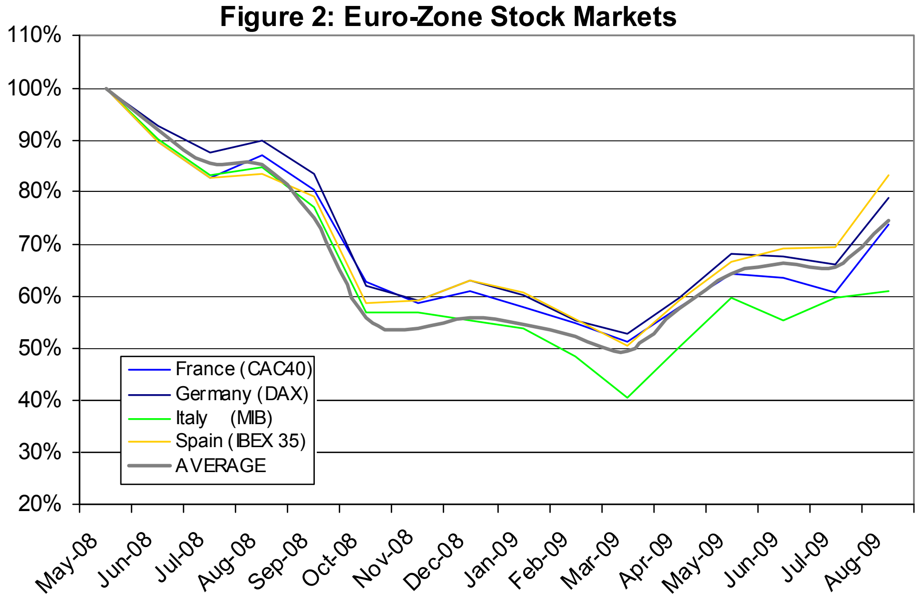
In the graphics to follow we have used stock market indices, tracked over the last 15 months (i.e. from about 4 months before all those markets fell off a cliff) for the same 10 countries plus the UAE, and again separated them into 3 categories: Euro-zone markets, Mature markets outside the Euro-zone and Emerging markets. In each of the graphics below the broad line represents a simple average for the stock markets we shall review here.

We have normalized the data presented such that the index at May 2008 = 100% for all countries, and thus makes it possible to see how far we are from 'a return to normality'. Note that the low point of virtually every market occurred around March of this year, coinciding with the release of the last Perspectives article, so we were forecasting from the bottom of the market.

Euro-Zone Countries

We see the Euro-zone countries closely tracking the general average (the thick grey line), with France, Germany and interestingly Spain now having recovered to over 70% of their May '08 levels. Italy has not fared so well, its recovery having stalled since May at around the 60% level.

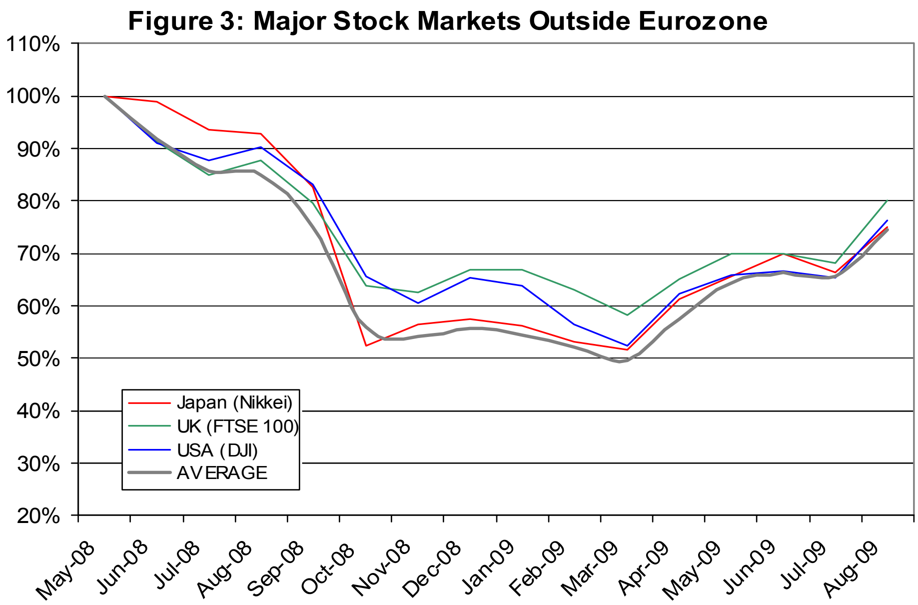
In consultant salary terms, we see a similar pattern. France and Germany, in both strategy and operations, have seen reductions in base and bonus payments equating to an overall fall of around 5% of base, very much in line with the 'global' salary trend.



In Italy and Spain the impact on operations-based firms has been broadly the same, but strategy firms in both these countries have seen significantly greater reduction in their bonus payments, averaging ca. 8% of base across for all grades (compared to the average global reduction of 5.5%).

Mature Markets outside Euro-Zone

Surprisingly, the US, UK and Japanese stock markets have all fared better than the general trend. All three have recovered to over 75% of their May '08 level, and averaged across the whole 15 month period, the UK was the 'least worst' of all the markets tracked.



In consultant compensation terms, we have seen some interesting patterns:

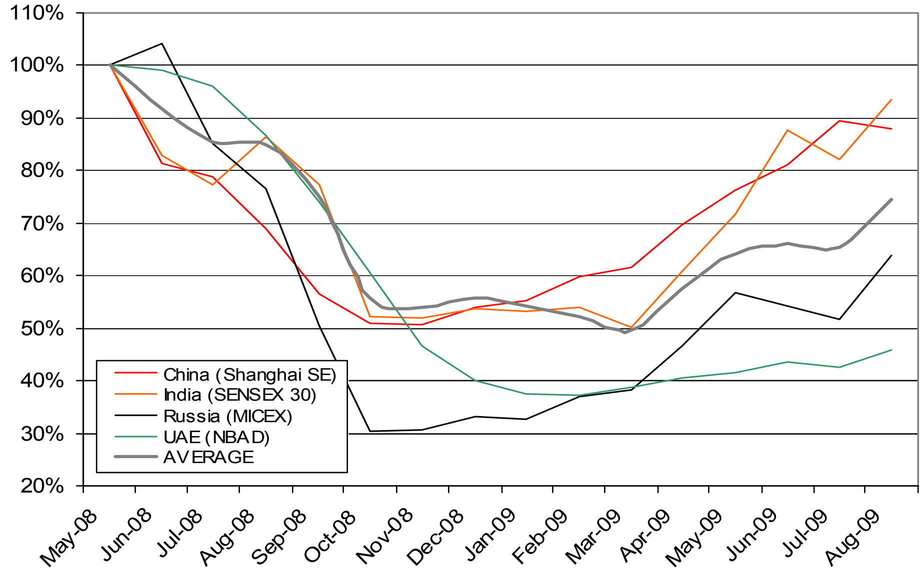
- In Japan, strategy consulting has followed the global trend almost exactly, and although operations-based consulting has experienced a decline, it has not been as pronounced as in other markets. Japan has always been less dynamic in its salary movement than almost every other market, but in this case it has been to the relative advantage of Japanese consultants.
- Operations consulting in both the US and the UK have seen quite significant reductions in base salary, approaching twice that of the global trend, with the US in particular adjusting salary grids at the more senior levels to effect an overall reduction. Bonus reductions were not as dramatic as in other markets, such that the combined effect of combined base and bonus adjustments has reduced total cash by the same amount as the overall trend, but has noticeably changed the base salary to bonus balance.
- Interestingly, the reverse is seen in strategy consulting, where base salaries have been reduced, although mainly at the entry levels, but bonus reductions were higher than seen generally; average bonus payments for strategy consultants in the US are down by almost a third.

Emerging Markets

Perhaps it’s no surprise that here we see the greatest variation.

- Looking at the stock market performance, it’s clear that India and China, though severely impacted by the global downturn, have both recovered to 90% or more or their May ’08 levels.
- The decline in both Russia and the UAE, however, appears as dramatic as their rise in the previous 15 month period. The Russian market dropped the fastest of any in our study, hitting the bottom in the last Quarter of 2008 and thereafter has gradually clawed its way back to 60% of its May 08 value. The UAE market dropped in line with the global trend until the end of 2008, but then kept on falling, and currently stands at less than 50% of its May 2008 value.

Figure 4: Stock Markets for Emerging Markets



In compensation terms, the trends and disparities are equally marked:

- China has seen significant realignment of compensation, both in strategy and operations, with the biggest change in the strategy sector.
- While both strategy and operations sectors saw bonus payments reduced by around 5% of base, strategy consulting saw an even greater reduction in base salaries - in fact the greatest base

salary reduction of any of the markets compared here. This may be attributed to the changing mix of consultants being employed, with firms becoming increasingly less dependant upon either expatriate staff or returning Chinese nationals, and now more willing to employ graduates from Chinese universities and business schools, so avoiding any ‘expatriate’ or ‘repatriate’ premium. This is a trend similar to that seen earlier in India, where the best students from the leading Indian business schools are now accepted as matching those from other leading international institutions.

India, Russia and UAE are all experiencing high Consumer Price Inflation – in the magnitude of 10% or more – and as we suggested in the previous ‘Perspectives’, this can distort their salary positioning. Hence, any salary increase of less than the CPI rate equates to an effective pay cut:

- India, as we anticipated in the last ‘Perspectives’, has weathered the storm in strategy consulting, with base salaries actually increasing, but offset by a similar reduction in bonus percentages to give a broadly neutral result. Operations-based firms have seen their bonus payments savaged, and are now typically only half that of the previous year, but without the compensation of any increase in base salary. Creative sourcing of candidates and a high employee churn seems to give greater flexibility to managing compensation packages in India.
- In Russia base salaries in both strategy and operations sectors are down dramatically, recording the biggest drop of any sector or country for operations-based firms; this has been compounded by bonus payments also decreasing in line with the global average. However, most salaries in Russia are quoted in Euros or US Dollars, and if converted to local currency, salaries are actually up by 10% or more. We hate to say it, but this was the line of our prediction in last Perspectives!
- In the UAE salaries are also often quoted in US Dollars, but the UAE Dirham is tied to the dollar so salaries are less subject to dramatic fluctuations. Within strategy consulting, reductions in both base salary and bonus percentages were seen, although these were focused on more junior levels, with senior staff actually seeing a modest increase. Operations-based firms actually saw base salaries increase virtually across the board, but experienced savage reductions in bonus payments, making the overall income position broadly neutral.

Sign-on Bonuses

Information on sign-on bonuses has been very limited, as most firms are waiting to see what others are doing in the coming recruitment round. The temptation must be to reduce or eliminate sign-on, given the anticipated reduced demand from consulting and elimination of much competition from the investment banks, and most firms have confirmed planning to do exactly this.

> ***“The wisdom of crowds”***
> *Francis Galton, described as ‘parent of modern statistical methods’ by the Royal Statistical Society, wanted to prove that the knowledge of experts should take precedence over the views of the ignorant masses. But at a ‘guess the weight of the ox’ contest at a country fair, he discovered that no-one – including “expert” farmers and butchers – got the right weight. However, to his chagrin, he discovered that the average guess of all 800 participants was 1,197 pounds: within 1 pound of the actual carcass weight. The crowd’s judgment was essentially perfect.*

However, with a recovery clearly underway, demand may increase, and with Goldman Sachs and JP Morgan both recently posting unexpected multi-billion dollar profits, investment banks may yet make a late re-appearance on campus.

Pseudo-economics 101

The cumulative decline in GDP recorded in our weighted average of 10 countries, as illustrated in figure 1, amounted to 3.8% - the same, in fact, as the World Bank’s latest projection for the fall in global GDP in 2009. In hard currency terms, that equates to a reduction in value of world production of USD 2.05 trillion.

Coincidentally, the IMF's most recent estimate of the total write-down of loan value by all the world's financial institutions as a result of the current financial crisis is USD 2.09 trillion. For the non-economists amongst us, maybe this provides an answer to our question 'So where did all that sub-prime money go?'

But even if the global economy were to return to the extraordinary (and, as we now suspect, unsustainable) 5% GDP growth levels experienced from 2003 – 2007, it would take until the end of 2010 just to get the economy back to where it was at the end of Quarter 2 last year. It's going to be a long, hard struggle, even without a 'double dip' recovery.

In making our reluctant forecasts of anticipated salary trends some 6 months ago we predicted:

- *"Sign-on bonuses will be down across the board, as competition for candidates is well down.*
- *"Base salary increases will be restricted to the dynamically growing regions of the world, e.g. India, China and economies which usually also have high inflationary pressures.*
- *"In Eastern Europe and South America, caught between the downward pressure of economic decline, and upward pressure of currency inflation, salary increases in local currency terms, but a decrease against international comparisons.*
- *"In Europe, a decrease for most countries during 2009 implemented by means of adjusting the "salary grid" downward for new entrants and promotions. Existing staff will face pay freezes.*
- *"A decrease in salaries for both the USA and Canada, with adjustments of over 5% in certain sectors."*

With the ineffable benefit of hindsight, we might amend the observation on sign-on bonuses; the temptation to reduce sign-ons may still obtain, but the Investment Banking sector is starting to look attractive again, and three of the biggest banks have already indicated they are revising their base-bonus mix (and thereby increase the base) to ensure any forthcoming regulation will not hamper their recruitment ability.

Other than that, compensation revisions were both in line with our forecasts, and followed the pattern we had projected in terms of exchange rate and inflation parameters; however, the variations were effected more by the temporary expedient of bonus adjustment and salary freeze than by salary grid revision, except in North America, where the anticipated 5% salary decrease was implemented.

Now, as economies around the world begin to recover, we should see an upturn in those sectors of consulting focused on growth, rather than cost reduction. Where salaries go from here we shall continue to monitor, and continue to update you.

Sources: BNPParibas, Centre for Monitoring Indian Economy, Economist, Federal Statistics Service of Russia, IMF, National Bureau of Statistics of China, OECD, Reuters, Vencon Research International, World Bank

Finally, a correction: In an early release of the last 'Perspectives' – Salary Trends 2009 we reported that Lehman Brothers had gone into receivership on 15th August 2008 (08/15/08). This should, of course, have read 15th September 2008 (09/15/08).