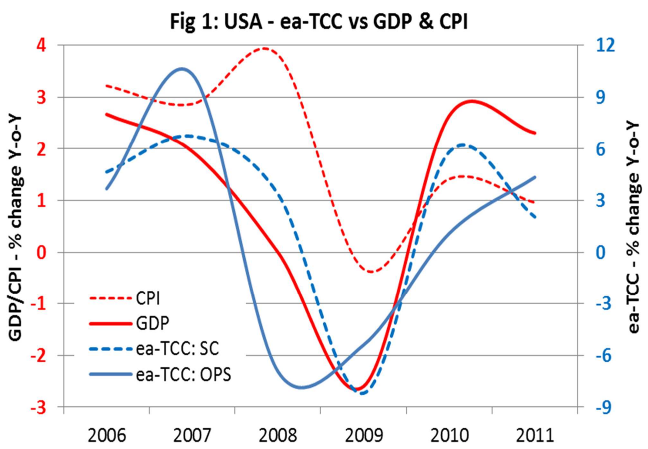
The Factors Driving Consultant Remuneration - The 'BRIC' Economies

The story so far …

A previous issue of ***Perspectives*** examined the apparent causal relationship between a country's GDP growth and the consulting industry activity that can be found there. In other words, GDP movement is a primary driver of consulting activity. Our analyses showed that this relationship held true in the largest developed economy, the USA, which accounts for nearly 25% of global GDP and almost 50% of the consulting market.

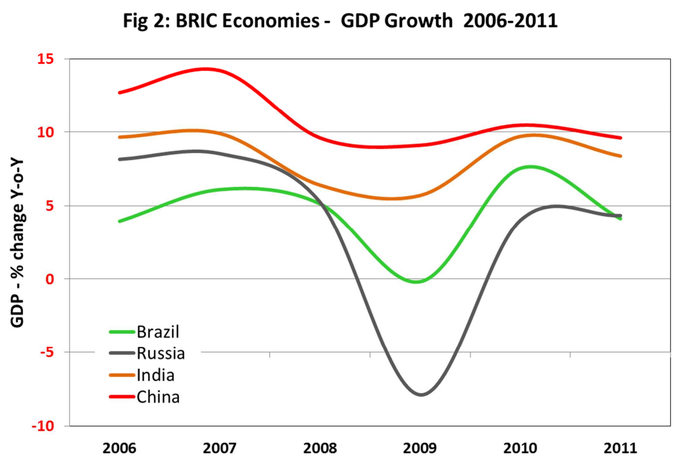
We also noted a clear relationship between inflation, as measured by the Consumer Price Index (CPI), and changes in consultant Base Salaries. Higher consumer costs generally translated into the higher salaries necessary to retain industry talent.

We then analysed the 5 year trend in consultant salaries using data from two major consulting sectors – the pure strategy consulting firms (Vencon Research's "SCF" reports) and the strategy practices of full-service operations consulting firms ("OPS" reports). This indicated that the higher bonus payments typically paid in strategy consulting firms over operations consulting - represented by our Total Cash (ea-TCC) figures – allowed for greater flexibility in responding to significant market changes, such as that seen in the recent global downturn; as a result, strategy earnings tended to track GDP movement quite closely, whereas operations earnings had an inherent lag (Figure 1).



With continuously updated data from over 65 countries and nearly 20 lines of business, Vencon Research is well positioned to examine these fundamental economic trends and how they translate into consultant compensation.

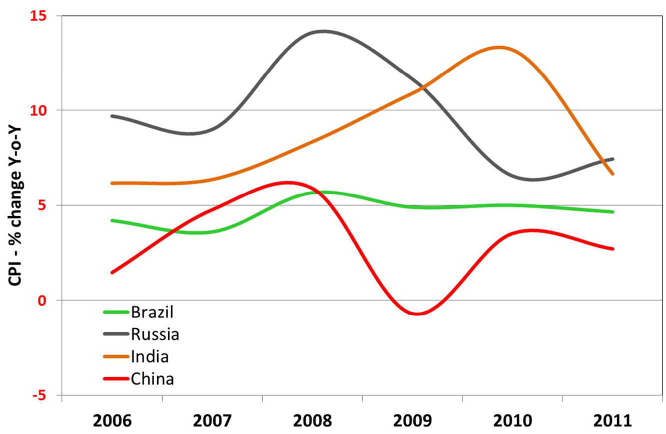
Having examined the situation in the USA, as the biggest player in the field, this issue of ***Perspectives*** extends our geographical focus to the 'BRIC' economies of Brazil, Russia, India and China. These four countries are currently the world's fastest growing and largest emerging markets, accounting for almost half of the world's total population and contributing a majority to global GDP



growth in recent years (Figure 2). As a consequence of this dynamic growth, we encounter myriad additional economic factors that may influence the relationships we saw when analysing the USA market.

With rapid economic growth, for example, come higher rates of inflation (Figure 3) and significant currency exchange fluctuations, as well as increasing GDP per capita. In addition, the development of a local pool of talent and improving higher educational institutions (particularly universities and business schools) cannot be discounted and can play a role in determining entry level salaries. Finally, the level of maturity of the consulting market in each country may also play a role.

Fig. 3: BRIC Economies - Consumer Price Inflation 2006-2011

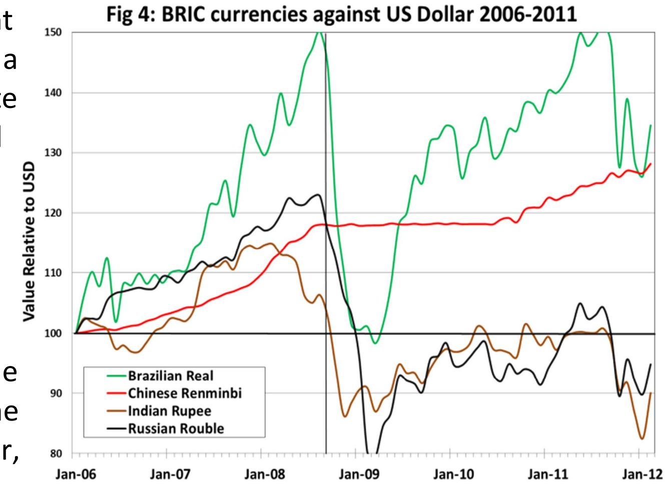


It is in the context of these many factors that this issue of ***Perspectives*** analyses the 5-year trend in consultant salaries for the BRIC countries.

These factors are exhibited in two characteristics we have previously noted with respect to consultant pay. Firstly, we see an almost direct correlation between the starting salary at the Analyst 1 level and GDP per capita of the country; as a country gets richer, starting salaries for Analysts increase in direct proportion. Secondly, at the most senior levels, total earnings tend toward the amount paid in the USA; as a consultant becomes more experienced, internationally mobile and hence marketable, their earnings tend to match that paid in the biggest consulting market.

But de facto harmonising of consultant earnings to that of the USA introduces a further variable – that of exchange rate fluctuation! This has been exceptional over the last 5 years, as the global crisis has shifted the economic balance. Figure 4 illustrates the movement in exchange rates of the BRIC economies relative to the US Dollar. In particular, we see how dramatically things changed following the collapse of Lehman Brothers, shown as the vertical line on the graph in mid-September, 2008.

Fig 4: BRIC currencies against US Dollar 2006-2011

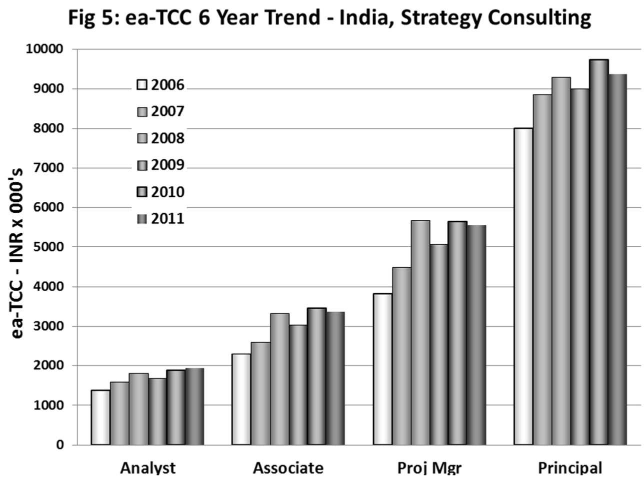


Since then, the Brazilian Real has strengthened dramatically; both the Russian Rouble and Indian Rupee have weakened, whilst the Chinese Yuan Renminbi has experienced a carefully managed growth.

We shall now look at how each of these markets has responded.

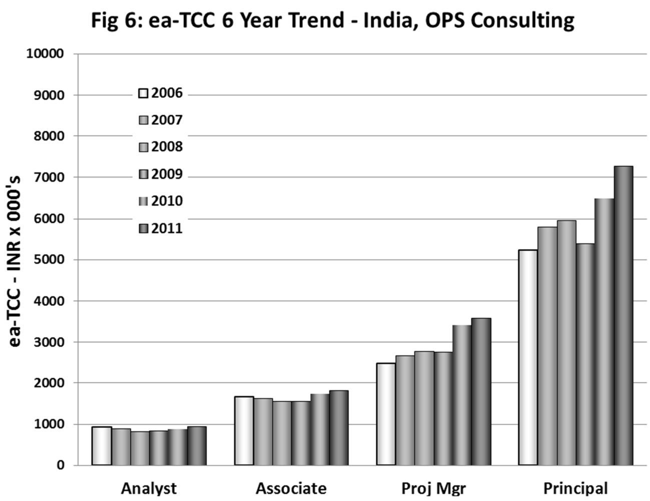
India

After implementing economic reforms and liberalisation policies through the 1990s, India, with the world's second largest (and growing) population, has experienced solid growth in its agriculture and services based economy. While much of the rest of the world went into recession during the global economic crisis, India enjoyed enviable and consistent annual GDP growth of between 6% and 10% throughout the period from 2006 to 2011, resulting in compound growth in Indian GDP of over 60% over the period. However, as is often the case with high growth, inflation (as measured by the Consumer Price Index – CPI) was also very high, reaching double digit levels in both 2009 and 2010. India's inflation rate has historically been high, averaging some 8% p.a. for over 40 years; in recent years it has been significantly affected by sharply rising food prices, a major element in the "basket of goods" used to compile India's CPI. At nearly 65%, compound inflation between 2006 and 2011 actually exceeded GDP growth. Thus, although we have seen consultant salaries increasing in India as a consequence of rising GDP, the impact of inflation has undermined these gains.



If we look more closely at strategy consulting (SCF) salaries in India between 2006-2011 period (Figure 5), we see that compensation increased progressively, in line with GDP growth, except at the depth of the recession in 2009 when growth slowed significantly (although unlike much of the rest of the world, did not actually go negative). Compound earnings growth over the period was between 40-50%, except at the Principal levels where it was a more modest 17% compound – as might be expected, in that Principal remuneration was already high, being determined more by global than by local factors.

However, the pattern is somewhat different when we look at the operations (OPS) firms over the same period (Figure 6), whereby the Principal earnings have increased by almost 40% - notwithstanding the same dip in the 2009 figures – reflecting the headroom afforded by the lower overall income in OPS earnings, as these individuals tend not to be as internationally mobile as their strategy counterparts.



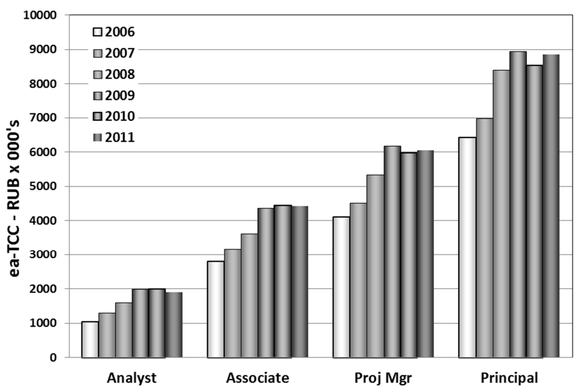
But the most significant difference comes at the junior levels – at the Analyst and (to a lesser extent) the Associate levels – where contrary to expectations, remuneration has remained almost flat despite the 65% compound inflation! Averaged over all the junior levels, Indian earnings have been flat or even decreasing.

How is this possible? We have seen Indian firms being very creative with their recruitment policies in order to retain the price advantage that has enabled India to become a global resource centre for many large players, and evidenced by the meteoric evolution of major indigenous players such as Infosys, Wipro and TCS. By recruiting outside the higher-cost mega-cities such as Mumbai, New Delhi and Bangalore - note that even the 100th biggest city in India still has a larger population than Atlanta, GA - and sponsoring relevant courses within the highly flexible Indian tertiary education system, firms have been able to manage entry salaries exceptionally well, and consequently reduce the upward pressure on Analyst and Associate salaries.

GDP growth continues at a commendably high level in India, with inherent implications for continued inflation and consultant earnings. Although in the past, firms have been able to partially mitigate this, there remains a risk that a return to the extreme inflation levels seen just 2 years ago could result in another upward spike in earnings.

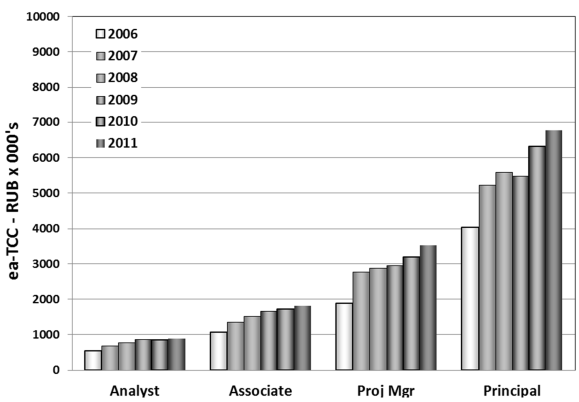
Russia

Fig 7: ea-TCC 6 Year Trend - Russia, Strategy Firms



Since economic reforms were implemented in the 1990s, Russia has undergone transition from a centrally-planned to a more market-based economy with the privatisation of most industry. As a significant exporter of natural gas, oil and steel, Russia has developed a growing middle class and throughout most of the period under examination enjoyed GDP growth of between 4% and 8% per annum. However, due to its heavy dependence on international oil prices, Russia experienced the most significant drop of any major economy during 2009, when GDP went negative by 8%. As a consequence, the Rouble decreased in value by 25% against the US dollar and resulted in the Central Bank of Russia spending one-third of its $600 billion international reserves to slow the devaluation.

Fig 8: ea-TCC 6 Year Trend - Russia, OPS Consulting



Like India, Russia's economic success has been accompanied by high rates of inflation averaging almost 10% per annum throughout the 2006-11 period, even though this fell to below 7% in 2010 as the knock-on effects of the downturn and currency decline reduced consumer demand.

As a result of these economic fundamentals, we would expect strong and continuous earnings growth throughout the period, and this indeed appears to be the case for both SCF (Figure 7) and OPS (Figure 8) remuneration.

However, given the known volatility of the Russian economy, exemplified by the government's domestic and international debt default and currency devaluation in 1998, many consultant contracts in Russia are delineated in either Euro or US Dollar terms.

Bringing currency exchange rates into the calculation has a significant impact, as the Rouble has declined markedly against both those reserve currencies since the 2008 crisis – in fact, in just seven months from July 2008 to February 2009 the Rouble dropped by 40% against the US Dollar.

When we re-cast the earnings parameters into US Dollar terms, we see that for operations consultants, earnings have been practically static for the last 4 years, whilst for strategy consultants earnings have declined markedly (Figures 9 and 10).

As we have seen before, the higher bonus payments in strategy consulting enables firms to adjust total remuneration more easily to rapidly changing economic circumstances – this time in response to the relative strengthening of the USD to the RUB. For their spending in their local markets, consultants have seen their income rise, even if it has not kept pace with inflation; but on an international comparison, earnings will continue to fall until the Rouble stabilises. The recent oil price spike, which so underpins the Russian economy, could provide that stability in the short to medium term.

Fig 9: ea-TCC 6 Year Trend - Russia, Strategy Firms

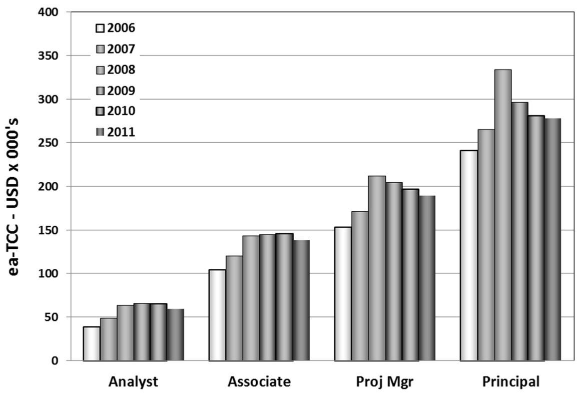
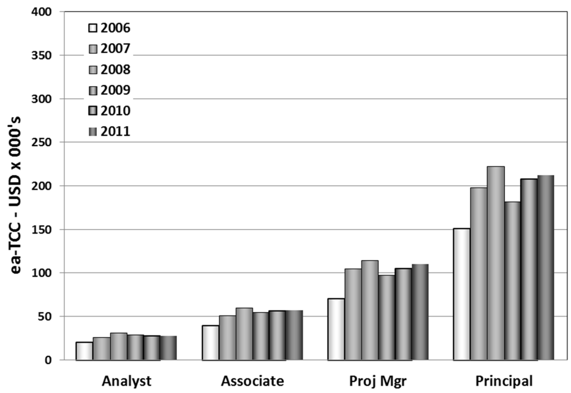


Fig 10: ea-TCC 6 Year Trend - Russia, OPS Consulting



China

Since 1978, when China opened to the West, market-oriented reforms, economic liberalisation and capital investment in infrastructure and technology have led to increased worker productivity and consequently impressive economic growth. From 2006 to 2011, GDP grew on average by nearly 11% per year, giving compound growth over the period in excess of 85%. And despite a still growing population, GDP per capita has also risen impressively.

As we have seen, strong growth is often accompanied by high inflation. However, compared with the other BRIC economies, China's inflation rate has actually been modest over the time period, averaging less than 3% per annum. Currency fluctuation has also been well controlled in China, with gradual and managed increases against the US Dollar over the time period.

Fig 11: ea-TCC 6 Year Trend - China, Strategy Firms

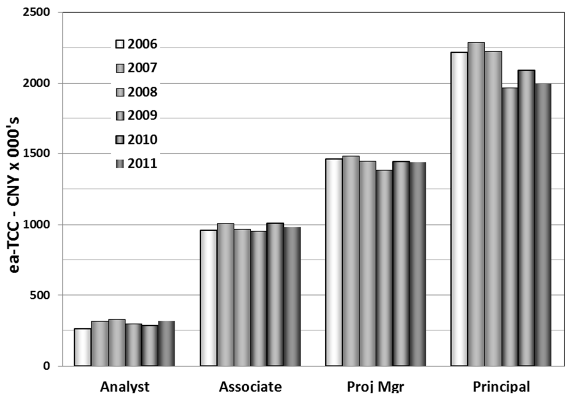
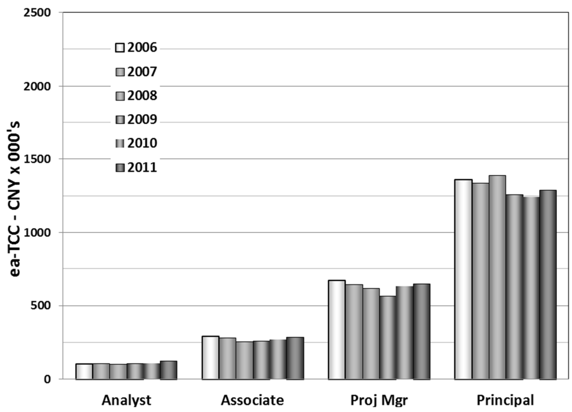


Fig 12: ea-TCC 6 Year Trend - China, OPS Consulting



Curiously, in a country of such significant economic growth and increasing wealth, the picture for consultant earnings appears counter-intuitive – for both strategy and operations total earnings have been at best flat, and at senior levels have declined markedly (Figures 11 and 12).

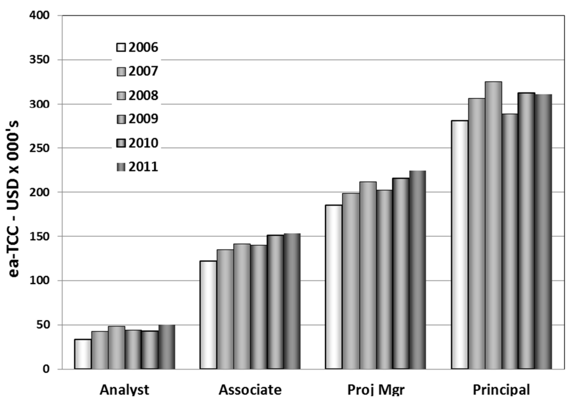
There are two factors at play here. First is the speed with which China has emerged as the world's second largest economy. Consulting – attracted by rapid GDP growth – had to establish itself in China on a large scale in a short time. The Chinese education system was - and to an extent still is – centrally controlled and unable to meet the demand for business education or experienced consulting practitioners.

Hence the genesis of consulting in China was heavily dependent upon the secondment or transfer of staff from other large economies, and extensive recruitment of expatriate Chinese being educated in Western schools and universities. Unlike other emergent consulting markets, therefore, senior salaries in China were matching those in the USA almost from inception.

When now overlaying the consistent strengthening of the Yuan Renminbi against the Dollar and we see the result – downward pressure on senior earnings, as the need to incentivise staff to transfer to China becomes a desire to work in the world's powerhouse economy, and an increasing number of graduates emerging from the country's nascent business education sector.

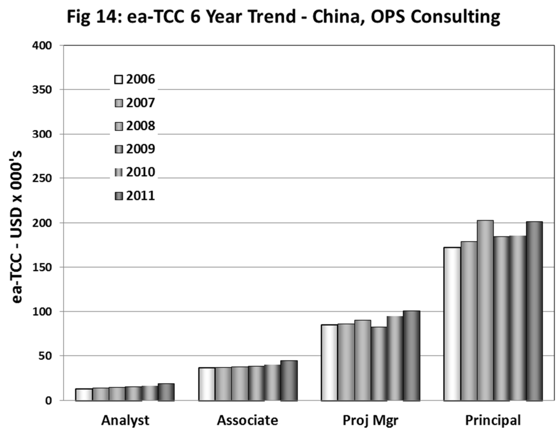
If we convert Chinese consultant earnings into US Dollar terms at the prevailing rate, we see that for strategy consulting (Figure 13) the values at senior levels mirror those

Fig 13: ea-TCC 6 Year Trend - China, Strategy Firms



in the equivalent sector in the USA to within a few percentage points, whilst Associate earnings have increased to the point where they too now match those in the USA. Analyst earnings are still below USA levels; however our hypothesis that Analyst entry salaries closely match growth in GDP per capita tells us these will also continue to rise.

The picture for operations consulting (Figure 14) is similar though less marked – earnings at senior levels have started to plateau, although since they have not yet reached the levels of the USA, there is still some headroom for modest earnings growth.

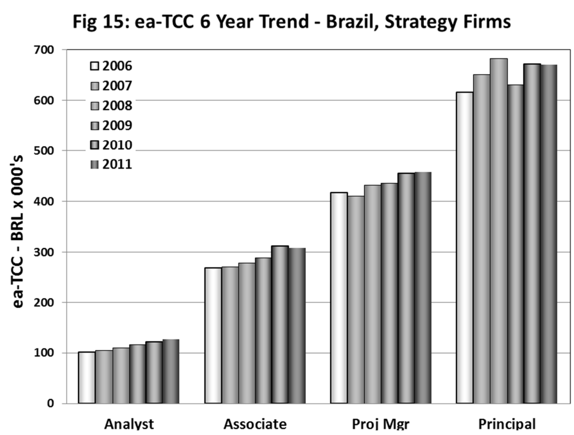


At all other levels, when expressed in US Dollars, earnings are continuing to climb from a low baseline. New entrants to operations consulting are now recruited from China's leading schools and universities so entry salaries can be expected to grow in line with increasing GDP per capita, but in local currency this effect is mitigated by the Renminbi's increasing value.

However, it is interesting to note that thus far in 2012 the Renminbi has stabilised and even declined marginally against the US Dollar, as the central bank tightens controls to prevent the economy from overheating, and the GDP growth rate has now dropped into single figures. Thus in addition to steady upward pressure on junior salaries, stabilisation against the US Dollar could see senior earnings change in line with USA earnings movement, both in US Dollar and local currency terms.

Brazil

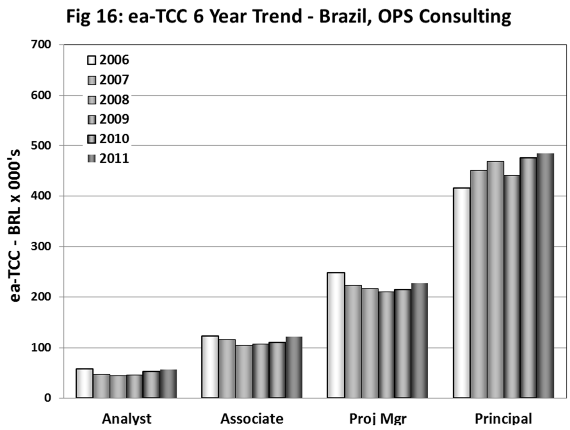
With the world's 6th largest economy and 5th largest population, Brazil has experienced strong economic growth over the past decade, built on the country's extensive natural resources, including oil and gas. The current resilient and well-developed economy has been attributed to a floating exchange rate, an inflation-targeting regime and strict fiscal policy following the disasters of the early 1990s, when inflation of over 1500% per annum led to debt default and devaluation.



Brazil's economic growth has created an asymmetric society, with Sao Paulo and Rio de Janeiro now the two most expensive cities in all of North and South America, but the country ranking only at number 115 out of 127 countries for income inequality. Meanwhile, Brazil's strategy consultants are now amongst the highest paid in the world, and senior operations consultants are also earning more than their US counterparts!

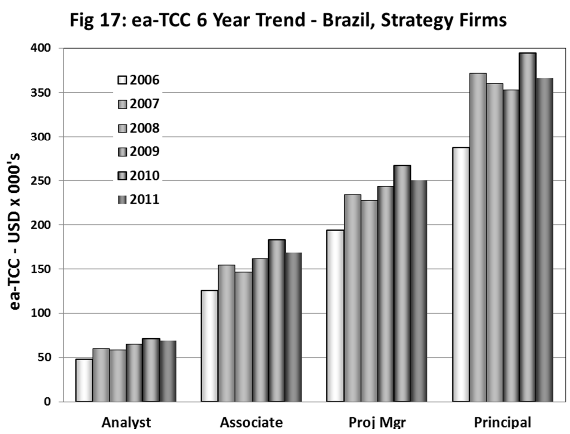
By now the consultant remuneration pattern is familiar: high GDP growth combined with modest but continuous inflation results in a progressive increase in earnings, which tends to plateau as total compensation approaches USA levels.

This is clearly seen in the earnings growth for both strategy and operations consulting (Figures 15 and 16); a slightly anomalous flattening of earnings growth at the mid-career levels in operations is explained by the exceptional bonus payments at those levels in the early days of Brazil's consulting industry, when bonus levels were set on par with those paid in strategy. These quickly declined to the levels more usually seen in operations consulting, and show on the graph as relatively static earnings overall.

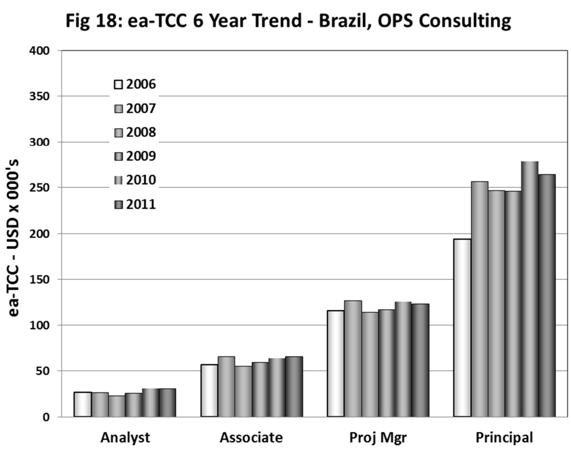


However, the real anomaly in Brazilian remuneration becomes clear when we review the highly volatile exchange rate of the Brazilian Real against the US Dollar – as seen in Figure 4, above. Although the general shape of the Real's variation is very similar to that of the Rouble, whereas the Rouble has declined against the US Dollar by about 10% over the last 5 years, the Real appreciated by over 50% in two years, then dropped back to the 2006 level, then strengthened again by 50% before declining to its present value at around 35% above the 2006 rate.

Thus when we compare Brazilian earnings in constant US Dollars, not only do we see the effects of this extreme volatility, but find what were competitive salaries only three years ago have inflated to the point where they are now notably higher than in the reference market of the USA.



The impact of the exchange rate movement can be clearly seen in both strategy and operations data (Figures 17 and 18) as a remarkable increase after the first year (2006-7) followed by a drop in the subsequent two years, another sharp rise in 2010 before dropping back again as the currency weakened slightly last year.



Averaged across the Principal levels, earnings in Brazil now exceed those in the US for both strategy and operations consulting – which is probably an unsustainable position. This should produce downward pressure on senior earnings, while entry level salaries continue to rise in line with Brazil's growing GDP per capita.

However, it is clear that the Brazilian Real is highly volatile, and most recently has retreated from a spike coinciding with the reverse privatisation of the Brazilian national oil company, Petrobras.

The position in Brazil is thus almost the reverse of that in Russia: in local currency, earnings have exhibited healthy growth, as is to be expected in a rapidly growing economy, but when translated into a common currency of US Dollars, Russian earnings have declined markedly, while Brazilian earnings have become amongst the world's highest. In both cases, currency fluctuation attributable to oil revenues have distorted the comparison, and the future outlook is thus dependent upon not just the growth of the consulting market, but also relative currency stability.

Conclusions

Whilst the four "BRIC" economies under review here are readily grouped together as major, high growth forces, there are also significant differences between them: Brazil and China have currencies that have appreciated against the US Dollar, have managed CPI to below 5% throughout the economic crisis, and have consultant earnings now equal to or exceeding those in the US, whereas India and Russia have declining currencies, inflation exceeding 10% per annum and earnings static or declining on an international comparison. China and India escaped recession during the crisis, whereas Brazil and Russia were both affected.

It should also be noted that whereby Brazil and Russia's economic has been driven by utilising their natural resources, China and India's growth was strongly based on the utilisation of their human resources.

The BRICs, therefore, are far from being a homogenous entity, and must be regarded as distinct consulting markets. But the driving factors we had identified hold true: GDP growth equates to consulting growth; CPI drives base salary increases; GDP per capita is a good proxy for movement in Analyst starting salaries, and earnings at the most senior level in the US is largely the upper level for earnings elsewhere.

Currency fluctuation appears to be the indeterminate variable in our otherwise logical equation.

In our next ***Perspectives*** we shall see how these factors apply to lower growth economies.