CONSULTANT REMUNERATION – WESTERN EUROPE

In the last issue of *Perspectives*, we applied our observations on consultant remuneration trends in the developed market of the USA to the four high-growth BRIC economies: Brazil, Russia, India and China. That study, which 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) - confirmed our hypotheses about the factors that determine the movement in consultant remuneration: GDP growth is directly related to industry growth, inflation drives base salaries, Analyst starting salaries correlate with GDP per capita, and Principal level earnings in the USA appear to set the upper limit for earnings elsewhere.

In this issue of *Perspectives*, we will apply that thinking to see how these factors impact consultant salaries in some of the more "mature" consulting markets of Western Europe, which are experiencing slower or even negative economic growth, specifically France, Germany, Spain and the UK.

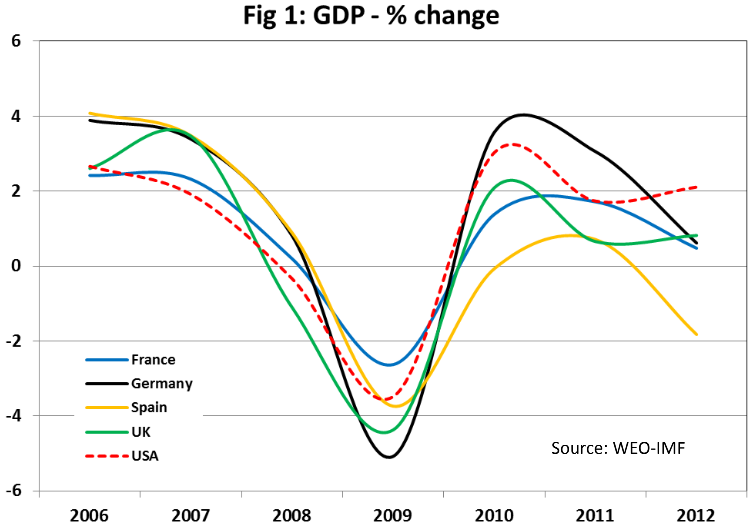
The European Dimension

Between them, these four countries have a total GDP of over 10 trillion dollars – nearly 60% of the entire output of the European Union (currently 27 countries). More significantly, according to the European Management Consulting Federation, these four countries comprise over 75% of the EU's entire management consulting revenues, and thereby equate to about a quarter of global consulting revenues. By comparison, Europe's only other trillion dollar economy, Italy, has a relatively minor consulting market compared to its GDP.

As before, we shall commence our analysis by examining the changes in GDP for the countries under consideration and compare them to developments in the USA.

From Figure 1, we can clearly see all the economies are closely linked, with all tracking almost exactly the same trajectory into the 2008-9 recession, followed by slow recovery thereafter, although there are some small but significant differences.

Fig 1: GDP - % change



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Both the USA and the UK entered that recession early and started their recovery before the other economies but both subsequently suffered a second decline in their GDP growth – the infamous double-dip recession. Both now appear to be on a more sustainable growth track, although the 2012 data are based on latest IMF estimates for the year and, like all projections, may be subject to revision once the year is over.

Curiously, of the three eurozone economies, it was Germany that went deepest into recession, before its dramatic bounce back. Closer examination of the Germany data on a quarter-to-quarter basis shows that the dramatic recovery occurred immediately before Germany's September 2009 election; we make no comment on this fortuitous timing, but note coincidentally that Japan experienced a similar economic bounce just before its August 2009 election.

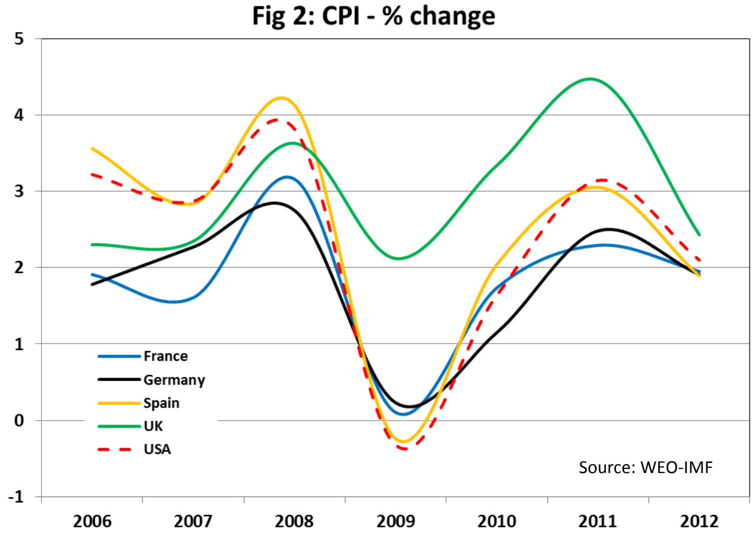
However, all three of the eurozone economies are currently again on a downward trajectory, with Spain already back into full recession.

Averaged over the full period of our study from 2006 - 2012 none of the countries under consideration – including the USA – has managed any better than the overall growth figure of 1% per annum achieved by Germany, with Spain now in negative territory when averaged over that full six-year period. Based on our earlier analyses of the relationship between GDP and total cash remuneration (ea-TCC) in consulting, we would subsequently expect to see only minimal growth in overall salaries for any of these countries when compared over the extended period.

If we now turn to price inflation – the determinant, in our remuneration theory, of Base Salary movements – we again see very similar trends across the geographies, but a greater disparity in actual values.

The clear exception here is the UK, where a relative devaluation of the pound sterling (GBP) against both the US Dollar (USD) and the Euro (EUR) has resulted in significantly higher inflation than experienced elsewhere.

Fig 2: CPI - % change



Whilst both Spain and the USA were experiencing relatively high inflation at the beginning of the period in consideration, from the time the recession hit, inflation dropped to zero across the eurozone and the USA before edging back up to around the 2% per annum mark.

Averaged over the 6 year period, inflation has ranged from a low of 1.8% per annum for France and Germany, to 2.5% for Spain and the USA to a high of 3.0% per annum over the whole period for the UK. We would therefore expect to see these ratios reflected in Base Salary movements over the same period.

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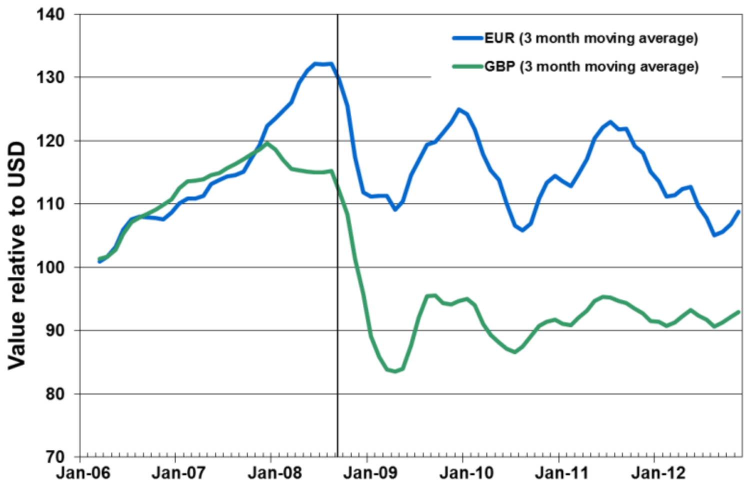
Finally, we must introduce a third factor into our deliberations – the impact of exchange rate fluctuation. If we accept that the USA sets the global trend for remuneration in management consulting, we cannot ignore the effect that currency movement has on international relativities.

Fig 3: EUR & GBP compared to USD



Both the GBP and EUR strengthened significantly against the USD up to the collapse of Lehman Bros in September 2008. However, since then the Euro has progressively declined such that it is now approaching barely 5% above its comparative value nearly 7 years ago. On this basis we would expect to see Euro salaries decline over time, as the impact of the 30% increment by mid-2008 will have made eurozone consultants expensive in international comparisons, but with a measure of stability in the last year or so as the currency returns to near-par value.

UK GBP, on the other hand, dropped markedly against both the USD and the EUR, and has stabilised at 10% below its 2006 par-value for the last 3 years. We would therefore expect to see UK salaries grow slightly to offset the relative decline of GBP earnings compared to the other major consulting markets.

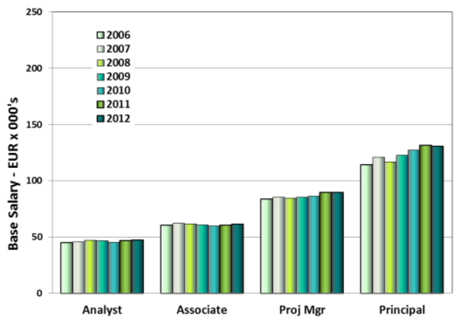
Having established the parameters in play, we can now review the remuneration trends to see how they have responded.

Germany

Although we see some modest increases in Base Salary within Operations (OPS) Consultants, this is almost negligible at the Associate level over the 6 year period, such that when the average salary movement is weighted to reflect consultant numbers per grade, the overall change in Base becomes less than 1% per annum. The change for Strategy (SCF) Consultants is even less, and we can clearly see in Figure 4b that at Principal level Base Salaries have actually declined over the period.

If we set this in a context of base salaries in the USA increasing by an average 1.5-2% per annum against an inflation figure of ca. 2.5%, this becomes commensurate with the lower inflation figures seen for Germany over the same period.

Fig 4a: Base Trend (€) - Germany, OPS Consulting



Indeed this earnings hiatus is reflected generally in Germany where household disposable incomes have been declining over the last decade, with a net effect of making German products ever more competitive on the world stage.

Extending our hypothesis to total remuneration (Base plus expected bonus, ea-TCC in Vencon Research parlance) Germany's modest growth in GDP over the period should result in an earnings growth that is at least comparable to those in the USA. When expressed in US Dollar terms, this is indeed true, but as we have seen the Euro has strengthened against the Dollar and this has suppressed any growth in Euro earnings.

For the OPS firms, bonus levels have decreased steadily throughout the period to offset the modest gains seen in Base Salary. Overall, when weighted by consultant numbers per career level, OPS earnings in Germany have actually decreased by around half a per cent per annum on average over 6 years.

Strategy consulting bonuses have now recovered to the levels last seen in 2006, so combined with the minimal increase in base salaries, across most levels overall earnings are now above their 2006 level – but again, by fractions of a per cent per annum when weighted by consultant numbers.

Fig 4b: Base Trend (€) - Germany, Strategy Firms

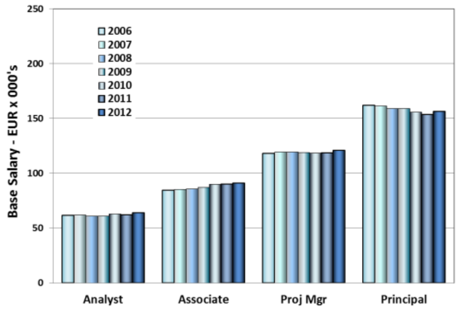


Fig 4c: ea-TCC Trend (€) - Germany, OPS Consulting

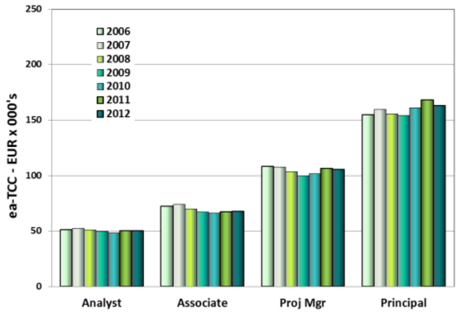
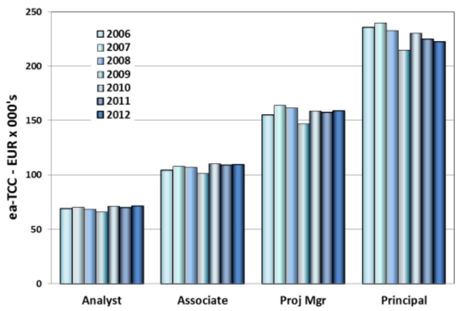


Fig 4d: ea-TCC Trend (€) - Germany, Strategy Firms



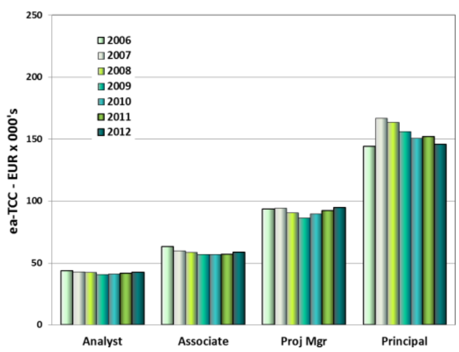
France

The GDP per Capita of France is almost identical to that of Germany. Both countries use the same currency, the compound inflation rate over the last six years is identical and the GDP growth rate averaged over 6 years is less than half a percentage point different.

We can therefore anticipate that remuneration trends, over the medium term, will be very similar – as indeed they are.

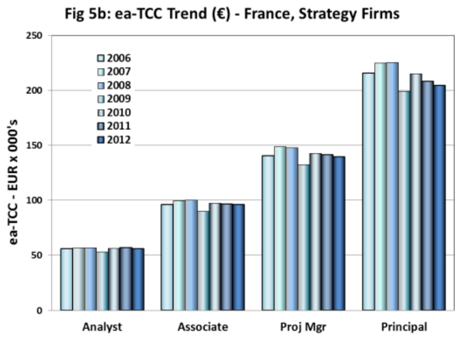
At the Base Salary level, average change over the 6 year period is virtually identical to that in Germany. Analyst salaries in Germany tend to be higher than in France, although this is mainly due to differing tertiary education systems, whereby French

Fig 5a: ea-TCC Trend (€) - France, OPS Consulting



graduates enter the workforce several years before their German counterparts.

At the total remuneration level (ea-TCC) we again see virtually identical earnings movement, with the singular exception of slightly elevated French bonus levels for Principals within Operations Consulting during 2007-08.

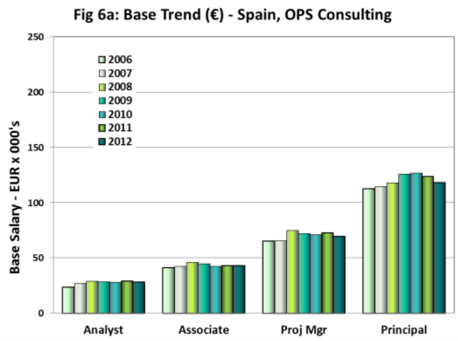


The overall parallel between earnings growth in France and Germany is clearly seen by comparing Figures 4 c/d with Figures 5 a/b.

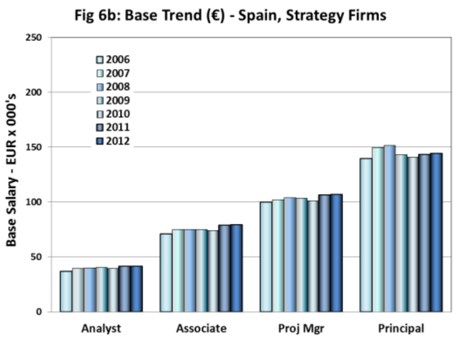
Spain

The magnitude of Spain's economic problems are best understood by considering the dramatic growth it was experiencing before the 2008 downturn; in the decade up to 2006 Spain had enjoyed an average GDP growth of nearly 4% per annum. Thus a reversal of such magnitude, in which Spain's average GDP movement over the last 6 years is still negative, shows how extreme this change has been.

As a high-growth economy, Spain was also experiencing inflation above the level of its eurozone counterparts – amongst this comparator group, Spain is at the top of the league in both Figures 1 and 2 (GDP and CPI growth) in 2006, but at the bottom in 2012.



Notwithstanding its decade of growth, Spain's GDP per Capita remains notably lower than that of France and Germany, by some 30%; hence we would expect that Analyst salaries would be commensurately lower, as indeed we see in Figures 6 a/b. It is also possible to identify the above average increases awarded to the Analyst levels in the early years of these analyses, when Spain's GDP growth was still relatively high.



However, with an inflation rate averaging nearly 50% above that of either France or Germany, Base Salary growth for all levels in Spain has equally been higher than its eurozone peers. In fact, not only does Spain's average CPI growth match that of the USA to within one decimal point, but also its average Base Salary growth over the same period. Unfortunately Spain's currency has meanwhile appreciated against the US Dollar, making such Base Salary growth unsustainable.

However having generally lower Base Salaries consequent upon a lesser GDP per Capita meant that the difference could be largely offset by higher than normal bonus percentages in Spain; this then offered scope to reduce overall earnings when the economy slowed.

This is not immediately obvious when comparing total earnings (ea-TCC) over the 2006-12 period, as the initial year was still within Spain's economic high-growth decade; consequently average ea-TCC movement is still positive, albeit by a fraction of a per cent per annum.

Were we to discount the 2006 data and average ea-TCC over the period 2007-12, however, a more dramatic and appropriate figure of an incumbent weighted -1.5 per cent per annum is revealed for Strategy Consulting, and -1.2 per cent per annum for Operations Consulting.

Fig 6c: ea-TCC Trend (€) - Spain, OPS Consulting

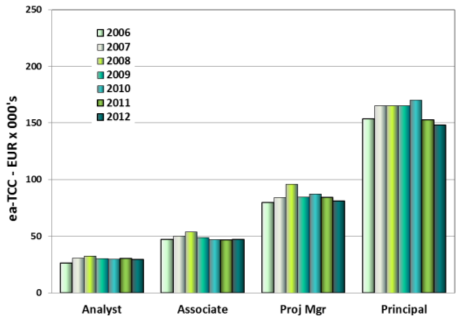
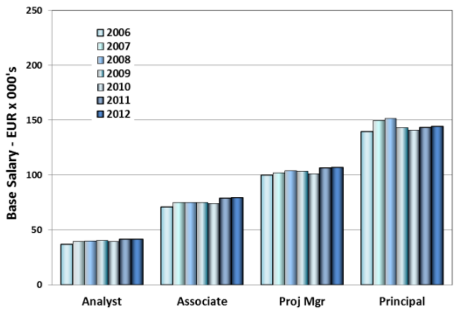


Fig 6b: Base Trend (€) - Spain, Strategy Firms



These are significant reductions in overall earnings, as they remain negative even averaged over a period of 5 years. Unfortunately the outlook for Spain remains depressed, with the GDP graph still trending into negative territory.

The UK

Being outside the eurozone, the UK appears to operate under a different economic cycle; its average inflation ranks as the highest of the countries reviewed here, and both the timing and nature of its GDP performance during the downturn was more like the USA than its European neighbours. As a major trading nation, the relative devaluation of the GBP against both other major reserve currencies – the USD and EUR – will have contributed to this higher than average inflation figure.

With an average inflation figure of 3% per annum throughout the period in consideration we expect to see an increase in Base Salaries – though as we have seen in each of the other geographies, the average increment is below the rate of inflation, as salaries were effectively being managed down to cope with the economic problems.

Fig 7a: Base Trend (£) - UK, OPS Consulting

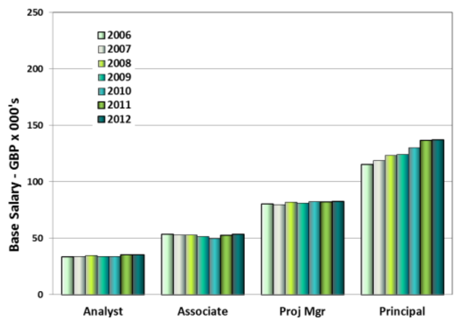
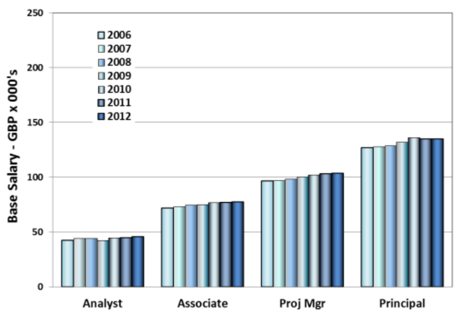


Fig 7b: Base Trend (£) - UK, Strategy Firms

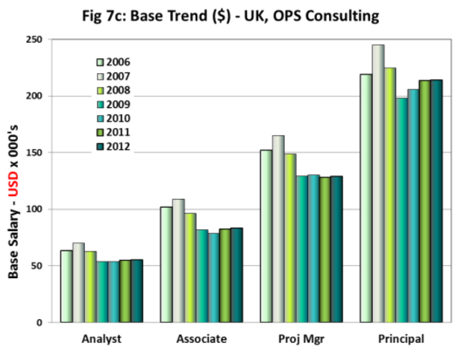


In the UK's case Base Salary increments were even less than those seen in Spain or the USA, which had experienced similar levels of inflation, as firms appeared to be rebalancing total remuneration to establish a higher proportion of variable, rather than fixed, earnings. Furthermore, in Operations Consulting almost all the increase can be attributed to the Principal levels, with the other career levels experiencing negligible movement across the period.

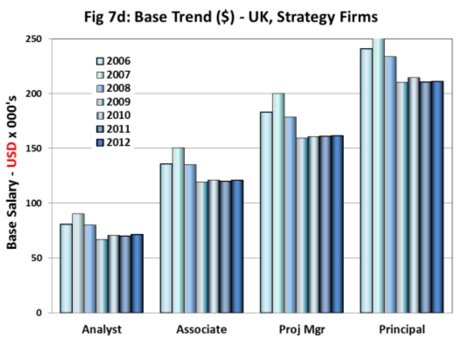
In Strategy Consulting the changes seen in Base Salary are more consistent across the career levels, but still constitute less than half of the inflation increase over the same period, and are below the levels recorded for Spain and the USA.

Overall the UK is a close parallel to the USA consulting market, sharing not just industry structure and economic cycle but also language, making staff transition between geographies quite straightforward at senior levels; hence we see the UK more likely to track the USA market dynamic than that of the eurozone.

However, although the UK's average growth in GDP over the period has been close to zero, overall total remuneration has nonetheless increased on a level comparable to that in the USA, where GDP growth, though still minimal, has been twice as high. The issue here is the dramatic change in currency exchange rates - as shown in Figure 3, whilst the Euro currently remains above its par value against the Dollar from 2006, the pound initially increased by some 20%, then plummeted to nearly to 20% below 'par' before recovering to its current 10% below 2006 value.



The impact is clearly seen if we present the UK's total remuneration (ea-TCC) levels converted to US Dollars, at the prevailing exchange rate. UK total remuneration was already high by international standards in 2006, and the strengthening of the GBP pushed Principal level earnings literally 'off the scale' for 2007 when plotted on the same axis as USA earnings. As the recession reached its nadir in 2009 bonuses were already being cut, and the pound was heading for a near 30% devaluation against the dollar. Consequently, when both bonuses and exchange rates had stabilised in 2010 there had been an effective over-correction, requiring total earnings to be adjusted by slightly more than GDP growth alone would suggest.



With UK inflation now trending down and GDP provisionally on an upward curve UK consultant earnings are now more in line with expectations.

The Mature Economies

We have now examined consultant remuneration trends across nine of the world's twelve largest economies – the USA, the BRIC economies and now the majority of the other 'mature' economies within the trillion-dollar bracket (we shall cover Australia, Japan and South Korea in a future *Perspectives*).

Within the mature economies the characteristics we have consistently found include modest consumer price inflation averaging typically 2 – 3% per annum combined with almost static economic growth. A return to the era of continuous 3% per annum GDP growth seems a remote prospect at present.

For consultants, over the medium term neither Base nor Total remuneration have kept pace with inflation, despite significant year-on-year volatility, so in real terms incomes have fallen. In two of the largest economies – France and Germany – they have actually fallen in absolute terms, as they have in Spain if we exclude the 2006 data as the last year of Spain's boom decade. Where GDP is actually declining, as in Spain, starting salaries may equally be reduced.

Yet despite this the last year has seen near record levels of MBA graduates going into consulting as investment banking loses both its appeal and status and MBA starting salaries from the top schools into consulting have noticeably jumped.

The Outlook …

Taking our hypothesis that inflation drives Base Salary increases, and is a lagging indicator, we note that inflation in the mature economies appears to have peaked last year, and is now declining. Hence we may anticipate that Base Salaries will rise in the next pay-round, although many firms are looking to adjust the fixed-variable balance, and may see this as a good opportunity to do so.

Meanwhile clients remain understandably cost-conscious, and the commissioning of new consulting projects is still being assessed on the basis of measurable pay-back – a scenario which also argues for increasing the performance-based element of remuneration.

Overall, then, we would expect to see only modest increases in total remuneration packages, but with increasing emphasis on the variable element. The USA is showing signs of full recovery, and as this is the engine of consulting activity throughout the world, the outlook is hopefully more promising.

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