Deltek | CLARITY

Government Contracting Industry Study

11th Annual Comprehensive Report

Discover the latest trends and industry conditions that are transforming the government contracting market

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Introduction

The 10th annual Deltek Clarity Government Contracting Industry Study demonstrated that widespread optimism in 2018 was largely expected to continue. Organizations expected continued growth and revenue increases. Those expectations were affirmed by strong annual financial performance figures for 2019.

In 2019, both small and large businesses experienced healthy profit margin growth, with small companies improving 27% and large companies increasing 57%, compared to 2018. The median profit margin was 8% for the second year in a row despite a significant increase in unallowable costs.

Since the completion of this year's Survey on March 2, 2020, however, a unique and unprecedented event occurred – a global pandemic took hold and it is having a discernable and abrupt effect on the economy. While the full effect of the COVID-19 pandemic is yet unknown, companies are focused on managing growth, protecting margins and preserving cash flow as they enter a temporary phase of potentially flat or declining revenue.

The results of the 11th Annual Study remain positive, with high expectations of continued growth and profitability in 2020.

Some sectors, like defense-oriented businesses, are less sensitive to recession because they are less reliant on the credit markets, consumers and commercial markets. It is also clear that government stimulus plans will help to offset some effects of a recession, as Washington, D.C., attempts to inject liquidity into the marketplace and spur economic activity. As of the publication of this Study, the details of the stimulus' applicability to the government contracting sector are not yet known.

At a high level, there were several key challenges identified in this year's Study that resonated through all sections:

- Government contractors continue to struggle to find, attract and retain a highly qualified workforce while competing with commercial sectors for the best and brightest.
- Tools such as Microsoft® Excel – and even paper – are still widely used in an attempt to comply and cope with increasing complexity and growing regulatory demands.
- A shortage of experienced project managers and a decrease in training spend per full-time equivalent (FTE) is having a detrimental impact on successful delivery.
- Failure to utilize top technology and software tools is impeding progress in all functions, particularly project management and human capital management.

The 11th Annual Deltek Clarity Government Contracting Industry Study is full of information from a wide variety of businesses, from all sizes and U.S. geographies. Please take the time to review the data and information contained in this Study in order to evaluate how your company's functions and progress compare with your peers and competitors. It is our hope that this information will help guide your decisions in 2020 and contribute measurably to your go-forward success.

About This Study

Deltek conducted an online survey of government contracting companies to gain an understanding of the key issues and trends affecting the market and forecasts for 2020. The survey was developed in close consultation with industry experts.

Areas of interest include business development, finance and financial compliance, project and risk management, human capital management, contract management and procurement, information technology (IT) and manufacturing. The findings of this survey reveal a concise picture of challenges, opportunities and benchmarks for government contractors.

The survey was developed in partnership with CMG Consulting, which conducted the online survey with executive decision makers at government contracting companies. The Study was fielded between January 6, 2020 and March 2, 2020.

The findings of this survey reveal a concise picture of challenges, opportunities and benchmarks for goverment contractors.

Businesses that participated in the Study comprise a wide range of size and industry specializations:

- Thirty-eight percent (38%) of respondents were active in both federal and SLED (state, local, kindergarten through grade 12, and higher education) markets, while 55% were active only in federal business. Seven percent (7%) were limited to the SLED sector.
- Revenue size was diverse. Companies with less than $20 million in annual revenues — referred to as small businesses moving forward — represented 44% of participating companies. Companies with annual revenues between $20 million and $99.9 million, or medium-sized companies, represented 25% of participants. Lastly, companies with annual revenues between $100 million and $999.9 million and those with more than $1 billion accounted for 16% and 14%, respectively. These last two categories have been combined and will be referred to as large companies throughout the Study.

The three largest industry functions captured in the 2020 Study were IT (25%), professional services (19%) and defense, weapons, aerospace or manufacturing (16%).

Geographic locations of the respondents were also diverse.

- 44% were from the Washington, D.C., Maryland and Virginia area
- 21% were from the Southern United States
- 16% from the West
- 8% from the Northeast
- 10% from the Midwest

Executive Summary

At the time the 11th Annual Deltek Clarity Government Contracting Industry Survey was in field, industry growth had been steady over several years, with respondents indicating positive expectations for continued strong financial performance.

Since the completion of the Survey on March 2, 2020, however, the COVID-19 pandemic has affected the economy and how people work, and it is yet unclear how lasting those changes may be. Consensus expectations call for significant negative growth in the second half of 2020, and there is not yet a clear path to recovery.

The good news for government contractors is that this sector generally outperforms other industries significantly, particularly in times of economic crisis, given the degree of shielding these businesses have from credit markets, the consumer marketplace and the broader economy. Commercial sectors of government contracting businesses, however, are likely to be more severely affected by economic weakness and uncertainty.

Close attention to fundamentals will be essential to strong performance and solid recovery for all companies. Now that there is a high degree of uncertainty, it is more important than ever to monitor and understand the metrics in this Study. Assessing and managing risk, protecting profit-margins and maintaining critical staff levels will be key while businesses navigate the short- and long-term impacts.

There is an ongoing struggle for talent.

Managing the workforce in this industry requires new thinking about recruiting, retention, compensation, training, and generational changeover. An inability to recruit and retain the best and brightest will hamstring other efforts to achieve growth and maintain profitability. The industry is not making the investments necessary in an intensely competitive environment and may be tracking the wrong key performance indicators to do so. Investment in training and development is needed, particularly within the project and risk management functions.

Compliance with ever-increasing regulation is a burden that cannot be ignored.

Many companies are still trying to use tools such as Microsoft Excel – and even paper – to comply and cope with increasing complexity and growing regulatory demands. Companies must improve their training, processes and software in order to achieve operational excellence and compliance.

Data availability is growing.

Companies are tightly focused on analyzing and extracting value from data using artificial intelligence and machine learning. The companies that apply their learning to improve quality, project execution and operations will prevail.

Information technology and data security are a key focus, along with satisfying government system security and regulatory requirements.

Cybersecurity incidents, mostly in the form of technology viruses, continue to increase, although at a slower rate. In order to mitigate security breaches, businesses are prioritizing IT investments in two areas: "security and authentication" and "accounting and finance." Migration to the cloud continues, but investment in tools is still lower than needed.

Diversification is a go-forward objective that encompasses both product set and customer type.

Companies are focused on obtaining new offerings and gaining access to new customers, and indicated a desire to continue pursuing those goals, particularly with merger and acquisition (M&A) activity. That said, the current environment is likely to have a heavy influence on some companies' willingness to utilize cash to pursue those goals in the near-term, while others may choose to hold off on selling in the interest of allowing valuations to steady later in the year.

Government Contractor Confidence Index

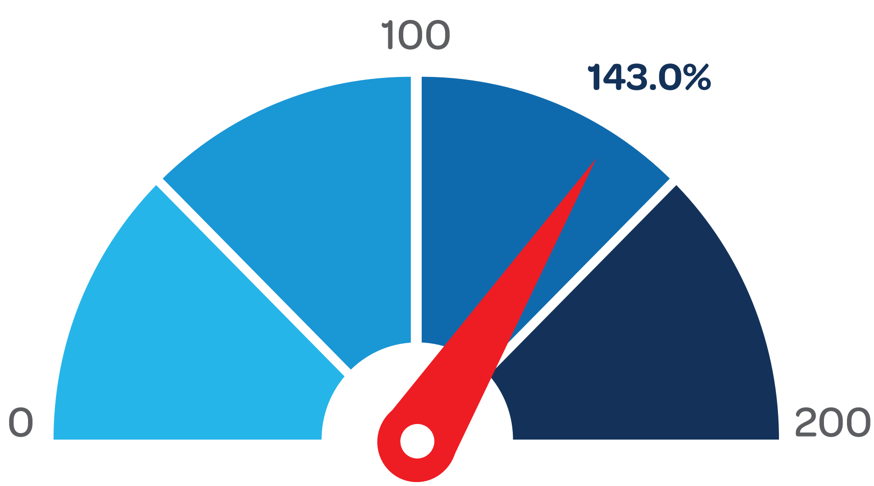
The composite Government Contractor Confidence Index (GCCI) indicates high confidence in public sector sales for the coming year.

The GCCI measures overall confidence that government contractors can grow their public sector sales over the next 12 months. The GCCI is measured on a scale of zero to 200, with zero indicating the lowest confidence level, 100 indicating neutral confidence, and 200 reflecting the highest confidence.

The calculation is based on a series of questions regarding government sales in the last 12 months and respondents' overall impression of the spending environment. While the index is subjective based on opinion, it is indicative of the level of risk business leaders see in the marketplace.

This year's Study shows a GCCI score of 143.0, which is an increase of 3.4 points from 139.6 in 2019. This score reflects strong confidence in the market and an expectation on the part of business leaders that growth in government sales is expected to be sustained and strong. However, the recent COVID-19 outbreak and subsequent economic effects can be expected to impact respondents' expectations and grading of the government contracting space.

Government Contractor Confidence Index



SECTION ONE

Business Development

Government market sales were the same or higher than a year ago. At the time of the Study, a significant majority (70%) of respondents believed that government sales would be higher in 2020. Growth expectations remained high.

The onset of the COVID-19 pandemic is likely to have substantial effects on 2020 performance. The ability to predict when the economy can transition back to a more normal state is uncertain. It is likely, however, that substantial stimulus dollars will make their way to the government contracting sector. This will be true not only in federal markets, but also in SLED (state, local, kindergarten through grade 12, and higher education) sectors. Typically, SLED contracts are funded through federal programs and executed at the local level. This is likely to be the case with stimulus dollars as well.

Limited business development resources continue to limit the agility required to compete in an environment where faster responses to task order vehicles are required. Contractors' customers are also using contract vehicles with which they are not associated, limiting the ability to compete.

59%

challenged by limited business development resources

46%

of participants are plagued by increased competition

80%

want to understand opportunity requirements sooner

Key Takeways

The top three business development challenges ("limited business development resources," "increased competition," and "customer using contract vehicles we are not associated with") remain consistent with last year's results. However, there was a significant uptick (44% versus 34% year-over-year) in the category of "not enough time to assemble high-quality responses for RFPs and RFIs." Companies are looking to increase investment and better understand requirements and opportunities earlier in the bidding process.

Relationships are key to business development because they facilitate identification of opportunities and widen the range with diverse contract vehicles. Teaming relationships should be in place, rather than sought for a specific opportunity.

Overall win rates declined slightly in 2019 compared to the previous year (40% versus 43% year-over-year).

Large businesses had the highest win rate of 45%. Medium-sized businesses experienced the biggest decline (35% versus 42% year-over-year), suggesting a sharper effect from increased business development challenges. The small business win rate remained the same (40% versus 41% year-over-year). Average pipeline multiples fell from 5.4 to 4.5, indicating fewer contracts needed to achieve sales objectives and that pipeline quality should be evaluated regularly. The trend toward contract consolidation, which drives more contracts to master agreements, may be misleading in evaluating pipeline multiples.

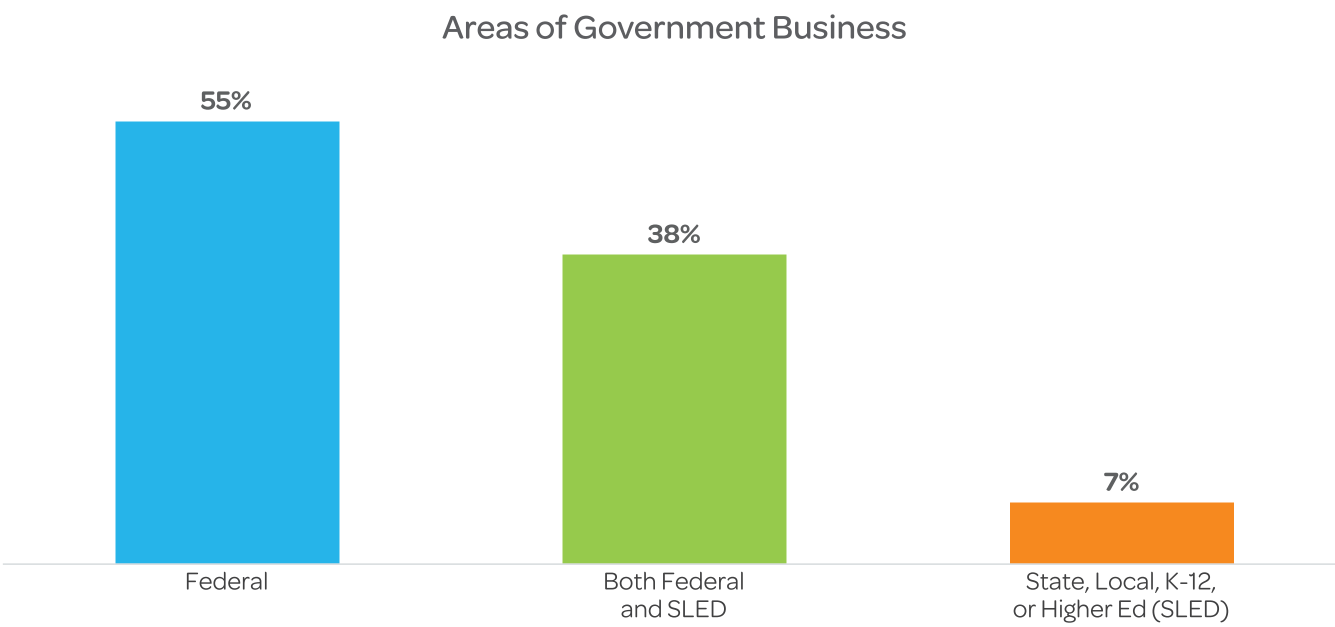
In 2019, the improvement process began, with medium-sized and large businesses adding dedicated full-time employees to identify and target opportunities faster. Though business development resources continue to be limited, the investment outlook for 2020 is positive, with 58% of companies planning to increase resources.

Areas of Government Business

The breakdown between companies doing business with the federal government and those doing business at the SLED level remained largely consistent with last year.

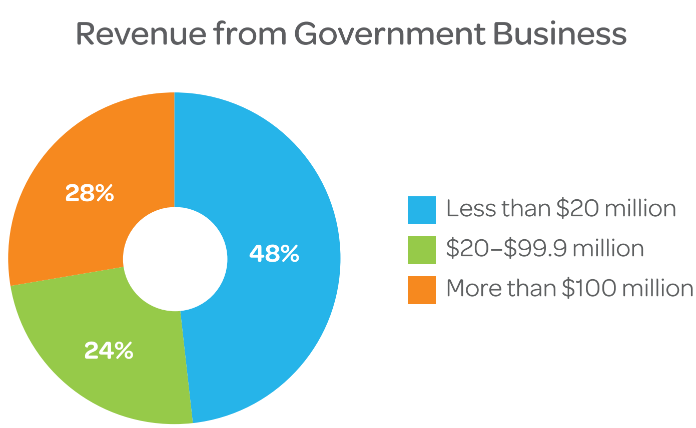
Most companies (93%) conduct business with the federal government, compared to 7% operating exclusively in the SLED market (4% reported last year). However, 38% of companies participate in both the federal and SLED sectors. This may be due to the fact that many contracts are bid at the federal level but executed through state and local governments and agencies. Companies may also find new areas of opportunity in the SLED market if appropriate contract vehicles are identified.

Consolidation of contracts may disadvantage small and medium-sized businesses, but mergers and acquisitions (M&A) may provide greater critical mass to succeed in changing markets.



Revenue from Government Business

The percent of revenue received from government business remained consistent across all business sizes in 2019, except for a decrease for medium-sized businesses (24% versus 30% year-over-year) that corresponded with an increase for small businesses.



Win Rate

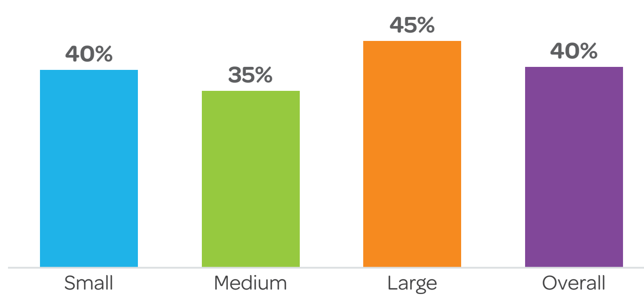
The overall win rate in 2019 decreased slightly to an average of 40% compared with 43% the prior year. The decrease was driven by reported declines from both medium-sized and large businesses. Small businesses held steady at a 40% win rate.

Medium-sized businesses saw a decrease from 42% to 35% year-over-year, which may indicate increased difficulty operating in more fragmented and competitive markets.

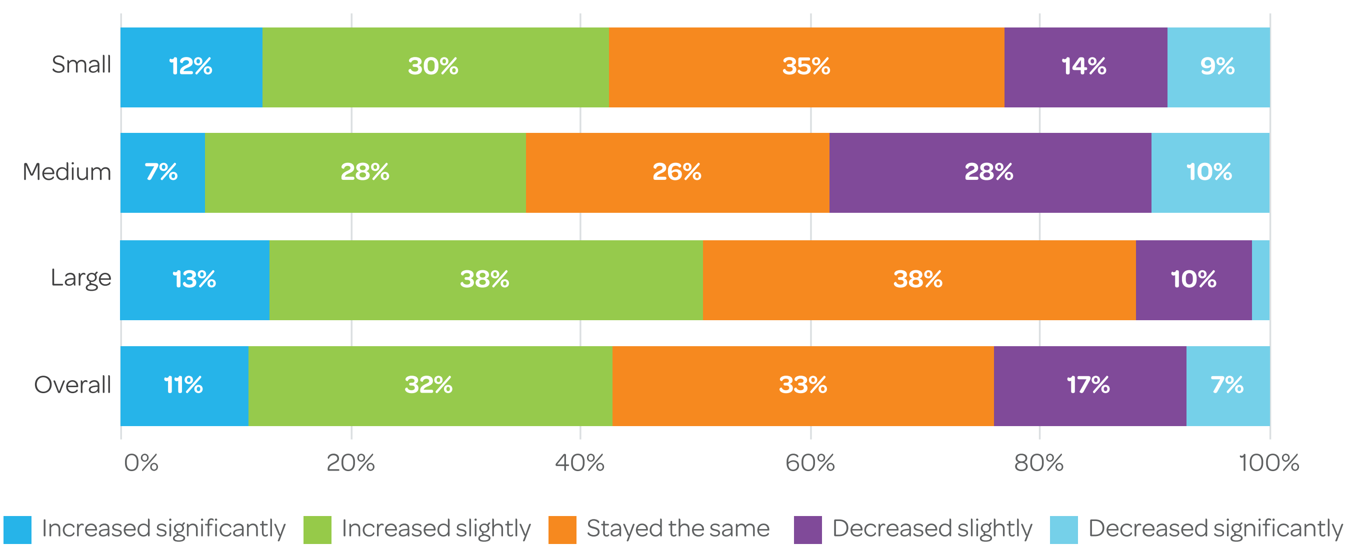
Companies should understand both their current and desired win rate in order to adjust business development strategy appropriately. Bidding on familiar business that has a higher probability of success should be evaluated against opportunities that move up the value chain but might be less winnable. Once decisions are reached on which opportunities to pursue, understanding the effect this will have on the pipeline multiple is just as important. It is crucial to understand how often the pipeline needs to turn to generate forecasted sales.

A high win rate is not the only indicator of long-term success. It could mean that a company is too conservative in identifying opportunities, either identifying too few, or a problematic method of pursuit. Win rates based on dollar value versus number of contracts can vary dramatically. Companies' business development key performance indicators (KPIs) should reflect their growth objectives and strategies.

Average Win Rate



Win Rate Change

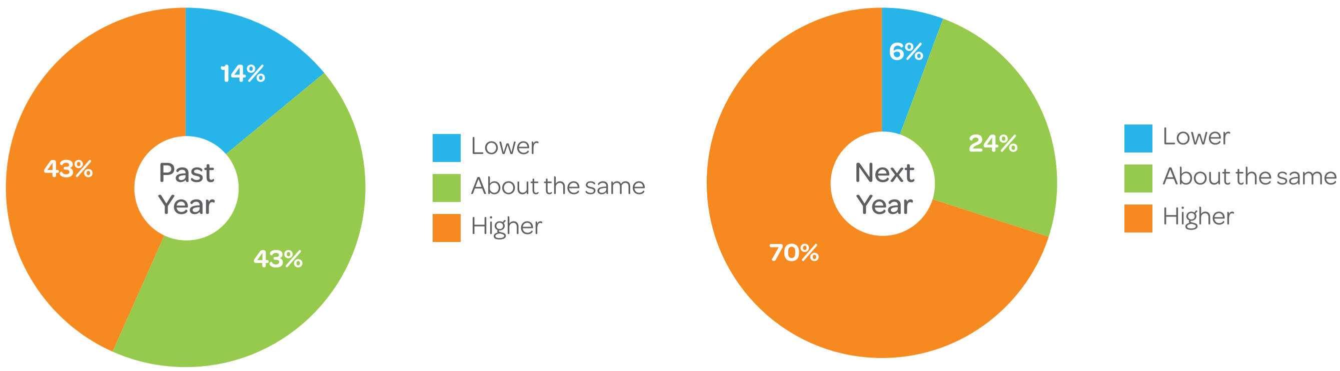


Sales in Government Markets

In last year's Study, optimism reigned in the outlook for 2019. An overwhelming percentage of respondents expected higher or stable government sales. These expectations proved to be accurate, as revenues from government markets remained about the same in 2019.

A bright outlook for 2020 carried over from 2019, with 94% of respondents looking for increased (70%) or stable (24%) sales. It is yet unknown how this outlook may be affected by the COVID-19 pandemic.

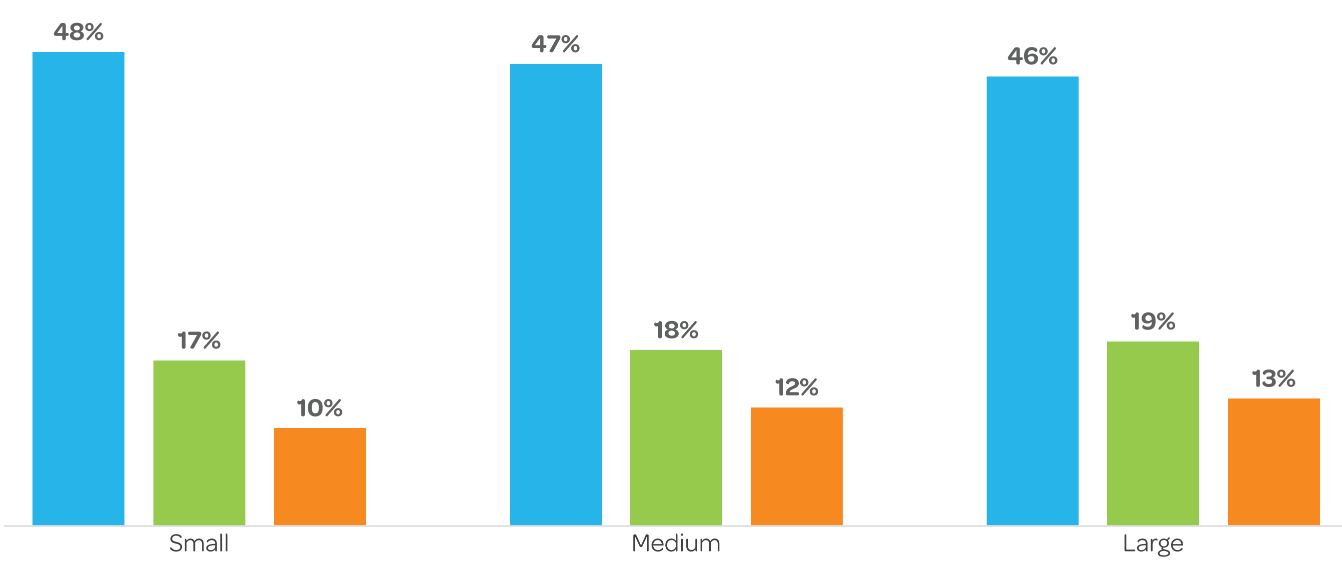
Past Year's and Next Year's Government Market Sales



Average Revenue Generated from Top Three Customers

A high percentage of business comes from the top three customers. This is particularly striking in that on average, respondents indicated their largest customers were responsible for nearly half (47%) of their net revenue, with the second and third largest customers generating an incremental 28% of net revenue. The good news is that strong customer relationships lead to a stable base of business. The potential bad news is that over-reliance on a small number of customers can be negative if those relationships fall apart or need to change based on the environment.

Average Revenue Generated from Top Three Customers



Top Business Development Challenges

Perceptions of the top three business development challenges remained unchanged this year, with "limited business development resources," ranking first at 59%, followed by "increased competition," (46%) and "customer using contract vehicles we are not associated with," (46%). It is interesting to note that "increased competition," slipped from 57% to 46% in the lineup of concerns. Importantly, there was a 10-point jump to 44% in the fourth category, "not enough time to assemble high-quality responses for requests for proposal (RFPs) and requests for information (RFIs)."

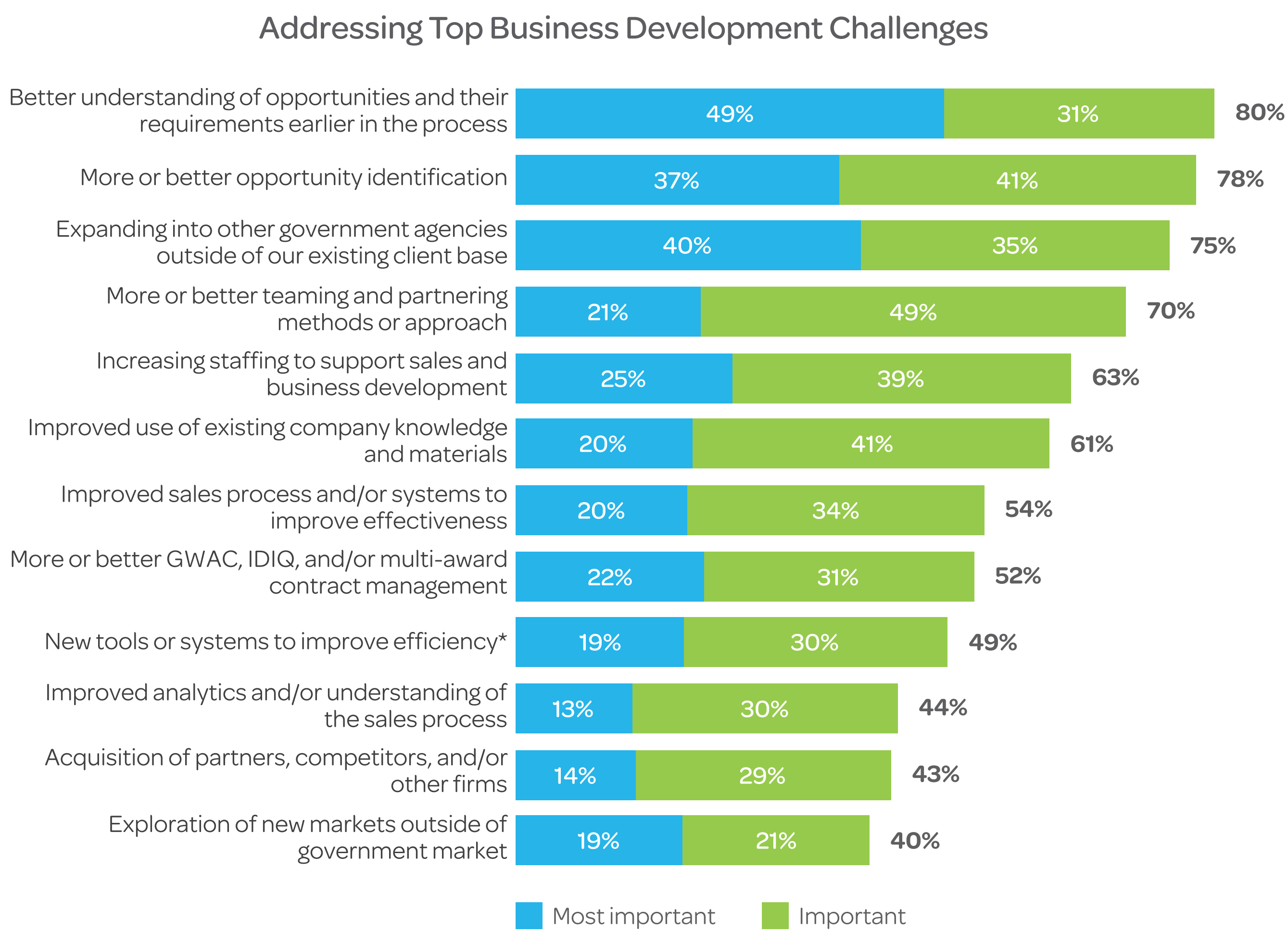
With increasing adoption of task order vehicles, fast responses are required. Companies sometimes have as little as two weeks to identify and bid for an opportunity, requiring a much higher level of agility. These changes highlight the need for more dedicated staff, tools and well-established business relationships that are in place before the opportunity presents itself. In the category of "not able to find appropriate partners," 22% of respondents identified this as an important challenge, up from 19% last year. Inter-functional challenges within companies also appear to be impeding business development, with issues such as "need for improved sales support," and "inability to effectively share company knowledge," highlighting weaknesses that need to be addressed.

Addressing Top Business Development Challenges

The top two initiatives cited by respondents in addressing top business challenges center on understanding the requirements of opportunities faster (80%) and developing effective mechanisms to find and identify better quality opportunities (78%). The third most-cited way to address business development challenges was "expansion into other government agencies outside existing customer bases," (75%).

The fourth highest response, "more or better teaming and partnering methods or approach," went up from 61% to 70% year-over-year. New tasking vehicles are requiring extremely fast responses from companies. Teaming partner relationships must already be established if a company wants to compete. Agility in business development is a trend that is becoming increasingly important.

The pandemic may cause temporary disruption in the market, which may benefit some contractors and negatively affect others. The stimulus dollars that reach the industry will have differing impacts based on the government's prioritization.



* (such as proposal creation, reporting, and CRM automation)

New Opportunities Identification

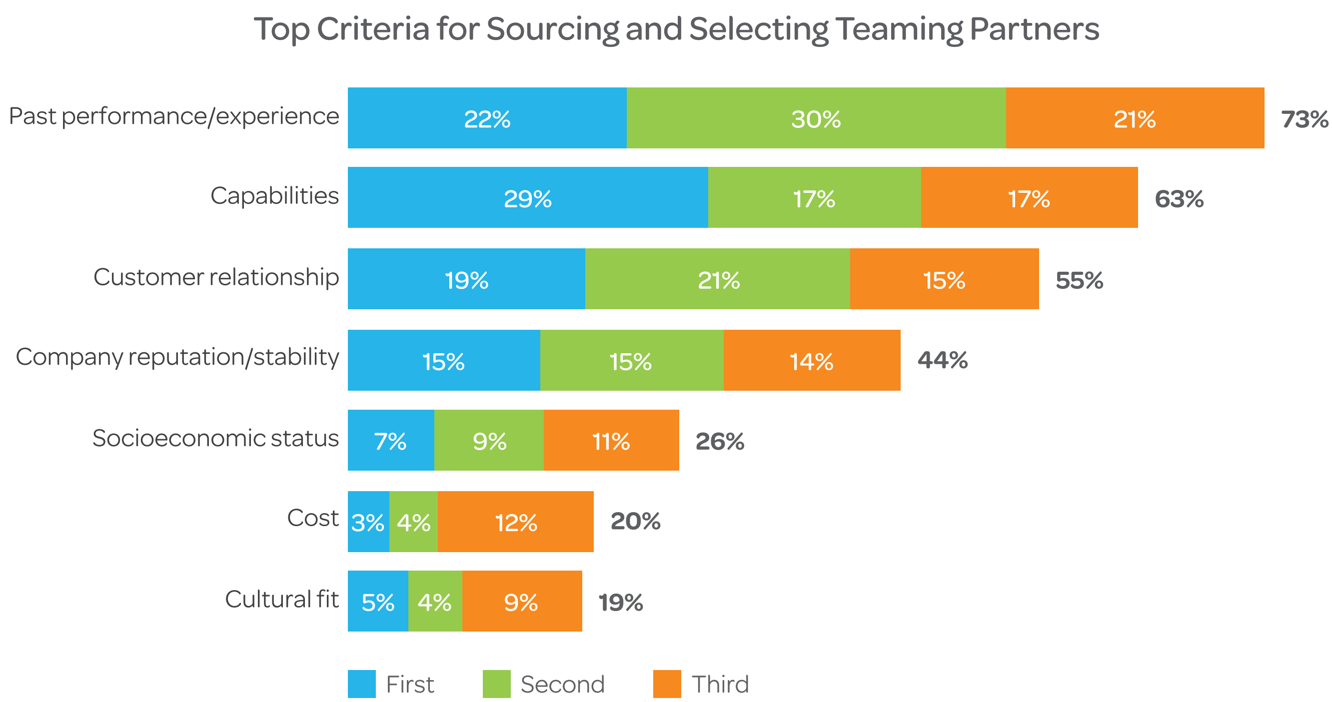
The top sources of new opportunities are "active customer relationships," "teaming partners and networking," and "Requests for Proposals/Requests for Qualifications." Only 33% of opportunities were "marketing-generated leads," which rated lower than "website searches," (42%). "Business development staff" accounted for 71% of new opportunity identification, which implies a high rate of return on investment in dedicated staff.

Top Criteria for Sourcing and Selecting Teaming Partners

The top three criteria for sourcing and selecting teaming partners are "past performance/experience," (73%, unchanged), "capabilities," (63%, down from 73%) and "customer relationship," (55% up from 47% last year).

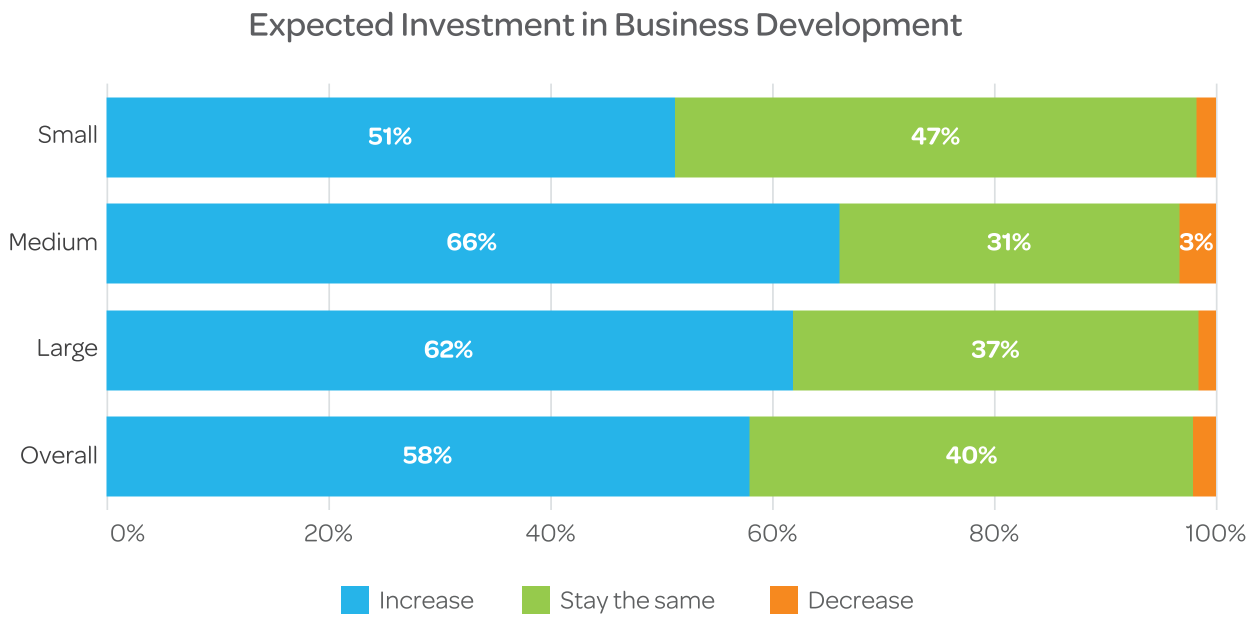
"Company reputation/stability," is rated at 44%, or fourth, in terms of importance in the selection process.

The existence of partnerships with proven capabilities is important in an atmosphere of speed accompanied by price sensitivity. While rated toward the bottom, the need for culture consistency should not be underestimated. When there is cultural consistency, teams typically work faster and more efficiently. Achieving these types of relationships may be a particular challenge for small businesses with limited resources.



Expected Investment in Business Development

Despite the clear need for upgrading dedicated business development staff and tools, only 58% of companies plan to increase their existing level of investment in business development. Sixty-six percent (66%) of medium-sized businesses expect an increase. Interestingly, many companies still rely on generic tools, such as Microsoft Excel, rather than specialized products, to manage their business development activities.



CLARITY OUTLOOK

Business Development

The COVID-19 pandemic significantly clouds the outlook for 2020. It is unknown how much this will stretch out procurement and contract awards. It is also unknown to what extent this may impact revenue recognition as some contracts temporarily slow. How companies behave during this period will determine how well they bear the brunt of the economic downturn.

Before the pandemic, government contractors exited 2019 with a rosy outlook for 2020, with an expectation of continued revenue growth and strong profit margins. The top five markets in which respondents expected growth include federal, IT, professional services, aerospace and defense, and SLED.

Early identification of opportunities improves the ability to win, as do strong customer relationships and diversification of the business portfolio. These capabilities will be particularly important in the current uncertain business environment. The ability to quickly identify opportunities and respond fast will separate the successful companies from those that can't move beyond their current market position.

SECTION TWO

Finance and Financial Compliance

Businesses reported healthy revenue growth and profit margins in 2019 and are strongly focused on protecting their financial fundamentals in 2020. There are new uncertainties to consider as a result of the COVID-19 pandemic.

Companies can use this time to address areas of opportunities and disruptions to their financial health. Monitoring key metrics and re-evaluating plans, budgets and strategies to adjust for a new reality will help companies fare better than those that do not adapt.

Generally, companies are effectively controlling costs, but the costs of compliance are rising. More labor hours and more full-time employees are required to meet compliance requirements that have grown in number as well as complexity. With ever-increasing regulations, this trend is likely to continue, so exploration of tools and methods to reduce these costs would be an excellent time investment.

58%

are focused on increasing profitability

65%

aim to diversify the customer base

Key Takeways

Protecting cash flow will require keen attention in coming months as the nation recovers its economic momentum. Reducing days sales outstanding (DSO), particularly for small businesses, will make the difference between maintaining key cash levels at a critical time and coming up short. Companies that are new to contracts, or working for the first time with a particular government agency, may find that payments could slow. While the Defense Authorization Act mandating that prime contractors pay their subcontractors faster will certainly help small firms navigate these waters, nothing is as important as building relationships with customers. Doing so will ensure invoices can be trusted and will likely alleviate potential payment delays.

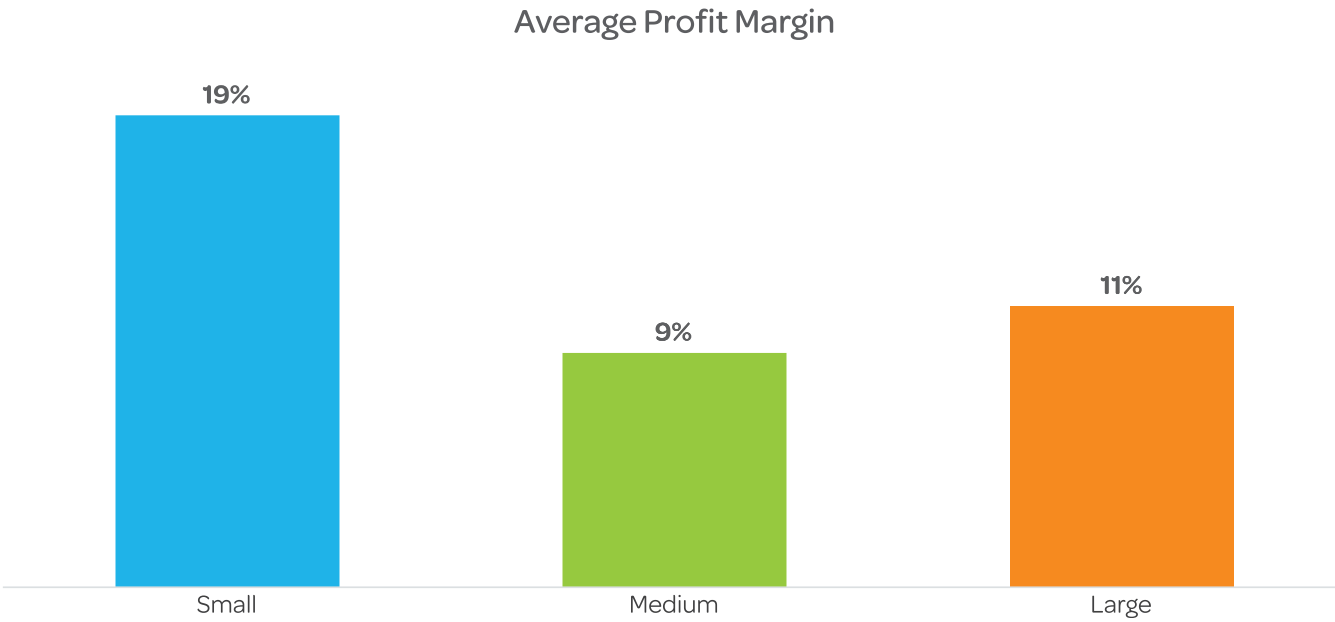
Finance departments should work to streamline processes in order to provide faster insights into the business in the near term. Eliminating inefficiencies in areas such as conducting audits, month-end closes, cost allocations, and reconciliations reduces the amount of time and resources required to complete repetitive tasks. That allows financial professionals to spend more time identifying problem areas that the business needs to address.

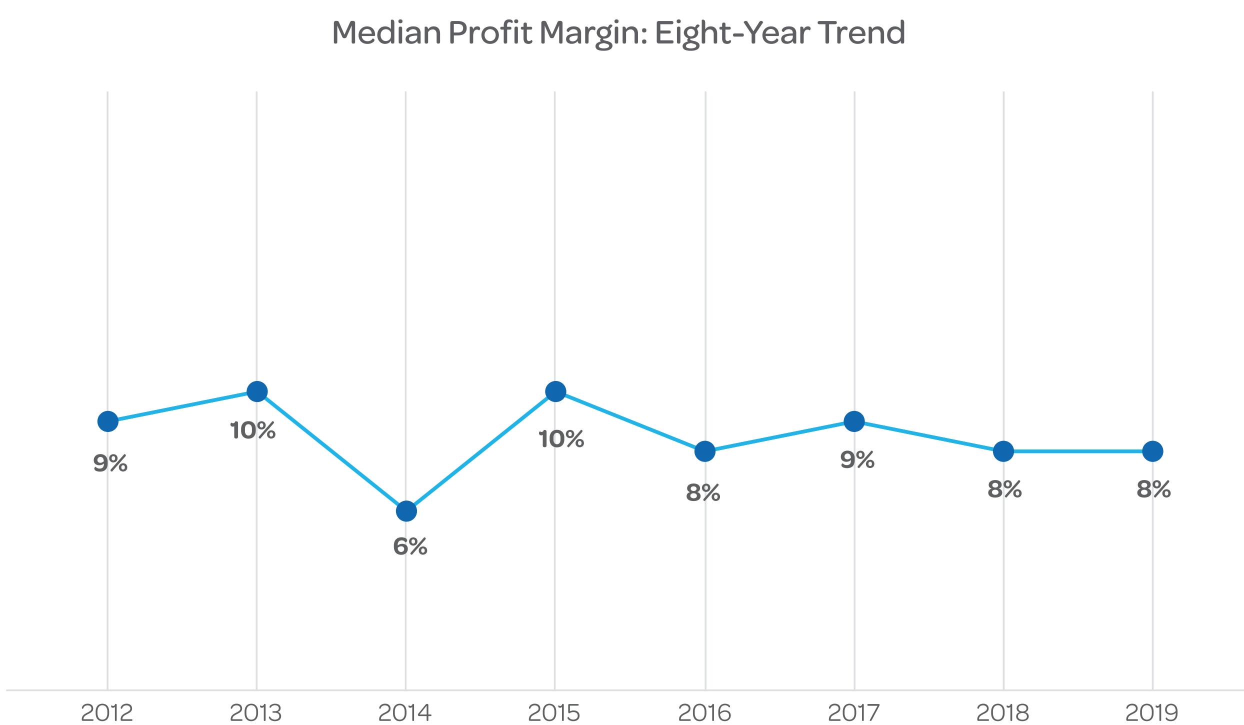
Mergers and acquisitions was an area of strong interest for survey participants, with an emphasis on buying. That said, the effect the pandemic is likely to have on company valuation may create a "wait and see" environment. However, the potential exists for companies to build their critical mass and diversify into new areas, should possible sellers become willing to accept lower valuations.

Profitability Among Survey Respondents

Companies achieved healthy growth in average profit margins in 2019. Small businesses improved by 27%, while large businesses increased nearly 60% compared to the previous year.

The median profit margin over the last eight years has been largely consistent, ranging from 8% to 10% overall. In both 2018 and 2019, the median profit margin was 8%, which is healthy in a heavily regulated business.



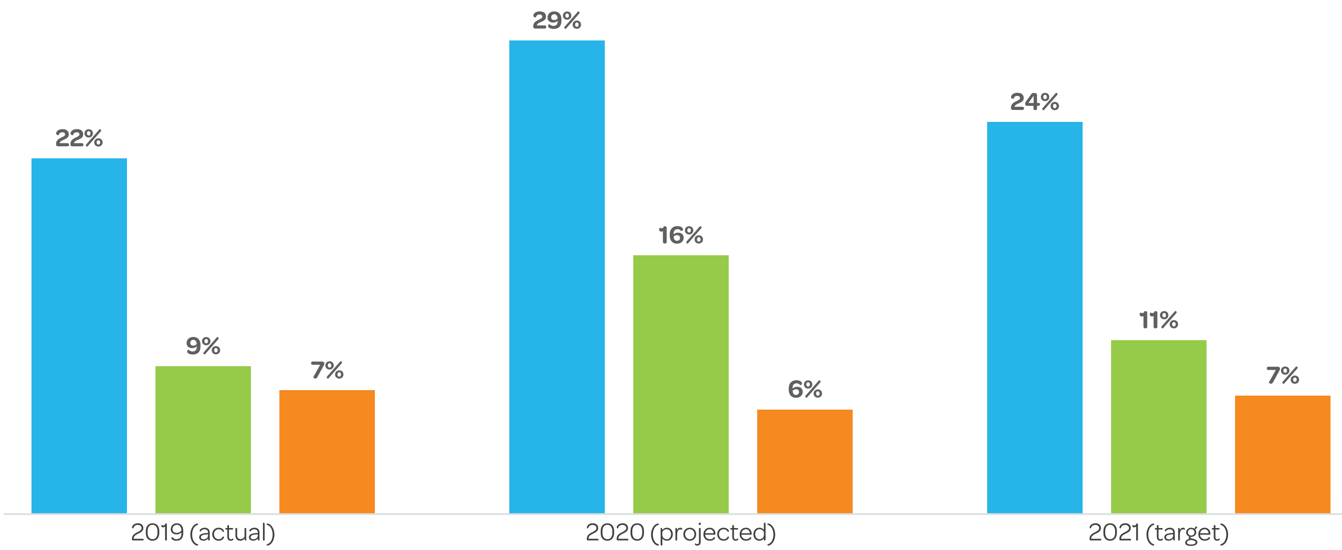


Growth Rates

Growth projections for fiscal year 2019 that were made in fiscal year 2018 were accurate across all business sizes. Small businesses outperformed their forecasts, realizing growth of 22%, compared with a projected 2019 increase of 14%.

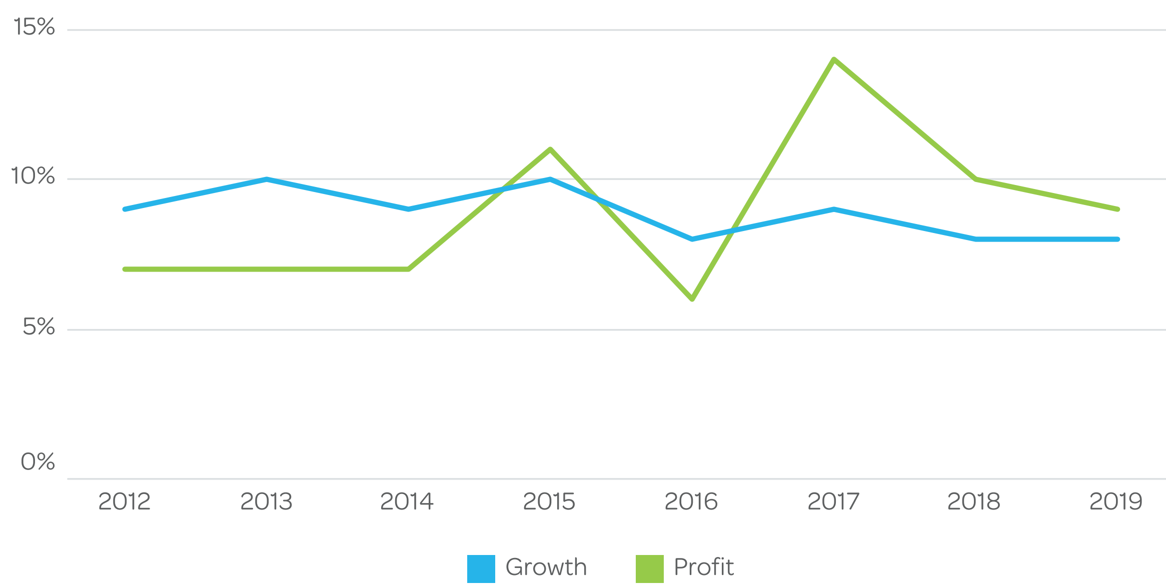
Prior to the current pandemic, companies were optimistic. Small businesses reported a robust outlook for 2021, expecting a growth rate of 24% over their 2020 fiscal year targets. Medium-sized companies were still bullish at 11%, while large companies looked for 7% growth, representing brisk expansion.

Average Revenue Generated from Top Three Customers



While growth has slowed since 2017, the industry still reported an expected expansion – at the time of the survey – of 9% in fiscal year 2020. While stability is a key feature of the government contracting sector, it is still unknown how this growth rate will be affected.

Median Growth Rates and Profit Margin: Eight-Year Trend

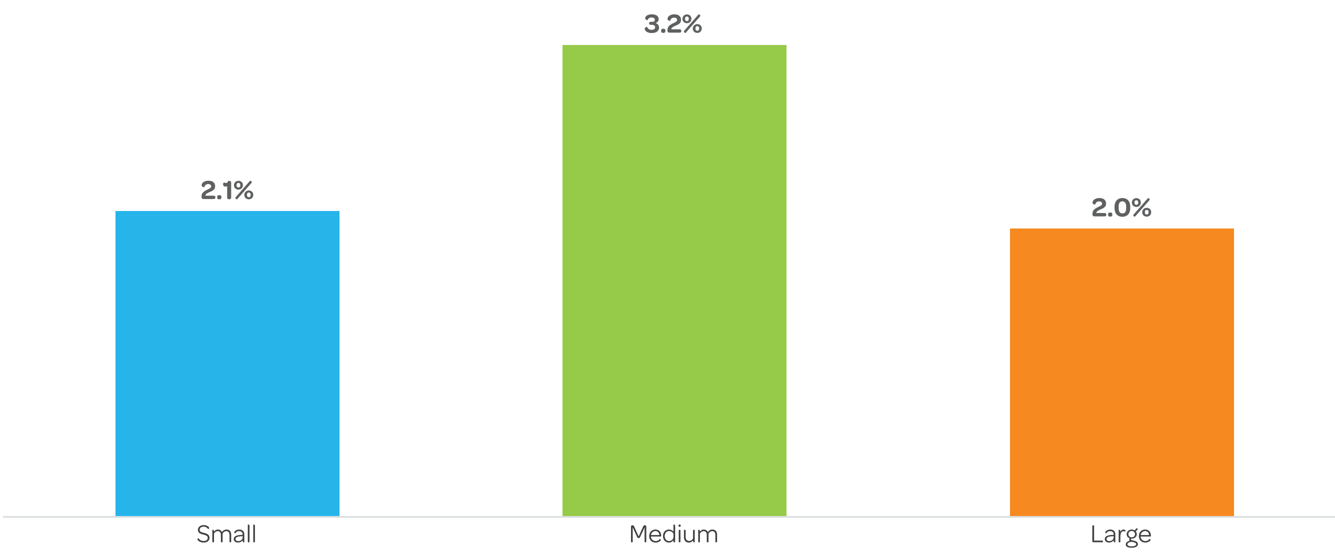


Unallowable Costs

In fiscal year 2019, medium-sized companies saw an increase of 78% year-over-year. Large companies' unallowable costs more than doubled from 2018 to 2019.

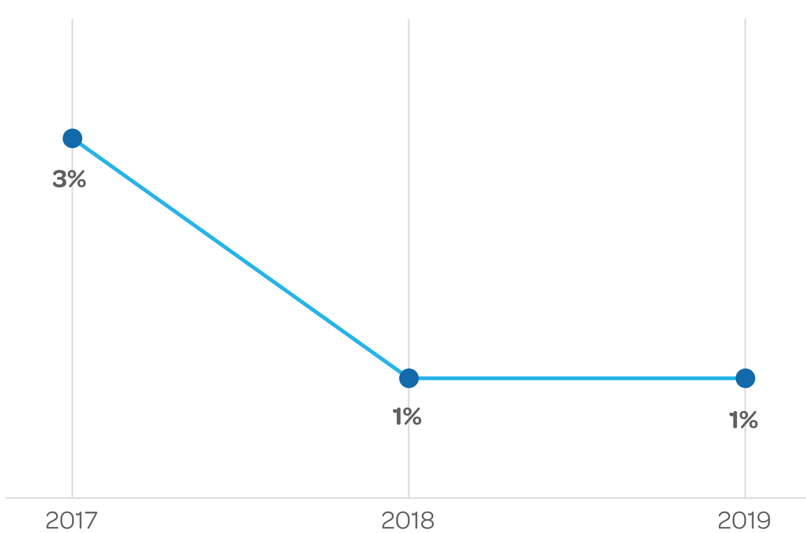
Managing this metric requires close attention, particularly during a time of economic unpredictability and potential revenue shrinkage. Closely tracking and accurately reporting unallowable costs is fundamental. Companies that are remiss not only violate rules and regulations of contracting, but also risk failure to be paid or exclusion from other contracts.

Average Unallowable Cost Rate



The trend in median unallowable cost rate remained flat overall compared with the prior year, finishing at about 1% of revenue.

Median Unallowable Cost Rate: Three-Year Trend

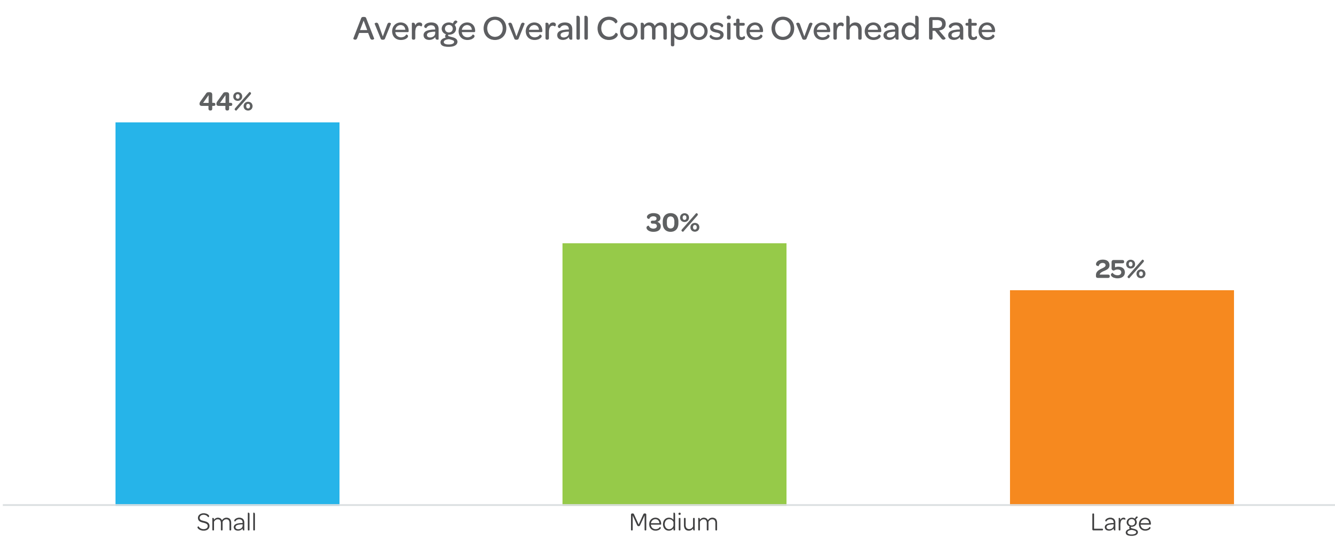


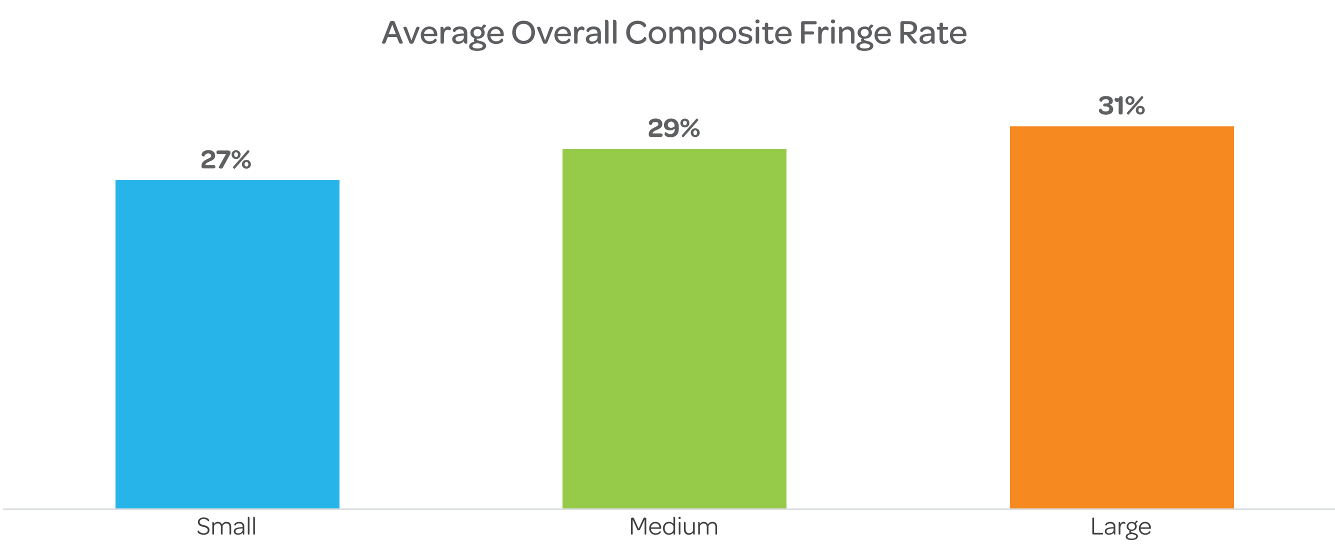
Average Composite Fringe and Overhead Rates

While large businesses tend to have higher average overall composite fringe rates, the delta between small and large businesses in 2019 was only four percentage points. This was down from 12 percentage points in 2018.

Large businesses appear to be reducing fringe rates, which may be a questionable strategy. While it could reduce costs in the near-term, the gain may be at the expense of investing in talent and employee training. The continued competition for talent would suggest that companies should offer the right benefit and compensation packages to attract candidates and retain employees.

Since fiscal year 2018, small businesses have seen a 10% increase in average overhead rates, which may correspond with higher revenues. Large businesses reported a decline of 20% during the same period, implying an increase in productivity.

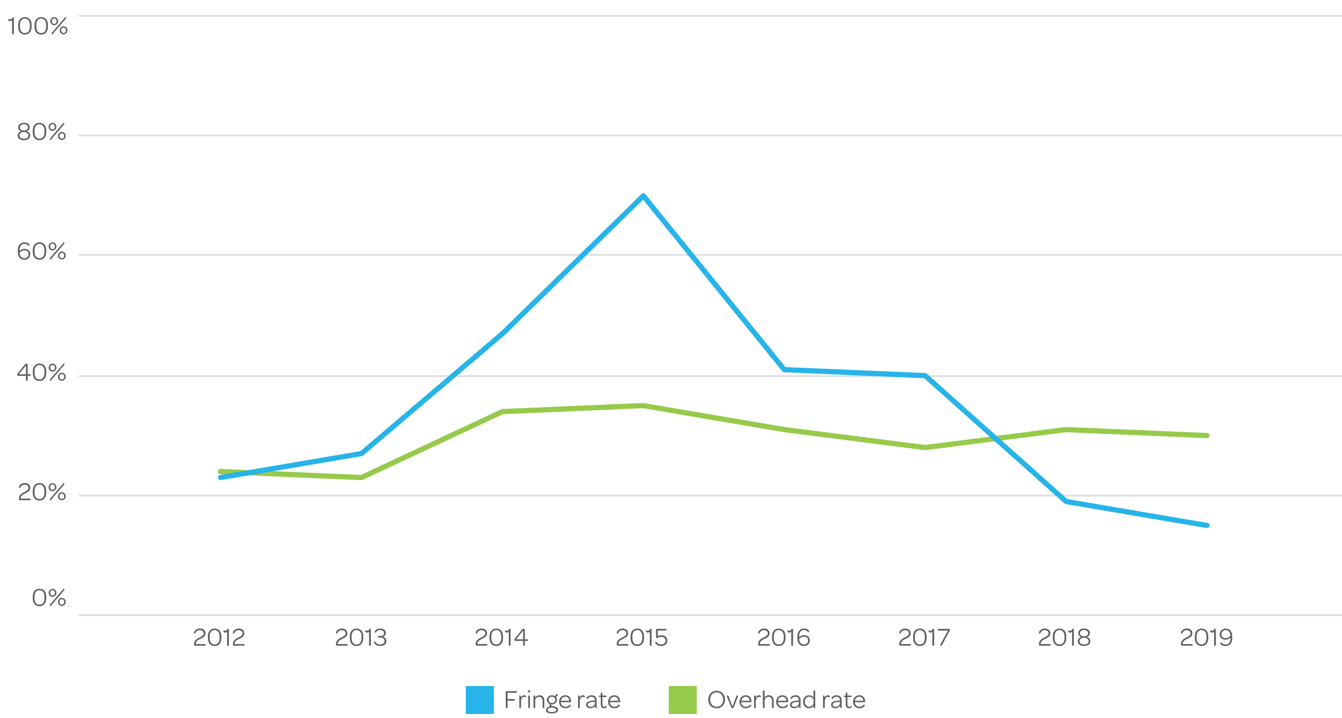




Median Fringe and Overhead Rates

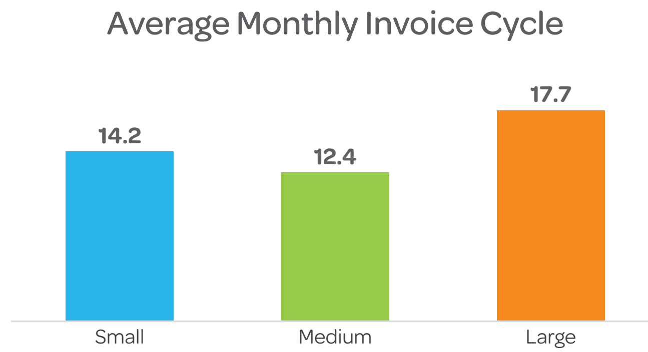
For each of the last four surveys, the median fringe rate has consistently been between 28% and 31%. The median overhead rate dropped four percentage points in 2019 compared with 2018. Profitability has benefited from effective cost control.

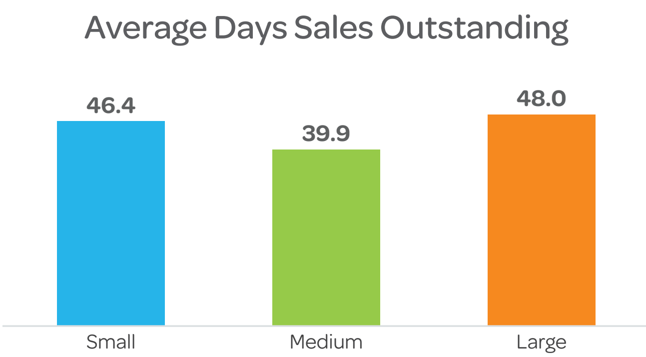
Median Fringe and Overhead Rates: Eight-Year Trend



Factors That Influence Cash Flow

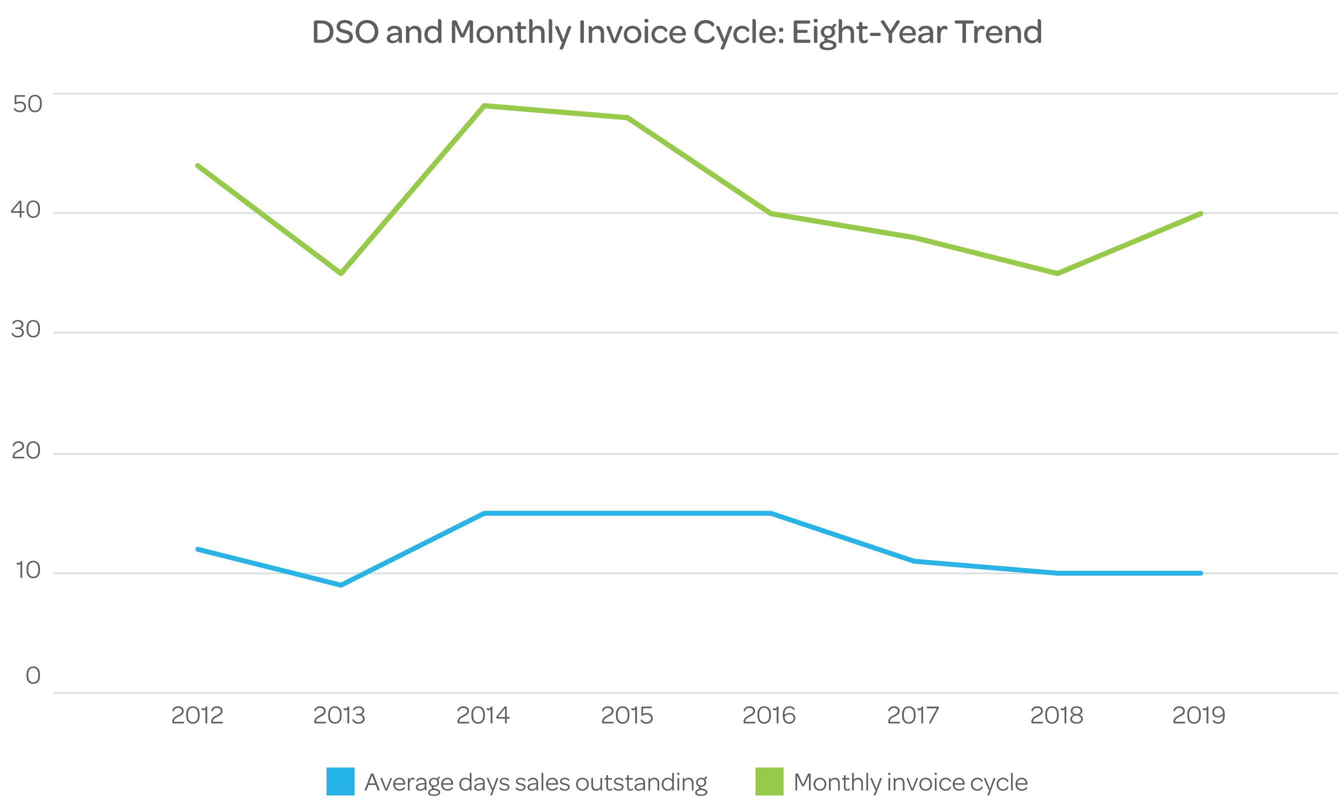
Faster collection of receivables is a factor in successful cash flow management. In both small and large companies, the average monthly invoice cycle reported by respondents increased by roughly two days over 2018. For medium-sized companies, the reported invoice cycle dropped by about three days over the same period. Each day that a company can gain throughout the invoice cycle translates to an improved cash flow position.





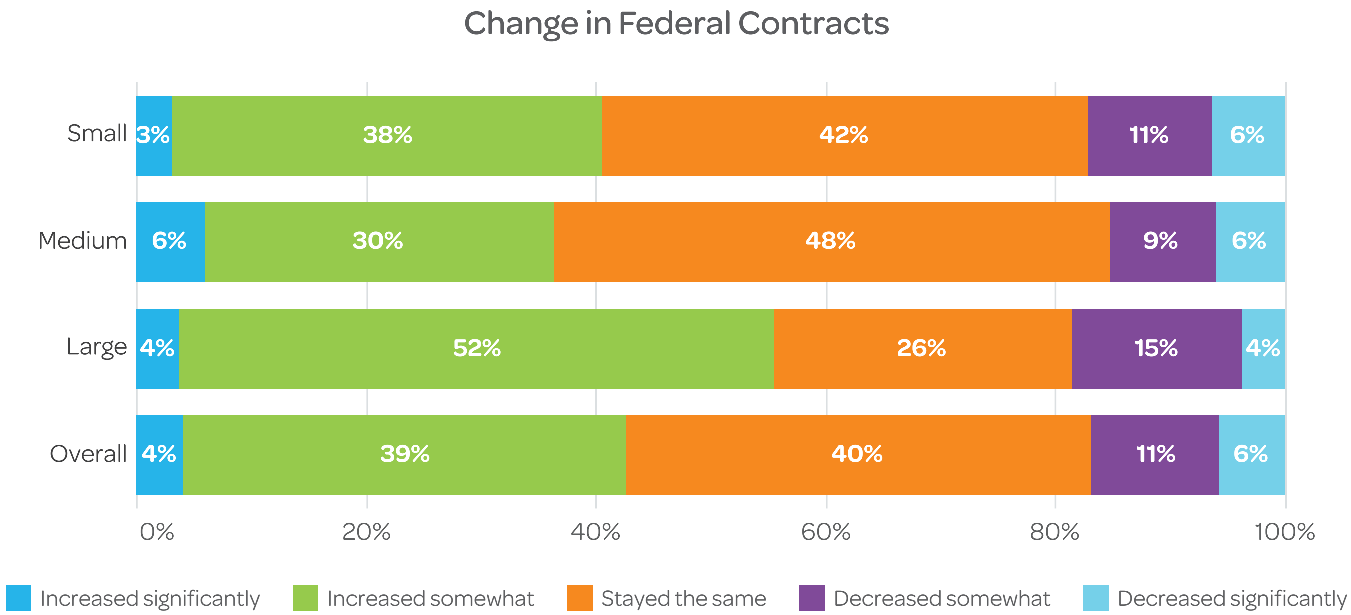
Average days sales outstanding (DSO) increased by nearly seven days (17%) for small businesses in 2019, likely offsetting the benefit of a faster invoice cycle. Large businesses saw DSO increase by nine days (23%) over the same period. This trend is not indicative of businesses increasing their abilities to effectively manage and maintain a strong cash flow.

In fiscal year 2019, the median of average DSO increased by roughly five days (14%), while the median monthly invoice cycle remained flat at 10 days between the end of a billing cycle and invoice submission. Shortening the invoice cycle would create positive efficiencies and improve cash management.

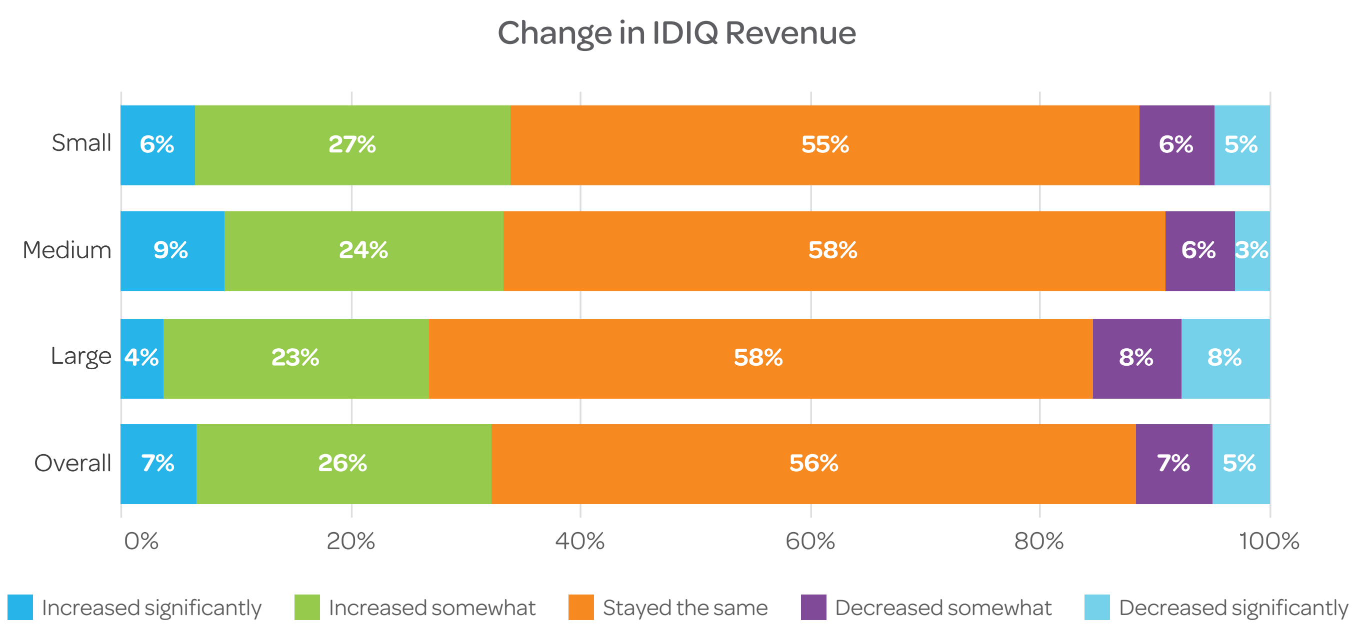


Trends in Federal Contracts

Overall, survey respondents indicated a greater degree of volatility in the number of federal contracts awarded in the last 12 months, which tends to also increase the degree of difficulty in planning and forecasting both revenue and costs. This volatility was reported by businesses of all sizes.



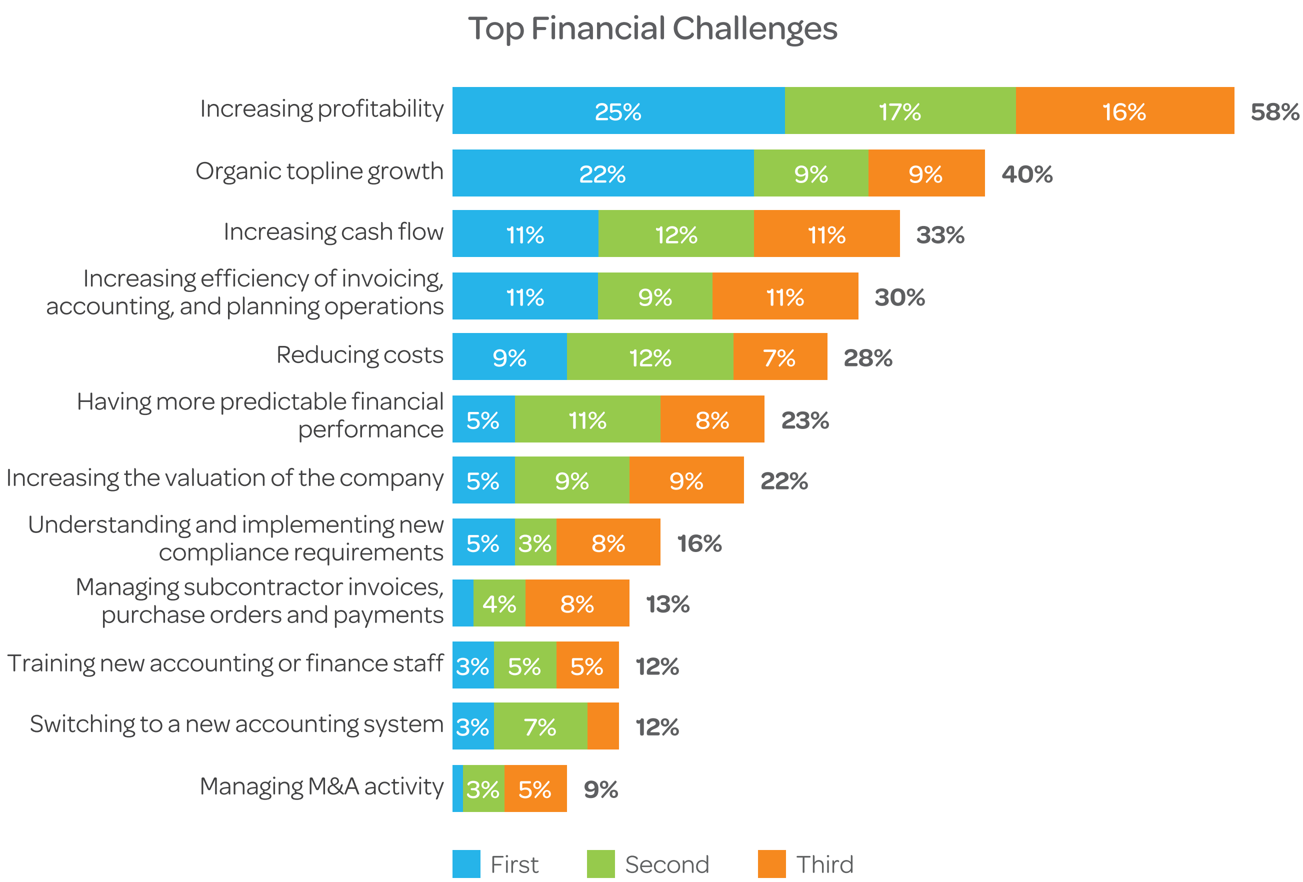
Similar to the change in federal contract awards, respondents indicated changes at the extremes in terms of increasing and decreasing levels of indefinite delivery, indefinite quantity (IDIQ) revenue in fiscal year 2019. Fortunately, changes were more positive than negative, but the difficulty in predicting IDIQ revenue is highlighted by respondents. The increase was driven by medium-sized businesses, with large businesses indicating a greater decrease in IDIQ revenue recognition. Companies may have significant IDIQ revenue in backlog, but their inability to predict the rate at which that will flow through their businesses increases uncertainty.



Top Finance Challenges

The 2019 survey saw responses that were more concentrated across a narrower group of selections, with particular focus on "increasing profitability," and "organic topline growth," compared with the 2018 survey. "Increasing cash flow," "reducing costs," and "having more predictable financial performance," were key concerns.

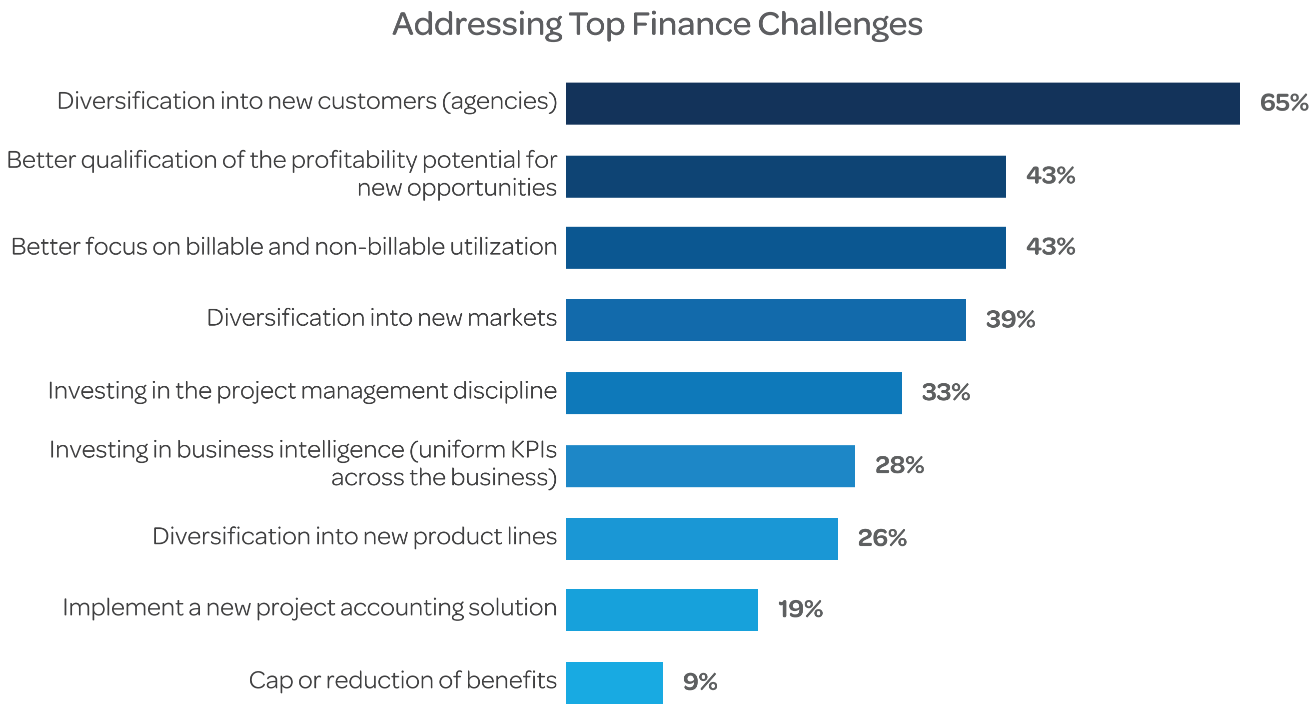
Administrative concerns were of lower – but not insignificant – interest. Companies also cited several other needs like "managing subcontractor invoices, purchase orders and payments," "training new accounting or finance staff," and "switching to a new accounting system." As many as 24% of companies indicated they still use tools like QuickBooks® and basic spreadsheets for financial management and reporting, which is limiting their ability to monitor key performance indicators, manage risk and compliance, and swiftly react to changing economic drivers. In contrast, integrated financial tools designed for government contractors provide greater visibility and insights to support informed business decisions.



Addressing Top Finance Challenges

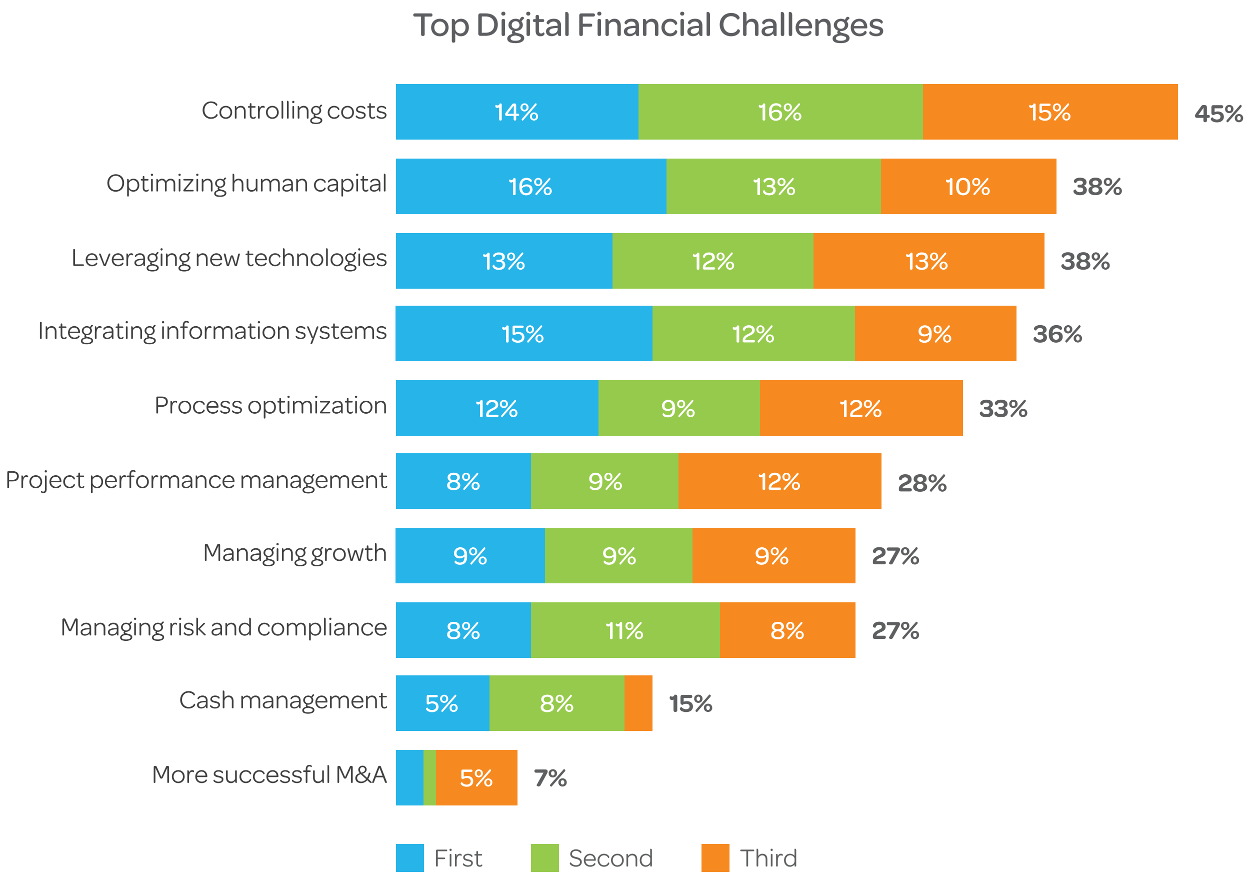
In an effort to increase growth and profitability, 65% of respondents cited "diversification into new customers (agencies)," as their top priority. Forty-three percent (43%) indicated they were looking for "better qualification of new opportunities for profitability," along with "a better focus on billable and non-billable utilization."

Companies should continue to address diversification and cost controls in order to protect financial performance. Additionally, companies would be wise to revisit their strategic planning process and budgeting for the balance of 2020 and 2021, given possible impact from current events.



Top Digital Financial Challenges

An emphasis on controlling costs in fiscal year 2018 shifted more broadly in 2019 to include "optimizing human capital," "leveraging new technologies," and "integrating information systems." Process optimization and project performance management rely increasingly on the continuing digitization of information, tools and resources. Going forward, companies should prioritize the evaluation of their financial management and reporting tools to identify opportunities to improve processes and gain efficiencies.

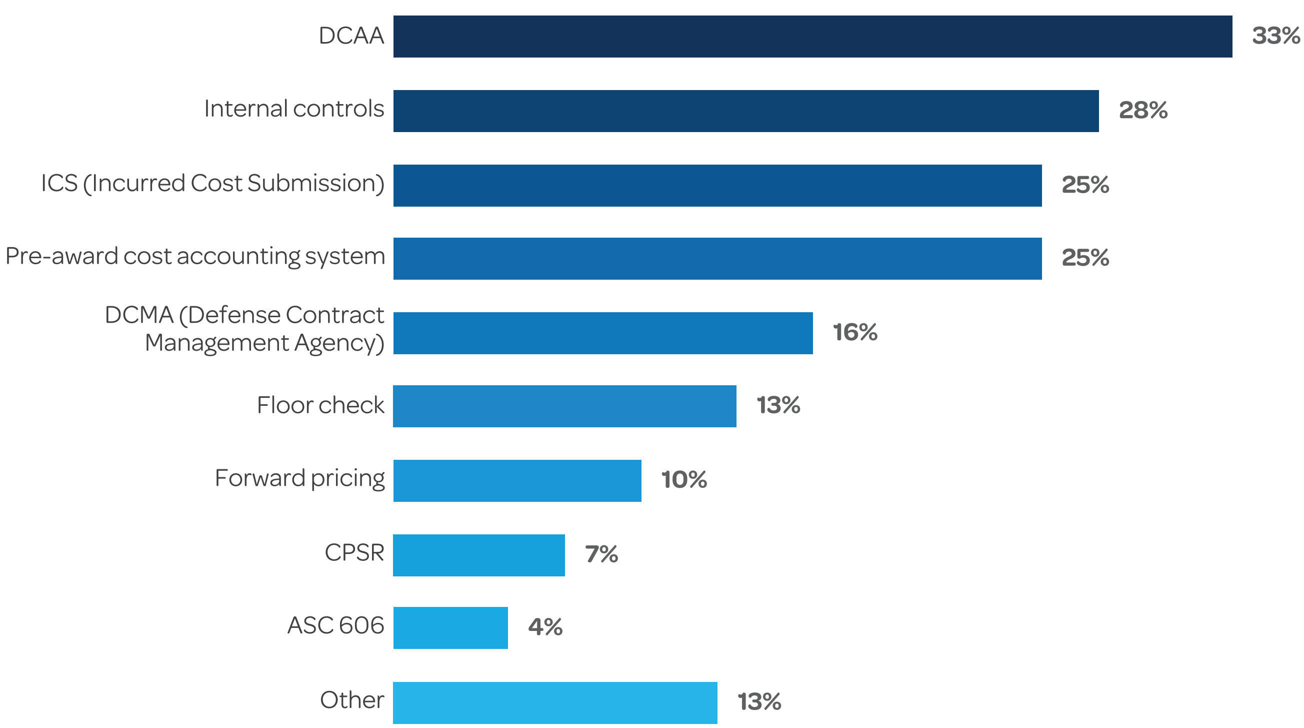


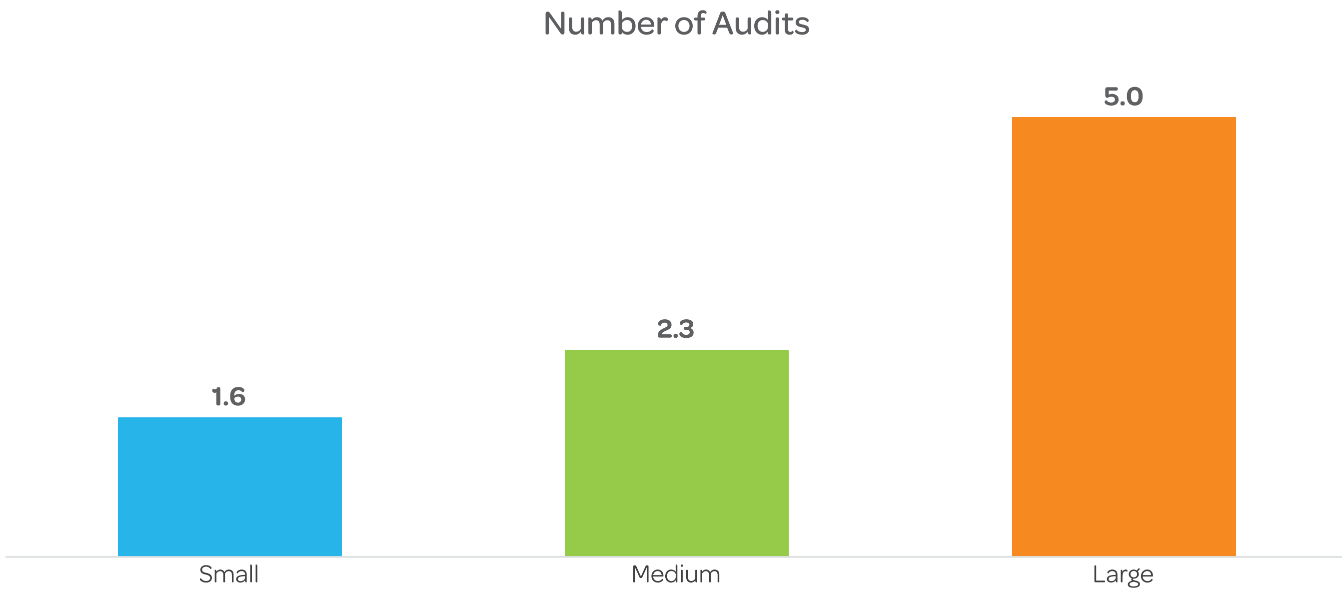
Compliance

The survey asked respondents for information about audits in 2019, and their answers revealed roughly the same rank order of challenges stemming from audits in 2018. While, in aggregate, the total number of reported audits in 2019 remained the same versus 2018, respondents indicated that Defense Contract Audit Agency (DCAA) audits dropped significantly as a component of their audit activity, from 49% to 33%. Every other category of audit except for ASC 606 (a revenue recognition standard) was reported to have decreased in incidence, year-over-year, which is potentially the result of a shift away from on-site audits by agencies. On-site audits are being supplemented by data submissions, which still require time and energy to produce reports and comply with requirements. This is not a shift away from governance and oversight on the part of these agencies.

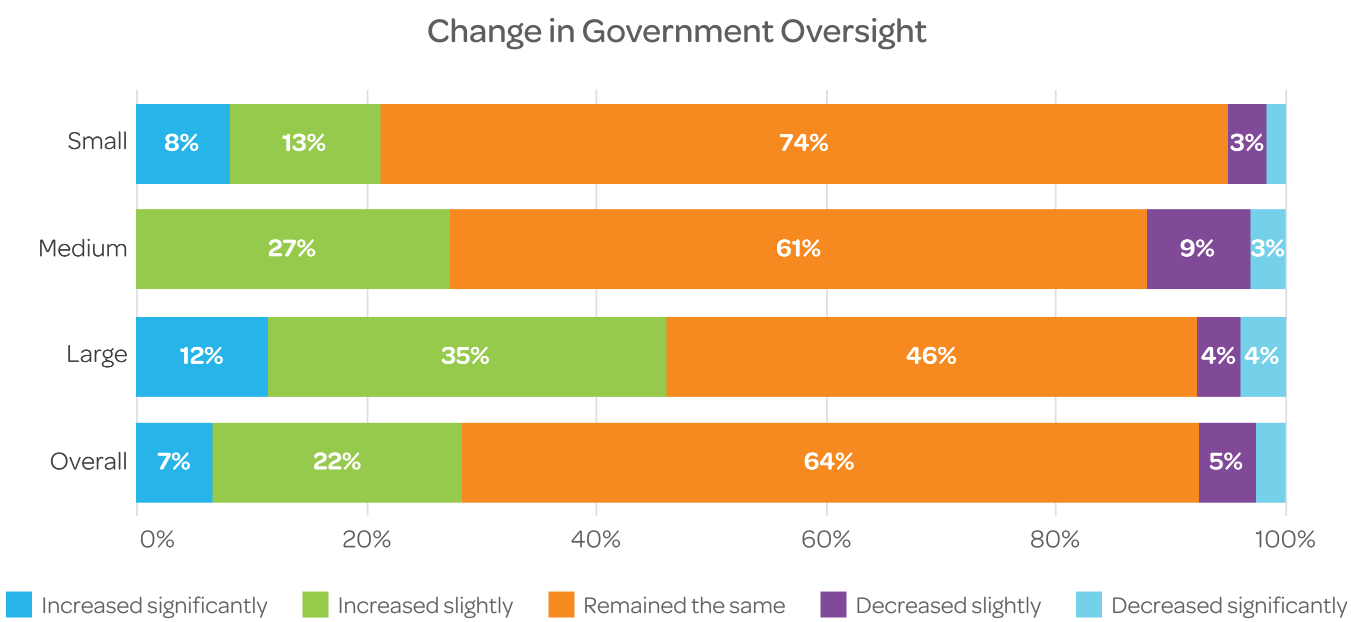
Audit activity by business size on a year-over-year basis appears to have been relatively unchanged in 2019. Government oversight is seen as increasing by fewer respondents than the previous year, and some even note a decrease in oversight. The costs of compliance may reflect fewer on-site audits, but the reality is that existing (and new) regulations continue to require administrative attention and investment to ensure compliance.

Types of Audits in Past Two Years





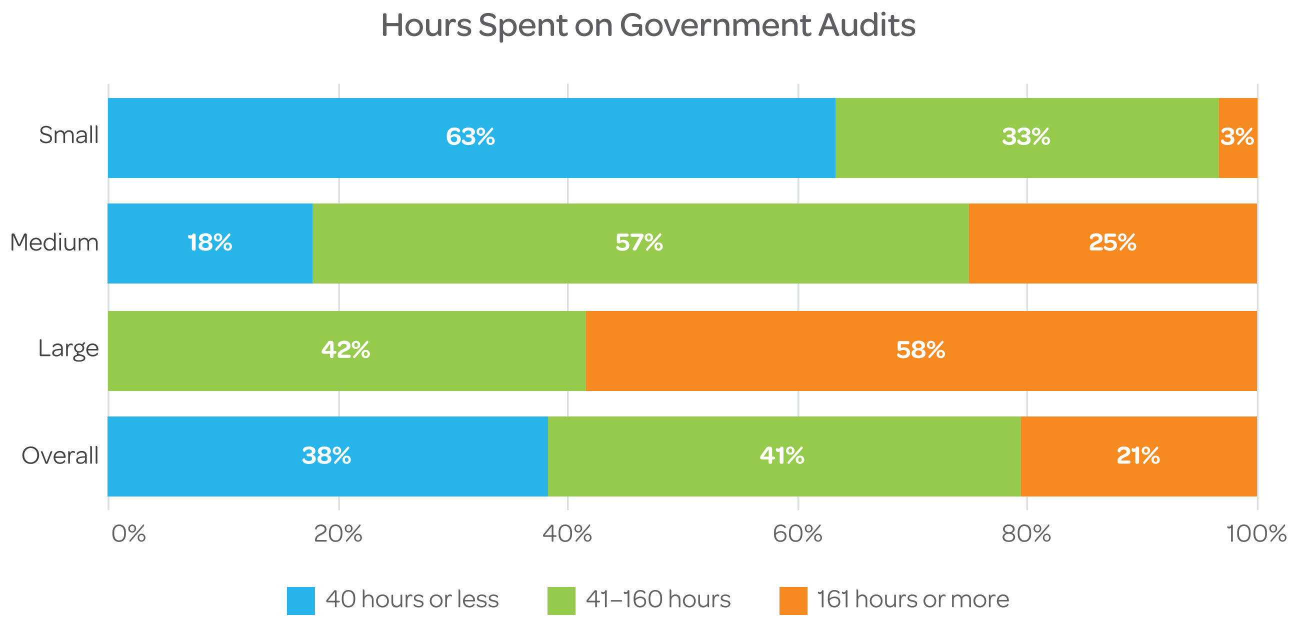
Number of Audits
5.0
2.3
1.6
Small
Medium
Large

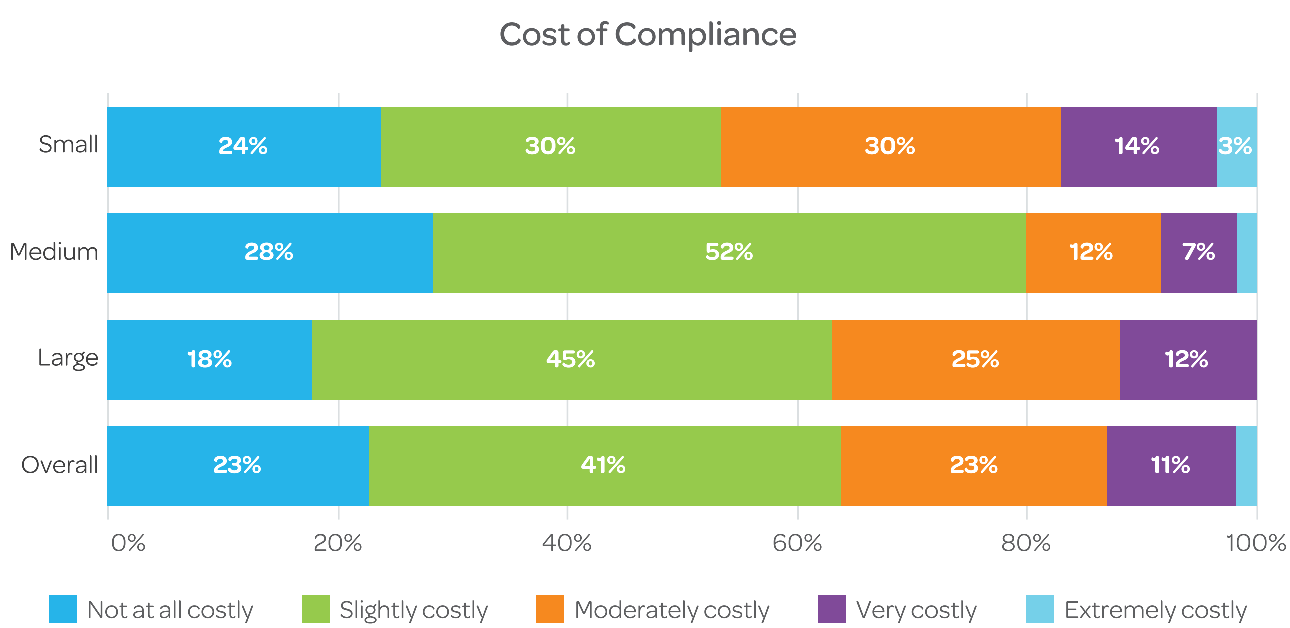


Change in Government Oversight
Small
8%
13%
74%
3%
Medium
27%
61%
9%
3%
Large
12%
35%
46%
4%
4%
Overall
7%
22%
64%
5%
0%
20%
40%
60%
80%
100%
Increased significantly
Increased slightly
Remained the same
Decreased slightly
Decreased significantly

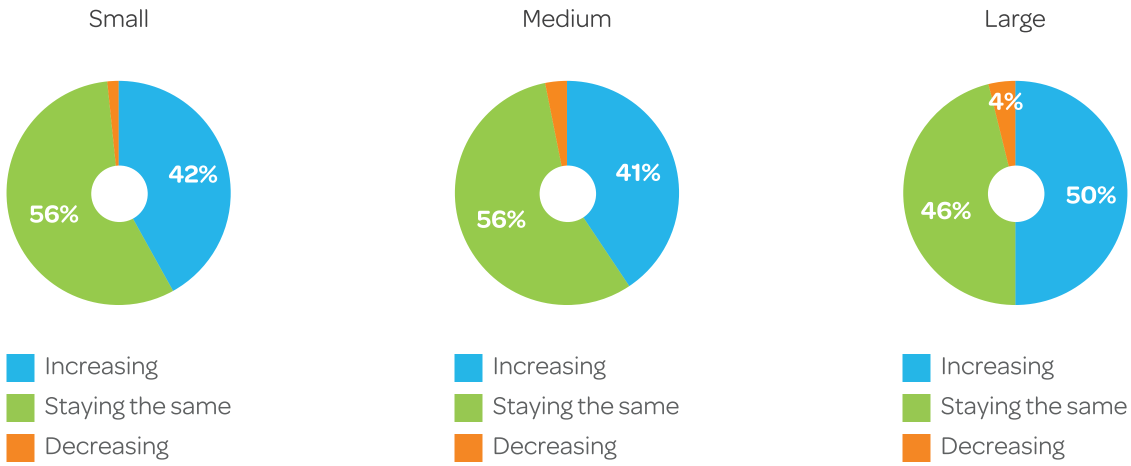
Hours and Costs Spent on Government Audits

Given that the number of audits performed was reported to be relatively flat versus the previous year, the costs of compliance stemming from those audits shifted by business size in fiscal year 2019. Respondents from large businesses indicated a greater degree of "slightly costly," and "not at all costly," compared to a year ago. Similarly, medium-sized businesses saw a decrease in the percentage of respondents indicating compliance costs had increased, with only 20% indicating compliance was "moderately costly," "very costly," or "extremely costly." Around 16% of small businesses, however, responded that costs of compliance were "very costly," or "extremely costly," up from 7% a year ago.





The cost of compliance is expected by half of the respondents in large companies to increase, while fewer small and medium-sized businesses expect these costs to increase.



Top Audit Challenges

Nearly half of 2019 survey respondents named "indirect rates," in their top three challenges. "Labor and timekeeping," saw a significant increase year-over-year, while "billing," and "consultant fees," declined overall in rank.

"Internal control systems," continued to occupy the number three position, indicating a possible need to upgrade systems and tools. In view of the high cost of audits, any decrease in the complexity and cost of tracking and analysis would be a positive step forward.

Addressing Top Audit Challenges

On a year-over-year basis, the rank order of audit remediation methods was largely the same, with respondents indicating a broader recognition of methods in 2019. A quarter (25%) of respondents cited “hiring better qualified/experienced people,” while 20% named “investing in business systems training.” It is clear that there are opportunities for improvement through staffing, training and tools.

CLARITY OUTLOOK

Finance and Financial Compliance

Heading into 2020, the overall financial health of the government contracting industry was strong, with stable growth and solid profit expectations. The uncertainty generated by the COVID-19 global pandemic will have an impact on those early expectations for 2020 and likely into 2021.

Businesses are aware of the need for cost control and compliance with government oversight, but the COVID-19 pandemic is an anomaly that cannot be adequately evaluated yet. During the period, while the economy is operating at a highly reduced capacity, businesses should revisit their strategic planning and budgeting processes, and monitor the market.

Diversification is a go-forward focus for many respondents to build a broader revenue base. Mergers and acquisitions activity was on the radar for many companies at the time this survey concluded in early March, but the current environment will likely drive a "wait and see" approach for companies reconsidering how to best use their cash to drive growth. Changing valuations and cash needs may open new opportunities later this year or next.

The number of audits is largely constant across all business categories, while the cost of complying with audits is expected to continue increasing. Companies should evaluate their staff numbers and capabilities, along with their systems and tools, to maximize audit success and efficiency.

Protecting cash flow must be a key focus during this period. Days sales outstanding and the time required to bill have already increased. Companies need a keen focus on cash flow management in 2020.

SECTION THREE

Project and Risk Management

Improvements in project forecasting and project management training and development are necessary to improve the effectiveness of the project management and risk management functions.

Businesses are recognizing that greater investment in training is needed to close the gap between more experienced project managers and those with limited project management experience. Project management tools are largely outdated, with many relying on manual methods for critical roles in risk management and resource scheduling. As needs continue to grow and the institutional knowledge of more experienced project managers becomes displaced by resources with less experience, robust and impactful tools will be needed to address a growing set of complexities across delivery and regulatory compliance.

5%

decline in projects on or under budget

48%

cite accurate project cost forecasting as a top challenge

50%

intend to invest in training project managers

Key Takeaways

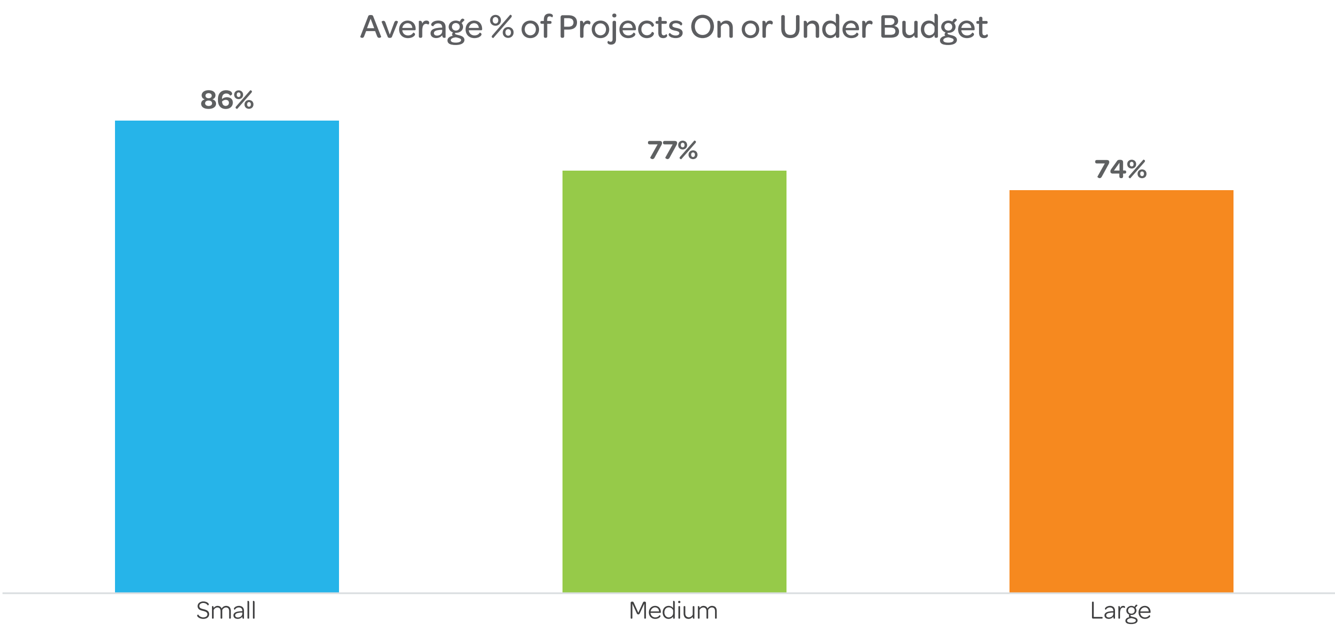
Companies are aware, to varying degrees, of the importance of discipline in project and risk management and continue to invest in developing resources and improving project management tools. That said, more emphasis may be needed as contractors in medium-sized and large businesses experienced slippage in the average percentage of projects at or under budget in fiscal year 2019.

Respondents indicated growing awareness that "accurate project cost forecasting," must be a top priority followed by "collaboration and communication," and the challenge of "inexperienced project managers." Companies plan to address these execution challenges with tactics that focus on investments in specialized training, development and implementation of best practices, and ensuring that projects are tracked more formally by both managers and software.

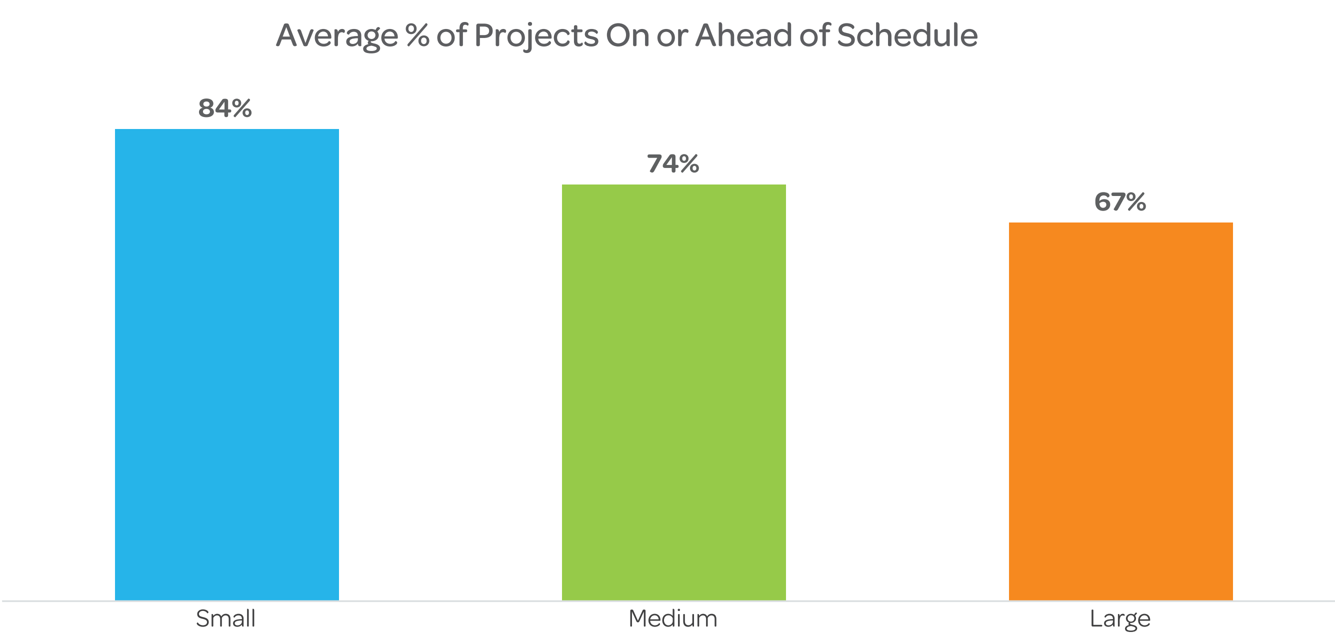
The results in this year's human capital management survey section reflect the across-the-board challenge of recruiting, training and retaining qualified staff, particularly in project management. As generational changeover continues, knowledge transfer will become more important to achieving and maintaining seamless project management.

Project Management Status

The average percentage of projects on or under budget declined by 5% year-over-year. Respondents from medium-sized and large businesses reported substantial declines from fiscal year 2018. Large businesses reported only about three quarters (74%) of projects on or under budget. These results have negative implications for cost control, financial performance and customer satisfaction.



Companies reported modestly improved performance in meeting schedules compared with fiscal year 2018. Overall, the percentage of projects on or ahead of schedule increased two percentage points year-over-year, with small businesses achieving an increase of 8%. Large businesses, however, indicated that only 67% of projects are on or ahead of schedule, a decrease of six percentage points from last year. Improving scheduling best practices and assessing risk to project timelines will allow project managers to proactively adjust before problems arise.

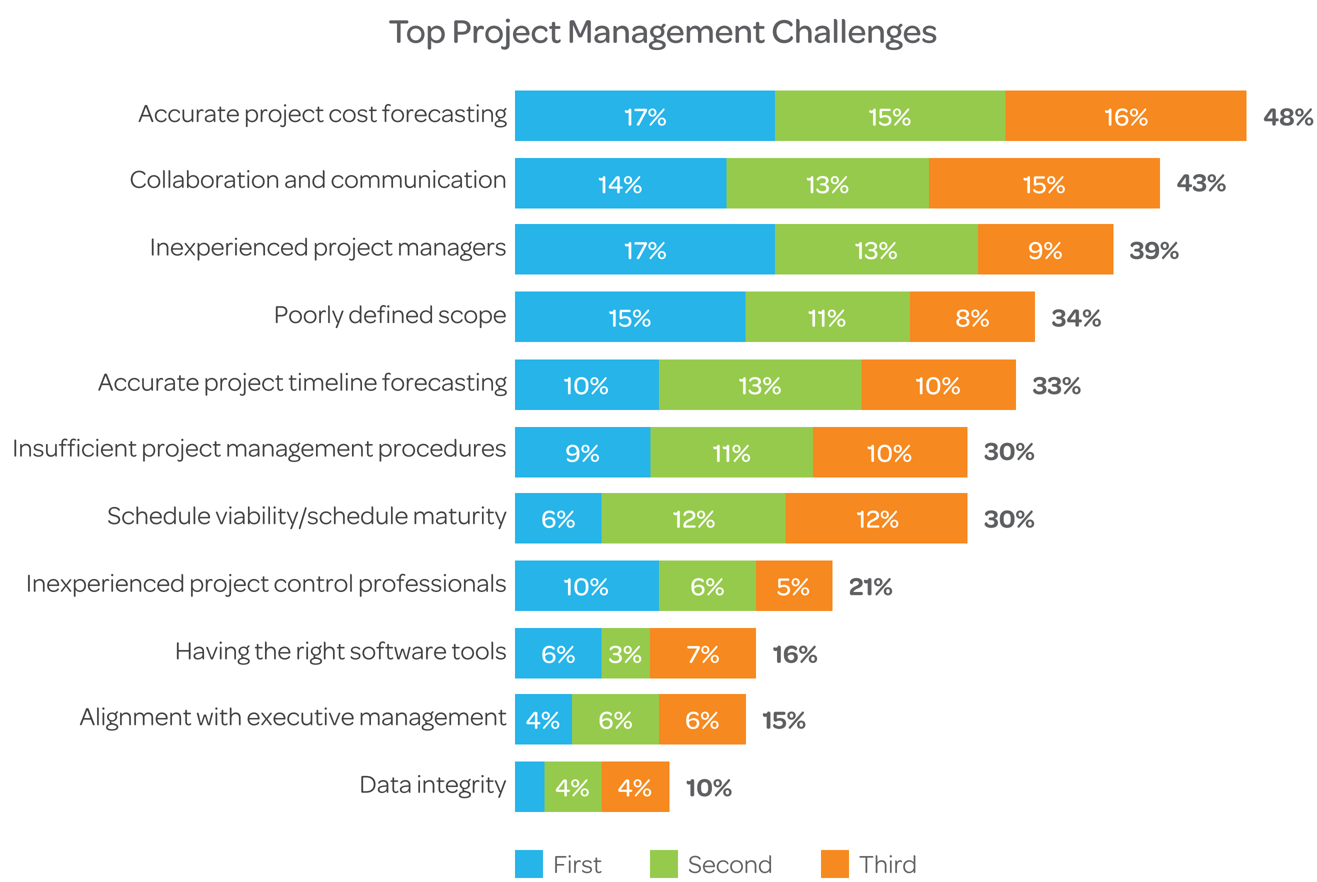


Top Project Management Challenges

Responses to 2019's survey reveal a number of challenges related to project management. The ability to "accurately project cost," is the top concern noted (48%), with "inexperienced project managers," the third highest concern (39%).

"Inexperienced project managers," is a top concern of both government contractors and the contracting officers they serve. The ability to meet project milestones will determine the pace at which a contractor receives payments and qualifies for incentives. Once a project is off track, it is difficult to recover. As a result, companies may experience damage to their reputation and impair their future prospects for winning new contracts.

Approximately a third of respondents viewed "scope definition," "accurate timeline forecasting," and "insufficient project management procedures," as concerning. Sixteen percent (16%) are concerned by the "software tools available," and when combined with inexperienced project managers, this increases the chances of projects falling behind schedule and finishing over budget.

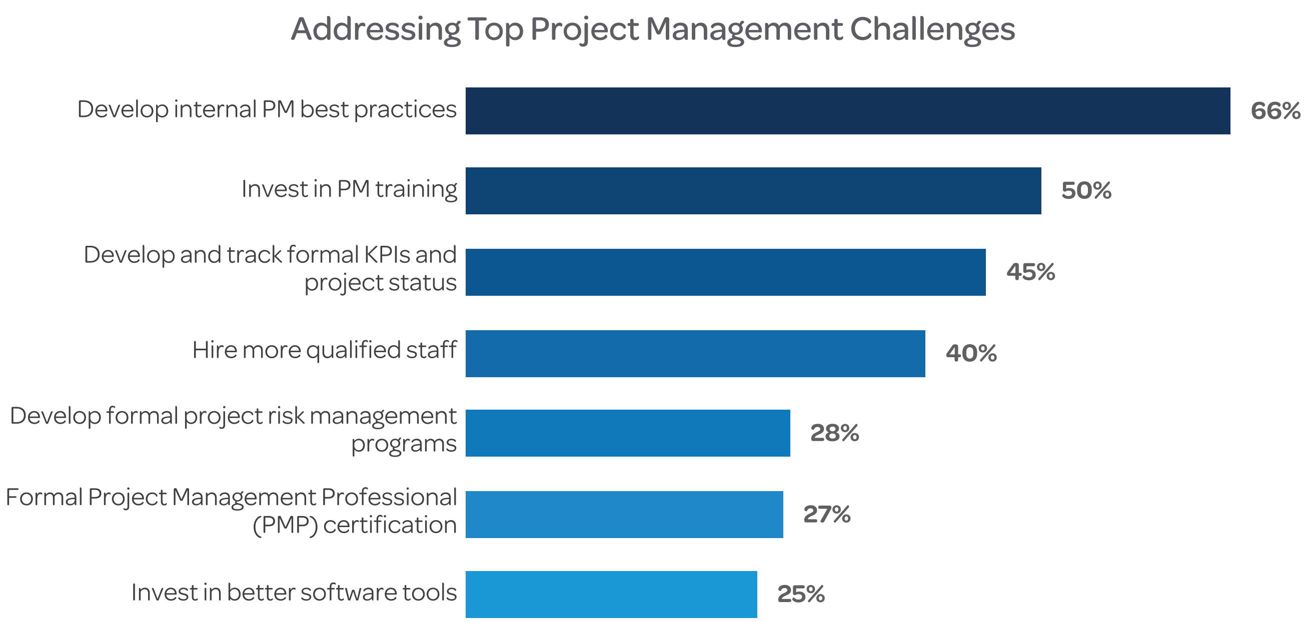


Addressing Top Project Management Challenges

Fifty percent (50%) of respondents in this year's Study indicated the need to "invest in project manager training," while 40% called out "hiring of more qualified staff." In addition to investments in these areas, it will be critical to "develop formal risk management programs," (28%) and "develop and track formal KPIs (key performance indicators) and project status" (45%).

The talent shortage noted in other sections of this Study affects project delivery as well. Employees in key functions, such as scheduling and estimating, may also be new to their roles and lack the training and experience to effectively execute their responsibilities.

It is important that government contractors address these challenges. Working to retain experienced project managers, while making the effort to develop high-potential hires. Companies need to invest in training and, when possible, offer mentoring programs to pass along the skills and knowledge they need to succeed in their roles.

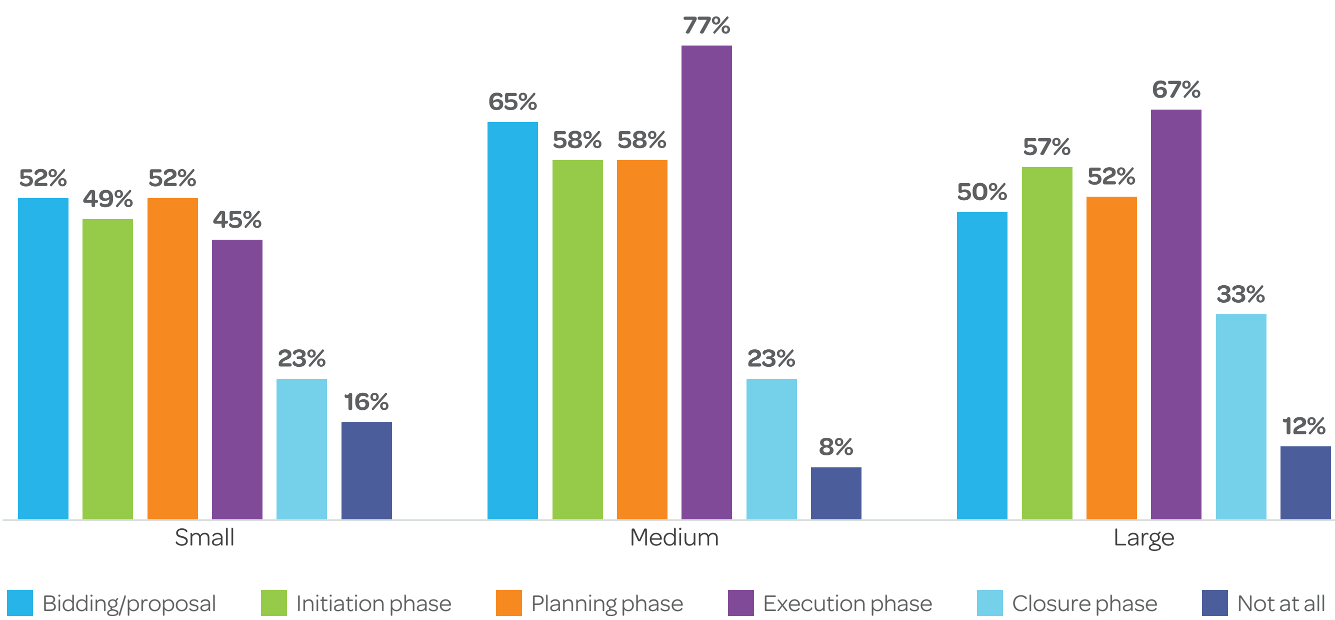


Timing of Schedule Risk Analysis

Information regarding the timing of schedule risk analysis in 2019 is largely consistent across business sizes. Respondents indicated that schedule risk analysis occurs throughout the lifecycle of the project. Not surprisingly, the majority of activity occurs during the bidding/proposal and execution phases of projects and continues through project closure. Sixteen percent (16%) of small businesses are not performing schedule risk analysis at all, failing to execute this important task completely.

Schedule risk analysis should be performed continuously over the lifecycle of a project. Occasional or intermittent analysis may miss problems that could be identified and quickly addressed to avoid potential execution difficulties before it is too late to course correct.

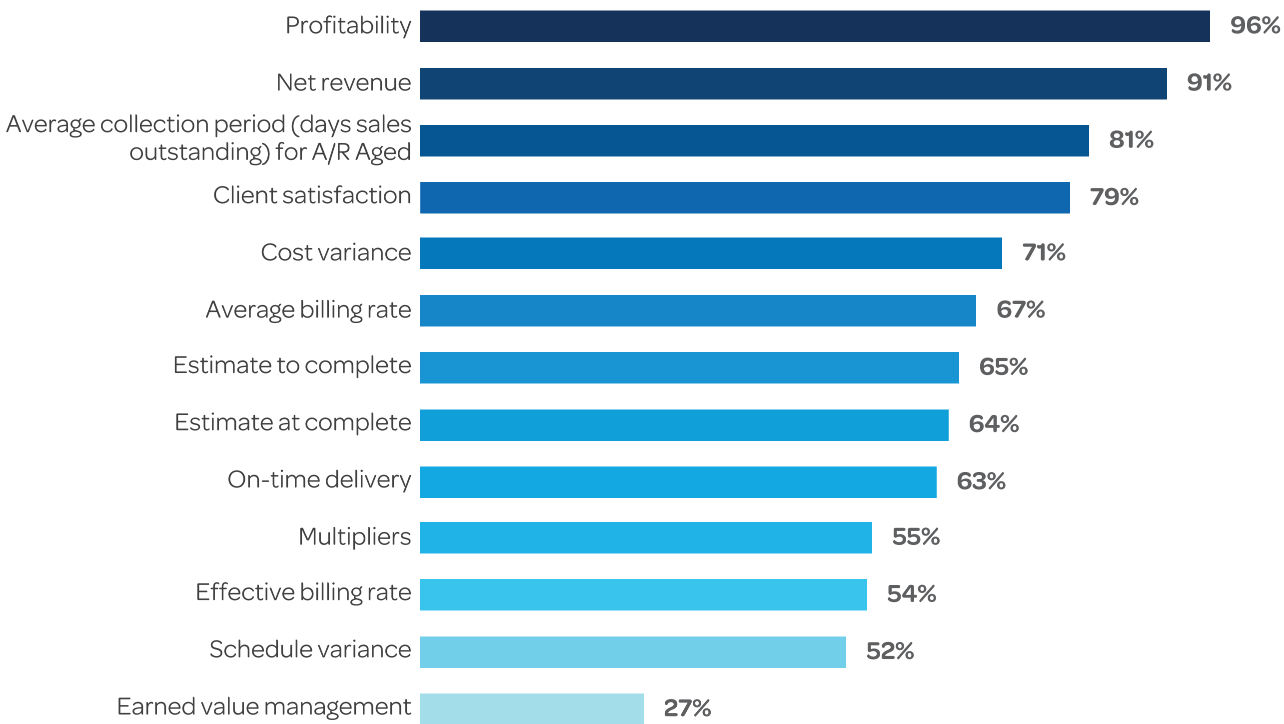
When Organizations Perform Schedule Risk Analysis



Project Management KPIs

"Project profitability," and "net project revenue," continue as top KPIs in the project management space, with more than 90% of companies tracking them. Many also track the average collection period for aged accounts receivable (81%) to ensure a high degree of visibility to outstanding receivables. The importance of "customer satisfaction," (79%) on performance is apparent, as it is also a top metric tracked by project management teams. Not surprisingly, large companies are more likely tracking earned value management (EVM) metrics (43%), while overall EVM is more sparingly used (27%).

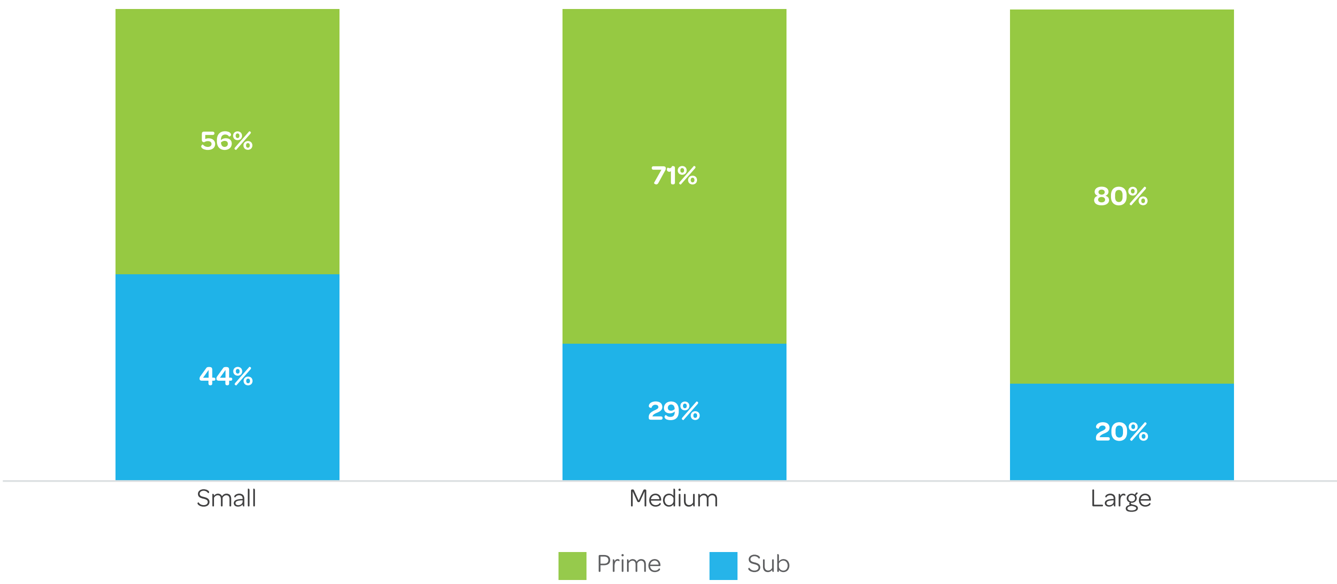
Project and Risk Management KPIs Tracked



Prime Versus Subcontracts

Despite the indication in 2019 from large businesses that the mix in their positions as prime and subcontractor have shifted (80% prime versus 62% year-over-year), the overall split was largely flat. The observed shift toward prime status in large businesses is likely due to consolidation either in companies or contracts. Mergers and acquisitions activity may be providing these businesses greater access to prime contract vehicle positions than seen previously.

Prime Versus Subcontracts



CLARITY OUTLOOK

Project and Risk Management

Developing project managers into project leaders requires established, consistent best practices and specialized tools for proactive project and risk management. It appears that businesses are moving in this direction but should accelerate efforts to ensure project timelines are met, costs are controlled and customers are satisfied.

A strong project manager needs to be able to understand all aspects of project planning and delivery, including, but not limited to, people management, business acumen and anticipating and overcoming project risk. Companies can support project managers by standardizing best practices and metrics around cost, schedule and risk.

It appears that many companies are not appropriately prioritizing the use of specialized tools to help project managers assess risk or manage schedules, which could result in cost and schedule overruns. Tools that help support consistent best practices and metrics across projects and programs ensure better schedules, cost management and project delivery.

SECTION FOUR

Human Capital Management

Finding, recruiting and retaining qualified talent continues to challenge the government contracting sector. Talent shortages and commercial competition for candidates have complicated matters for human capital management leaders.

The struggle to offer competitive compensation packages that would secure the highly specialized employees needed to staff projects continued to stand out as a top challenge. Lastly, while the labor market has favored candidates, both passive and active, for the last several years, the talent market may shift in favor of the employer for some types of roles in the short term.

The number one challenge for human resources, as identified in this survey, is "retaining top talent." Companies are attempting to address this by "offering more formal career development programs," and "overhauling reward and recognition approaches," over the next 12 months. It will be important for companies to maintain critical staff levels in key roles during this period of uncertainty in order to scale when the economy eventually begins to reset.

73%

struggle to find qualified talent

40%

concerned about effective performance management

Key Takeaways

Despite stated recruiting and retention challenges, companies of all sizes grew headcount during 2019. Small businesses showed the greatest growth at 20%. With 70% of all companies anticipating continued growth in sales in 2020, an increase in hiring needs is expected to follow.

Government contractors are beginning to recognize the effects that enhanced reward/recognition programs and formal development plans can have on their workforce.

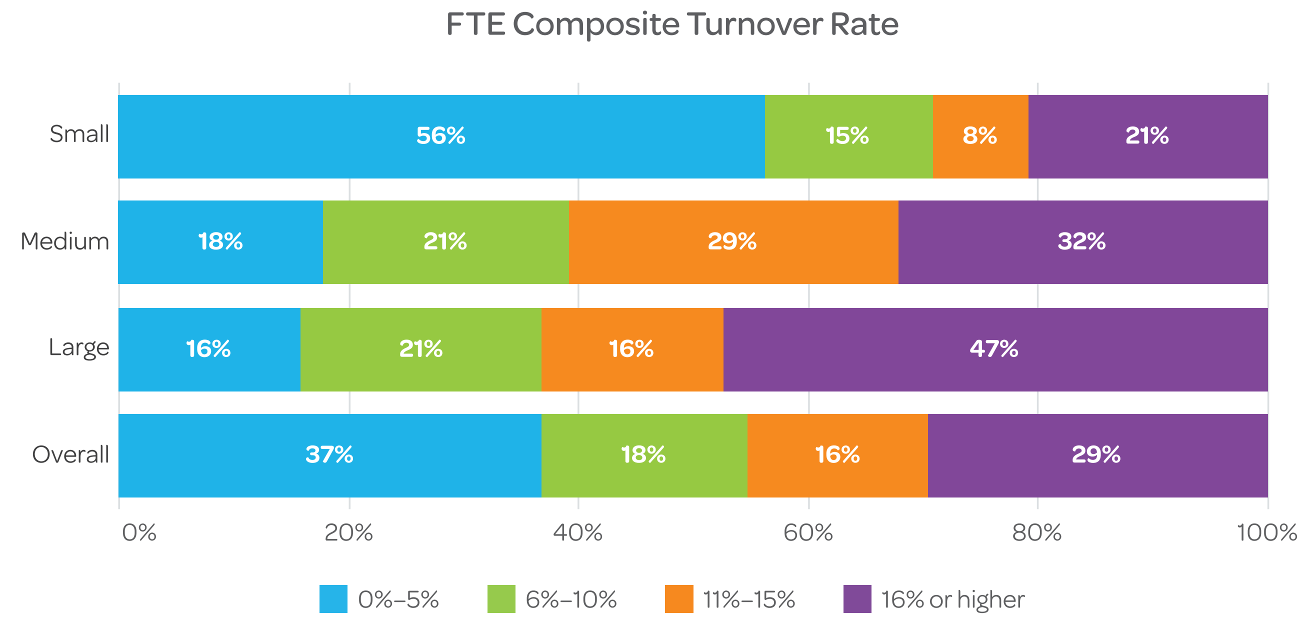
High turnover rates are affecting all companies, but 47% of large businesses are experiencing 16% or higher turnover. High turnover can have a negative impact on all aspects of operations, from cost containment to customer satisfaction and project profitability.

The cost of replacing trained employees and the lag time before new employees can be assigned to billable work has a significant impact on cost and utilization.

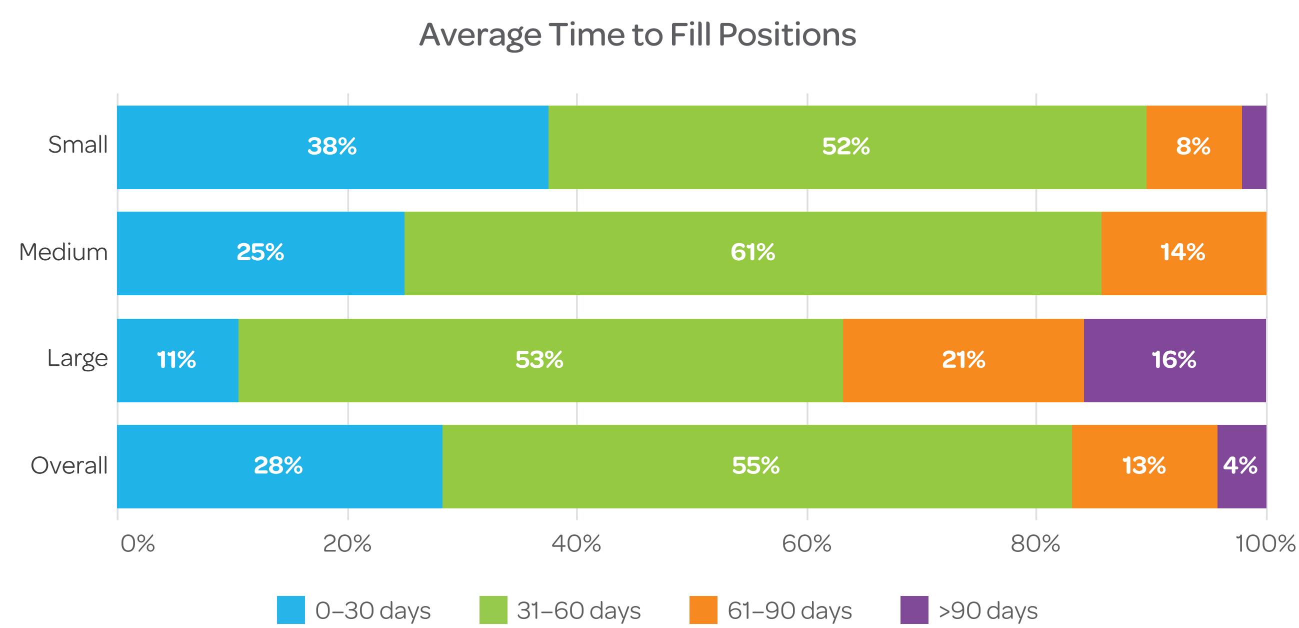
Some turnover may be due to employees following contracts as work moves from one organization to another. In addition, contracts may be shifting to prime status, causing shrinkage in the workforce attached to the contract. Other factors include continued generational turnover as older workers leave the workforce, and highly-specialized employees are being passively recruited by competing companies in both the commercial and government contracting sectors.

Turnover, Retention and Time to Fill Positions

Full-time equivalent (FTE) turnover rates are a problem for employers of all sizes. The composite turnover rate grew, with more companies reporting high turnover rates (16% or higher). This is a considerable jump from the previous year and may be contributing to the increase in overhead rates. Overall, the retention rate has decreased to 81% versus 84% year-over-year. All sizes of companies experienced declines. Some possible reasons are that 79% of companies responding do not have a formal career development plan in place, and average annual training dollars have decreased by 46% year-over-year.



The average time to fill positions remained relatively constant year-over-year. The number of open positions and the time it takes for a new employee to become billable translates to unrecoverable expenditures. Long and ineffective hiring processes producing low-quality hires are more costly than many companies realize.

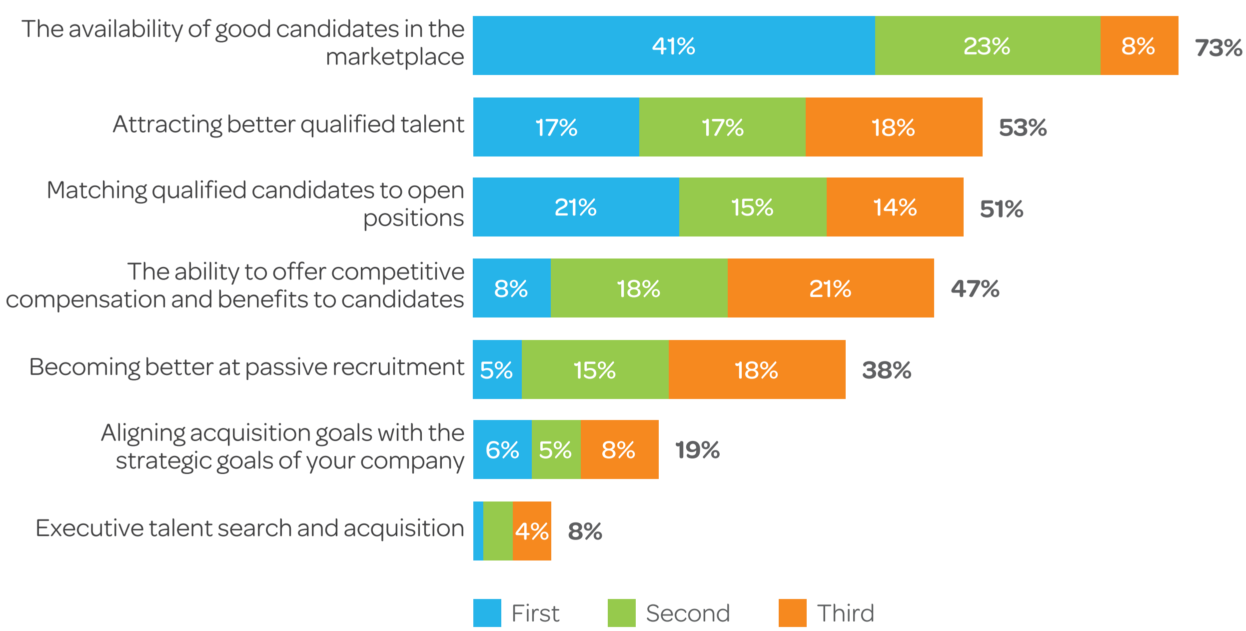


Top Talent Acquisition Challenges

The top challenge cited in this year's Study is "the availability of good candidates in the marketplace," (73%). The second and third top challenges are "attracting better qualified talent," (53%) and "matching qualified candidates to open positions," (51% versus 41% year-over-year). The difficulty of matching candidates is often due to the need for an exact qualifications match under a contract. In order to better find and attract qualified talent, companies may have to cast a wider net and be more flexible in terms of location and remote working arrangements wherever possible. An experienced workforce is critical for staffing projects in an industry with strict compliance and regulatory rules.

Another key challenge is "the ability to offer competitive compensation and benefits to candidates," noted by 47% of respondents. In a strong talent market, candidates have less reason to accept below-market compensation when compared to similar roles in the commercial market. It is also important for government contractors to regularly review compensation packages to ensure they are attractive to the younger qualified workers that typically prefer more modern and updated work arrangements and benefits.

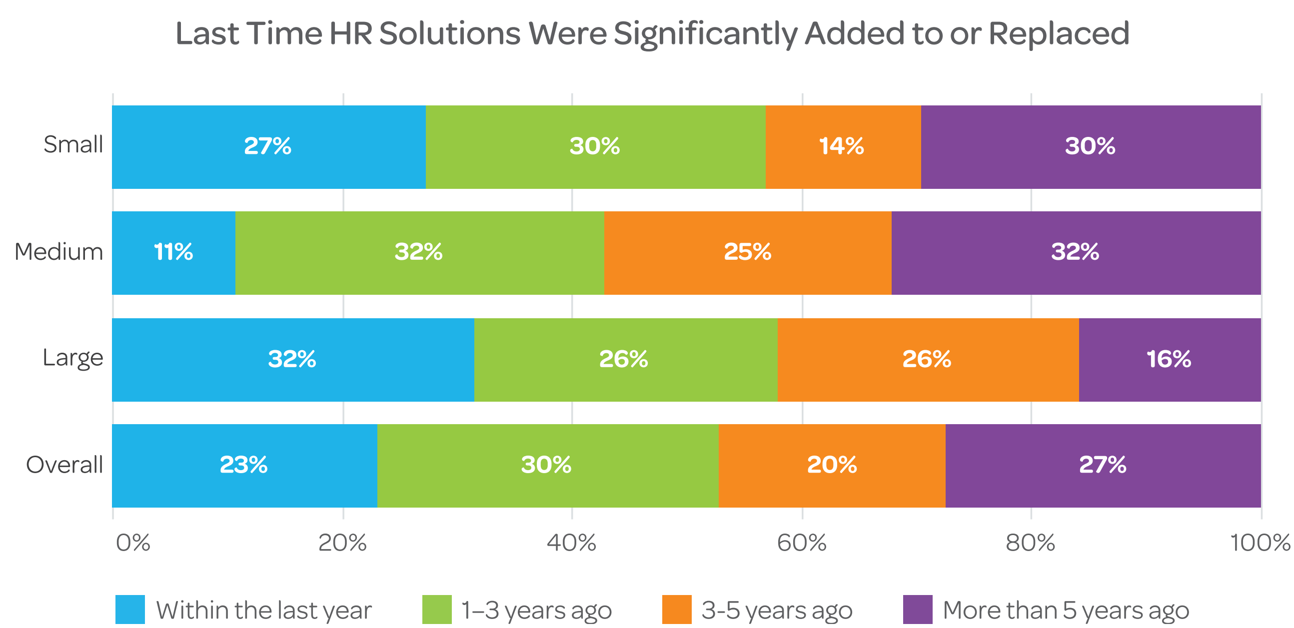
Top Talent Acquisition Challenges



Addressing Top Talent Acquisition Challenges

Companies are increasingly relying on "outsourcing for recruitment," (36%), which is an expensive solution to a potentially broader problem. Thirty-five percent (35%) of respondents are "increasing incentives for employee referrals," while 30% are "rebranding to attract better qualified talent." Large businesses in particular have been working to rebrand by reinventing themselves with a focus on innovation in an attempt to mirror technology companies who are perceived by young workers as more attractive. Small and medium-sized companies have an opportunity to move more quickly in this area because their hiring practices tend to be more streamlined, however, we are not yet seeing a marked shift in this area.

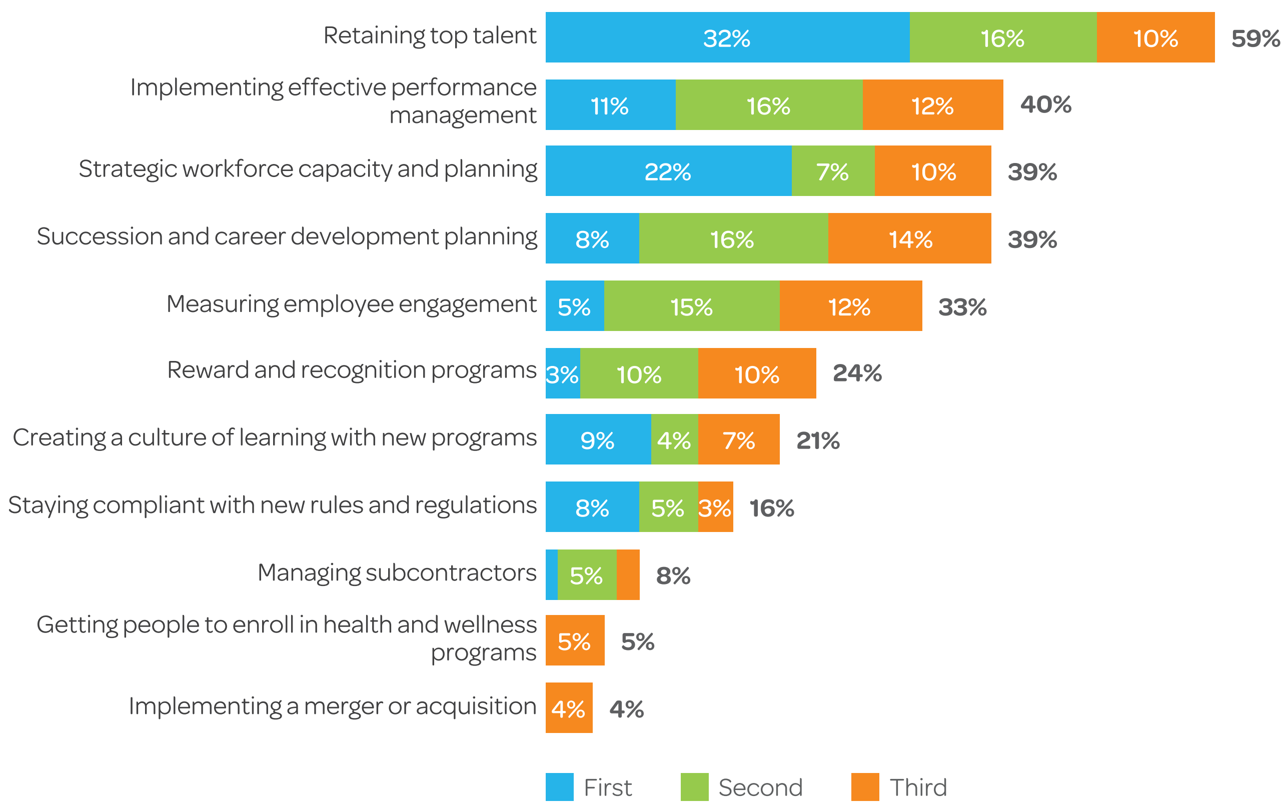
In general, companies should evaluate increasing their investments in human capital management, including training and tools, to drive continuous performance improvement.



Top Human Resources Management Challenges

The most cited challenges for human resources (HR) management were “retaining top talent,” (59%), “implementing effective performance management,” (40%), and “strategic workforce capacity and planning,” (39%). The next five concerns are geared toward retention and workforce excellence, such as “succession and career development planning,” (39%) and “measuring employee engagement,” (33%).

Top HR Management Challenges

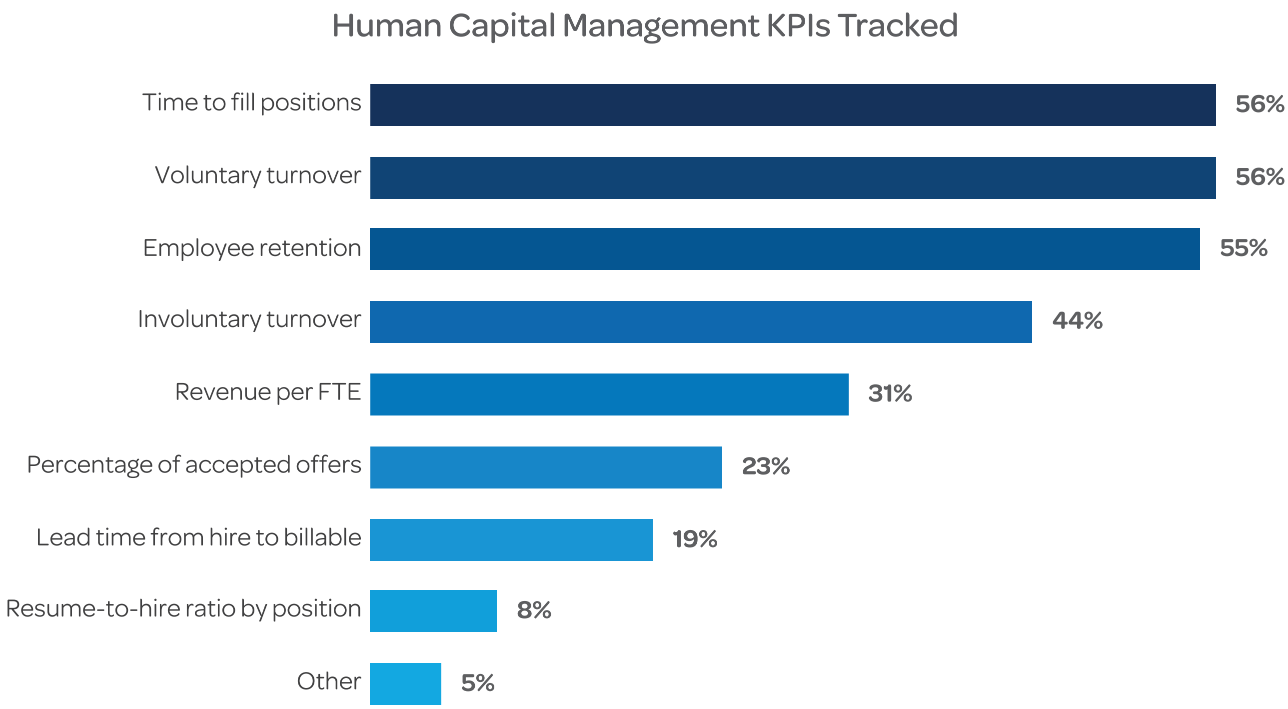


Addressing Top Human Resources Management Challenges

With retention of top talent as the top reported HR management challenge, companies are addressing it by aiming to create and implement programs to improve employee engagement and involvement. With highly skilled talent in high demand, companies need to raise their investments in human capital management to stem the tide of turnover, and lean into a greater focus on employee satisfaction and rewards/recognition.

Tracking Human Capital Management Metrics

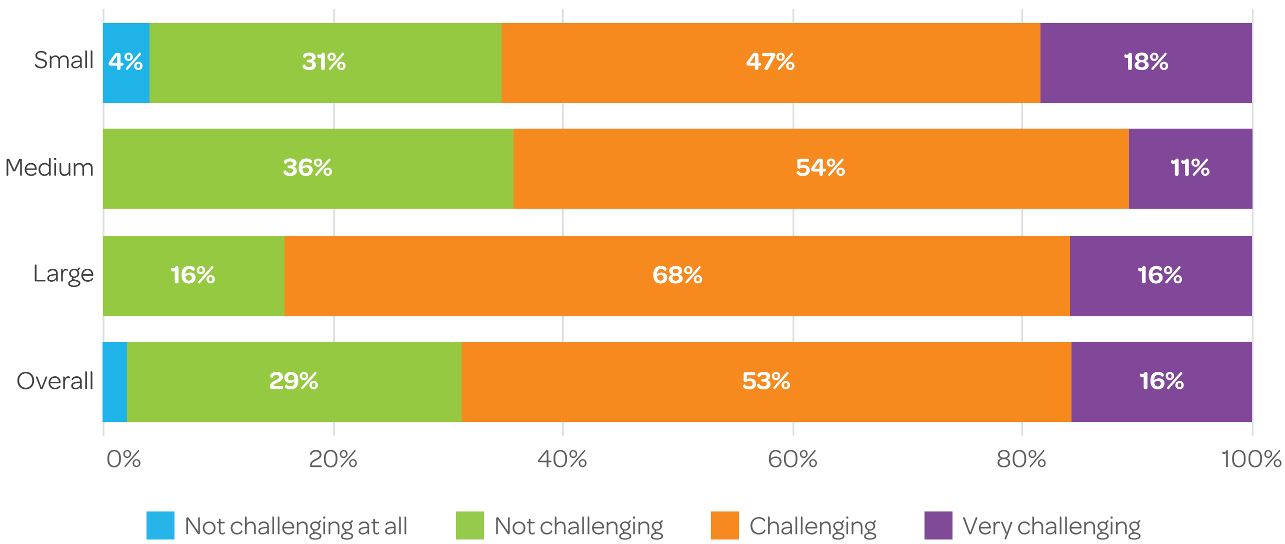
Companies continue to track human capital management metrics like, "time to fill positions," "voluntary turnover," and "employee retention." While these top three KPIs are important, there are many other metrics around engagement, retention and acquisition that would help HR professionals assess the success of talent strategies. For example, understanding the "offer acceptance rate," and "lead time to billable," metrics would help companies assess hiring and onboarding practices.



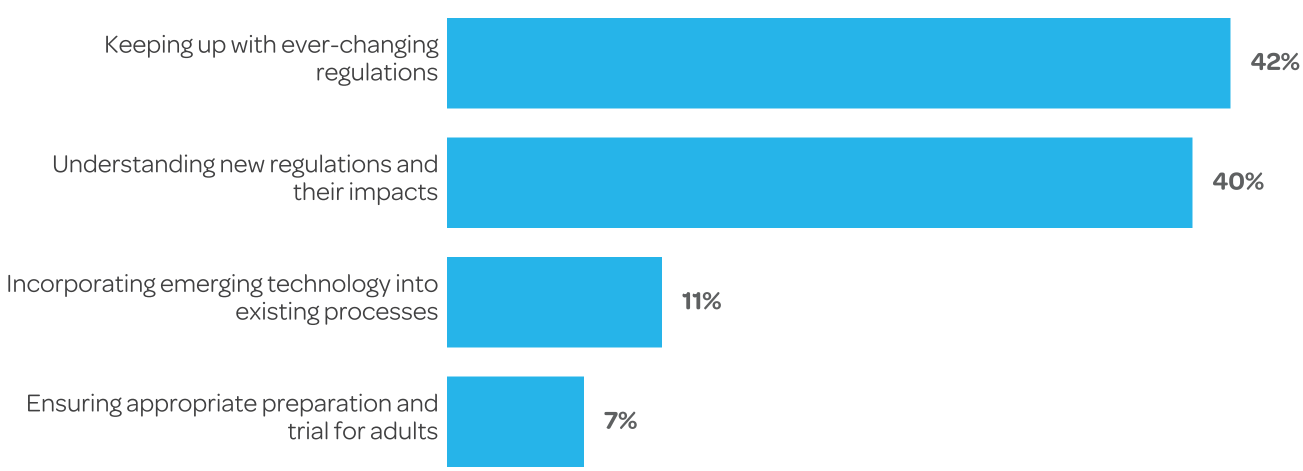
Changing Human Resources Compliance Issues

Companies of all sizes reported in 2019 that staying on top of HR compliance is challenging or very challenging. Respondents are also concerned with "keeping up with ever-changing regulations," (42%) and "understanding new regulations and their impacts," (40%). Existing and new regulations rolled out to government contractors require HR teams to increase documentation about staff and qualifications. Producing reports and documentation to satisfy audit requests continues to challenge many organizations. Adequate tracking and reporting continue to be a hindrance for HR professionals using outdated or generic solutions.

Staying on Top of Changing HR Compliance Issues



Greatest Concern about HR Compliance



CLARITY OUTLOOK

Human Capital Management

The struggle to find, attract and retain the best and brightest will require companies to rethink and revamp employer branding, compensation packages and training and development opportunities.

Understanding what drives younger workers and adapting to the changing workforce demands will be essential. The market has been a candidate's market for several years as companies focused on growth. Current economic activity may well shift that balance in greater favor of the employer, but highly specialized talent will likely remain difficult to secure. However, the stability of the government contracting sector during this time of uncertainty may become more attractive to passive candidates in competing industries.

SECTION FIVE

Contract Management and Procurement

Contract management and procurement are essential components in delivering value to the government. At present, few have deployed available tools, resources and people needed to deliver against potential value.

The level of complexity is significant and the cost of getting it wrong is high, yet headcount and tools are not highly prioritized. The average number of full-time equivalent employees in both contract management and procurement is limited, even in larger companies. In many companies, teams do double duty managing both functions. The results show that companies are not adequately set up to manage documentation and information across programs.

26%

use contracts management software

63%

reported a desire to make procurement more strategic

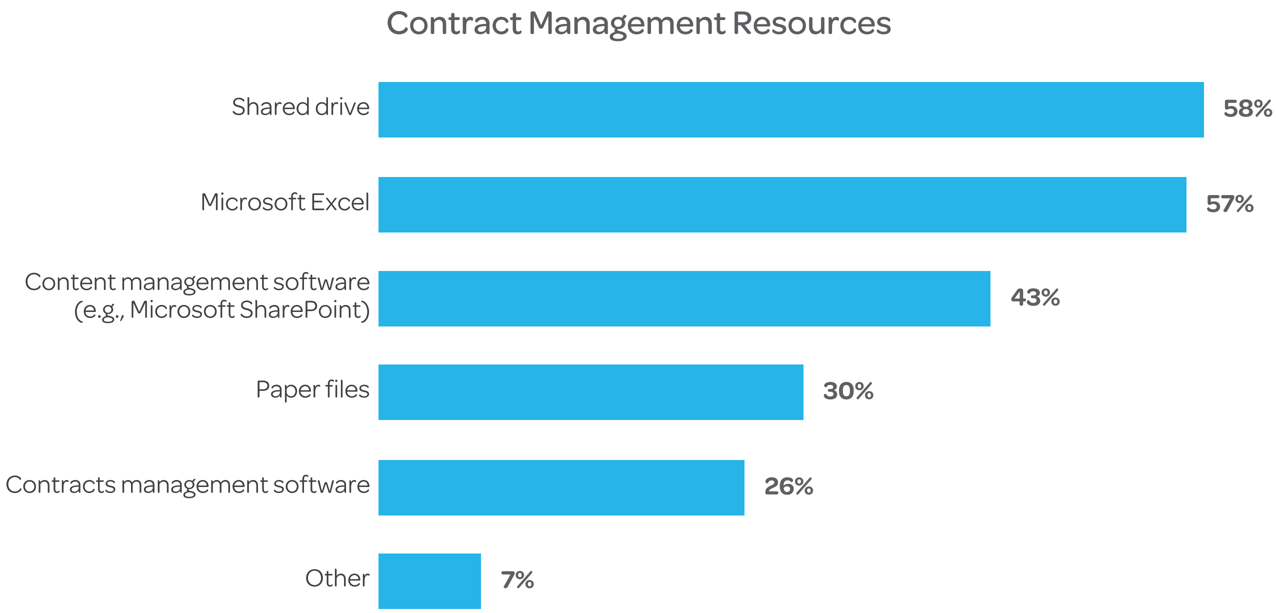
Key Takeaways

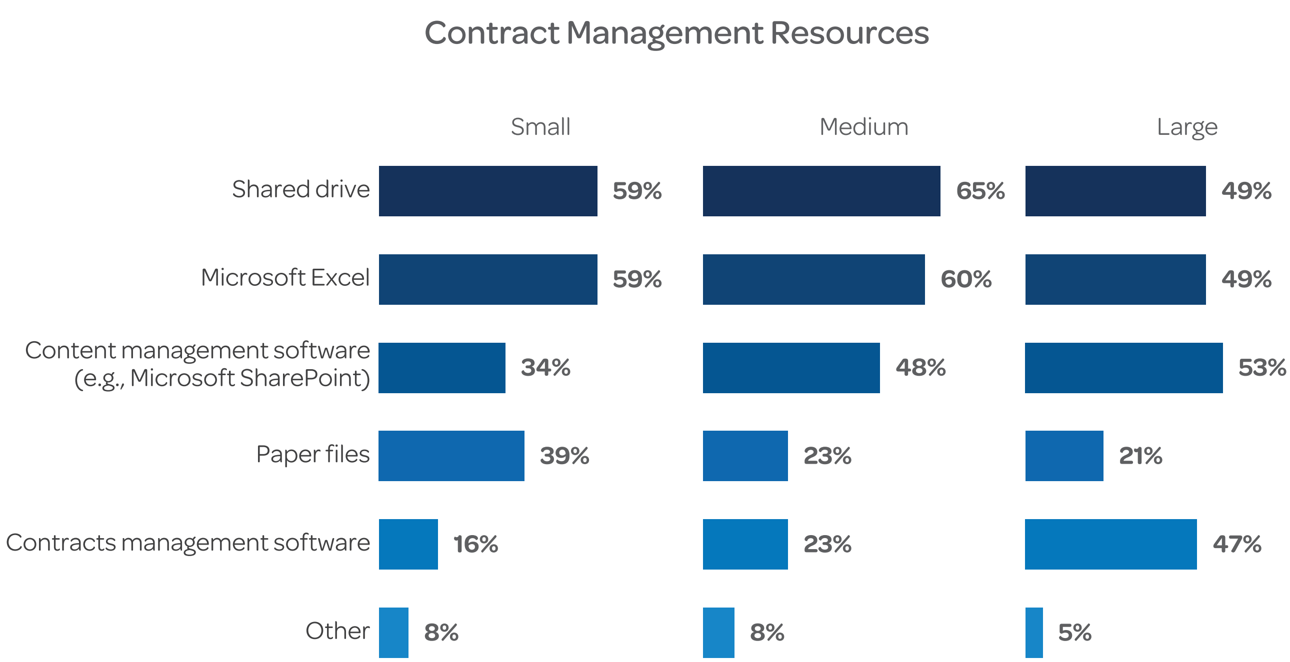
Small and medium-sized businesses may not be fully optimizing contract management and procurement functions. Less than half (43%) of businesses use “content management software,” and only 26% use “contracts management software.” Outdated software and tools may limit the ability to analyze operations, integrate with other corporate functions, and reduce hands-on processes. In companies of all sizes, staff may be stretched to fulfill required tasks rather than think strategically. The many tools available to manage costs and efficiencies offer a pathway to more strategic contributions from these disciplines. Procurement should place greater emphasis on finding solutions to business problems to gain competitive advantage over companies that fail to do so.

Contract Management Resources

Shared drives and spreadsheet solutions like Microsoft Excel are the most widely used tools for managing contracts. Lack of resources and bandwidth are key reasons that companies often fail to track vendor performance and other KPIs that would drive continuous improvement. Companies should consider potential new solutions that solve problems across the business.

A large percentage of small businesses (39%) are heavily reliant on paper files. Even large businesses (21%) combine paper files with other methods, primarily spreadsheets and shared drives. Digitization and upgrading software capabilities and systems are crucial in an era where business continuity can be threatened by unforeseen events.



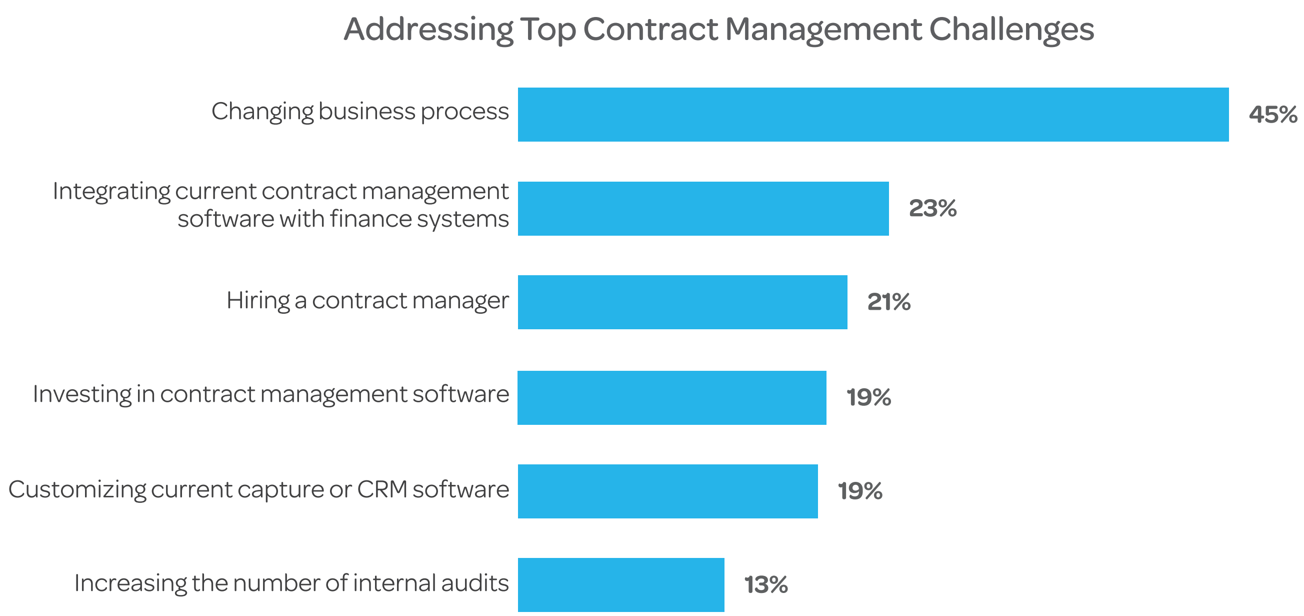


Top Contract Management Challenges

"Maintaining data integrity between opportunity, contract and project records," was the top reported challenge (47%). "Tracking non-financial aspects of contracts," was ranked second (45%), and "time required entering information into systems," was ranked third (37%). Nearly all of the reported challenges by respondents are related to data systems and capabilities.

Addressing Top Contract Management Challenges

Respondents indicated a strong preference (45% versus 23%) for "changing business processes," over "integrating current contract management software with finance systems." However, 19% of respondents cited both "investing in contract management software," and "customizing their current or CRM software," as options to consider. In addition, 21% cite "hiring a contract manager," as a priority, as companies try to adapt to and address new challenges. This shows an increasing need for companies to look for efficiencies in their processes and secondly, assess tools designed to meet the unique complexity needs within this sector.

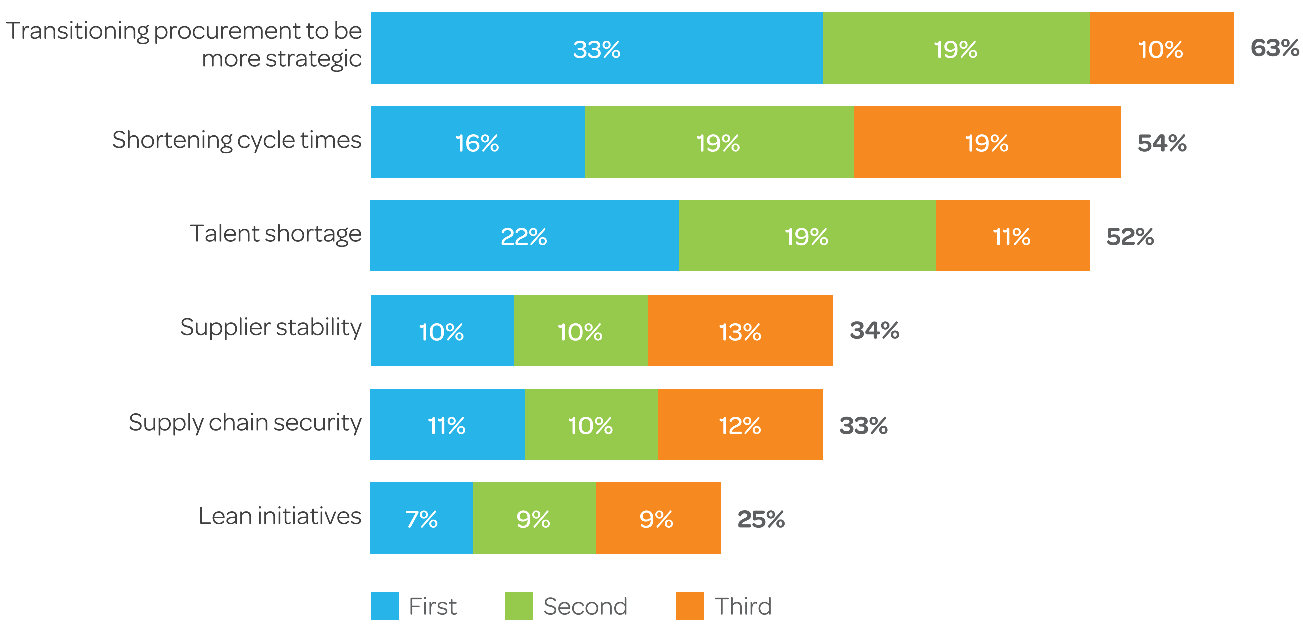


Top Procurement Challenges

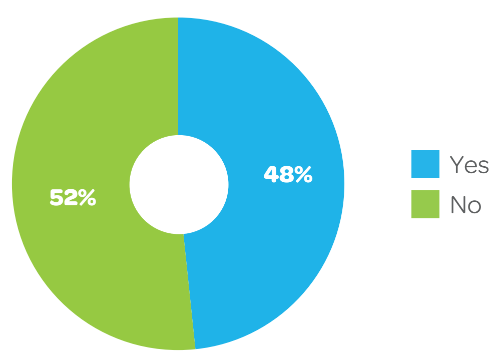
The need for a "more strategic procurement function," is recognized by 63% of respondents, followed by "shortening procurement cycles," at 54%. The third priority is "talent shortage," (52%), reflecting issues seen across all sections of this Study. A transition away from a task-oriented function to a more strategic role will allow procurement staff to deliver the greatest value to their customers at the best possible cost.

Approximately half (48%) of companies have combined contract management and procurement departments. Separation of these functions could allow greater concentration of resources and improve specialized focus on two very important functions.

Top Challenges Procurement Will Face in Next 12 Months



Procurement Team Also Manages Contracts

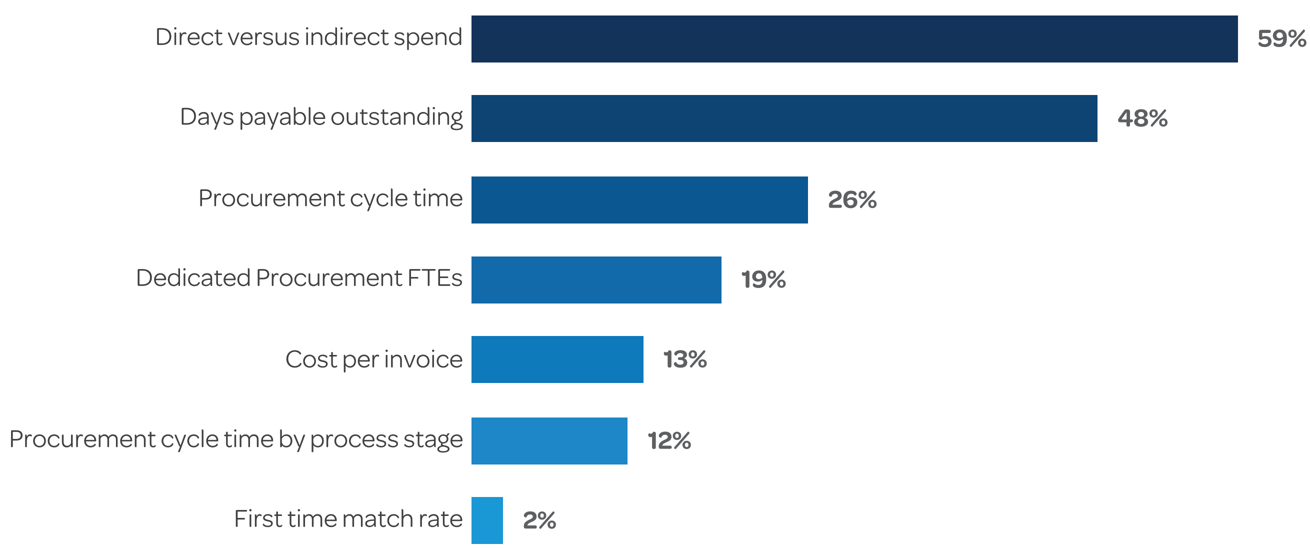


Tracking Procurement Key Performance Indicators

The most widely tracked KPIs in procurement are "direct versus indirect spend," (59%) and "days payable outstanding," (48%). Other key indicators include "procurement cycle time," "cost per invoice," and "dedicated procurement FTEs."

A company's ability to quickly match invoices to purchase orders has a corresponding impact on the billing cycle. Effective procurement functions use technology to speed up matching and billing, and improve cash flow. Alternatively, the rise in days sales outstanding may be due in part to increased billing time and is a trend to watch closely. Continued increases in these metrics may lead to reduced cash flow.

Procurement KPIs Tracked



CLARITY OUTLOOK

Contract Management and Procurement

Contract management needs to focus on process efficiencies and consider specialized tools to help manage contracts and documentation. Procurement departments should be working in lockstep with their finance teams to ensure accurate cost allocations and timely billing.

The demands within small and medium-sized companies on contract management and procurement staff are complex and growing. As these two disciplines are difficult to optimize with shared resources, however, many companies are constrained by this limitation. The requirements to track numerous metrics, control the buying process with a diverse number of suppliers, and keep processes moving on time are stretching capabilities.

Companies should examine whether combined staffs are the best approach to support the creation of a more strategic role. They also should consider greater investments in staffing and tools that can free people to concentrate more on strategic initiatives. Training should be provided to maximize the value of data and its reach across the business. Companies that make these investments will benefit measurably.

SECTION SIX

Information Technology (IT)

IT's leading objective continued to be data security in 2019. A strong focus on compliance combined with ever-increasing government regulations heightened IT challenges. Extracting value from big data to improve operational effectiveness.

The success and growth of many government contractors is significantly influenced by a company's ability to recruit, train and retain high-quality skilled IT professionals. There is intense competition for skilled and cleared talent, particularly among certain sectors of the industry.

Companies continue to prioritize investment in new IT infrastructure and are focused on tools that increase the efficiency and effectiveness of the organization. Migration to the cloud continues to gain momentum, with half of responding companies planning to increase their on-premises to cloud movement within the next 12 months. Business continuity should be a key consideration with new infrastructure, particularly as current events have demonstrated the crucial importance of remote working.

64%

cited IT and data security as a top challenge

57%

are concerned about meeting regulatory requirements

53%

plan to move on-premises solutions to the cloud

Key Takeways

The ability to mine big data is understood as a means to improve operations and project execution. Artificial intelligence and machine learning are important areas of focus to achieve this goal. The increased use of data implies a potential opportunity to connect all aspects of the project lifecycle to allow leaders to make critical business decisions.

Security regulations coming from the government, like Cybersecurity Maturity Model Certification (CMMC), National Institute of Standards & Technology (NIST) mandates and International Traffic in Arms Regulation (ITAR) requirements are making a new level of IT maturity necessary. The onus will be placed on government contractors to adhere to changing standards in security requirements. Small businesses need to pay close attention to compliance if they wish to avoid being left out of bidding opportunities.

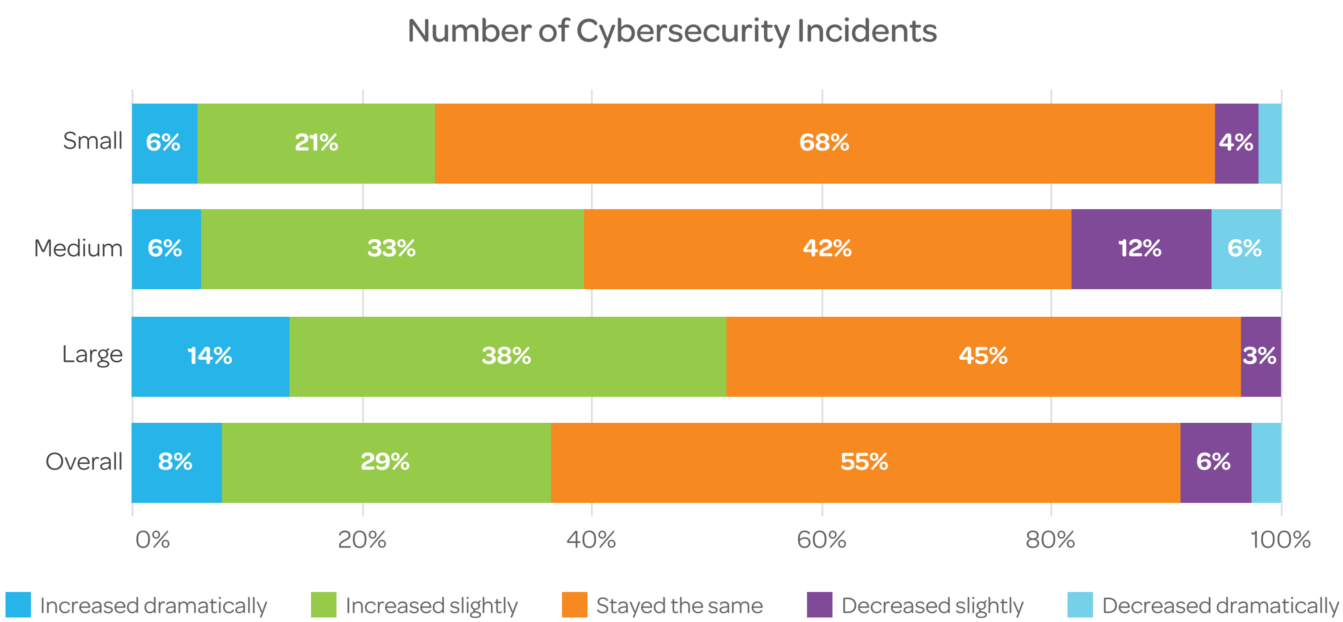
Businesses are prioritizing IT investments in "security and authentication," as well as "finance and accounting," applications as part of their efforts to mitigate security breaches. Overall, cybersecurity incidents remained level year-over-year, with technology viruses remaining the top security challenge.

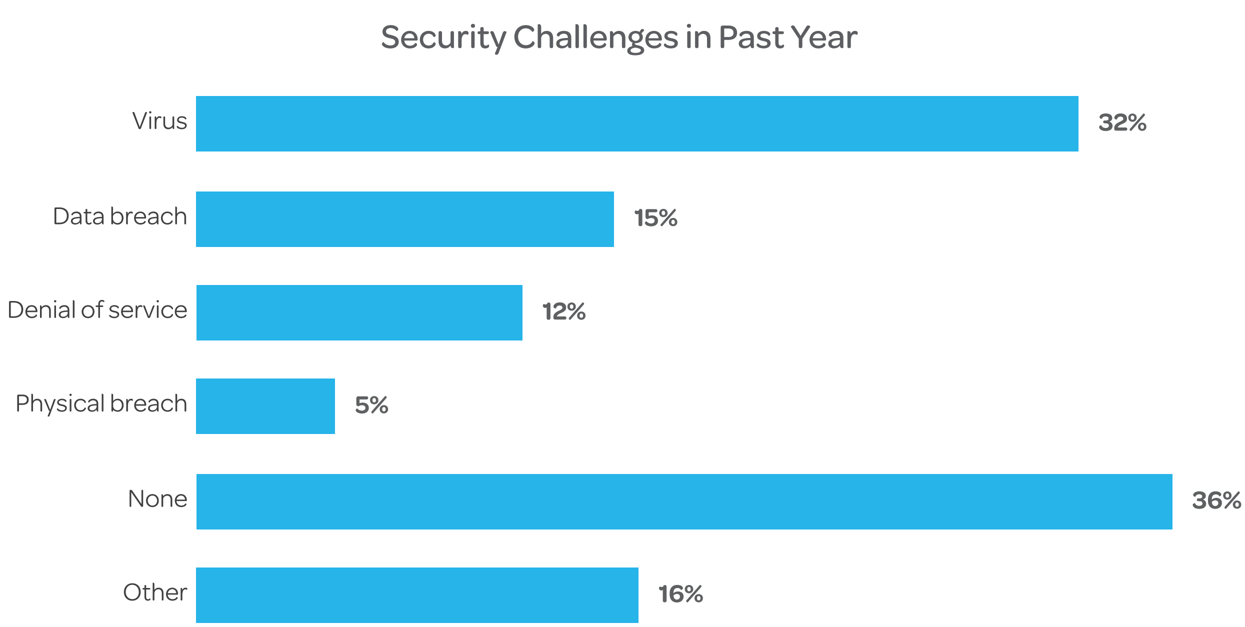
Number and Nature of Cybersecurity Incidents

Overall, the percentage of businesses experiencing an increase in cybersecurity incidents remained consistent year-over-year. Large businesses saw the highest level of increase, which likely is because they are bigger and more attractive targets for cyber threats.

Technology viruses are the leading problem among those companies that have a security challenge (32%). There has been a significant decrease in data breaches (15% versus 20% year-over-year) most likely due to improved security protocols and procedures. "Denial of service," or ransomware attacks, have also decreased as companies better prepare and back up their systems.

Thirty-six percent (36%) of companies cited "no security challenges," in the past year. Companies are urged to review their security procedures and check for incursions regularly. Malware and other problems are often present for long periods before they are activated or discovered.

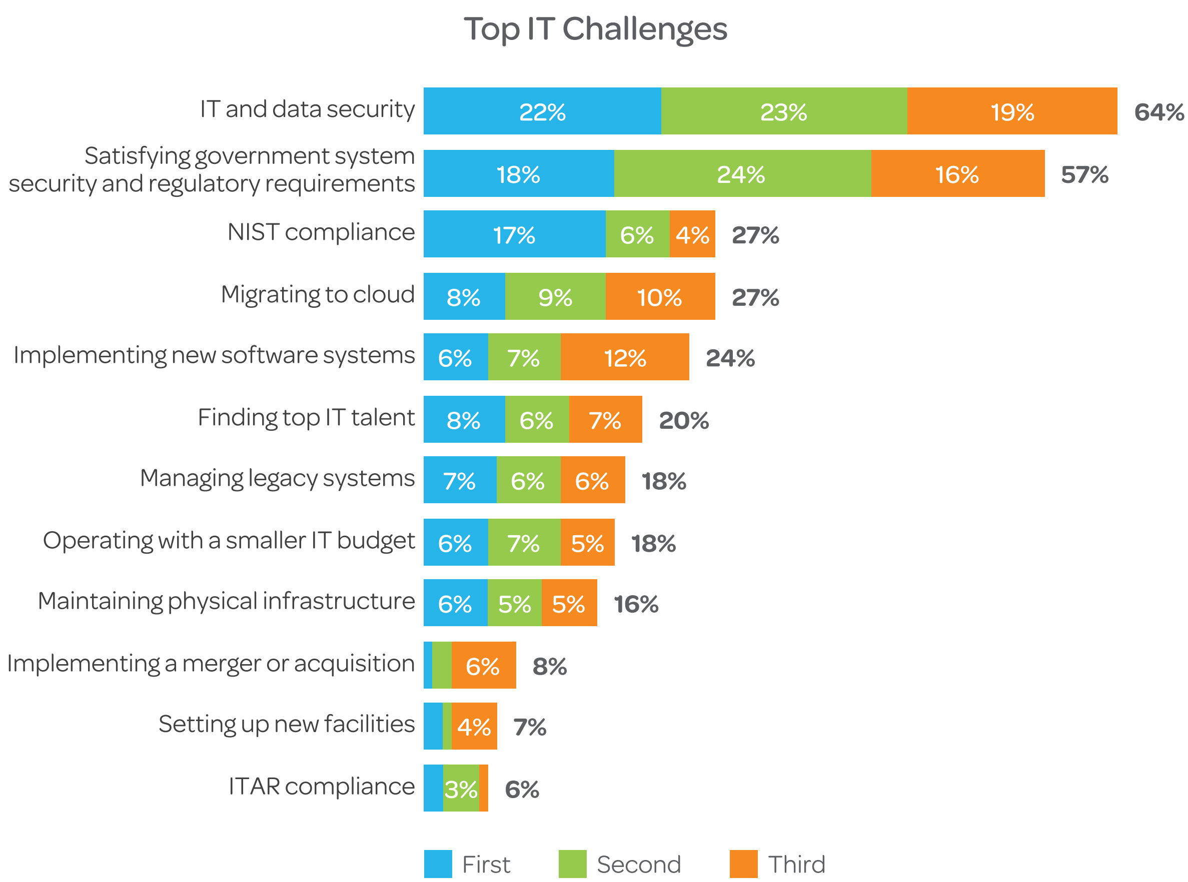




Top IT Challenges

Among the numerous IT challenges facing government contractors, "IT and data security," are cited most (64%) as the top concern. This level of attention is certainly warranted in view of the necessity to protect operations and data and to maintain a level of security acceptable to customers.

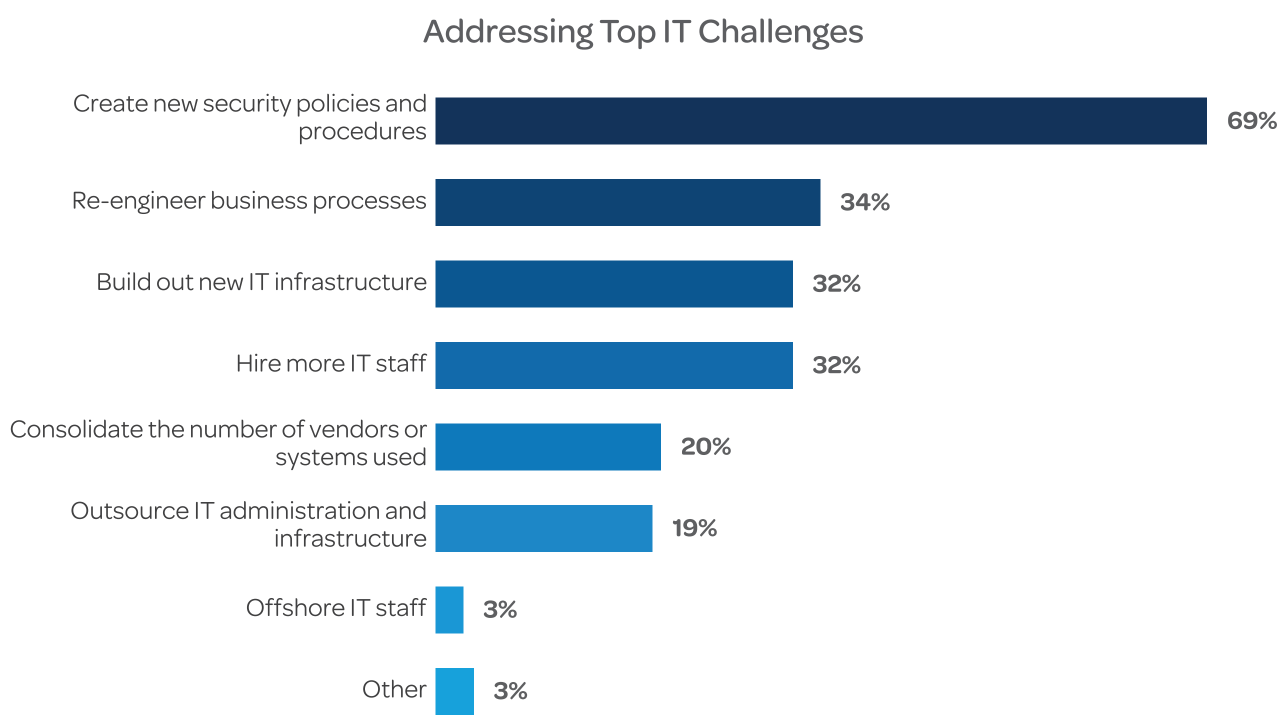
"Satisfying government system security and regulatory requirements," is a strong second area of concern that has jumped twenty percentage points over the past year from 37% to 57%. Following closely is "NIST compliance," a high priority at 27%. Changes are coming on top of existing requirements, most notably CMMC, that will increase the complexity and challenge of compliance with regard to some contracts. Companies should evaluate whether their existing IT systems, software and staff are ready for increased regulatory oversight.



Addressing Top IT Challenges

Survey responses once again highlight the importance of IT talent, which is crucial to achieving the improvements sought by leaders. Thirty-two percent (32%) of respondents in this year's Study view adding staff as a priority, compared with 23% the previous year.

Sixty-nine percent (69%) of the Study's base cited "create new security policies and procedures," compared with 59% last year, as their top priority. "Re-engineering business processes," and "building out new IT infrastructure," were second and third in terms of priority. None of these can be achieved without adequate IT leadership.

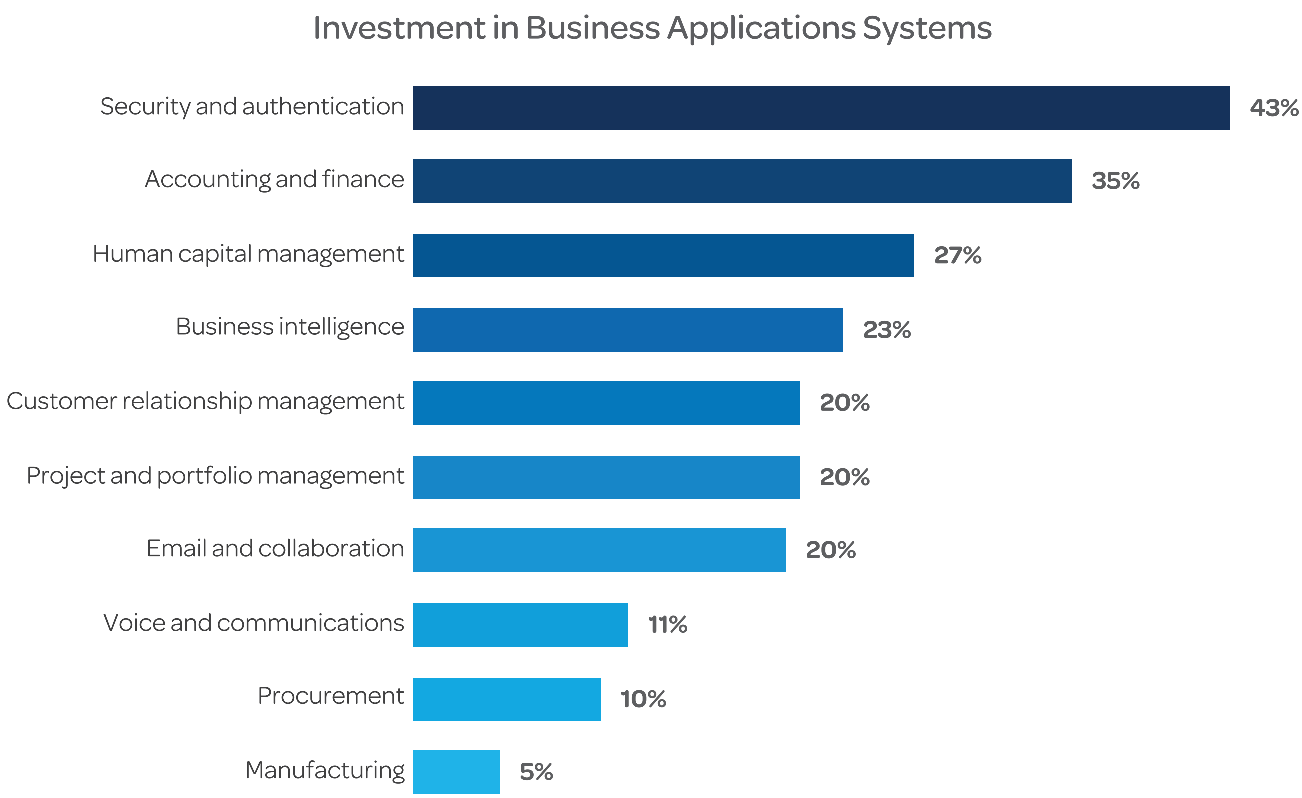


Investment in Business Applications Systems

While "security and authentication," received the highest level of investment (43%) – followed by "accounting and finance," (35%) – it is "human capital management," that jumped markedly year-over-year (18% to 27%) in resources devoted. This is a positive development reflecting the essential importance of dedicated staff to all other IT objectives and many other business goals.

"Business intelligence," spending (23%) and "customer relationship management," (20%) are consistent with the need for more sophisticated and robust business development efforts detailed in the business development section of this Study.

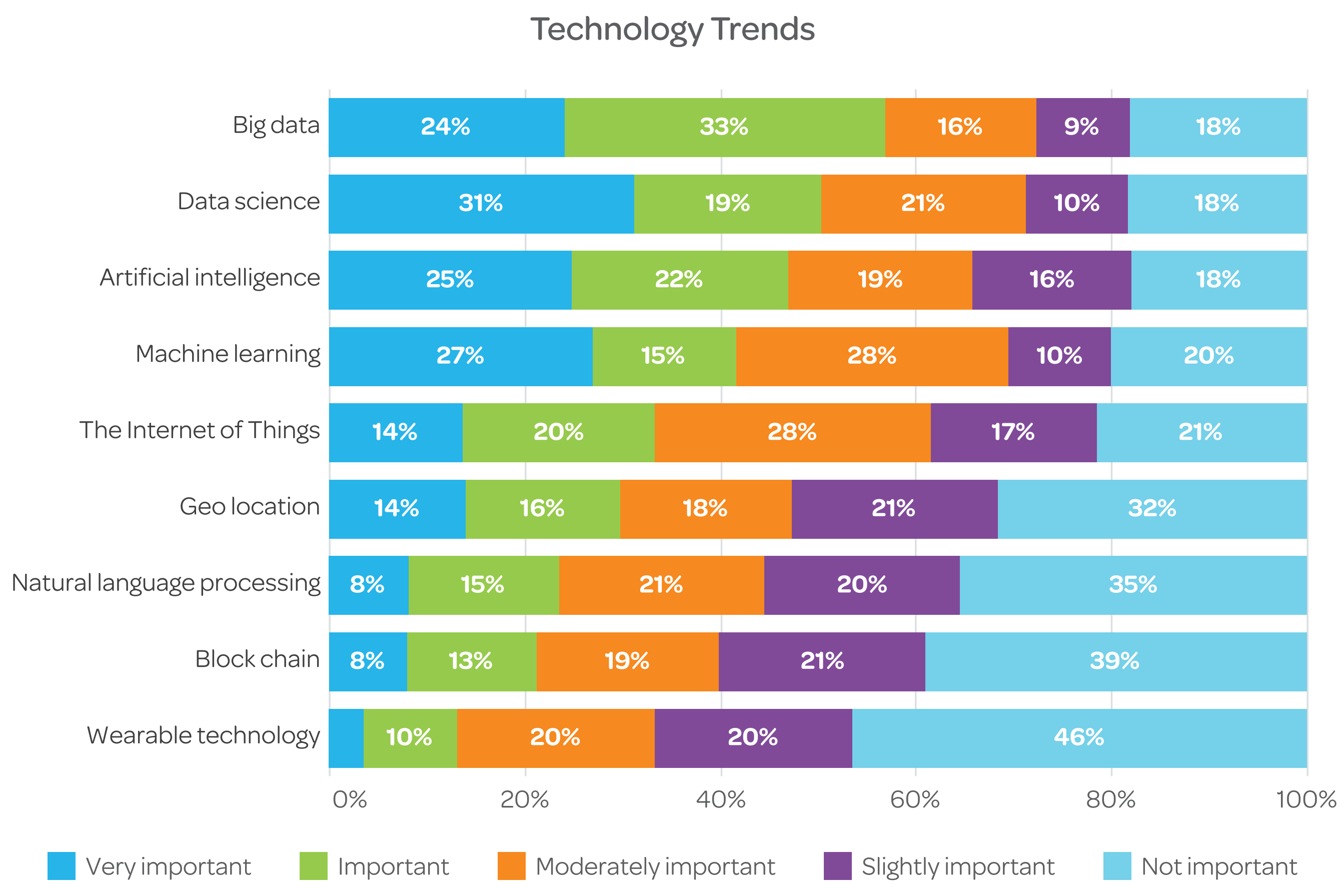
Companies should evaluate whether other efficiencies are achievable through additional investment in specialized software and services.



Technology Trends

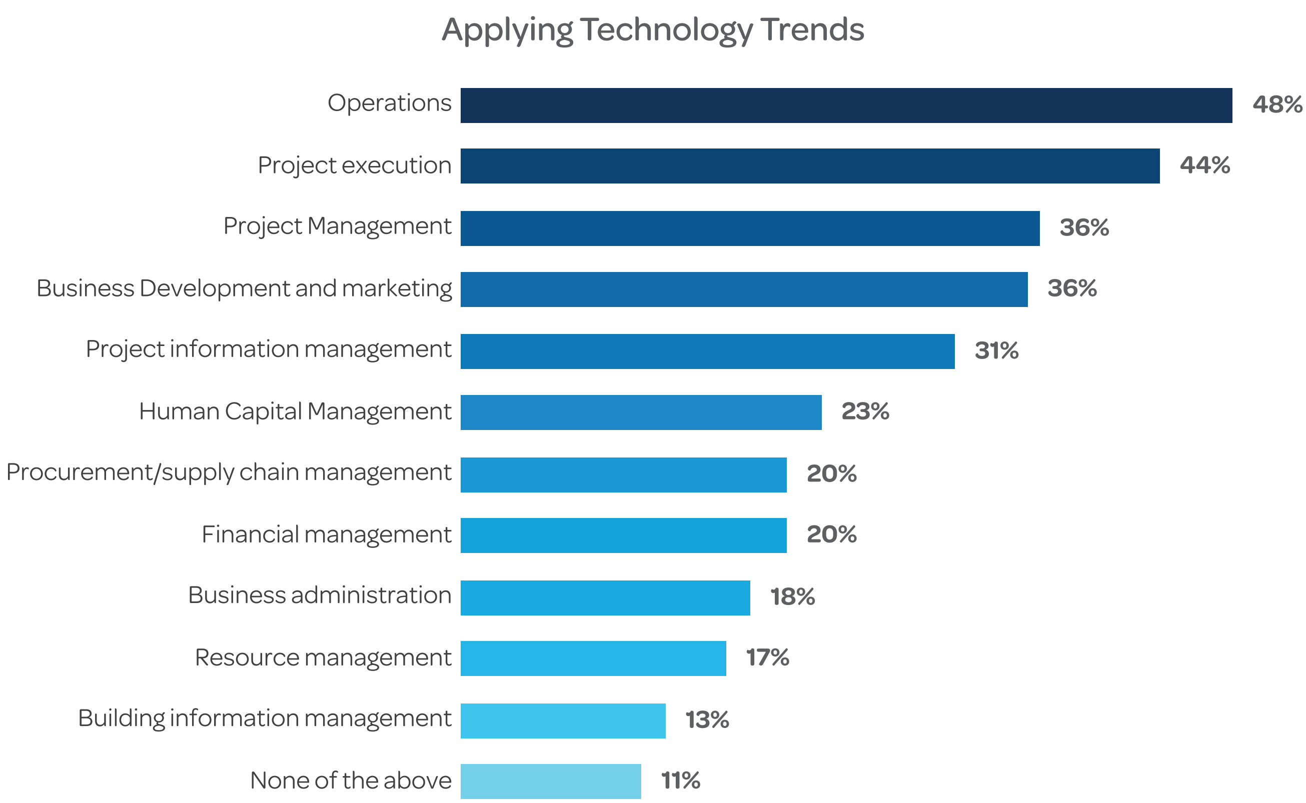
"Big data," and the techniques to analyze it – "data science," "artificial intelligence," and "machine learning" – remain the most important technology trends as businesses look to leverage data to improve operations.

Other previously top trends, such as "wearable technology," and "block chain," have decreased in focus, overshadowed by big data.



Applying Technology Trends

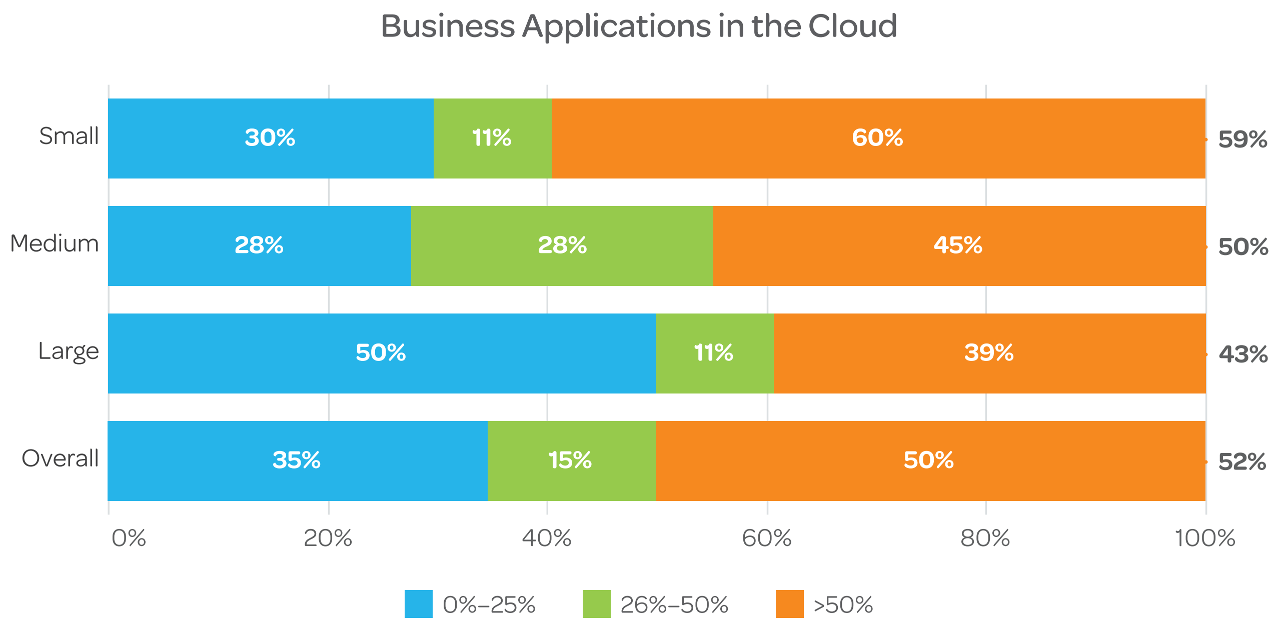
The top applications for technology trends are focused around operational efficiencies and project execution. This is consistent with trends observed elsewhere in the Study, particularly in opportunities for improvement in project management and financial management. This demonstrates IT's movement beyond transactional tasks, now setting technology strategy that benefits the entire project lifecycle.



Business Applications in the Cloud

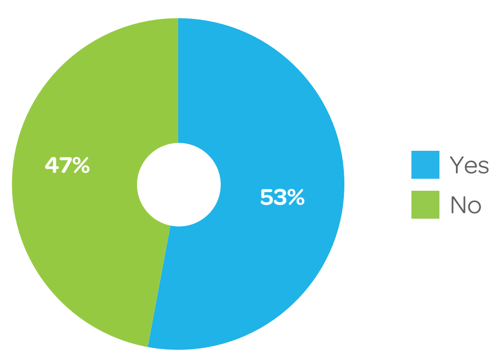
Businesses continued to migrate applications to the cloud in 2019, with total volume edging up slightly. This year, 73% of medium-sized companies indicated at least a quarter of their business applications were migrated to the cloud, up from 58% last year.

As the migration to the cloud continues, companies will need to be careful with security and compliance requirements. Business continuity and the use of the cloud should be considered, particularly given recent experiences and the need for remote working.



Plans to Move to Cloud in the Next Year

Consistent with 2018, about half (53%) of all businesses plan to move on-premises solutions to the cloud in the next 12 months, an increase from 48%. This will be of heightened importance in the current environment of virtual and remote working.



CLARITY OUTLOOK

Information Technology (IT)

A strong focus on compliance and meeting new regulations for security and IT maturity will be foundational for future contracts. As the need for IT professionals to strategically contribute to a business' operational effectiveness.

One way in which businesses can gain an IT competitive advantage is to be first adopters of big data analysis and applications. Using big data to improve processes and outcomes before the competition will move companies ahead of others who wait to do so.

Businesses should continue to evolve their security protocols to prevent cybersecurity attacks and incursions while maintaining their progressive move to the cloud. This will be important to daily business operations, in addition to meeting increasing compliance requirements imposed by the federal government.

As the nature of how we conduct business changes, adopting modern tools and best practices will become the standard. Business continuity, IT capabilities and remote working should receive renewed attention after the experience of the recent pandemic.

SECTION SEVEN

Manufacturing

Quality control continues to challenge manufacturers; a result of strict quality guidelines and oversight. This is compounded by compliance needs being met with manual, and even paper-based, tracking – problematic, and potentially costly, with things like defective or counterfeit parts.

48%

note compliance requirements pose significant risk

35%

identified security as a key need

Key Takeways

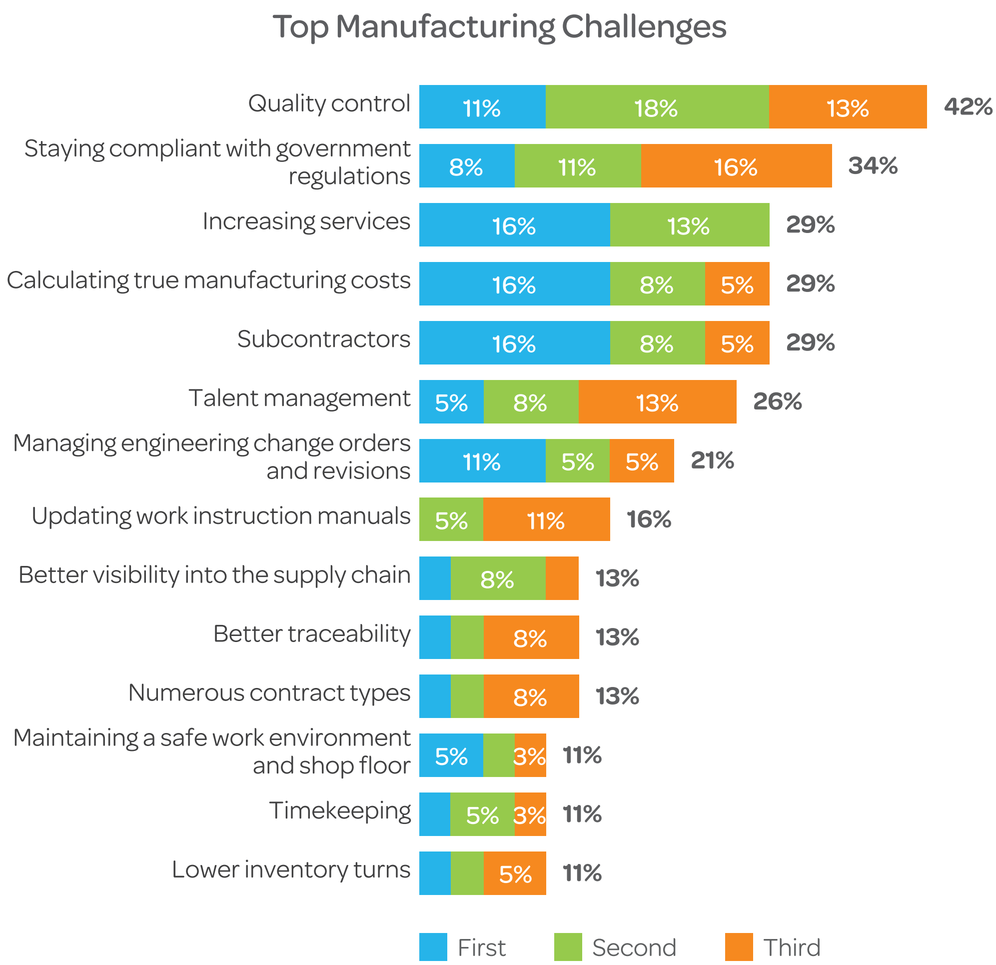
Moving away from outdated legacy systems and toward tools designed to meet rigid government compliance requirements is a meaningful step toward better quality control. This will be increasingly important as the use of subcontractors, and the need to manage them, increases.

Many manufacturers are shifting their desire for digital transformation into action. While systems and processes are vital, the talent shortage is a key area of vulnerability. Re-engineering processes can be costly and cause companies to miss shipping deadlines if they do not have the coveted highly skilled engineers and machinists.

Manufacturing revenue growth dipped in 2019, and the outlook for 2020 is more conservative year-over-year. More than sixty percent (66%) of manufacturers are planning for growth rates of 5% or less, compared to 50% in 2019.

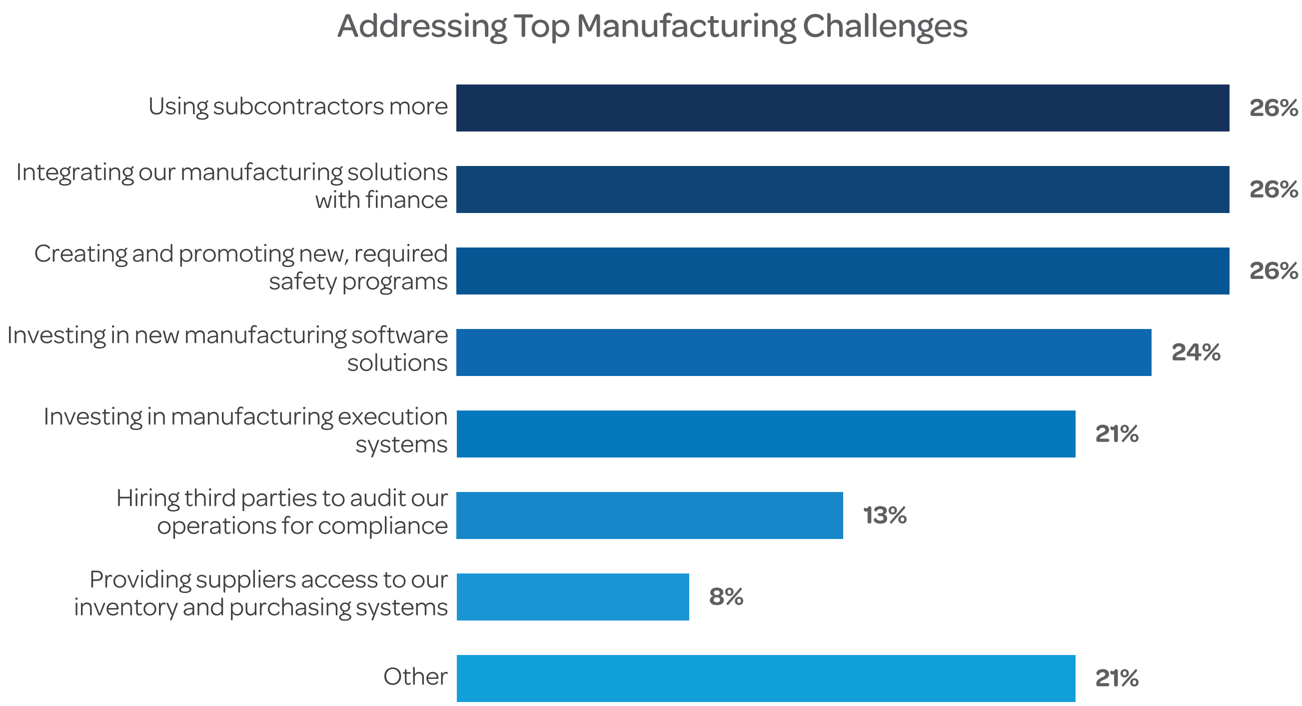
Top Manufacturing Challenges

The top priorities cited were "quality control," and "compliance," which were reported as expected. "Managing subcontractors," is a pain point (29%), as is the need to deal with "change order and revisions," (21%). Managers are looking for "better visibility into the supply chain," (13%) and "better traceability," (13%). Safety is always a concern.



Addressing Top Manufacturing Challenges

In order to address the top challenges of control and compliance, manufacturers are using a variety of tactics. These include an "increased use of subcontractors," (26%) and "investment in new manufacturing software solutions," (24%). "Creating and promoting new, required safety programs," is a priority for 26% of respondents. Twenty-six percent (26%) are also looking to "integrate manufacturing with finance," facilitating greater visibility and understanding of costs, thus ultimately implementing changes to improve control and efficiency.

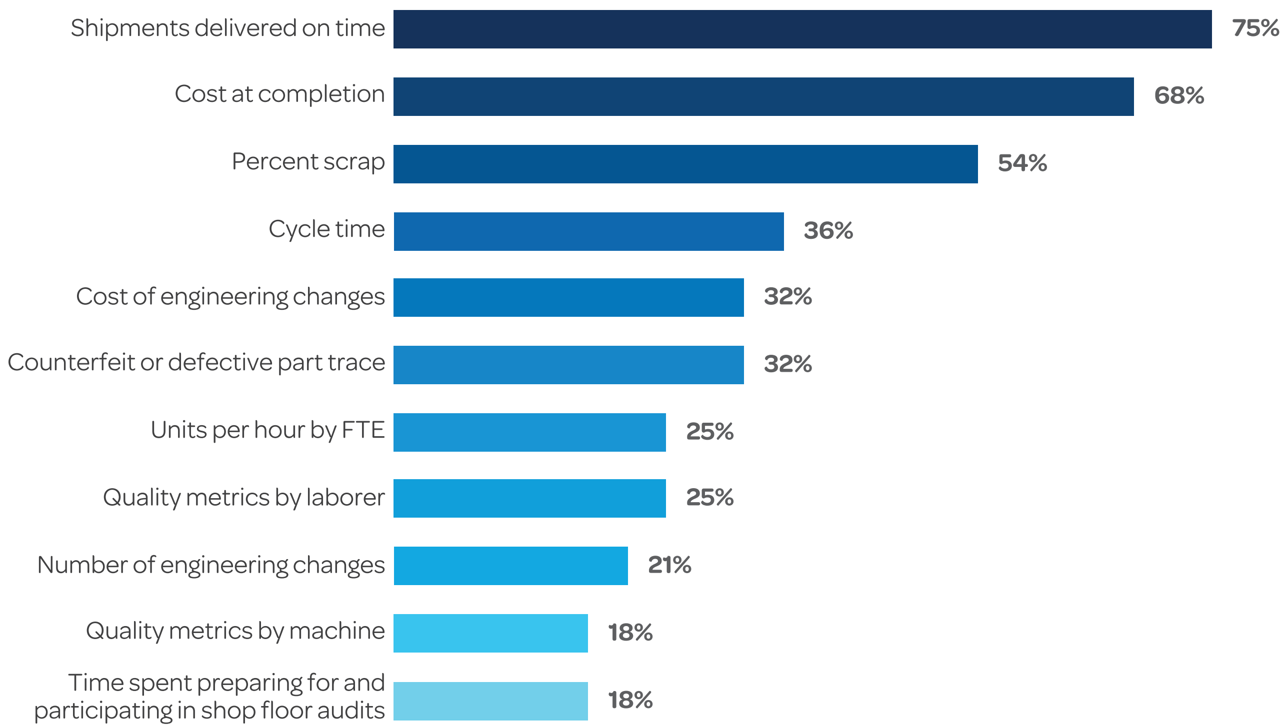


Current Key Performance Indicators Tracked

The top metric tracked is "shipments delivered on time," (75%). On-time deliveries reported in 2019 ranged widely, from a low of 76% among medium-sized businesses, to a high of 96% among small businesses.

A majority are tracking the "percent of scrap or waste." The scrape rate held steady at 2% to 4%. The "cost of engineering changes," and tracing "counterfeit or defective parts," is of high interest to approximately a third of respondents.

Manufacturing KPIs Tracked

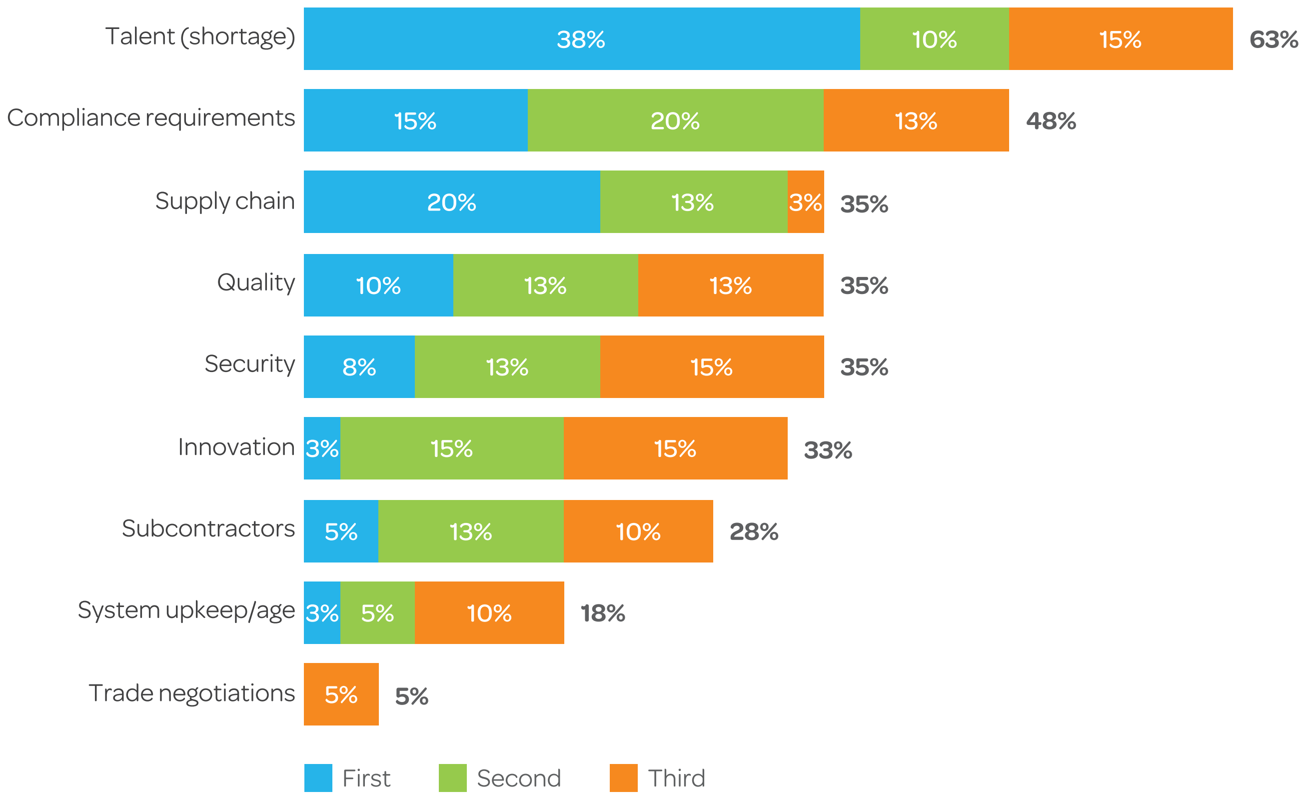


Areas of Risk

The talent shortage is a clear number one in the rankings of priority (63%). As noted above, an inability to recruit and retain quality staff limits all other activities. As shown in other areas in this Study, talent is clearly an area of focus for the majority of businesses.

"Compliance requirements," are a strong concern (48%), as is the "supply chain," (35%). "Security," is a key need (35%) in manufacturing just as it is across the rest of the business.

Top Areas That Pose Greatest Potential for Risk



CLARITY OUTLOOK

Manufacturing

Manufacturers are strongly focused on achieving on-time deliveries and realizing financial results. Process improvements and greater utilization of subcontractors are the primary ways respondents intend to address the quality and compliance challenges.

Some companies will attempt to re-engineer their processes, some will look to tools and technology, while those that hope to be successful in the long term will focus on both approaches. Regardless of approach, the staff to execute the changes is essential.

The ability to integrate data from manufacturing operations with other functions, such as finance, will facilitate cost management and accurate financial forecasting, which should in turn help manufacturers improve profitability.

Summary

A year of strong financial performance in 2019 engendered positive forecasts for high growth and profitability in 2020. With the COVID-19 pandemic now upon us, it is difficult to forecast what 2020 will bring. What is clear is that government contractors will need to pay close attention to fundamentals, protecting growth, margins and cash flow now more than ever. While defense businesses may have less exposure to economic buffeting, they are not immune.

Business continuity is vital. The ability for employees to work remotely and access systems while complying with security and clearance requirements will permit the business to carry on. Having the right information systems and software in place will support that effort. Capturing the efficiencies and knowledge from across an organization will contribute to cost control, greater profitability and fewer interruptions in the business.

Companies that weather this storm successfully will leverage information and metrics to understand the current status of their businesses and plan for navigating a time of turmoil. Pre-COVID-19 strategic plans and budgets for 2020 may no longer apply, but the disciplines of creating new ones are essential. This is a time when successful companies will differentiate themselves from those that will not prosper.

Statistics at a Glance

		SMALL	MEDIUM	LARGE
BUSINESS DEVELOPMENT				
Percent Prime Contracts (Average)		56%	71%	80%
Percent Subcontracts (Average)		44%	29%	20%
Win Rate (Median)		30%	30%	43%
PROJECT AND RISK MANAGMENT				
Change Order Win Rate (Median)		73%	80%	80%
EAC/ETC Forecasts (Median)		90%	90%	90%
Projects On or Under Budget (Median)		95%	85%	86%
Projects On or Ahead of Schedule (Median)		98%	85%	78%
Schedule Risk Analysis (% of Organizations by Phase)	Bid/Proposal:	52%	65%	50%
	Initiation Phase:	49%	58%	57%
	Planning Phase:	52%	58%	52%
	Execution Phase:	45%	77%	67%
	Closure Phase:	23%	23%	33%
	Not at All:	16%	8%	12%
FINANCIAL METRICS				
Net Profit Margin (Median)		10%	8%	6%
Growth Rate (Median)		11%	8%	8%
Invoice Cycle (Median Days)		10	8	14
Days Sales Outstanding (Median Days)		40	37	45
Percentage of Organizations Experiencing At Least One Audit		63%	90%	96%
CONTRACT MANAGEMENT AND PROCUREMENT				
Percent Using Contract Management Software		16%	23%	47%
First Time Rate (Median)		38%	Null	99%
Days Payable Outstanding (Median Days)		37	37	32
HUMAN CAPITAL MANAGEMENT				
Training Spend Per FTE (Median Dollars)		$200	$120	$363
Composite Turnover Rate (% Over 10%)		29%	60%	63%
Time to Fill Position (% 60+ Days)		10%	14%	36%
INFORMATION TECHNOLOGY				
Percent of Apps in the Cloud		75%	50%	28%
MANUFACTURING				
Shipments Delivered on Time (Median)		97%	95%	95%
Scrap Rate (Median)		1%	1%	2%

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