Deltek | CLARITY

Government Contracting Industry Study

9TH ANNUAL INDUSTRY STUDY

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INTRODUCTION

Last year's Deltek Clarity Government Contracting Industry Study report exhibited a cautious optimism that the industry was climbing towards its strongest level in years. The report told a story of major triumphs and challenges and noted several predictions for the year ahead.

This year, that optimism has been borne out in full. Profits and growth both climbed in 2017 and organizations now project double-digit growth into the foreseeable future. The budget outlook improved considerably when Congress reached a two year spending agreement that should provide significant growth to both federal defense and civilian sectors. The new budget provides the largest influx of new money to agency discretionary budgets since the economic stimulus legislation of 2008.

Professional services organizations outside of the contracting industry are missing out on these opportunities. As a result of the industry's improved outlook, companies are betting on the market and investing in business development, project management, and human capital, with expectations of even greater profit and growth to come. Alongside all these positive signs, however, are several key challenges that organizations will face in the year to come. Some of these obstacles, like the limited resources facing business development departments, are new this year. Others, like the struggle to recruit top talent and the lagging development of formal risk/opportunity management, have been on the rise for years now.

In this 9th annual Deltek Clarity Government Contracting Industry Study, nearly 650 respondents from across the country shared insights into their organization's processes, challenges, and growth areas related to specific business functions. Please take some time to review the data and insights inside this report and see how your own company compares. We hope this report will serve as a useful guidebook for your year ahead.

Results from our annual Deltek Clarity Government Contracting Industry Study show

a healthy market full of optimism.

ABOUT THIS STUDY

Deltek conducted a survey of government contracting organizations to identify key issues impacting the market and forecast trends into 2018 and beyond. The survey was developed in consultation with industry experts and included the following topics: business development, project and risk management, finance, financial compliance, human capital management, and information technology trends.

The survey was emailed to key decision makers at government contracting organizations and was fielded over a 43-day period from January-March 2018. In total, 638 individuals responded to the survey. The survey data was analyzed using descriptive statistics and statistical comparison tests.

Organizations of various sizes are represented in the survey. 44% of firms reported 2017 revenues under $20 million (small organizations, for the purposes of this report), 27% reported revenues between $20 and $99.9 million (medium-sized organizations), and 29% reported revenues of $100 million or more (large organizations). Between 10 and 30 percent of respondents from small organizations participated in small business programs such as Women-Owned Small Business, Small Disadvantaged Business, and HUBZone.

The survey was completed by government contractors across the entire United States. The largest portion of respondents (43%) were located in the District of Columbia, Maryland, and Virginia, but other regions of the country, categorized as the Midwest, Northeast, South, and West, each contained at least 10% of survey respondents.

EXECUTIVE SUMMARY

The 9th Annual Deltek Clarity Government Contracting Industry Study shows a healthy market full of optimism but also reveals challenges in key areas.

From 638 unique responses to over 90 questions, we have identified trends in the business development, project management, finance, financial compliance, human capital management, and information technology areas. The following trends and data points offer a clear snapshot of today's government contracting environment.

Growth is up and organizations are investing in business development, but they face resource limitations

As government agencies are increasing spending, companies are investing in their business development departments, but they cite limited resources as their biggest challenge for the year ahead. In an attempt to capitalize on market conditions, companies are diversifying their work and focusing on growth.

Organizations are growing quickly, which is leading to confusion about project and risk management procedures

While a larger percentage of projects are being finished on time, several key project management metrics declined since last year's survey. Survey trends surrounding risk/opportunity management are primarily negative—we saw decreased maturity, less centralization, and fewer CRO positions than last year.

Organizations are reporting healthy financials, and the industry seems to have recovered from lean years earlier in the decade

The lean budget years brought on by the Budget Control Act are over, and they've been replaced with healthy increases in agency budgets. Overall, average net profit increased one point this year to 9%, and growth more than doubled from 6% to 14%. However, organizations still say growth and profitability are their top financial challenges. Contractors are controlling costs by reducing fringe and overhead rates, and they're more quickly turning labor into cash by speeding up invoice creation and processing.

Less time and resources are being spent on compliance and regulations

Government regulation of contractors is decreasing (9% of companies reported decreased oversight), and organizations are being subjected to a smaller number of audits. The audits that organizations are facing are being completed more quickly and efficiently now than in the past—every audit category this year was rated by the majority of respondents as just moderately costly or lower. This eased compliance burden may be a large contributor to increased profit and growth.

With growth returning to the market, firms are hiring staff and facing stiff competition for talent

The competitive marketplace is leading to increased talent turnover and making it harder for organizations to fill open positions. In light of this trend, companies are devoting more resources to talent acquisition and are placing more emphasis on retaining workers. Millennials in particular are proving difficult for government contractors to recruit and retain. With this in mind, many contractors are focusing on rebranding their companies to help in all aspects of talent acquisition and retention.

IT departments show incredible year-over-year stability, and organizations continue to move to the cloud

IT departments in the industry continue to focus on data security. Last year's rush to the cloud was at least mostly completed by 37% of organizations, and another 43% plan to migrate on-premise solutions to the cloud over the next 12 months. Looking to the future, organizations predict that data science, artificial intelligence, and machine learning will have a growing impact on their business.

SECTION ONE

BUSINESS DEVELOPMENT

Growth is up and organizations are investing in business development, but they face resource limitations

Recent budget and spending increases in the government have led to increased opportunities for contractors, and respondents reported growth across survey sections. In response to this improved outlook, organizations are investing in business development and looking to diversify their client bases. However, many organizations feel like they lack sufficient business development resources to support these new pursuits. The top challenges and initiatives cited by organizations relate to opportunity growth and the resulting strain on resources.

Key Takeaways

"Limited resources," "Customers using contract vehicles organizations are not associated with," and "Increased competition" remain the top three business development challenges facing organizations. Top initiatives to address these challenges include "Expanding into other government agencies," "Identifying opportunities earlier and better," and "Understanding opportunity requirements earlier in the process."

As companies are moving back to growth-based initiatives, more pressure is being put on business development teams. Dedicated business development staff are the overwhelming source of new opportunities in the industry. Reliance on project management staffs for building pipeline opportunities has waned over the past couple years.

Government agencies continue to adopt indefinite delivery/indefinite quantity (IDIQ) contracts as their preferred mode of contracting. Over two-thirds of respondents reported having worked on task order IDIQ contracts. This has led companies to increasingly use centralized or blended management approaches to manage contracts; just 12% of organizations still manage their contracts in a decentralized manner.

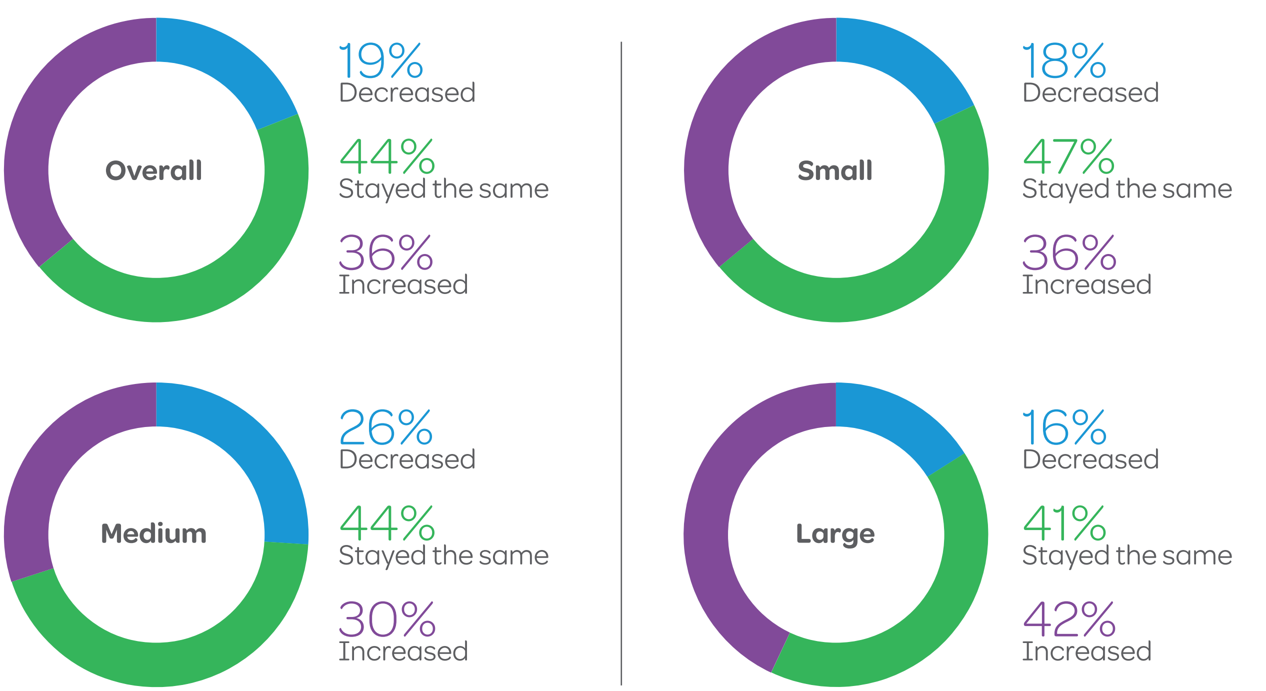
Win Rate

Win rates have returned to normal in 2017 after a particularly high year in 2016. Win rates have been generally increasing across the industry in recent years, which is a sign of a healthy business environment. This trend is consistent across all business sizes, with small businesses exhibiting slightly lower win rates (38%) than medium companies (44%) or large companies (42%). These win rates represent a mix of new business and recompetes (which usually have higher win rates than new work).

Respondents also answered questions about how their organization's win rates have changed over the past three years. Overall, more than 80% of respondents said their organizations had seen increased or steady win rates—a very positive sign for the industry. Medium-sized organizations lagged slightly behind, as 26% of companies reported decreased win rates.

40%
Win Rate

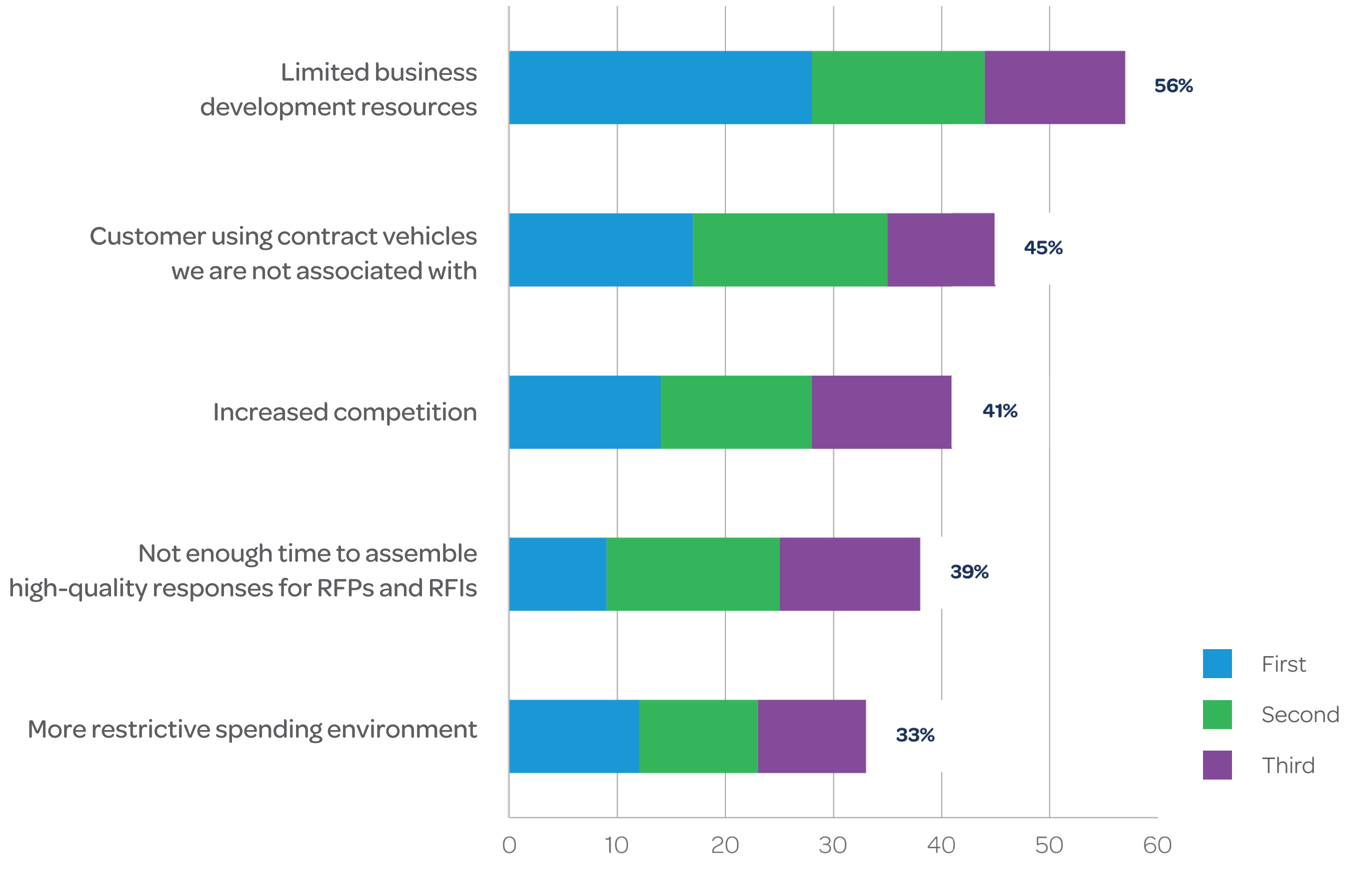
WIN RATE



Top Business Development Challenges

Overall, the top reported business development challenges reflect an improved business environment. Government agencies are spending money more freely, and companies are struggling to find the staffing and resources to keep up—although companies with the highest win rates were far less likely to indicate challenges in this area. After several lean years, companies are beginning to reinvest in business development and facing challenges until their resources are built back up. Responses for "Need for improved sales support" rose by 11% this year. Another notable result is the continued year-after-year decline of "More restrictive spending environment" as a business development challenge. This used to be a pressing issue in the field, but is now just the fifth most reported concern among respondents.

TOP BUSINESS DEVELOPMENT CHALLENGES

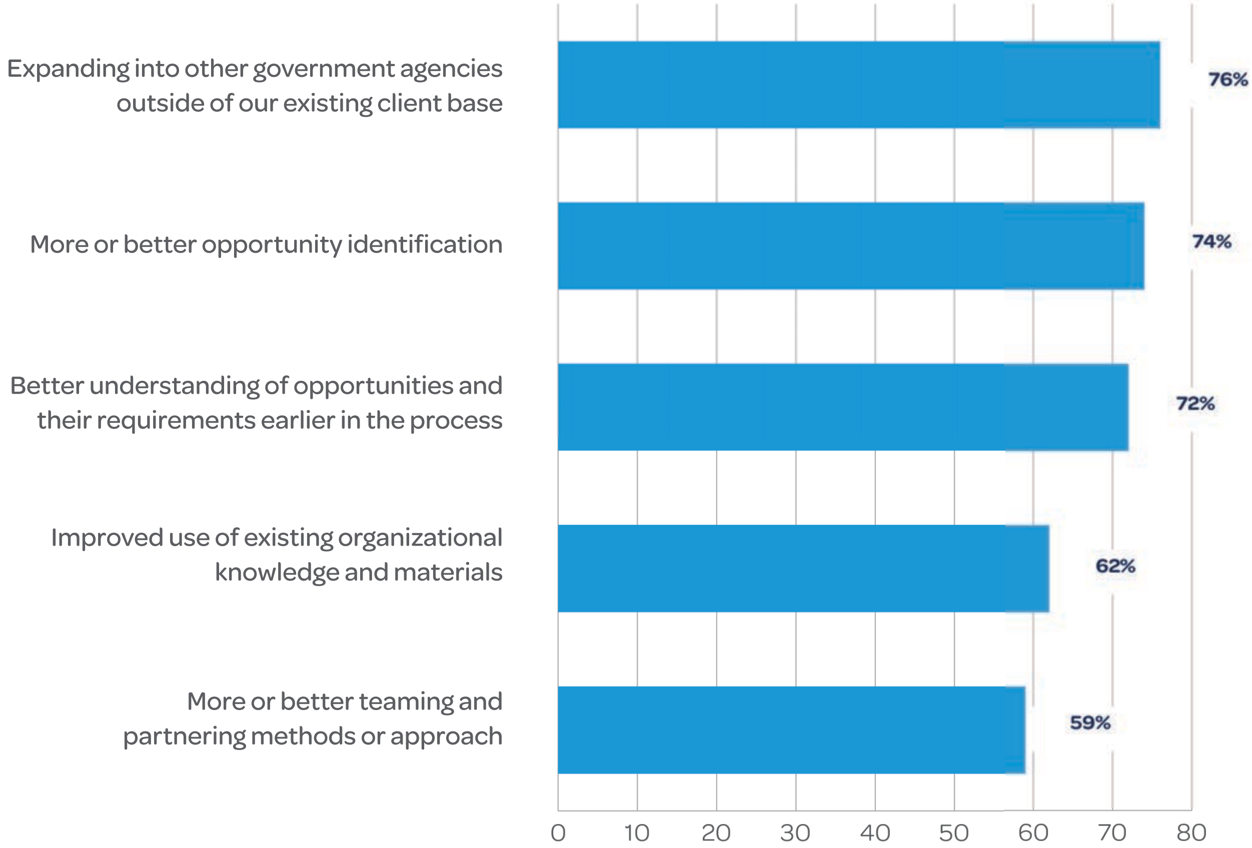


Addressing Top Business Development Challenges

A new survey response option this year, "Expanding into other government agencies outside of our existing client base," immediately became the top reported initiative organizations are pursuing to address their business development challenges (76%). Simultaneously, responses for the "Exploration of new markets outside of government market" option dropped over 30 points to 41%, and the metric is now among the least selected initiatives.

These shifts align with recent improvements in market conditions in the federal contracting market. The Department of Defense has seen its budget increase this year and companies are trying to get a piece of that business. This is the reverse of what happened a few years ago when budgets were slimmer and defense contractors were trying to build business on the commercial side. The other top selections all match up well with the top challenges and address the issue of limited resources.

ADDRESSING TOP BUSINESS DEVELOPMENT CHALLENGES

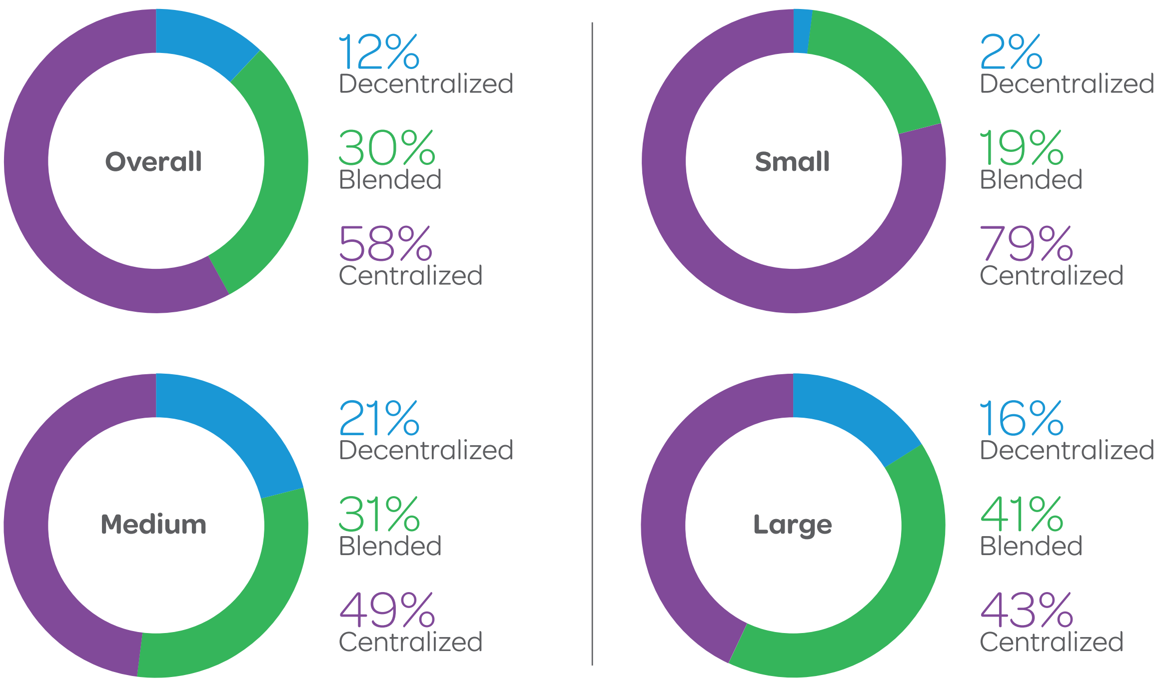


Task Order Program Management

More and more organizations report having task-order based IDIQ contracts (68% this year vs. 50% last year). The presence of these contracts varies by size of company, however; 84% of large companies have IDIQ contracts while only 56% of small companies have them. Despite this size split, these upward trends are representative of a longer trend of government agencies progressively switching to IDIQs as their preferred channel for competing their requirements.

Organizations of all sizes continue to shift away from decentralized management of task order programs to either blended or centralized management. This indicates that companies are intentionally managing utilization on contracts and focusing on efficiency. The increase in blended management is especially noteworthy, as organizations with diverse sets of customers need to be able to respond appropriately to the different issues that arise from different clients. Companies with the highest win rates have entirely abandoned decentralized management—none of them use decentralized task order management.

TASK ORDER PROGRAM MANAGEMENT



BUSINESS DEVELOPMENT

CLARITY OUTLOOK

Increased opportunities for government contractors, and the ensuing strain all these new opportunities place on their business development resources, loom large in the industry. To address this, organizations need to expand and diversify both their business development staff and client-base. This will allow companies to capture a piece of the expanded government spending while maintaining sufficient resources to support these efforts and their existing work.

SECTION TWO

PROJECT AND RISK MANAGEMENT

Organizations are growing quickly, leading to some confusion around project and risk management procedures

Despite increases in profits and the percentage of projects coming in on-budget and on-schedule, several key project management metrics, including project visibility and maturity, continue to show worrying signs of decline. This may be the result of the small number of experienced project managers and lack of project management training among responding organizations. These troubling metrics are also linked to risk management practices, and companies who do not conduct schedule risk analyses or manage risk/opportunity initiatives in a decentralized manner are more likely to report low project visibility and management maturity. This indicates that these problems go beyond first-level project managers and speak to problems at a wider, company level.

Key Takeaways

After a large decrease from 2016 to 2017, visibility into current project status remains nearly identical this year.

Organizations rebounded from a down year last year when it comes to the percentage of their projects being reported on or under budget and on or ahead of schedule. Both metrics experienced nearly 20-point bumps from 2017 to 2018.

“Inexperienced project managers” and “Poorly defined project scope” are the top two reported project management challenges this year. Last year’s top challenge, “Accurate project cost forecasting,” fell to fifth on this year’s survey. The top initiative to address these challenges—“Developing internal project management best practices”— remains the same, though fewer organizations are investing in project management training.

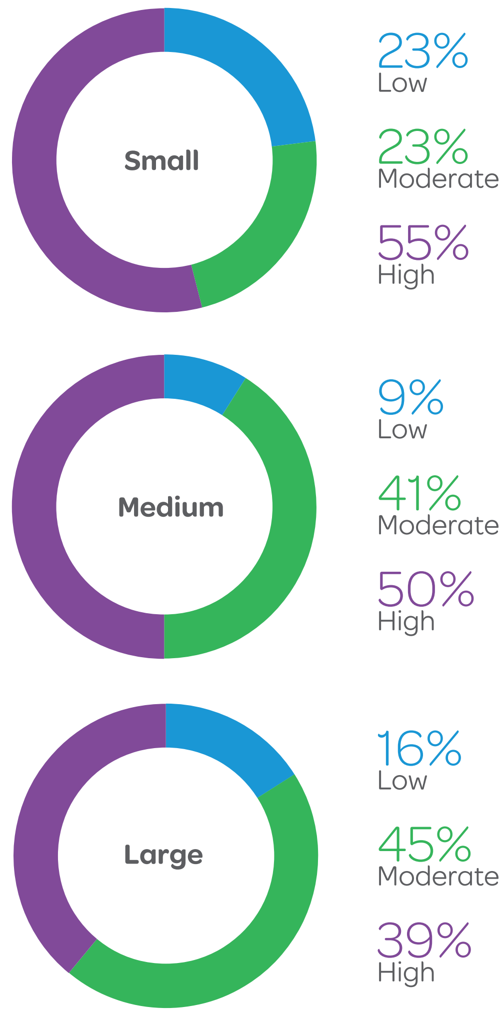
46% of organizations rate their risk/opportunity management as somewhat immature or very immature, up from only 37% last year.

Small organizations recognize the importance of risk/opportunity management, and half of small organizations make their CEO responsible for the task. As companies grow, however, CEOs cannot always continue this task. Medium-sized companies often (33% of the time) entrust risk/opportunity management to COOs, and CROs are exclusively found in large organizations.

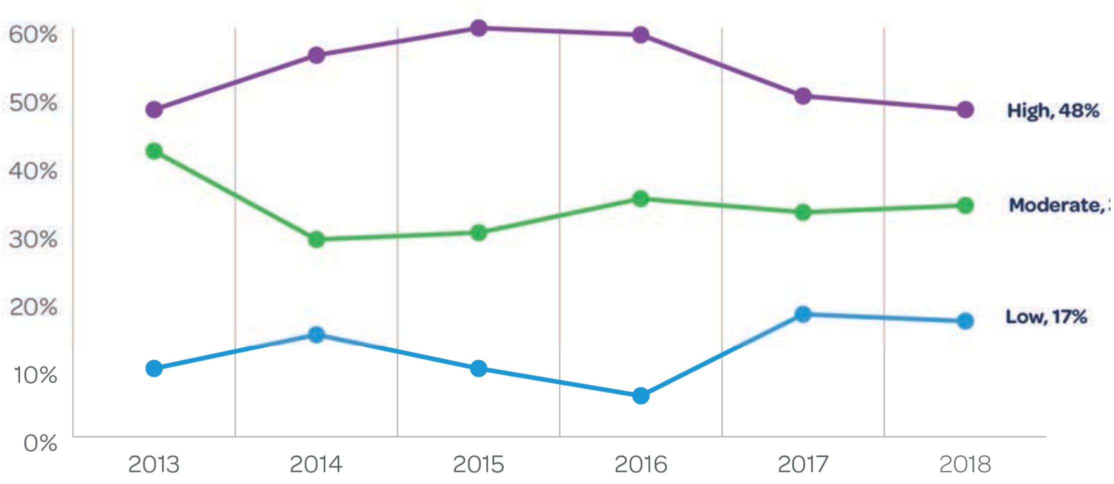
Visibility into Projects

After a big drop last year, companies reported nearly identical levels of visibility into the status of their current projects this year. Reported high and low visibility dropped one point each while moderate visibility exhibited a slight increase. These changes varied by organization size; many more small business reported low visibility (up 13 points), while the percentage of medium and large businesses reporting low visibility decreased. Unusually, these troubling visibility numbers are not reflected in other key metric areas, such as budget and timeline, though companies reporting lower visibility did see a smaller percentage of their projects completed on or under budget.

VISIBILITY INTO PROJECTS



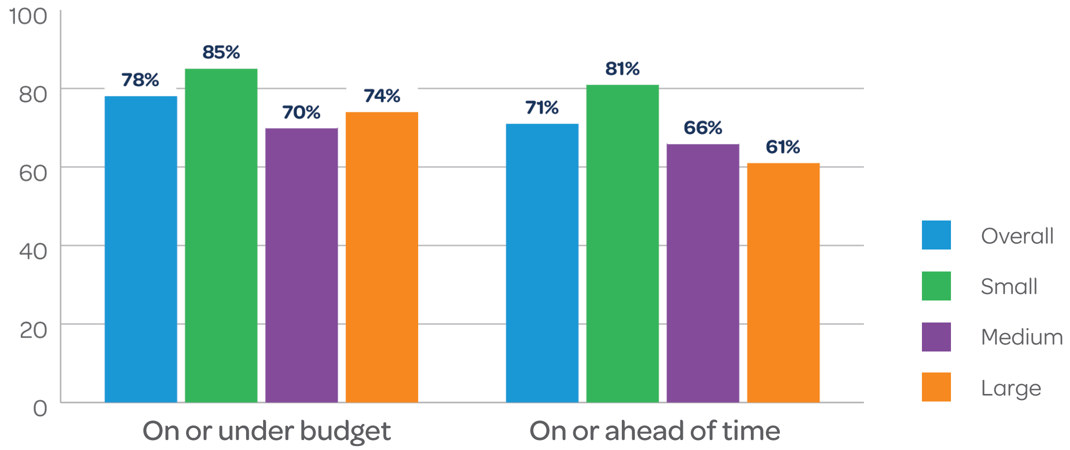
VISIBILITY INTO PROJECTS: SIX-YEAR TREND



Projects On Budget and On Schedule

Just as we saw with project status visibility, both of these key metrics experienced significant declines in last year's survey, indicating large problems with project management in the field. However, while visibility did not rebound this year, responses for "On or under budget" increased by 19 points and responses for "On or ahead of time" increased by 18 points. These increases are seen across organizations of all sizes, but small businesses in particular are reporting success managing budgets and timelines.

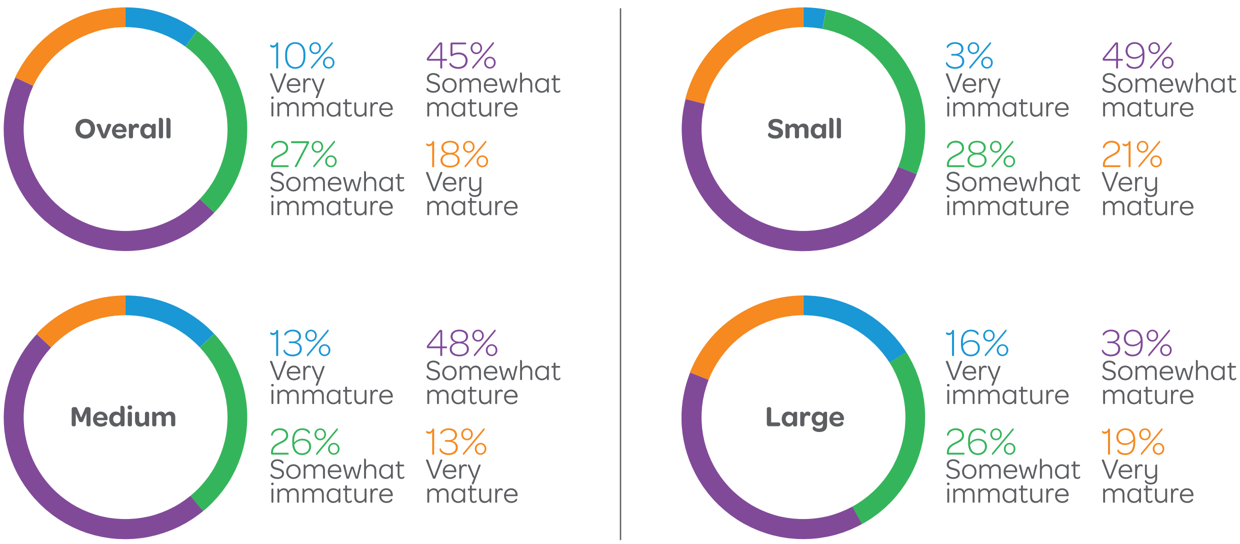
PROJECTS ON BUDGET AND ON SCHEDULE



Maturity of Project Management Discipline

Organizations reported significant drops in the maturity of their project management discipline. The percentage of firms rating their project management discipline as "Somewhat mature" or "Very mature" dropped nearly ten points, and that drop was largely driven by medium and large organizations. Interestingly, this decrease in maturity is not linked to worse outcomes in other key metrics, as, despite this setback, organizations reported increases in the percentage of projects on-time and on-budget.

MATURITY OF PROJECT MANAGEMENT DISCIPLINE

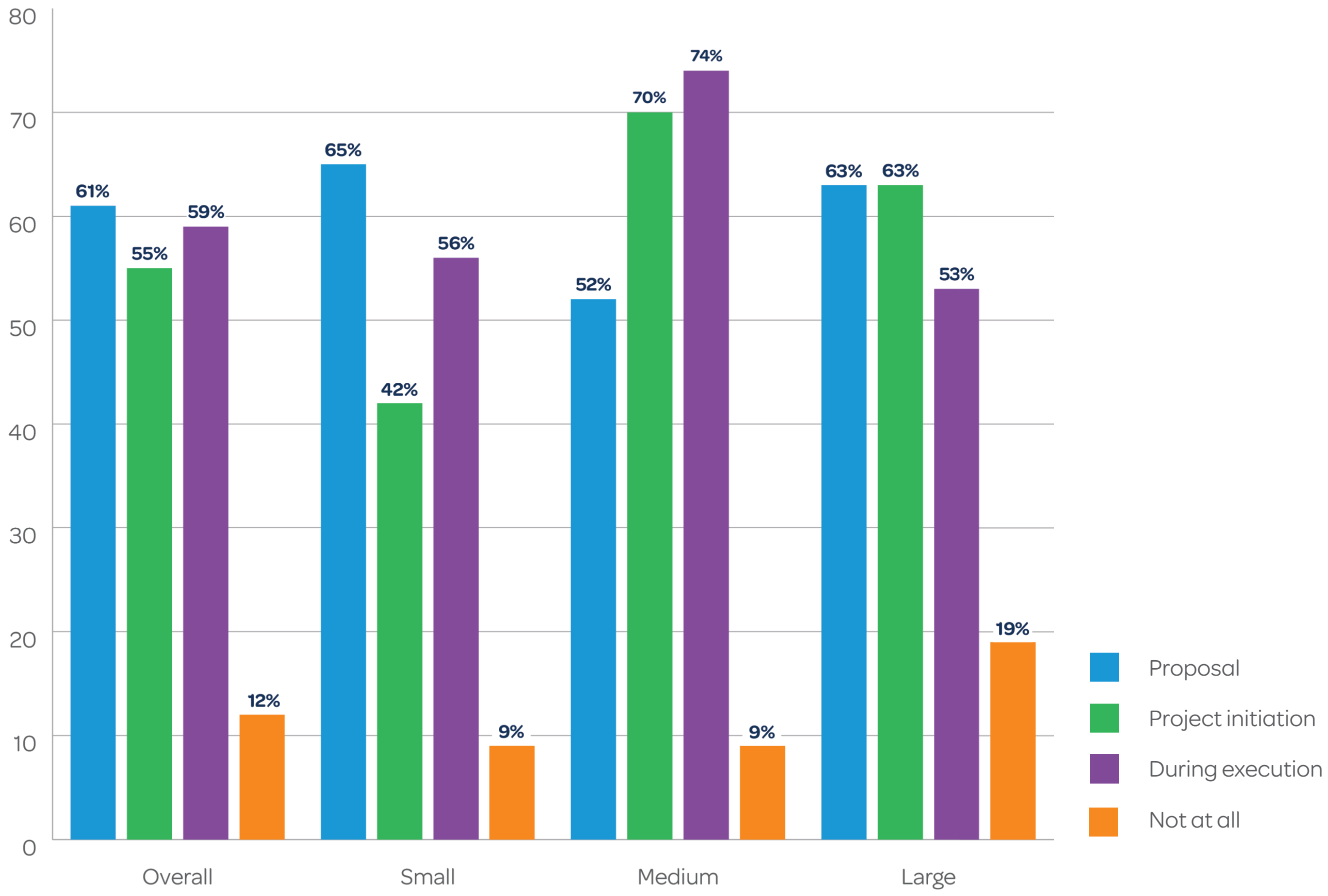


When Organization Peforms Schedule Risk Analysis

The number of organizations not conducting schedule risk analyses at any point in the project lifecycle continues to decrease. This figure dropped from 25% in 2016 to 18% in 2017, and now sits at 12% in 2018. This is important as organizations that do not perform schedule risk analyses were significantly more likely to report lower visibility into current projects and lower project management maturity— two key project management metrics. Large companies especially should take note, as they were the most likely to skip schedule risk analyses altogether.

While more companies are performing schedule risk analyses, the percent of organizations performing them at project initiation dropped 14 points this year (from 69% to 55%). Small companies in particular are more likely to skip this step: only 42% of small companies perform schedule risk analyses at project initiation. Small organizations should keep a close eye on this downward trend to ensure it does not develop into a larger problem.

WHEN ORGANIZATION PERFORMS SCHEDULE RISK ANALYSIS

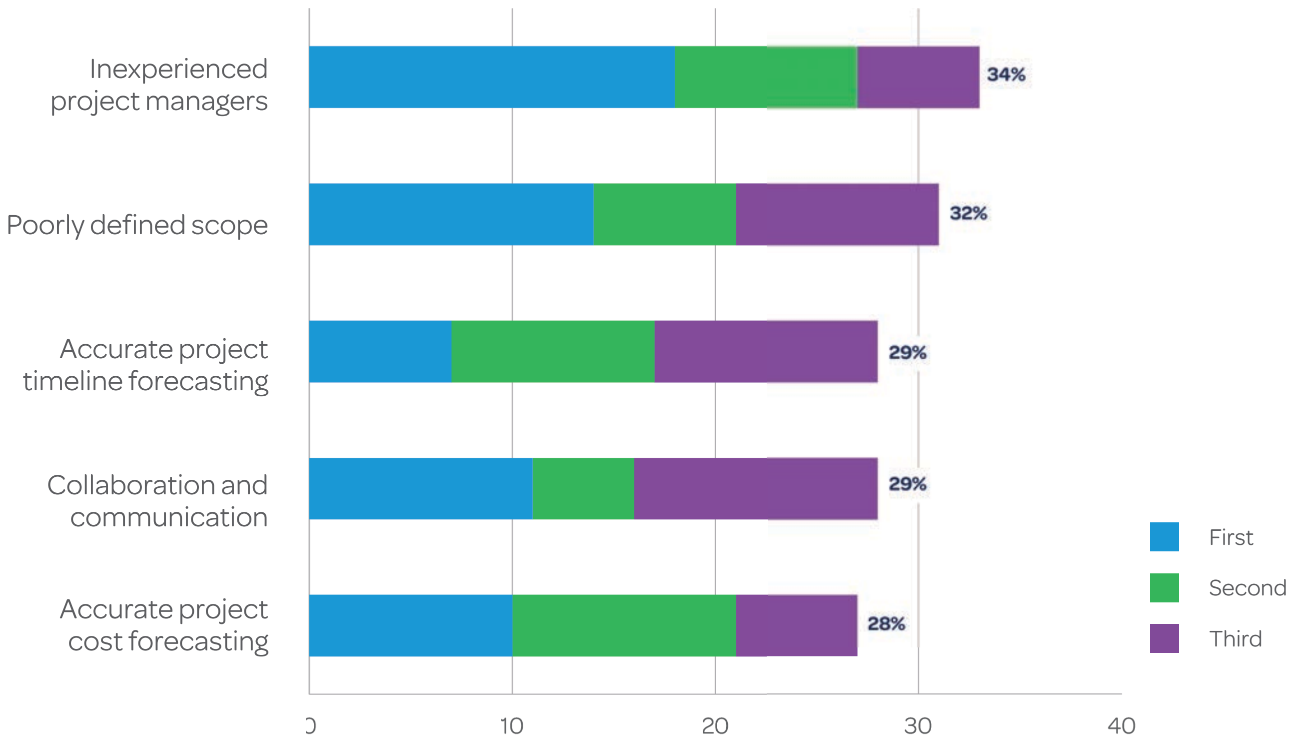


Top Project Management Challenges

For the first time in three years, the top four project management challenges reported by respondents have changed. "Accurate project cost forecasting" dropped from the top challenge last year to fifth this year. The other top challenges are closely linked to staffing challenges—namely employee retention and manager retirement. These trends are forcing companies to place unprepared staff in management roles, which can lead to problems forecasting delivery dates. This can also lead to declines in project visibility and project management maturity.

We also witness some positive trends in this data. Responses for the challenge "Alignment with executive management" continue to drop, and answers for "Data integrity" also saw a double-digit drop over the past year (from 21% to 8%). Both of these changes may be explained by the adoption of technological solutions such as enterprise PPM software or data management tools.

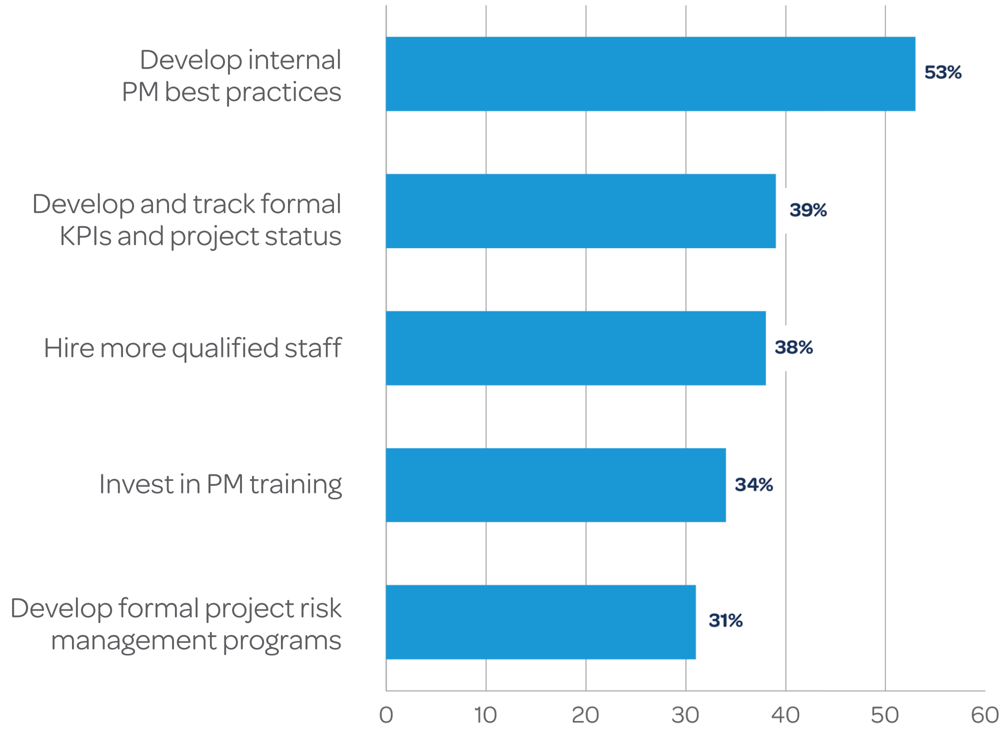
TOP PROJECT MANAGEMENT CHALLENGES



Addressing Top Project Management Challenges

Inexperienced project managers were cited as a top concern by over one-third of respondents, but when asked what they are doing to address this challenge, just 34% of organizations reported investing in project management training—down from 51% last year. Respondents may not feel the need to invest heavily in training as they are hiring more qualified staff and developing and tracking formal key performance indicators (KPIs) and tracking project status (both experienced slight upticks this year). Nevertheless, it is no surprise that companies are experiencing visibility and maturity problems when they are not focusing on training their inexperienced project managers. Another slight concern is the decline in companies developing formal project risk management programs (down from 39% last year to 31% this year). This could lead to major problems down the road as risks are not identified and dealt with early.

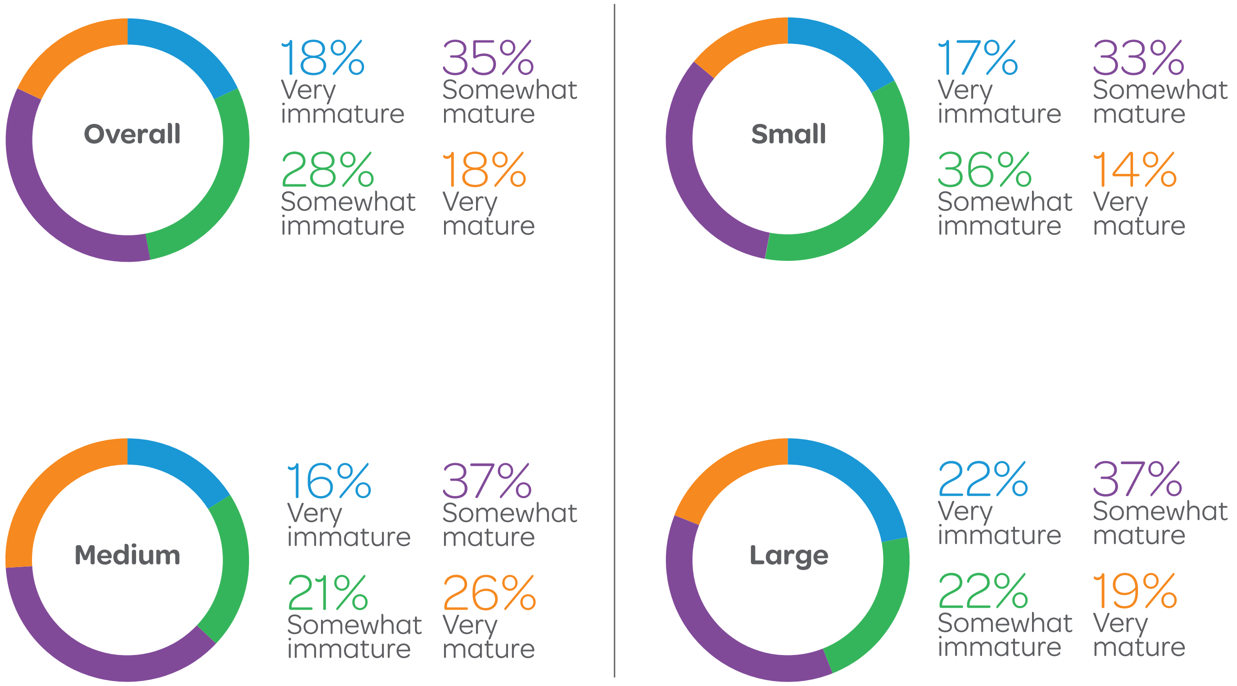
ADDRESSING TOP PROJECT MANAGEMENT CHALLENGES



Maturity of Organization's Risk/Opportunity Management

After a slight uptick last year in risk management maturity, firms of all sizes reported decreased maturity this year. The percentage of firms that cited this discipline as being "Very immature" nearly doubled this year, from 10% in 2017 to 18% in 2018. This decline in maturity has been especially stark in large firms, as only 17% rated their risk/opportunity management as "Very immature" or "Somewhat immature" in 2017, compared to 44% this year. This decrease in maturity may be linked to a decreased emphasis on employing chief risk officers (CROs). Last year, 12% of all companies and 21% of large companies employed CROs, compared to only 5% of all companies and 14% of large companies this year.

MATURITY OF ORGANIZATION'S RISK/OPPORTUNITY MANAGEMENT

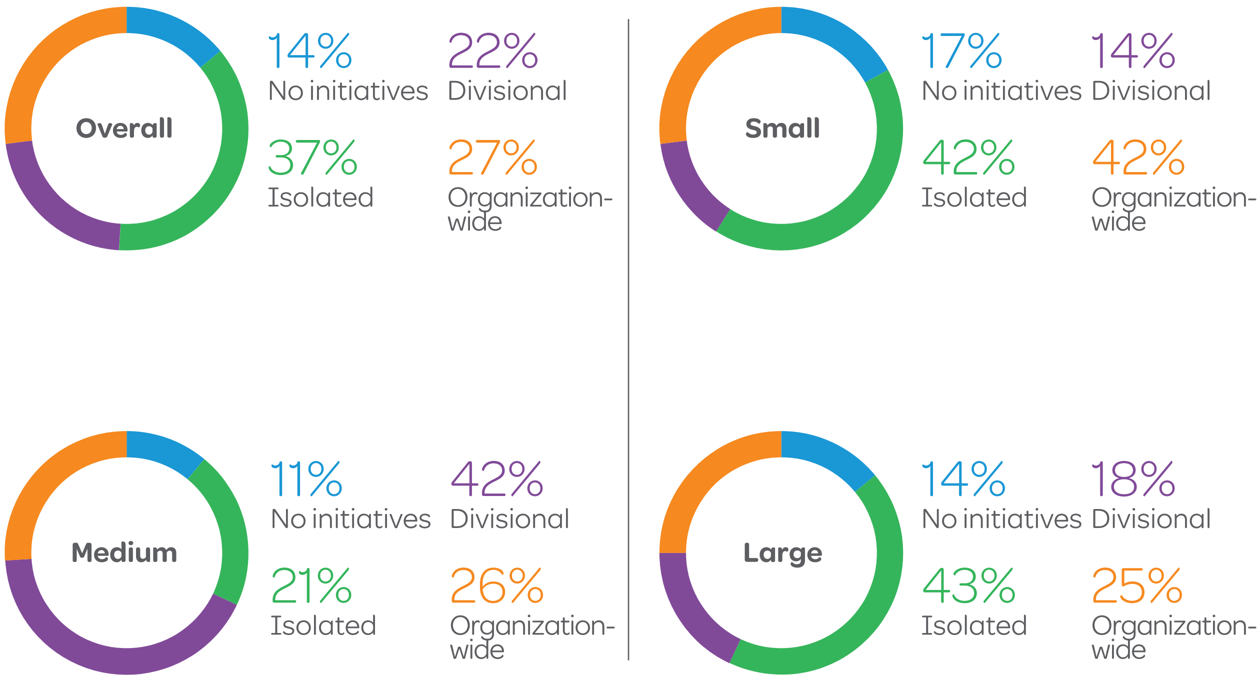


Scope of Organization's Risk/Opportunity Management

Respondents were asked to characterize the scope of the risk/opportunity management initiatives in their organizations. While the vast majority of respondents (86%) reported the presence of initiatives, they also reported stark differences in how initiatives are managed. This is an important subject for organizations to take seriously, as companies with organization-wide initiatives were linked to significantly higher project visibility and project management maturity in the survey. In particular, medium-sized companies seem confused over how to manage these initiatives, with nearly half managing them divisionally.

This confusion becomes especially clear when we examine who at these organizations is primarily responsible for risk/opportunity management. Nearly half (49%) of small companies hand this responsibility to their CEO. While it is good for companies to recognize that risk/opportunity management is important, the CEO should not be taking responsibility for this task. Large organizations are beginning to employ CROs (only large companies reported having CROs this year), but medium-sized companies seem to be caught in the middle: for the most part, they're using COOs to handle risk/opportunity management. As those organizations continue to grow, they will need to develop more mature procedures and formal CRO roles to avoid future management problems.

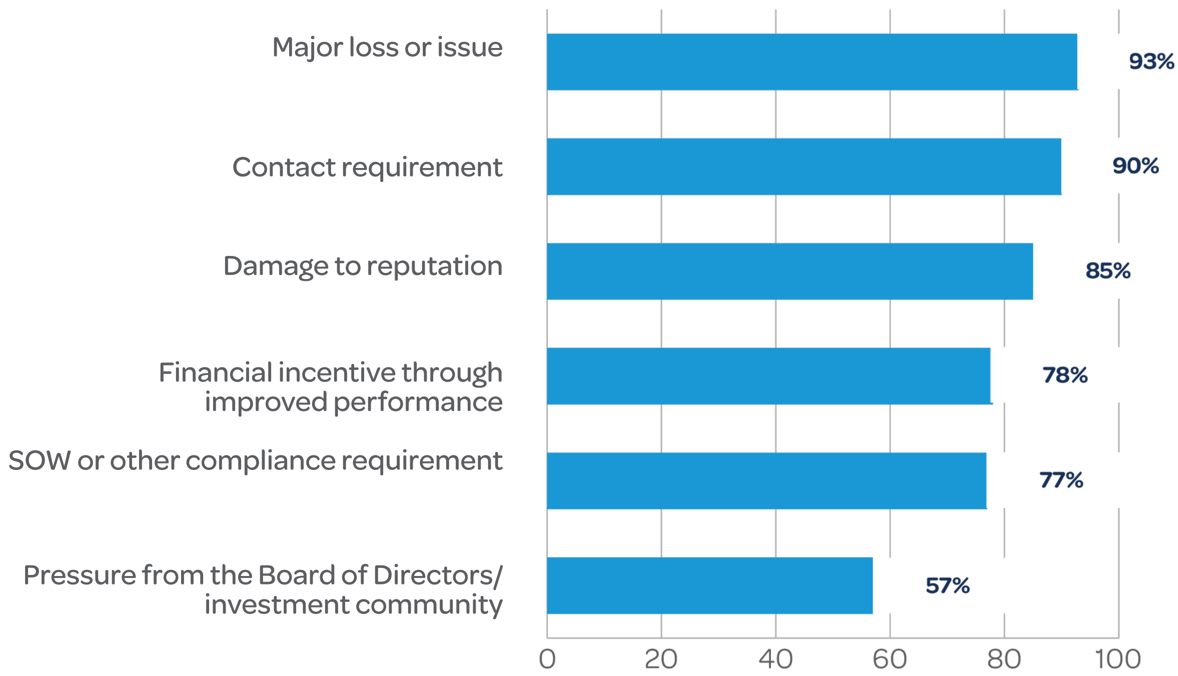
SCOPE OF ORGANIZATION'S RISK/OPPORTUNITY MANAGEMENT



Situations Triggering Risk/Opportunity Initiatives

Respondents were asked which situations would trigger a risk/opportunity initiative for their organization, and all situations received more support this year compared to last (26-45 point bumps across the board). This is an extremely encouraging sign for the industry, as it indicates that organizations are taking risk/opportunity management seriously. One warning sign, however, is that the top five responses are all reactive—that is, companies would only trigger the initiative in response to an undesirable event. Only the lowest rated situation—"Pressure from the board of directors/ investment community"—represents proactive risk/opportunity management. To prevent future problems, companies will need to increase proactive monitoring lest they experience a major event.

SITUATIONS TRIGGERING RISK/OPPORTUNITY INITIATIVES



PROJECT AND RISK MANAGEMENT

CLARITY OUTLOOK

Organizations are doing a good job keeping projects on-time and on-schedule but need to focus on both improving project visibility and developing more mature project management disciplines. Investing in project management training and advanced software systems will go a long way in helping bridge this gap. Similarly, risk management teams at government contractors face maturity problems, but organizations are actively working to address this problem by placing risk management responsibility at the C-level and by creating CRO positions.

SECTION THREE

FINANCE

Organizations are reporting very healthy financials, and the industry seems to have recovered from lean years earlier in the decade

Financial metrics are on the rise across the board, with the healthiest financials the industry has seen in several years. Profit and growth are up and companies are turning their work into money faster. Some of this may be being achieved by organizations controlling their costs, but it also appears to be the result of a healthy market—most respondents indicated an increase in federal contracts at their organizations and one-third reported an increase in IDIQs. Despite this improved performance and positive outlook, companies are still concerned about growth and increasing profit—citing those as their biggest challenges in the year ahead.

Key Takeaways

Overall net profit increased by one point to 9%, with medium-sized companies showing the biggest increase (6 points).

General and administrative (G&A) expense rate (15%), composite fringe rate (28%), and composite overhead rate (39%) all dropped this year, demonstrating that contractors are winning the battle to control costs.

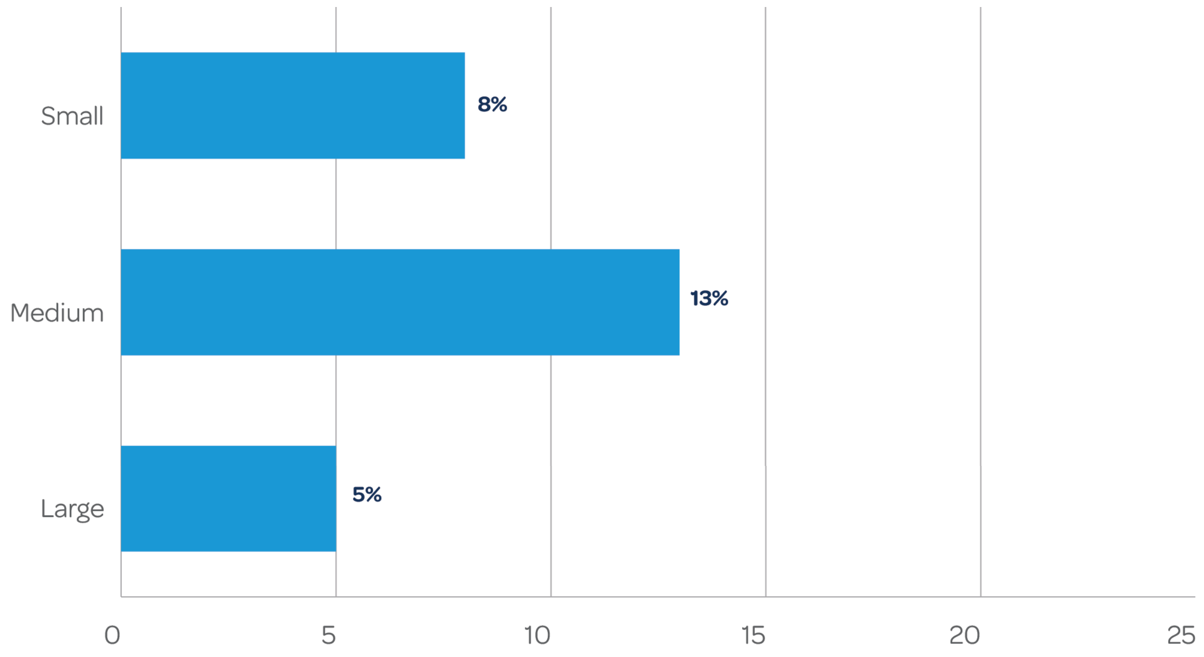
Growth rates rebounded, more than doubling from 6% last year to 14% this year. Looking ahead, companies are optimistic and expect approximately 15% growth rates over the next two years.

Most organizations are not managing contracts in an automated fashion, and one-quarter of companies still use paper filing systems. These organizations need to look ahead to the future and adopt automated digital tools.

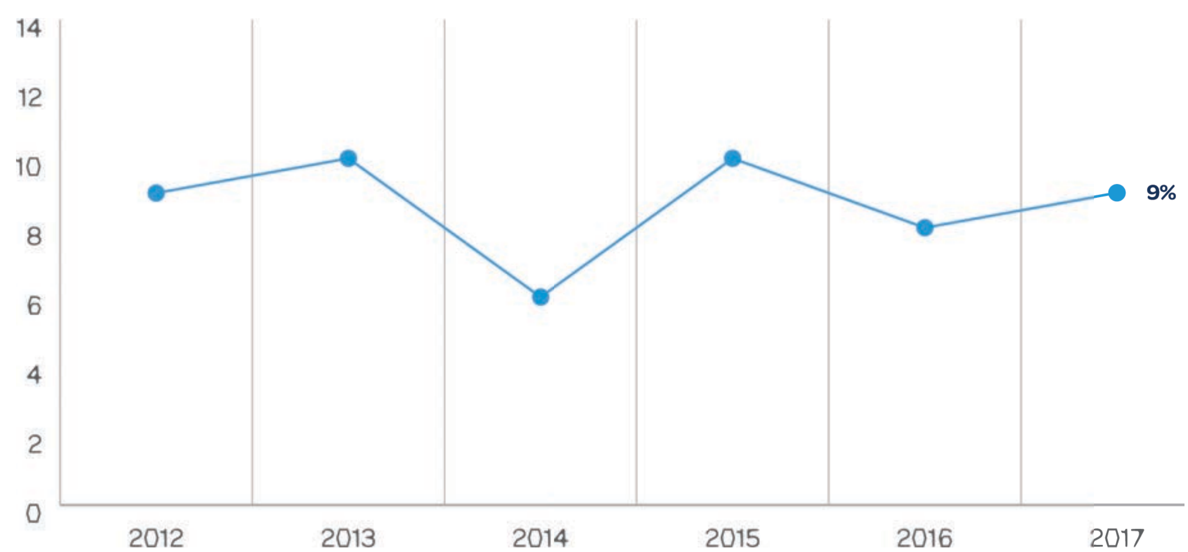
Profit/Loss Margin

While net profit has varied year-over-year since 2012, the industry experienced a slight bump in 2017. This latest bump in profit is driven almost entirely by medium-sized companies—they saw a six point increase in 2017.

PROFIT/LOSS MARGIN



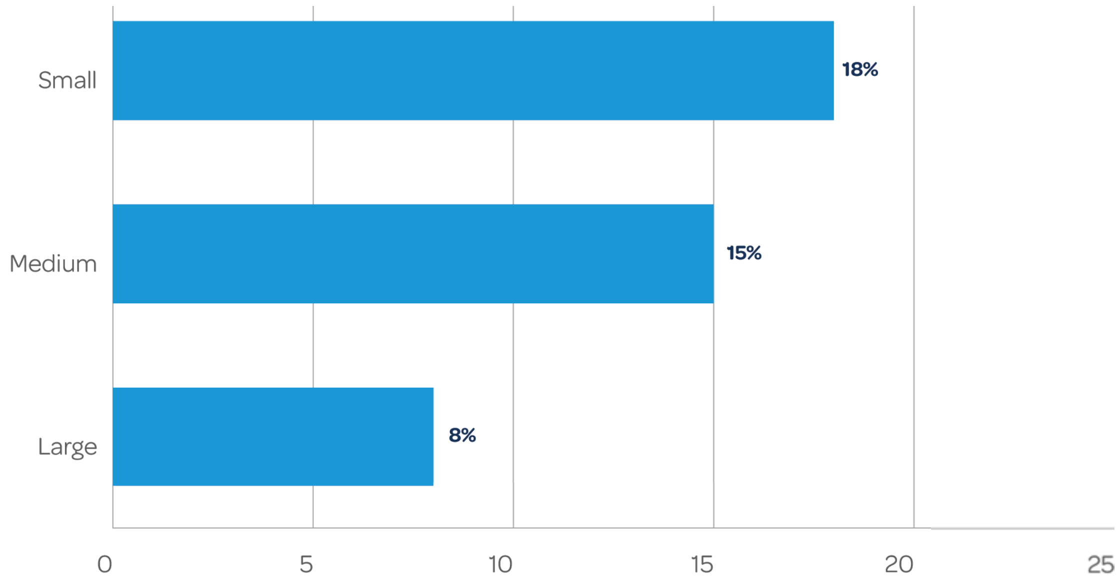
PROFIT/LOSS MARGIN: SIX-YEAR TREND



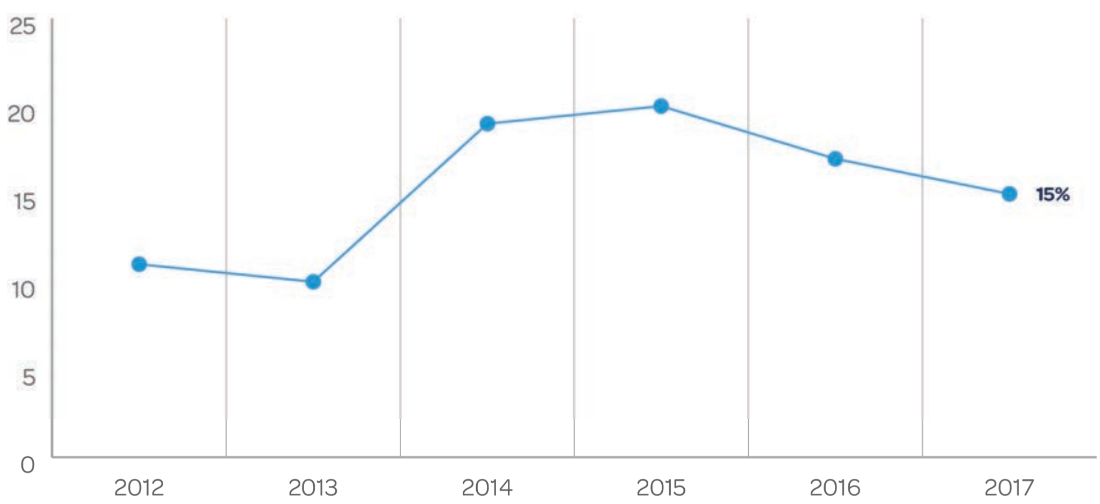
G&A Rate

After two years of increasing costs, G&A rate has now witnessed its second consecutive year of decline, falling 3 points to 15% overall. This drop was consistent across segments, as well, with small, medium, and large businesses all experiencing 2–4 point drops. These drops may be a function of an increasingly competitive marketplace, and companies may be trying to limit their G&A costs as much as possible to stay competitive on proposals.

G&A RATE



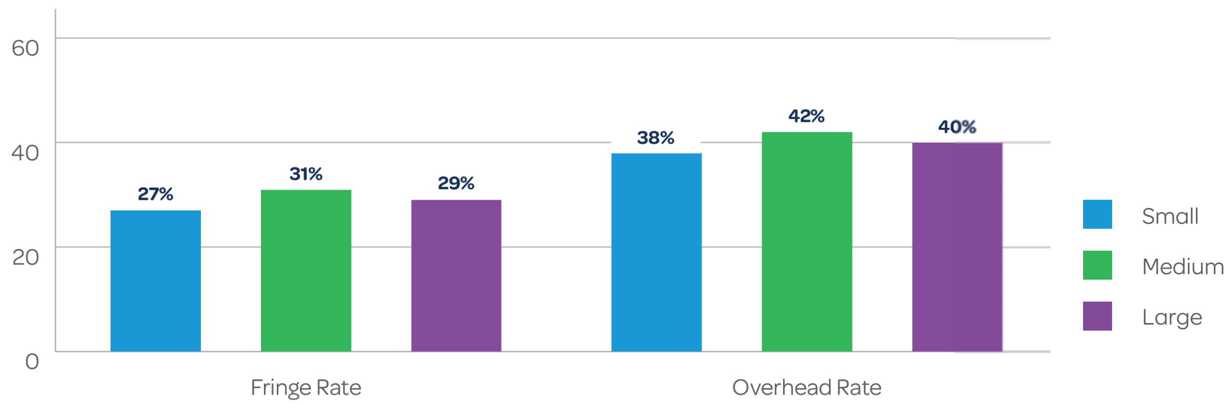
G&A RATE: SIX-YEAR TREND



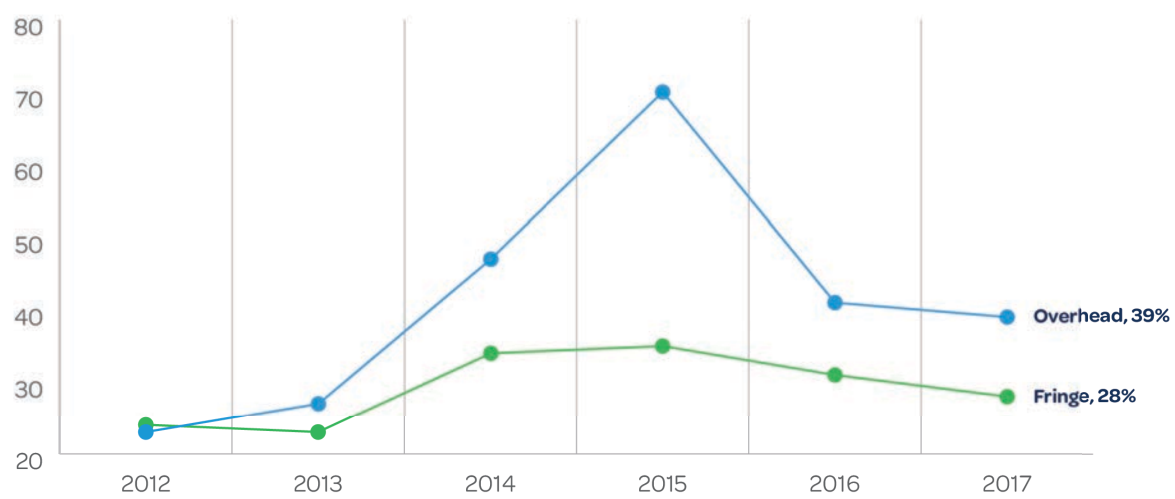
Overall Composite Fringe and Overhead Rate

Overall composite fringe and overhead rates fell for the second straight year, but they're beginning to stabilize—both decreased less this year than last. Organizations across all segments reported fringe rates only 2–3 points lower than last year. The story is very different when it comes to overhead rates, though. In 2016, medium and large companies saw plummeting overhead rates, with both segments seeing rate decreases of about 30%. Small businesses maintained moderate overhead rates (55%). This year, small businesses saw a 17-point drop in overhead rate (to 38%) while medium and large organizations both rebounded to upwards of 40%.

OVERALL COMPOSITE FRINGE AND OVERHEAD RATE



FRINGE RATE AND OVERHEAD RATE: SIX-YEAR TREND

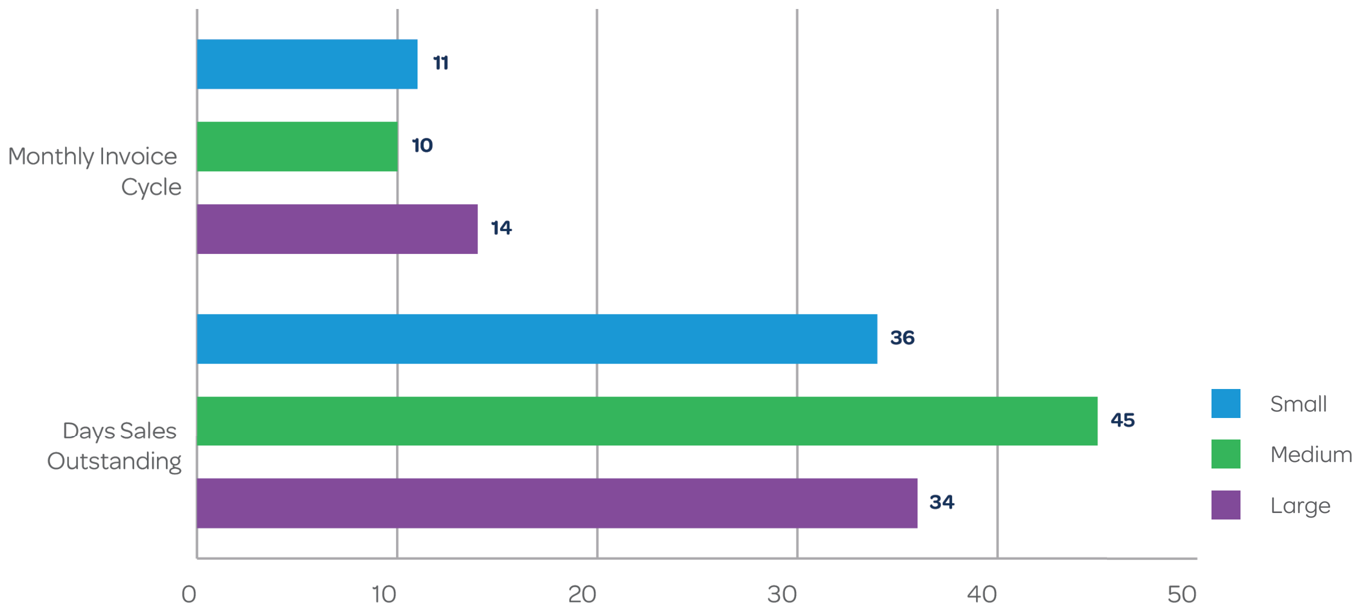


25%
decrease
in invoice
cycle

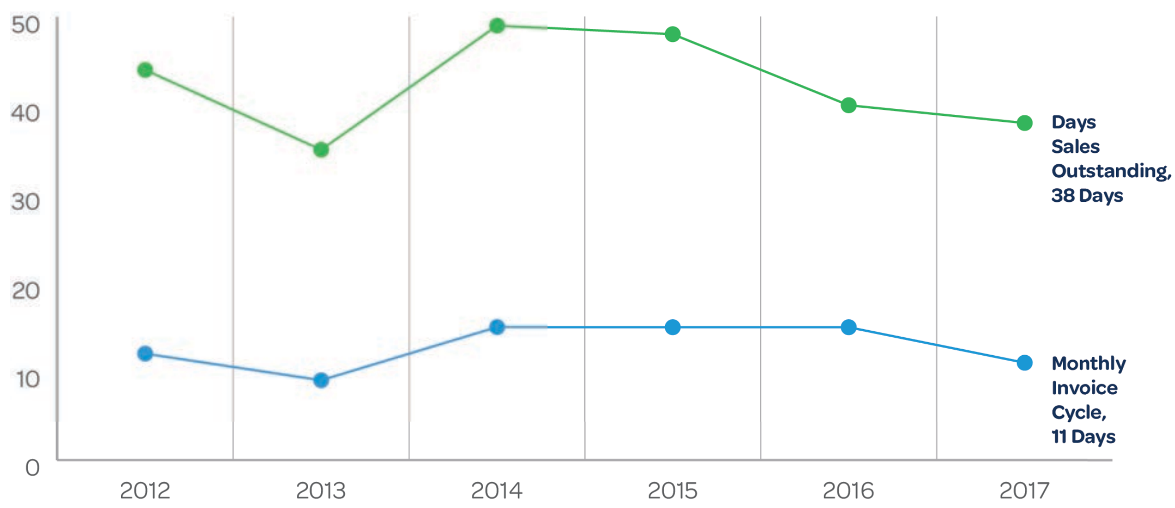
Average Monthly Invoice Cycle and Days Sales Outstanding

Average monthly invoice cycle declined by approximately 25% (from 15 days to 11), with medium-sized companies exhibiting the largest drop (6 days shorter, on average). This is beginning to near the lows of 2013 while still maintaining a strong emphasis on quality control, as can be seen by the continuing decrease in Days Sales Outstanding (DSO). DSO–the number of days from invoicing to payment–went down for the third straight year, with large companies driving this decline (a 10 day drop). These quicker times are very important in helping companies with their cash flow, and this trend is encouraging for the industry.

AVERAGE MONTHLY INVOICE CYCLE AND DAYS SALES OUTSTANDING



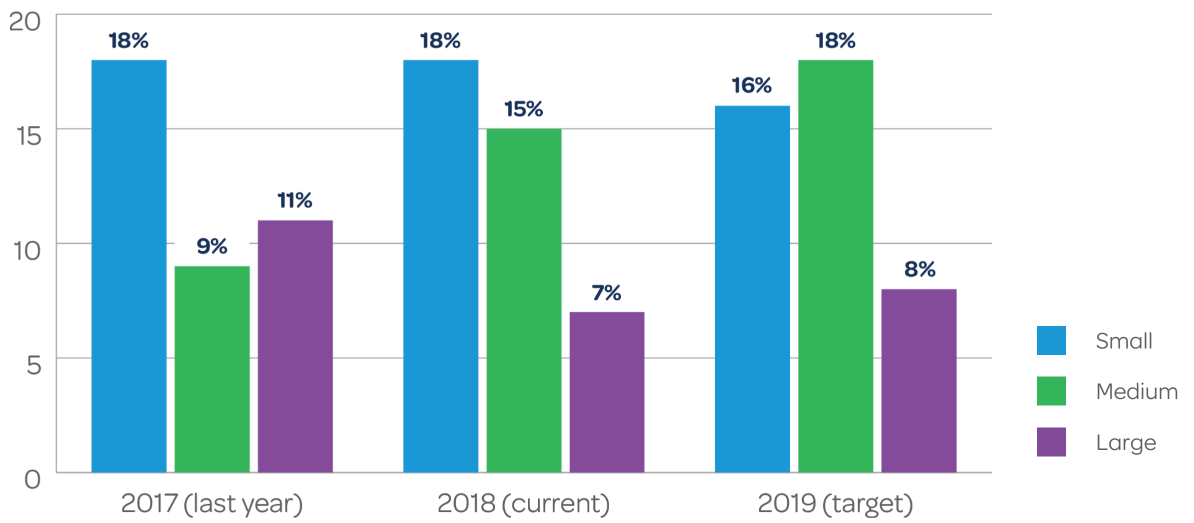
AVERAGE DAYS SALES OUTSTANDING AND MONTHLY INVOICE CYCLE: SIX-YEAR TREND



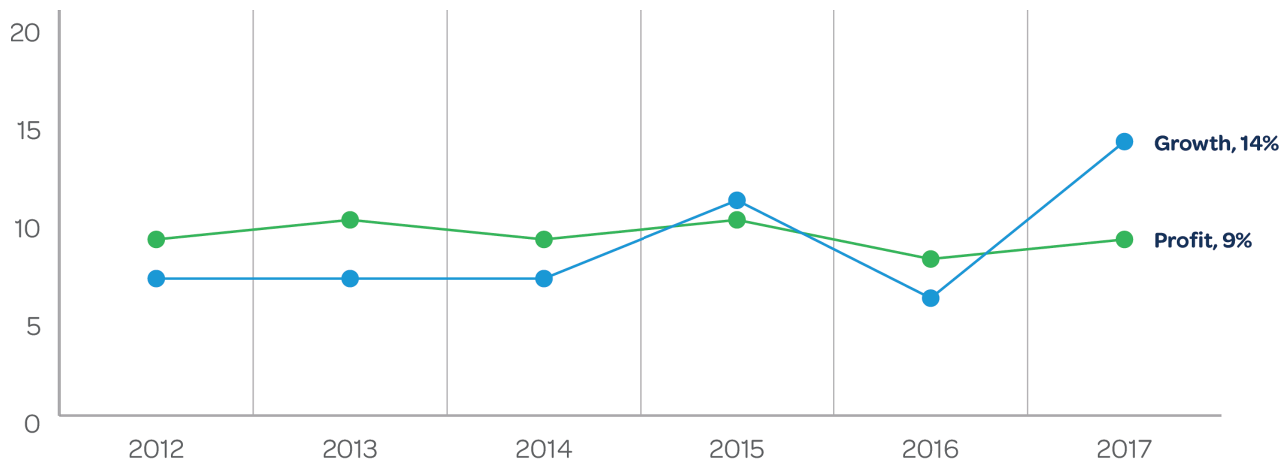
Historical and Planned Growth Rates

After a strong year of growth in 2017 (14% overall), organizations are looking ahead and forecasting similar growth through 2019. Last year, companies projected cautious optimism and ended up growing at double the rate of their expectations. The optimism is much greater this year, and companies expect approximately 15% growth in both 2018 and 2019, with larger companies, as expected, projecting lower growth than small and medium-sized businesses. This expected growth aligns with the increasing investments organizations are making in business development and human capital.

HISTORICAL AND PLANNED GROWTH RATES



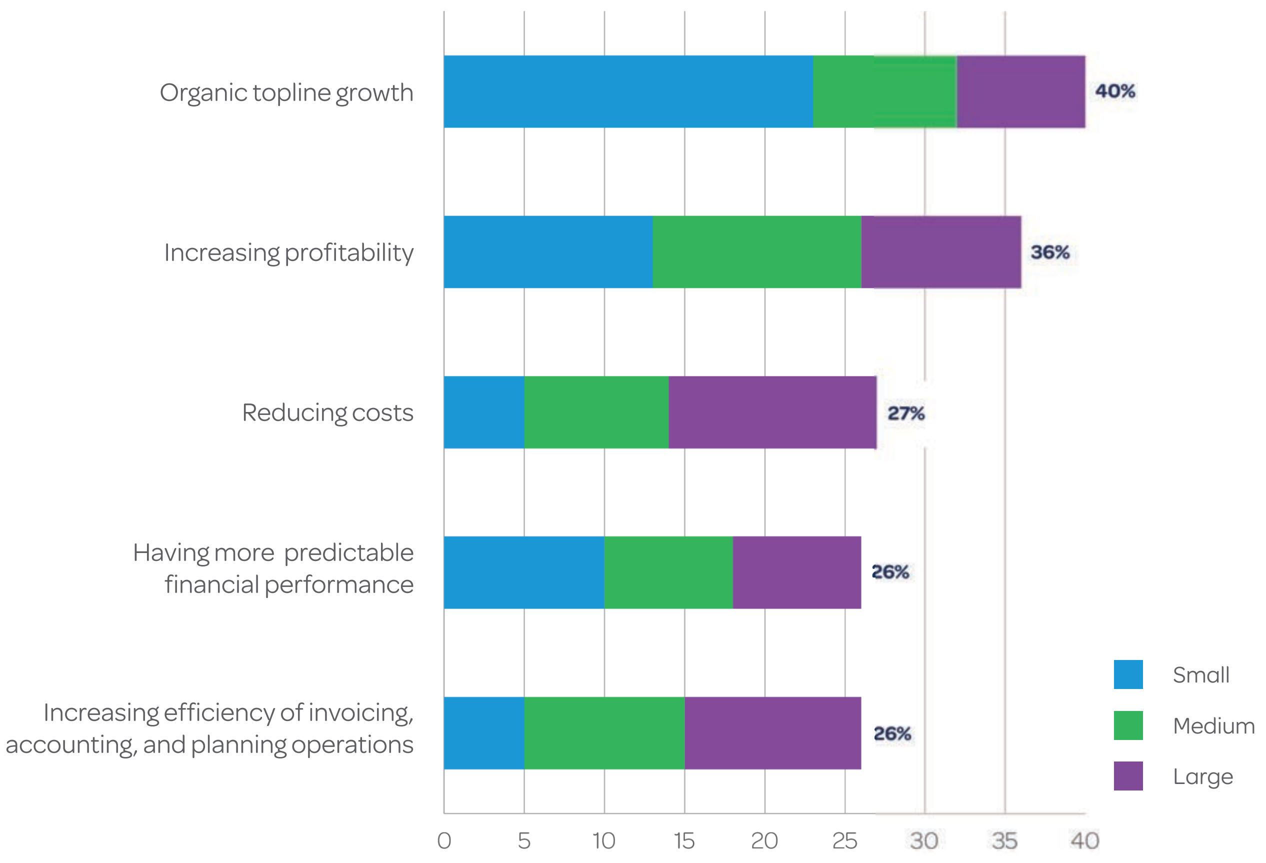
SIX-YEAR GROWTH VS. NET PROFIT



Top Financial Challenges

Organizations are continuing to invest in their businesses and cite "Organic topline growth" and "Increasing profitability" as the top challenges financials leaders will face in the next 12 months. These concerns reflect the fact that the respondents' companies are increasingly diversifying their business while staying in the public sector market. The top challenges are relatively stable across segments, with some minor differences. Small businesses cite "Having more predictable financial performance" as a top challenge at a much higher rate than medium or large companies. Conversely, no small business indicated "Managing M&A activity" as a top challenge, while nearly a quarter of large businesses did. "Managing subcontractor invoices, purchase orders, and payments" was a concern of many large organizations (24%), but the issue was very rarely brought up by small or medium-sized companies.

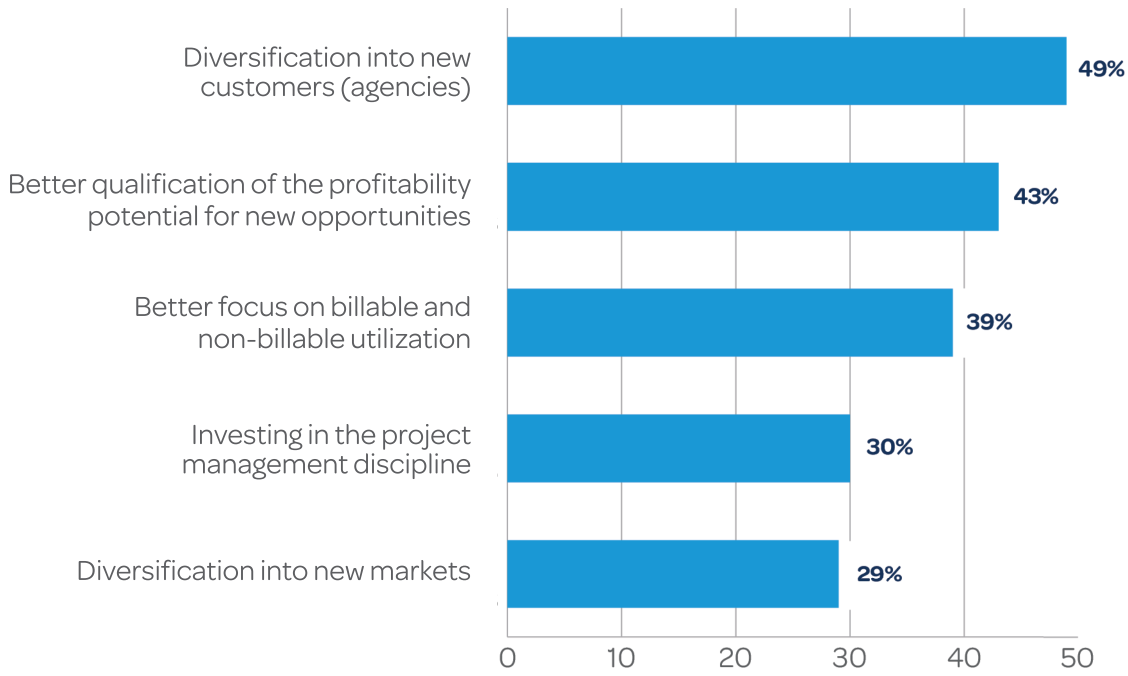
TOP FINANCIAL CHALLENGES



Addressing Top Financial Challenges

Respondents were asked to indicate how they planned on addressing their financial challenges in the next 12 months and, for the third straight year, Diversification into New Customers (Agencies) remains the top selection. The 20 point gap between it and Diversification into New Markets speaks to the fact that contractors are seeking to grow and increase their profits by expanding their government business much more than expanding into the commercial space. Relatedly, organizations are looking to be diligent about the work they go after, and nearly half of respondents cited the importance of Better Qualification of the Profitability Potential for New Opportunities.

ADDRESSING TOP FINANCIAL CHALLENGES

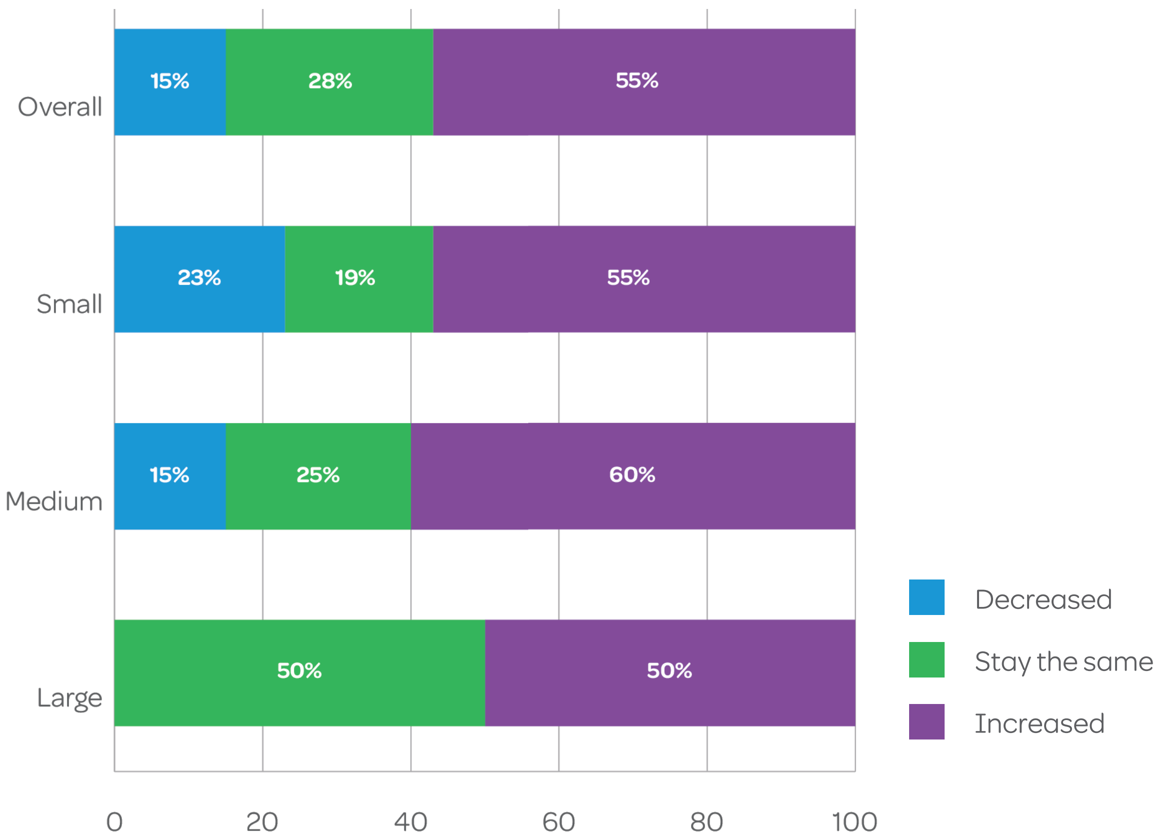


Change in Federal Contracts

Federal spending is up, and only 15% of all respondents reported a decrease in the number of federal contracts at their organization (not a single large company reported a decrease). Professional services organizations that are not in the contracting industry today are missing out on a huge opportunity to diversify their businesses and capture a part of this expanding industry. A majority of companies (across all size categories) indicated an increase in the number of federal contracts at their organization, with mid-sized organizations seeing the largest growth (60% saw an increase). This is generally indicative of increased government spending and a healthy government contracting market but could also be attributed to an increase in merger and acquisition activity. Many of these contracts could also be IDIQs. Government agencies continue to transition towards IDIQs as their preferred mode of contracting, and one-third of respondents reported increased revenue and nearly half reported stable revenue from IDIQs.

> "Resources bandwidth relative to the number of potential opportunities and conflicting pursuits [is a challenge.] You can't bid everything for which you are qualified!"

CHANGE IN FEDERAL CONTRACTS

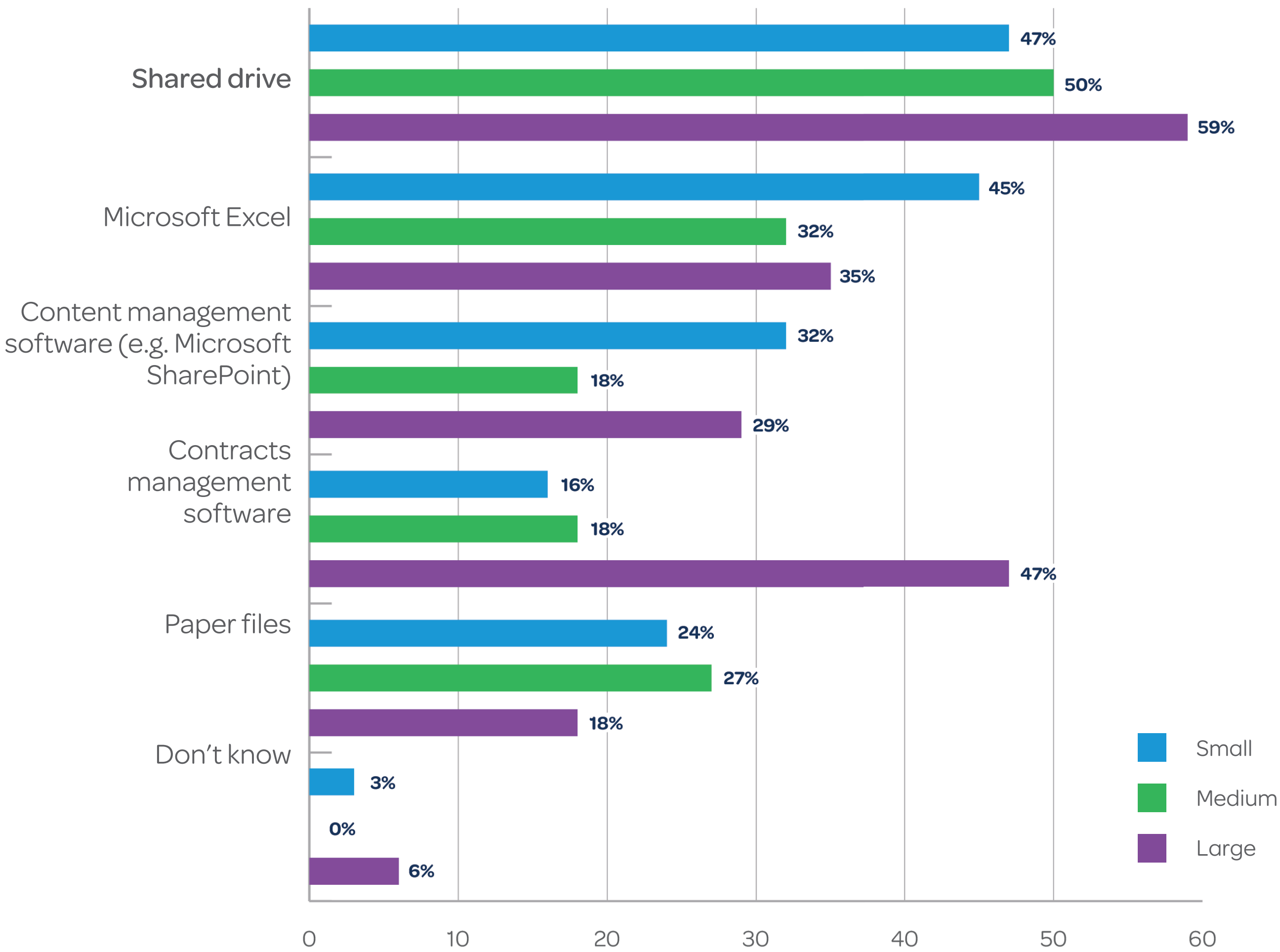


Resources Used Managing Contracts

Large organizations are well ahead of the curve when it comes to managing contracts. 47% of large companies use automated contracts management software, while less than 20% of small and medium-sized companies have invested in those systems. Similarly, small and medium businesses are nearly 50% more likely than large companies to still rely on paper files.

That means their contracts are not connected to their enterprise resource planning (ERP) systems, which, in turn, means they have to spend more time assembling contract information from multiple sources and spend less time on billable work. This trend could also indicate why large companies have G&A rates that are half those of small or mid-sized companies.

RESOURCES USED MANAGING CONTRACTS



FINANCE

CLARITY OUTLOOK

After several years of declining or meager gains, financial metrics are increasing across all sectors of government contracting agencies, and a recent increase in federal spending has been matched by increases in federal contracts at these organizations. During this time of expanding growth, companies would do well to invest in themselves and devote a portion of their increasing profits toward strengthening core business functions such as project management, contract management, and human capital management.

SECTION FOUR

FINANCIAL COMPLIANCE

Less time and resources are being spent on compliance and regulations

Government contractors are spending less time and money on audits than they have in years, as the number of audits is down across all sizes of organizations and existing audits are being completed more quickly and efficiently than in the past. The current administration promised a reduction in regulatory pressure and organizations appear to be seeing those fruits this year—companies reported that government oversight decreased from last year. Despite all these positive financial signs, companies are still experiencing some of the same challenges they do every year, particularly regarding indirect rates and labor and timekeeping.

Key Takeaways

The top three audits companies have undergone in the last two years are DCAA (36% of organizations), Incurred Cost Submission (ICS) (29%), and Internal Controls (26%).

Respondents indicated that ICS and Internal Controls audits are much less costly than in the past, perhaps as a result of compliance departments using software to automate the processes around these audits.

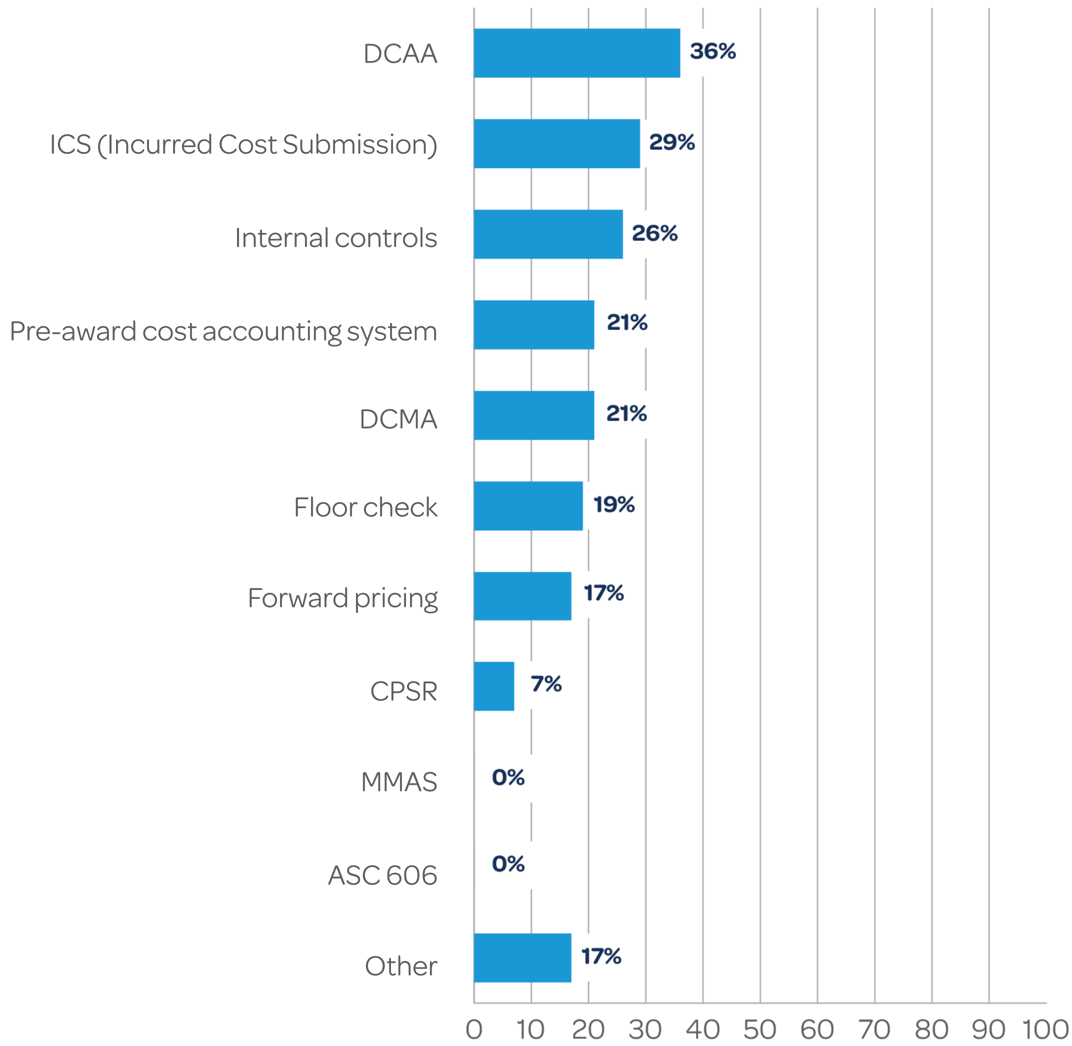
The percent of organizations reporting a decrease in government oversight more than doubled from last year (4% to 9%). Overall, this number is much higher than in years past, and large organizations in particular have seen a decrease.

Only 44% of respondents said that regulatory compliance and audit activity affect their organization's profitability, but this is still a significant concern—especially if organizations have to take away billable resources to spend time on audits.

Audits in Past Two Years

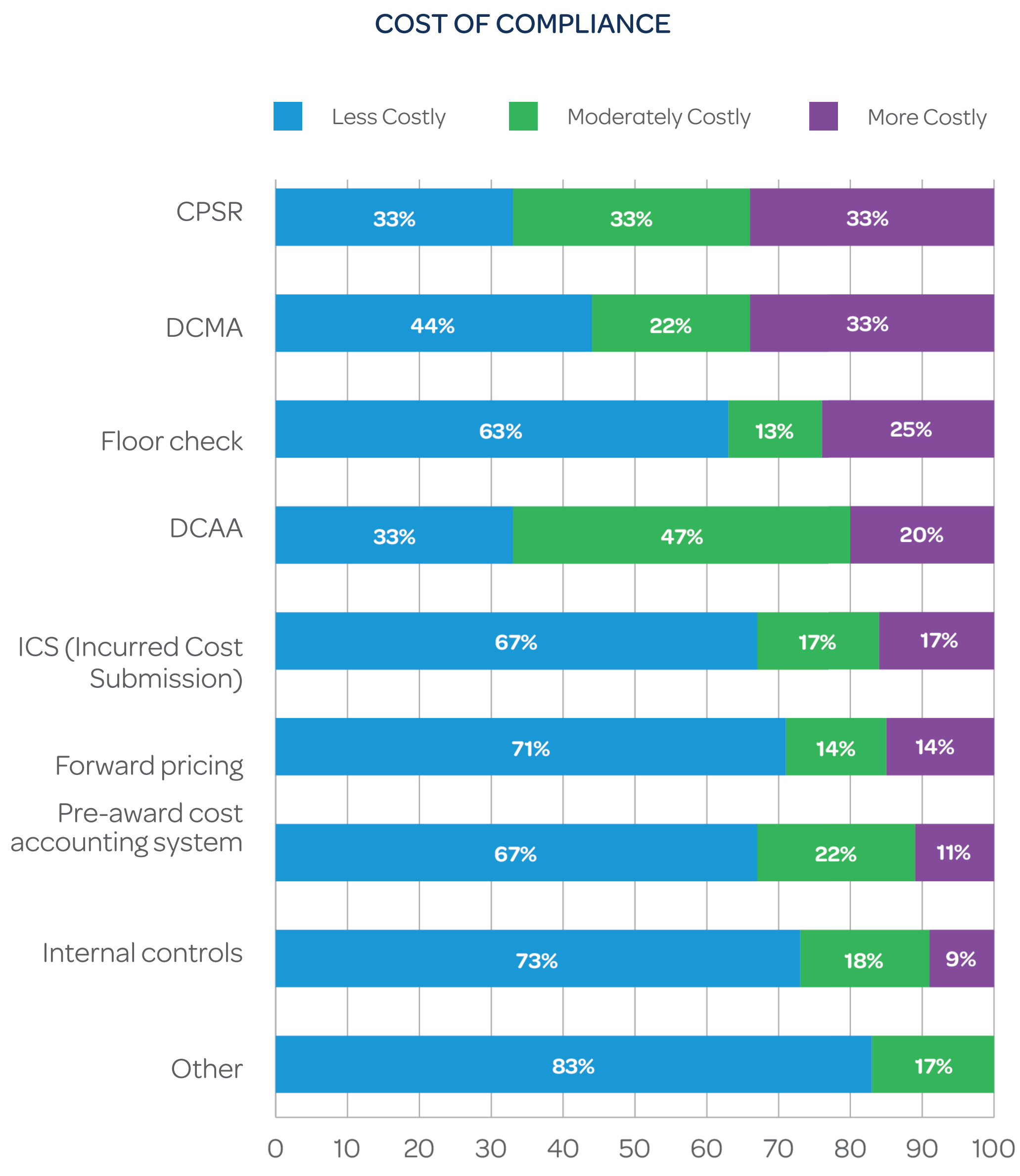
When asked which audits their organization had undergone in the last two years, respondents across all sectors were less likely to select any audit this year than last, and the only audit to see an increase in reporting this year is Forward Pricing. Large organizations were, however, more likely to report audits than medium-sized companies, who were in turn more likely to report audits than small businesses. The decrease in audits may be due in part to the 2016 administration change, as government contractors may be experiencing less regulation overall.

AUDITS IN THE PAST TWO YEARS



Cost of Compliance

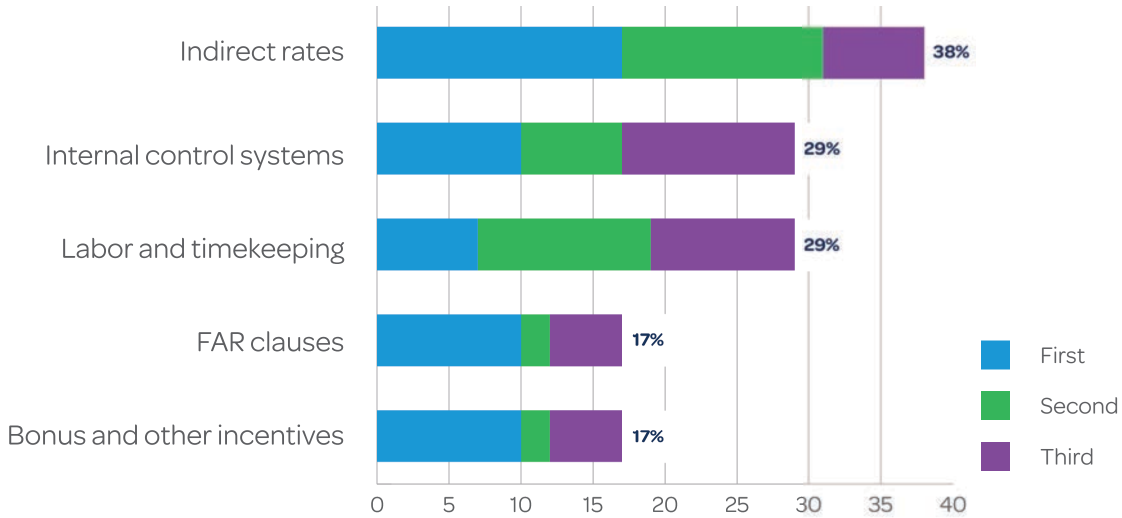
Respondents were asked to rate the cost of compliance with audits they had undergone in the past two years. The only audit to rate as more expensive this year than last is Floor Check, which still only tops out as the third most expensive audit. The reported price of Incurred Cost Submission and Internal Controls audits both experienced sharp drops. Last year, 64% of respondents rated Incurred Cost Submission audits as more costly than the previous year. This year, that number dropped to 17%. Meanwhile, Internal Controls audits saw an enormous 52 point drop. All of this indicates that while organizations are undergoing fewer audits this year, they are also dealing with them in a more cost-efficient manner.



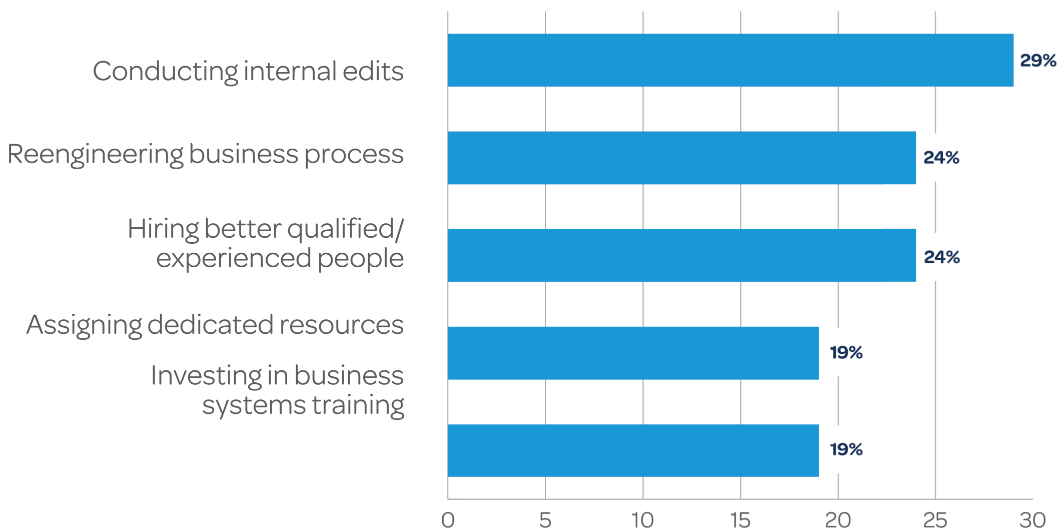
Top Audit Challenges and Addressing Top Audit Challenges

"Indirect rates" tops the list of financial compliance challenges for the fourth year in a row, and the top three audit challenges remain the same as last year, with "Internal controls systems" and "Labor and timekeeping" swapping the second and third places. Multiple challenges saw huge decreases in reporting this year, including "Unallowable costs" (36- point drop), "Billing" (24-point drop), and "CAS compliance" (14-point drop, disappearing entirely). Initiatives to address these challenges also saw drops across the board, indicating that while organizations are facing the same audit challenges, they are becoming more efficient and getting better at addressing their challenges.

TOP AUDIT CHALLENGES



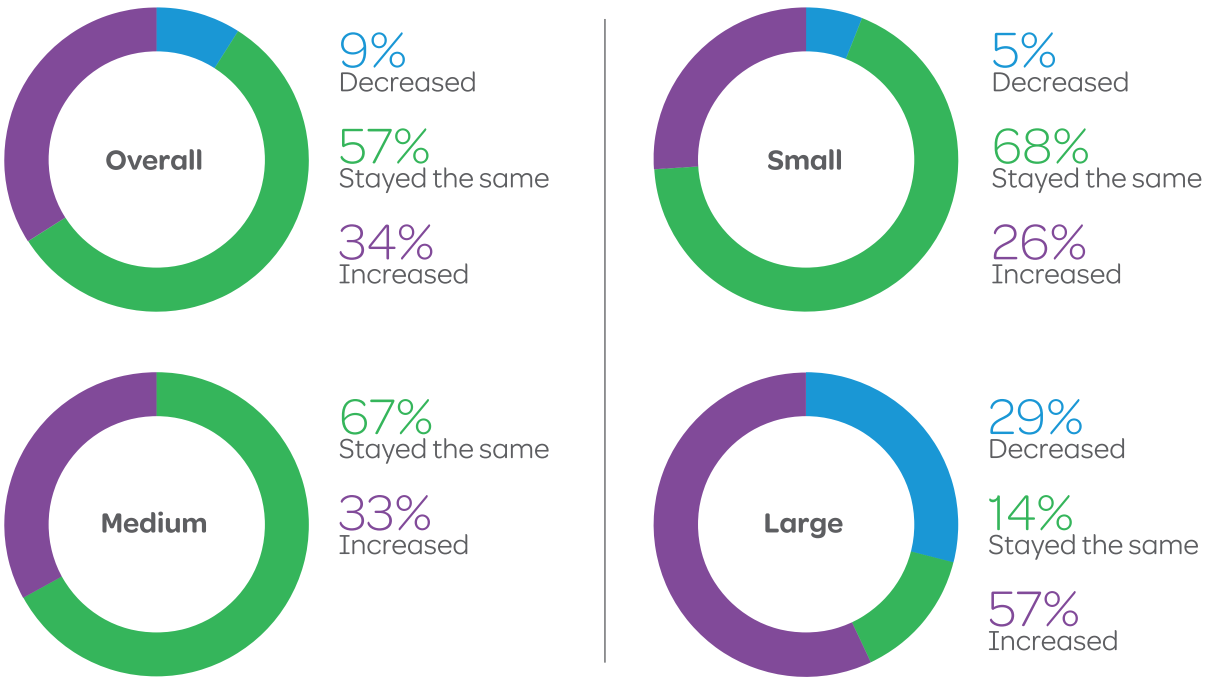
ADDRESSING TOP AUDIT CHALLENGES



Change in Government Oversight

After multiple years without change, organizations have begun reporting decreases in the overall level of government oversight. The percentage of organizations reporting increases in oversight declined by 6 points this year, while the number reporting decreases more than doubled. This is especially evident in the percentage of large companies reporting decreases in oversight, which nearly tripled. This remains consistent with the smaller number of audits reported by firms, and with talk in the industry of deregulation and reduced oversight in the new administration.

CHANGE IN GOVERNMENT OVERSIGHT



FINANCIAL COMPLIANCE

CLARITY OUTLOOK

Government regulation of contractors is decreasing, and organizations are being subjected to a smaller number of audits. Reduced regulatory pressure from the current administration seems to be reducing burden on contractors. Organizations need to remain prepared for audits, however, and need to position themselves to complete them quickly and efficiently to prevent an unexpected audit from derailing their finances.

SECTION FIVE

HUMAN CAPITAL MANAGEMENT

With growth returning to the market, firms are hiring facing stiff competition for talent

Government contractors are taking longer to fill open positions and are experiencing more turnover this year than last—a result of an increasingly competitive marketplace for talent. These trends, combined with and exacerbated by the generational shift in the workplace from baby boomers to millennials, are forcing employers to spend more time both on acquiring new talent and resources and on retaining current employees. This twofold strategy of talent acquisition and retention has become increasingly important, and government contractors are trying to rebrand themselves, engage employees, and strengthen their compensation and benefit packages as they compete against each other and commercial companies for the most talented individuals.

Key Takeaways

62% of respondents indicated that their companies have more open positions now than 12 months ago.

Organizations are taking longer to fill open positions as they compete over the same limited talent pool, particularly for upper level talent. Fewer than 75% of companies are filling positions in less than two months, compared to 90% last year.

Government contractors are having a hard time recruiting millennials. This could be due to competition in the marketplace or difficulty in making their open positions attractive to younger individuals. With this in mind, many contractors are focused on rebranding their companies to help in all aspects of talent acquisition and retention.

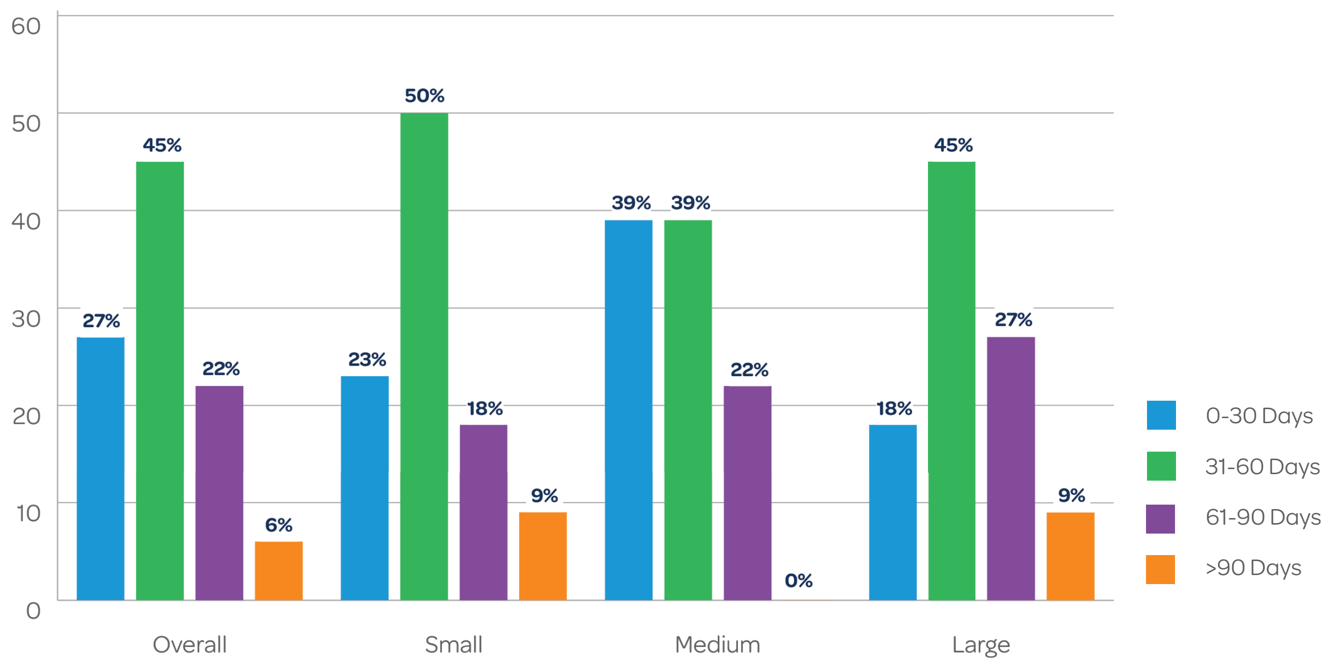
Government contractors are increasingly bringing on subcontractors to help with their work, though larger companies rely on subcontractors less often. When subcontractors are brought onboard, companies lack a consistent, automated way of managing them.

Retaining talent has become the top human capital issue in the industry. The percentage of organizations tracking employee retention as a KPI jumped from 16% to 66% in the last year. Most firms also track voluntary (53%) and involuntary (50%) turnover.

Average Time to Fill Positions

Companies are finding it harder to fill open positions this year than last, as the economy has grown and, with it, so has competition for talent. 6% of organizations reported taking more than 3 months to fill their positions—no companies reported that last year. Part of this may be because companies are having a harder time finding experienced people to fill senior level positions as baby boomers retire from the industry.

AVERAGE TIME TO FILL POSITIONS



Workforce Generational Composition

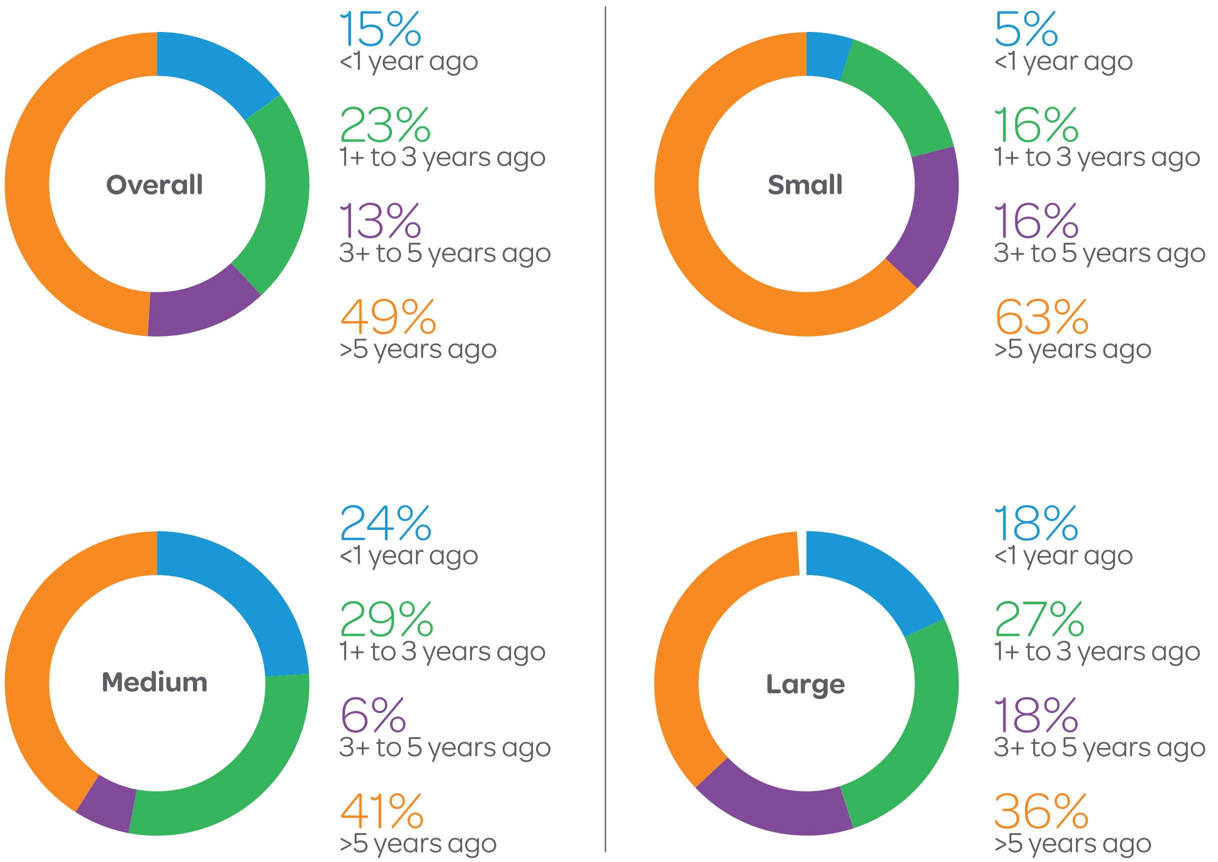
Less than one-third of employees at government contracting organizations are millennials, despite the fact that millennials are the largest generation in the workforce. Gen Xers, meanwhile, are vastly over-represented in the industry. This may be due in part to the perception that government contracting is not a very modern industry, especially compared to technology and new media companies that tend to attract more millennials. Workers from older generations appear to be leaving the government contracting industry at a fairly low rate—still 5% of individuals at responding organizations are 72 years of age or older.

WORKFORCE GENERATIONAL COMPOSITION

Last HCM Software Upgrade

Nearly half of respondents say that their organization has not updated its human capital management system in over five years, which may be contributing to the increasingly long times it is taking companies to fill open positions. The percentage of companies who updated their human capital management systems within the past year fell 20 points from last year, which is especially disappointing. Companies of all sizes need better systems in place to attract, recruit, and retain talent. As companies continue to face challenges recruiting and retaining talent, we expect to see significant investment in this area in the next 1-2 years.

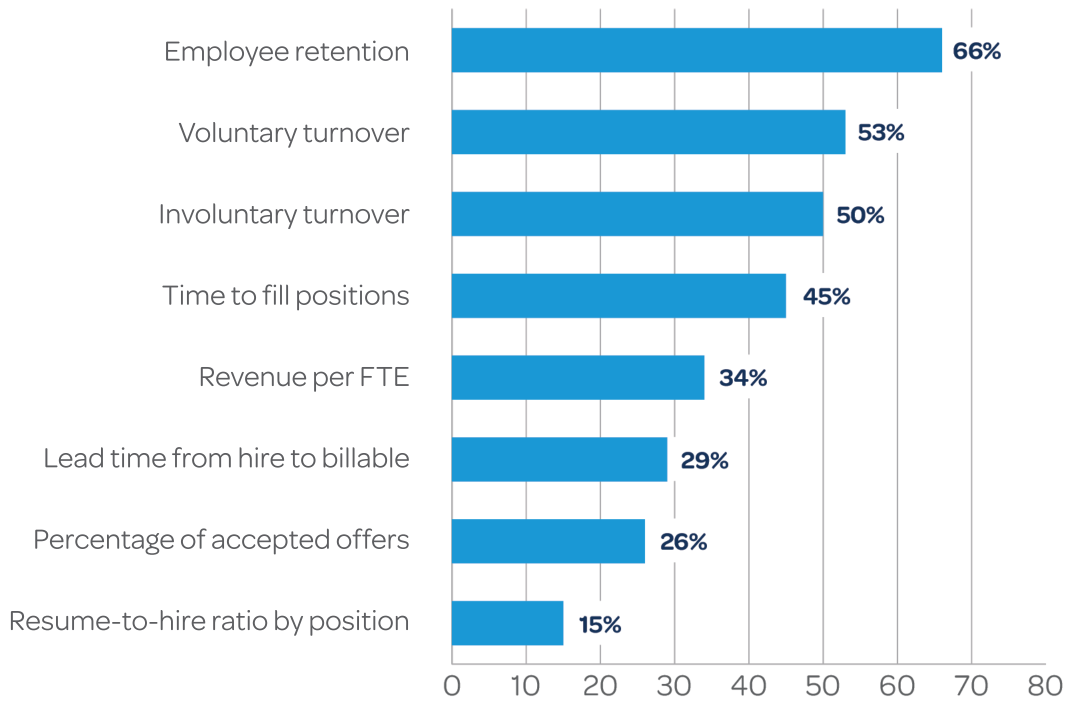
LAST HCM SOFTWARE UPGRADE



Current KPIs Tracked

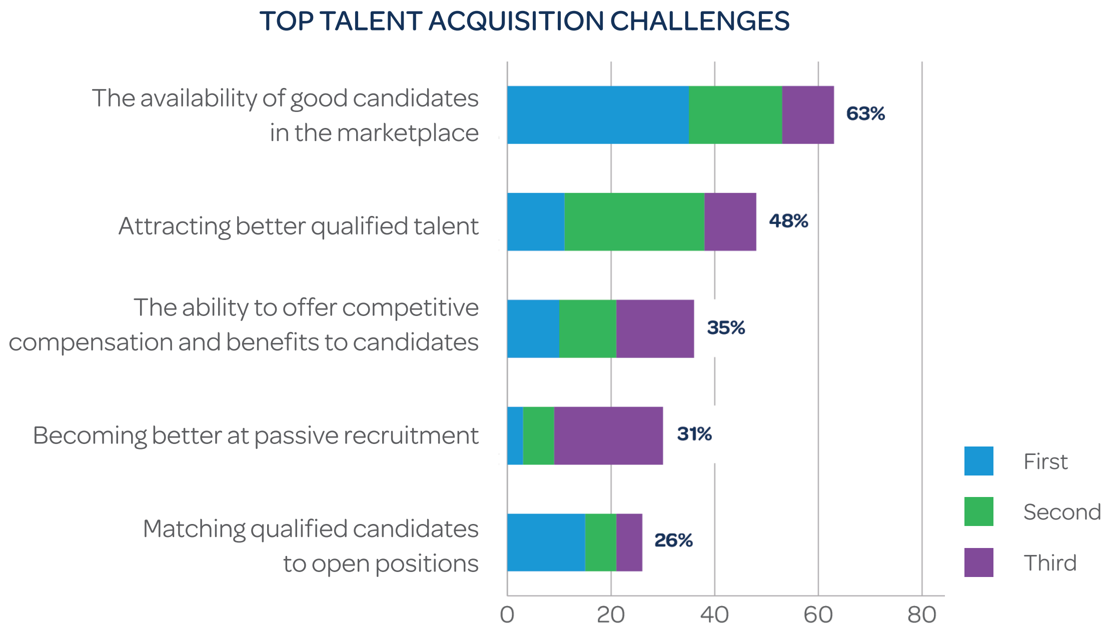
As the talent market becomes increasingly competitive and companies struggle to fill open positions, organizations have shifted much of their focus towards keeping talent. Respondents indicated what human capital management KPIs they track, and "Employee retention" increased 50 points this year. Every single metric in the survey saw double-digit increases. As organizations keep a closer eye on these KPIs, they will increasingly be able to predict changes in their workforce and manage challenges in talent acquisition and human capital management.

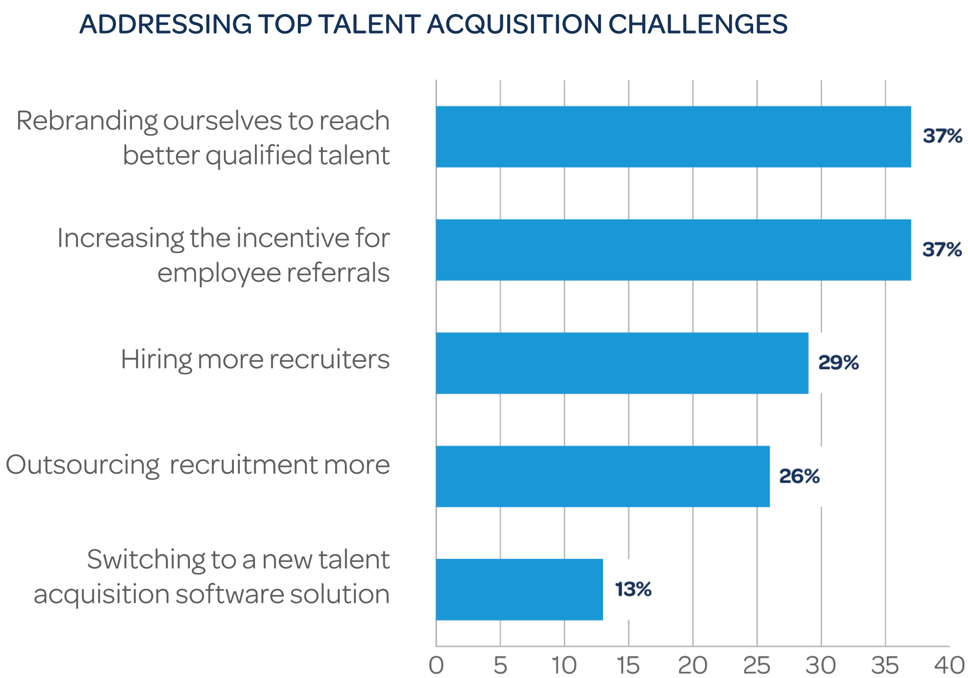
CURRENT KPIS TRACKED



Top Talent Acquisition Challenges and Addressing Top Talent Acquisition Challenges

Finding good talent remains far-and-away the top talent acquisition challenge facing government contractors. Fortunately, organizations are taking the right steps to address this challenge. They are increasingly focused on re-branding themselves and are seeking multiple ways to improve their recruiting in hopes of making their company competitive and attractive in the quest to win over talent.

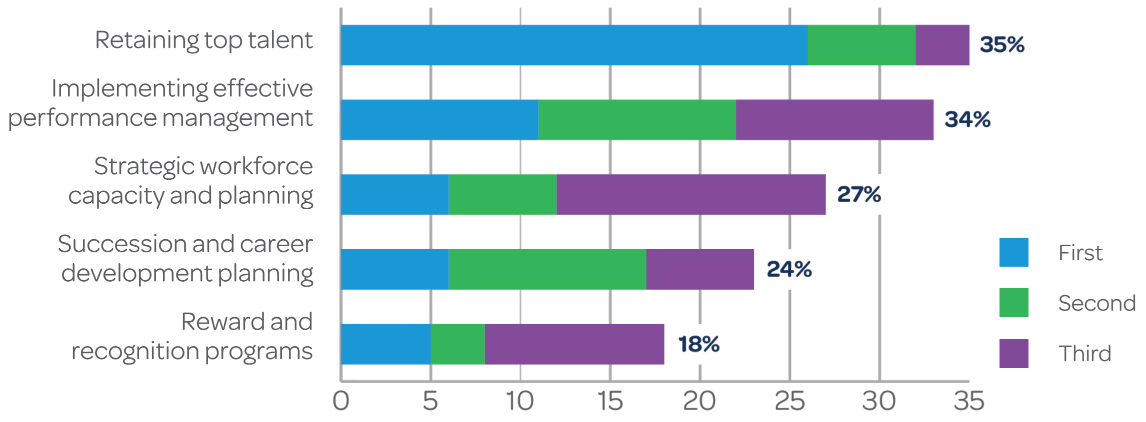




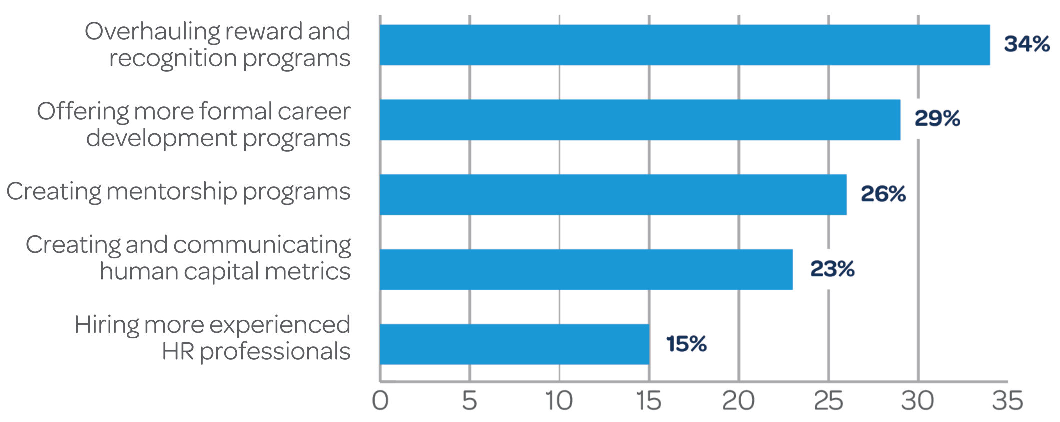
Top HR Management Challenges and Addressing Top HR Management Challenges

Government contractors are rightly focused on employee retention, as the government contracting space has shifted from an employer to employee market. Companies focused on retention will be able to spend less time recruiting new employees, which is an increasingly burdensome practice. The top five challenges reported by respondents all relate to employee retention, as do the top three initiatives to address challenges. Employers are notably focused on increasing the support and rewards they provide to employees, but they are also facing challenges with performance management programs. Revising their programs or adopting new performance management solutions will help organizations retain employees and address top human resource management challenges.

TOP HR MANAGEMENT CHALLENGES



ADDRESSING TOP HR MANAGEMENT CHALLENGES



HUMAN CAPITAL MANAGEMENT

CLARITY OUTLOOK

The key issues in human capital management remain unchanged: keeping a hold of their top talent and filling open positions with good employees from the marketplace. With growth up in the industry, the competition for talent has positioned one firm's retention directly at odds with another's new hiring. Organizations are, and need to continue, focusing on attracting Millennials, engaging employees, and strengthening their compensation and benefit packages to win the battle for top talent.

SECTION SIX

INFORMATION TECHNOLOGY

IT departments show incredible year-over-year stability, and organizations continue to move to the cloud

Government contracting IT departments show few changes from last year to this year, and they expect few changes in the near future. Organizational spending on IT increased at a similar pace as years past and cloud adoption remained steady. The top areas of investment in business applications are security, customer relationship management, accounting, and business intelligence. The top IT challenges all remain the same as last year, with IT and data security a clear frontrunner, and the largest portion of companies have made this issue their top IT priority.

Using new questions this year, we asked organizations to look further into the future and provide input on the impact of technology trends on their business. With a plethora of emerging trends, most organizations are focusing on technologies that can increase automatic data collection and connectivity.

Key Takeaways

The major focus of IT departments continues to be cybersecurity and data security, and the largest portion (34%) of respondents indicated that they plan to make the most investments into security and authentication systems.

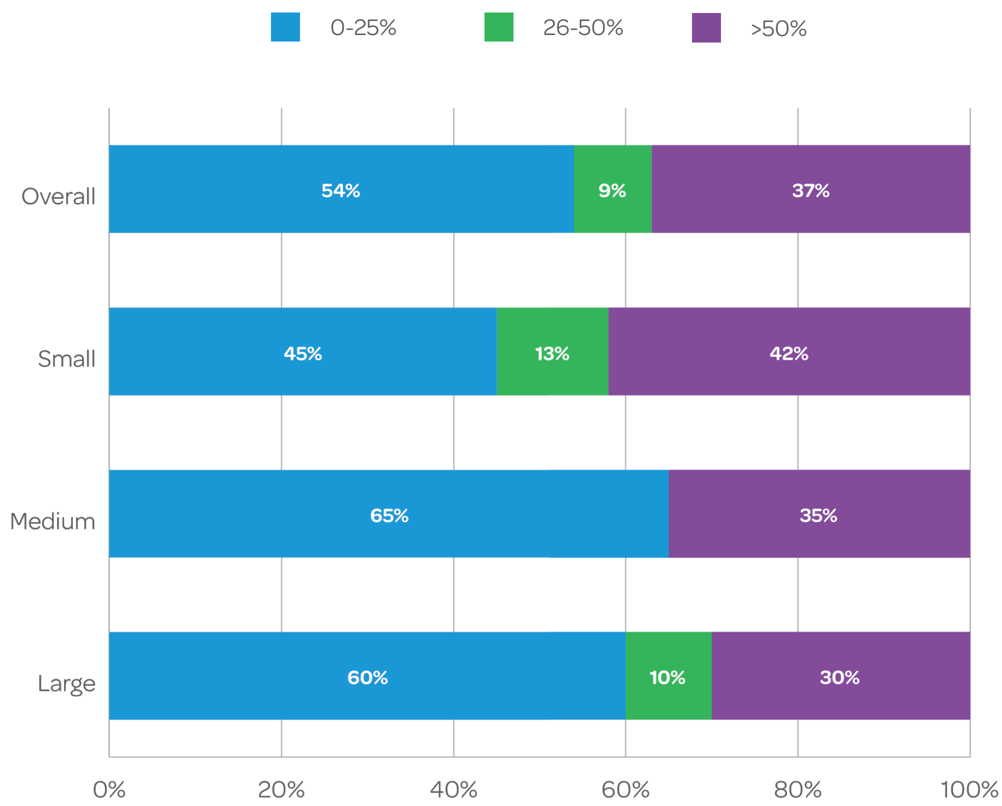
The largest portion of respondents (43%) indicated they have plans to move on-premise solutions to the cloud within the next 12 months.

Organizations have an eye on the future and are keeping track of several key technology trends, including data science, artificial intelligence, the Internet of Things, and machine learning.

Business Applications in the Cloud

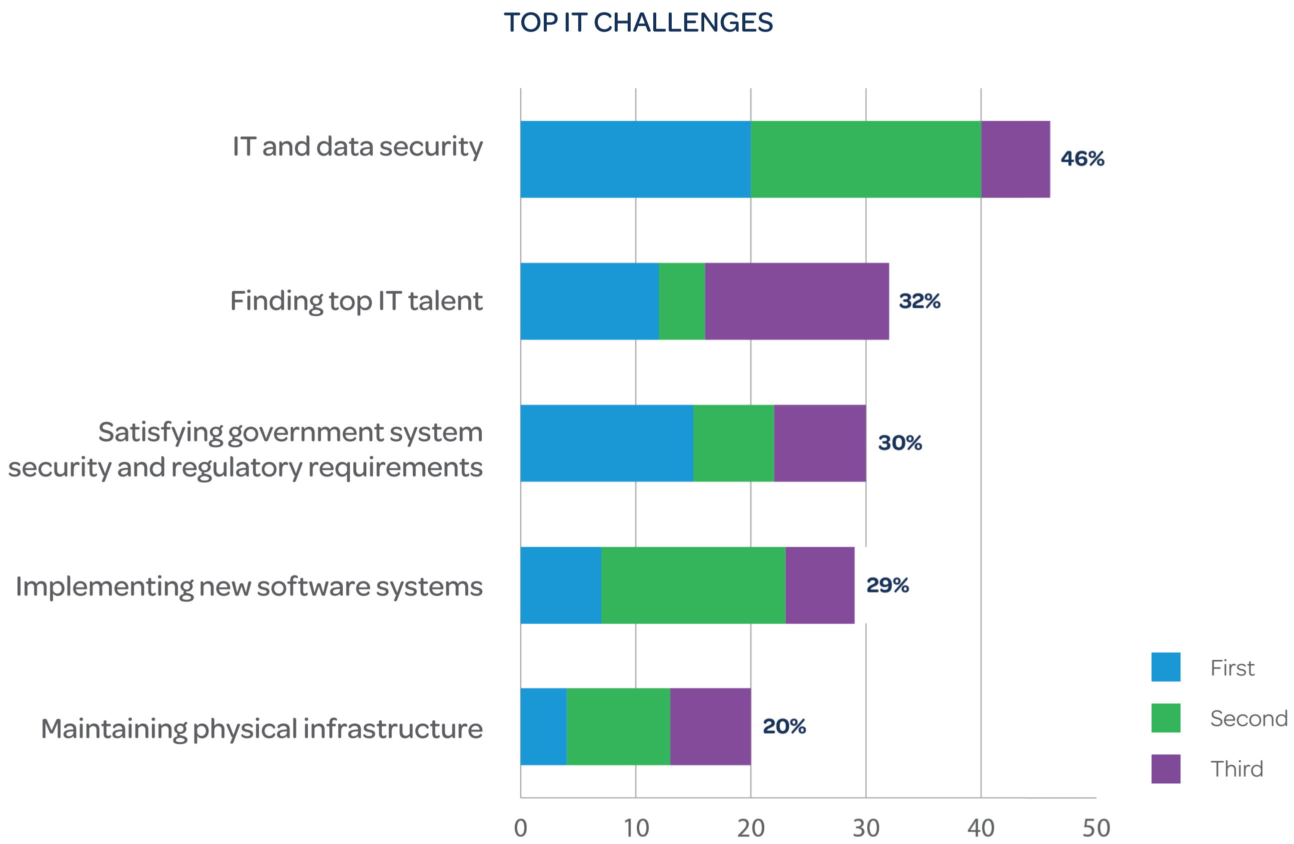
The past several years of survey results indicated that organizations were worried about moving to the cloud or foresaw challenges with the move. This year's results show a stark split between organizations that have already migrated to the cloud (37%) and those that haven't (54%). Organizations resisting a move to the cloud (most of them mid-sized or large) need to pay attention to smaller companies that are receiving tangible benefits from cloud first strategies. Organizations already heavily invested in the cloud report fewer concerns over IT costs since cloud solutions often come with a lower cost than local enterprise solutions. These companies are also often quicker to respond to challenges. Fortunately, the importance of shifting to the cloud seems to have been recognized by the industry, as nearly half (43%) of companies plan on moving on-premise solutions to the cloud in the next 12 months.

BUSINESS APPLICATIONS IN THE CLOUD

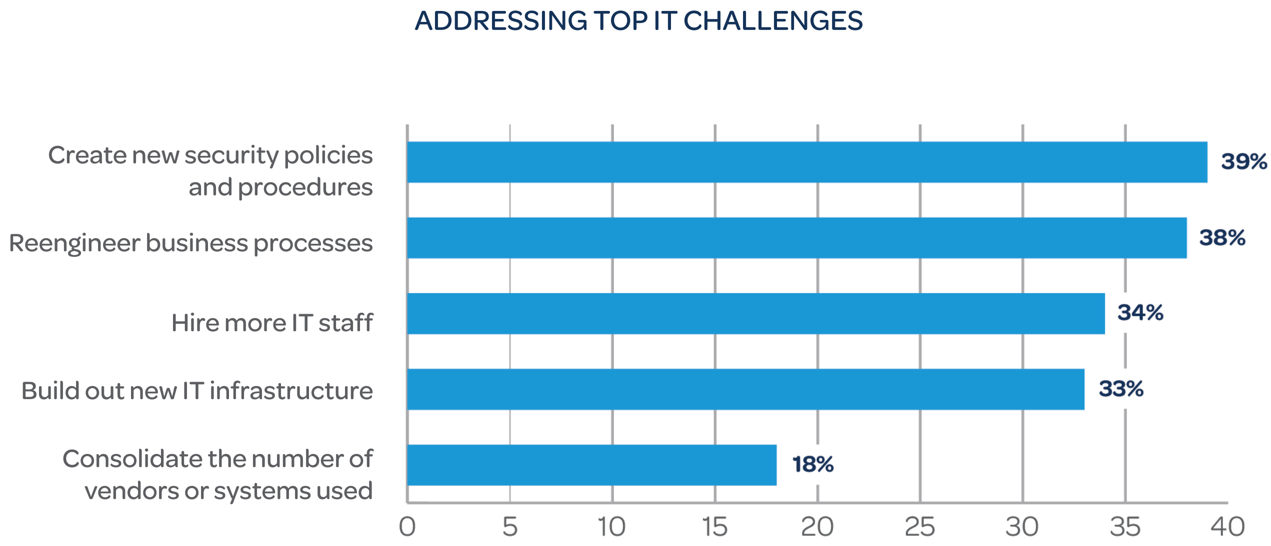


Top IT Challenges and Addressing Top IT Challenges

The top three challenges facing IT departments remained the same since last year; however, “Finding top IT talent” and “Satisfying government system security and regulatory requirements” swapped second and third, as regulations dropped 27 points this year. IT and data security is the clear burning issue facing IT leaders, and the survey reflected that as 46% of respondents cited the issue as a top challenge. Since last year, responses for “Offshore IT staff” dropped significantly (19 points), matching a similar 16 point drop in “Operating with a smaller IT budget.” Together, these drops indicate that IT budgets may not be facing the financial pressures they did in the past.



Top IT Challenges and Addressing Top IT Challenges Cont.

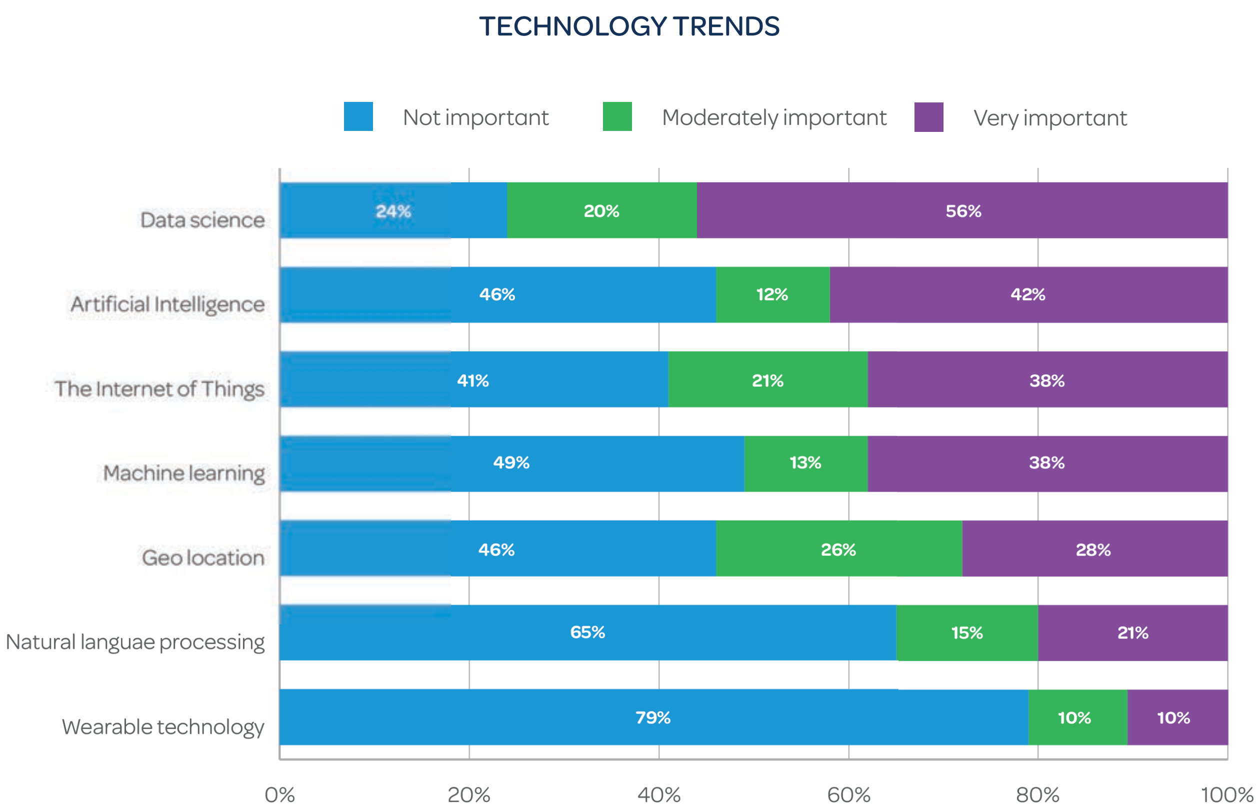


"Coping with government clients who are behind the technology curve and want to do everything in older ways... as opposed to much better, less costly, newer technology."

Technology Trends

Firms that aren't focusing on future technology trends are liable to fall behind competition or miss the next big thing. In a new question this year, organizations were asked to indicate how important they felt seven emerging technology trends were to their business. Three-quarters of all companies said that data science is very important or moderately important to their business, while artificial intelligence, the Internet of Things, machine learning, and geo location were all marked by a majority of respondents as very important or moderately important.

The discipline of data science is becoming more and more mature as techniques and tools continue to develop. Pulling information from each department into a common data store can give you a competitive advantage over your competitors. You may uncover patterns in your operations or customers that will help you win the next opportunity or gain the next efficiencies that lead to higher profits or more competitive rates.



INFORMATION TECHNOLOGY

CLARITY OUTLOOK

Each part of your business collects data about your operations, your customers, and your projects, and data security remains the top IT concern among the field. Continued investment in solutions to counter cyberattacks will help prevent unwanted security situations. Firms continue to move to the cloud to improve efficiency, and, looking even further ahead, organizations are keeping tabs on future trends that could help increase automatic data collection and connectivity.

APPENDIX

STATISTICS AT A GLANCE

Business Development	Small	Medium	Large
Win Rate	37.9%	43.7%	41.8%
Project Management			
Project Status Visibility	High 54% Moderate 23% Low 23%	High 50% Moderate 41% Low 9%	High 39% Moderate 45% Low 16%
Risk Management Maturity	Very Mature 14% Somewhat Mature 33% Somewhat Immature 36% Very Immature 17%	Very Mature 26% Somewhat Mature 37% Somewhat Immature 21% Very Immature 16%	Very Mature 19% Somewhat Mature 37% Somewhat Immature 22% Very Immature 22%
Top Project Management Challenges	Inexperienced project managers Poorly defined scope Accurate project timeline forecasting		
Finance			
Net Profit (avg. %)	8.4%	12.8%	5.4%
Growth Rate	18.2%	8.7%	11.0%
Invoice Cycle (avg. days)	10.9	10.1	13.9
Days Sales Outstanding (avg. days)	35.5	44.6	34.0
Top Finance Challenges	Organic topline growth Increasing profitability Reducing costs		
Financial Compliance			
Top Audit Issues	Indirect rates Internal control systems Labor and timekeeping		
Human Capital Management			
Top Challenges in Acquiring Talent	The availability of good candidates in the marketplace Attracting better qualified talent The ability to offer competitive compensation and benefits to candidates		
Top Challenges in Managing Human Resources	Retaining top talent Implementing effective performance management Strategic workforce capacity and planning		
Information Technology			
Top IT Challenges	IT and data security Finding top IT talent Satisfying regulations		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Improve contract win and retention rates
Complete projects on time and under budget
Ensure project, IT, and corporate governance
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