Practitioner Perspectives

WOLF DEN ASSOCIATES, LLC

March 2013 ***(Vol. 2; Issue 3)***

Ten Popular Sequestration Myths

1. ***Spending cuts will be temporary and will be more isolated than widespread***
2. ***Budgets will return to prior levels for GFY14***
3. ***Effective marketing can lead a customer to adopt a Best Value evaluation approach where cost will not be a significant factor***
4. ***SBSA pressures will wane now that the election is in the rearview mirror***
5. ***"Survive to one-five" (CY15) doing what you are doing and everything will be OK***
6. ***Reluctant or nervous buyers will reduce overall M&A volumes***
7. ***Sellers accept lower M&A valuations because of market softness or opacity***
8. ***Larger companies provide employees more job security than their smaller competitors***
9. ***Compensation and benefits for those that survive the layoffs will remain unchanged***
10. ***We can sacrifice margin now to keep altitude and airspeed and then get well on the recompete***

Crying Wolf Over The Sequester

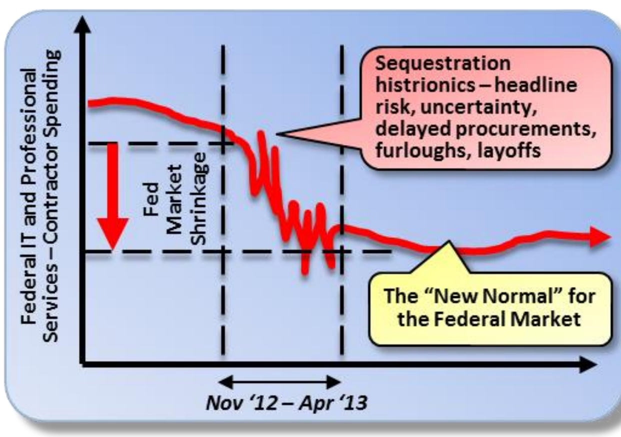
- Sequestration is tactically significant (layoffs, delays, cancellations) – but utterly irrelevant to long-term health of companies in the sector
- Federal IT and professional services market will not immediately return to *status quo ante*
- Independent of sequestration, federal contractors will be under pressure, LPTA mentality will persist, and uncertainty will prevail until a new equilibrium is reached
- Current uncertainty, clouded by budget cuts, will give way to greater clarity – but the picture will look more like 2006 than 2011
- Competition will cause rates and salaries to stagnate, and the government will increase its monopsonistic power to limit margins
- Companies need to position for and have a strategy to compete in the "new normal" or become the excess capacity that gets wrung out

Are We There Yet?

We have heard enough of the incessant whining about the catastrophic impacts of sequestration. While there will be cuts, cancellations, delays, and uncertainty, this represents a secular decline in federal spending, not an isolated event. Indeed, in many places the sequestration cuts are far smaller than those mandated by the Budget Control Act of 2011. Industry-wide growth rates began declining long before sequestration became the latest Washington whipping post.

How ≥ How Much

In addition to lower overall spending, the government has also altered how it procures, with a strong bias towards LPTA and SBSA awards. The challenge is no longer one of price to win (bundling existing services at ever tighter margins), it is solution to win. Companies need to invest in developing innovative solutions and business models that enable them to bid lower prices and still earn reasonable margins. Companies pursuing business in this environment by pencil-whipping conventional bids will be woefully outmatched. The three most common reflexive responses to market changes are:



#1 Stop, Drop, and Roll

These companies believe that the current budget environment will improve and the best approach is to reduce indirect costs to a bare minimum and wait it out. Competitive pressures coupled with an LPTA-centric evaluation mentality are driving cost reductions in all companies, but these firms do not believe in the new normal – they are waiting for the old market to come back to them. Even if the market does come back, these companies will have conditioned their customers to lower costs and will not be able to flip the switch back to higher prices for the same services.

#2 Diversify Now

The federal IT and professional services budget picture is unlikely to improve for the next several years, so these companies are rethinking their go-to-market strategies and entering healthcare, commercial IT, BPO, and other new markets. The challenge with this strategy is that those areas are not "greenfields" – they have well entrenched players who have significant competitive advantages and long-term customer relationships, and will be tough to displace.

#3 Bid More, Win More

These companies have concluded that there is very little differentiation in our industry and the wisest course is simply to bid more and hope that the law of large numbers will prevail. This "spray and pray" approach is tantamount to not having a strategy. The reality is that increased competition requires greater focus and effort to build relationships and engineer more efficient (lower cost) solutions. Talented people, who aspire to being more than cogs in a proposal factory, will desert these companies, taking with them the relationships, goodwill, and intellectual capital these companies invested dearly to create.

Thinning the Herd

Winners in the years ahead will be those companies who narrow their focus and who continue to have a compelling vision and strategy. They are already competing in the "new normal" based on lean infrastructure, capital-for-labor substitution, earlier emphasis on more substantive capture, innovative business models, pruning of marginal performers, and a culture that continues to attract and retain top talent despite the unprecedented churn in our industry. Companies that are slow in positioning for this "new normal" environment won't be around in three years.

8280 Greensboro Drive
McLean, VA 22102
wolfdenassociates.com

Barry Landew
(703) 477-7737
barry@wolfdenassociates.com

Noah Teates
(301) 742-6692
noah@wolfdenassociates.com

Dave West
(917) 657-4525
dave@wolfdenassociates.com