Winning in the New Normal of Government Services

Learn to balance scope, speed and rate to grow in a challenging environment.

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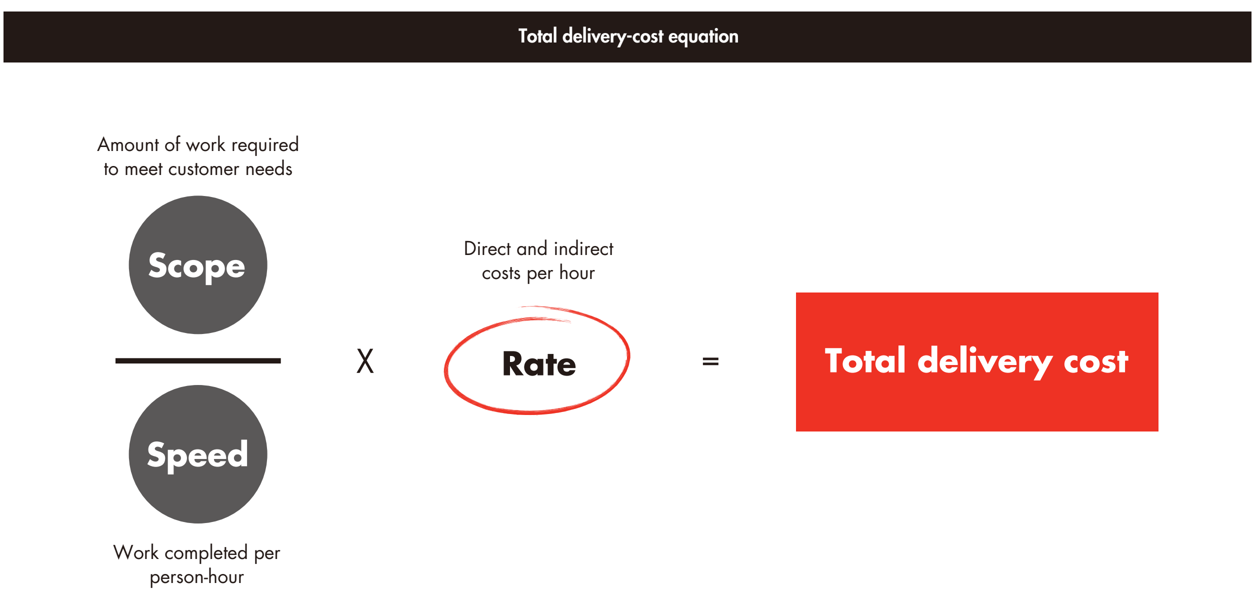
Even battle-hardened veterans of government services are unsettled by the challenges they face in the industry today. Gone are the days of rapidly growing federal budgets when a rising tide lifted all contractors. Spending on government services is down more than 25% from its peak and we do not expect much relief for contractors, particularly in non-defense agencies. Price continues to be the No. 1 bid criterion in most competitions. Yet customer needs remain as complex and diverse as ever. Add to this a shifting competitive landscape—with mergers, acquisitions and divestitures by many players as well as disruption by new commercial competitors—and it is no wonder that so many executives are struggling to find their footing.

To maintain revenue and profits in this environment, contractors have reacted aggressively—but often in ways that do not serve their long-term interests. They have lowballed bids and sacrificed margins to win on cost. They have skimped on the investment needed to build and sustain distinctive capabilities. They have chased all sorts of deals, spreading themselves too thin and depressing returns on business development investment. Even as they pursued these questionable approaches, several long-time incumbents lost franchise programs to competitors. To compensate for revenue and margin hits, some companies have tried M&A, adding new businesses far from their core capabilities or paying unjustifiable premiums for them.

These moves buy some short-term growth. But they do not add up to a strategy for long-term success. For that, companies need to go back to the basics and determine how to deliver the right capabilities at the lowest total cost.

Contractors that emerge as winners from this period of turbulence will be those that find ways to think and

Figure 1: To win in government services, focus on the most important factors determining your delivery cost



Source: Bain & Company

act strategically about cost and customer value. These companies will leverage all three factors in the delivery-cost equation—scope, speed *and* rate—to succeed more and improve margins *(see Figure 1)*. Scope defines the amount of work required to meet customer needs. Companies win on scope by developing differentiated knowledge of customer needs so they deliver precisely what is required and avoid unnecessary work that adds cost. Speed is the amount of work done per "person-hour" (productivity), which can be optimized with investments in tools, repeatable approaches and off-the-shelf solutions. Rate refers to both direct and indirect labor costs, which companies have far more control over than they typically realize.

Getting this equation right presents a challenge for all government services firms and requires trade-offs; no company will be a top performer on all three dimensions. Several government services companies have made a strategic decision to emphasize scope as a way to win while cutting delivery costs too. They realize that not all revenue is created equal, and they're making very careful decisions about where and when to play. For example, they don't waste money on long-shot business development efforts, but concentrate on work where they know they can win and deliver efficiently. They go after deals where they have distinctive customer knowledge and walk away from ones where they don't. One contractor has steered clear of large-scale Department of Defense programs because leadership recognizes that, despite the high revenue potential, such deals divert attention from core intelligence agency customers, for which the firm is sure to deliver profitably. Another company focuses primarily on fraud and claim-management programs for the Department of Health & Human Services and the Social Security Administration. It wins such bids because it knows these missions extremely well and can design cost-effective solutions that are tailored tightly to what those customers need.

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Speed is the source of strategic advantage—and lower cost—for many companies. The basic approach is simply to codify best practices. But contractors that outperform on this dimension go much further. They invest in software tools and new capabilities that make processes repeatable, rapid and inexpensive. For example, one contractor has developed a robust software tool that allows the company to complete "should-cost" analysis in a fraction of the time that it takes competitors. Other companies are investing in in-house software development capabilities so they can build basic solutions for case management, resource planning, performance tracking and other common applications that can then be modified and used with many different customers.

Another speed strategy is to "leverage the balance sheet" by investing capital in assets that can be shared across customers. Legacy commercial IT providers lead the way here, offering their government customers shared data and call centers as well as network operations facilities—taking hours and costs out of delivering IT infrastructure projects. Finally, companies have begun redirecting some of their high-end data science and advanced analytics capabilities internally to find ways to improve efficiency.

Even the approach to labor rates—the third factor in the equation—can be far more strategic. A common trap for government contractors is to place too much emphasis on cutting indirect costs, such as support functions and investments in business development. The assumption seems to be that direct labor costs are more or less fixed. That leaves a lot of money on the table. If companies think strategically about how they deploy top talent, they can reduce labor costs without jeopardizing revenue. For example, they can often shift projects from highly paid resources to lower-cost or less experienced workers as soon as the start-up phase is over. Companies can also think more strategically about the work they do directly vs. the work they can subcontract. By striking the right balance, companies can maintain differentiation while reducing overall delivery cost.

Regardless of how a company chooses to trade off the three dimensions of scope, speed and rate, for a contractor to be successful long term, it must also do three things:

- **Be clear.** An important first step is understanding where the company will differentiate on the total delivery-cost equation. However, to execute that strategy, the company must also be able to clearly articulate why it's the right strategy, how the company plans to execute it and what specific actions it will take. Top leaders can raise the odds that all stakeholders—board members, investors and employees—will follow them along a new strategic path if they make sure everyone knows where that path leads.

- **Be bold.** Driving a differentiated strategy takes more than minor one-off investments or small initiatives at the margin. Companies need to think about all the levers at their disposal to drive the strategy—including M&A and major capital investments. Companies may need to accept short-term hits to profitability as they reinvest operating dollars in new solutions. Some players may need to walk away from long-term programs or relationships that don't align with the new strategic approach.

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- **Be disciplined.** Moving a company aggressively in a new strategic direction is not for the faint of heart. Many forces can pull companies off their strategic paths—opportunistic M&A, for example. Companies that want to succeed for the long haul will need to get comfortable saying no in the short term to drive differentiation, stronger profits and growth.

In today's environment, competing on the total delivery cost is not optional. However, that does not mean contractors are locked into a rate-based race to the bottom. By viewing the total delivery-cost equation strategically and picking the right spots to differentiate with speed, scope and rate, top companies will uncover opportunities to deliver better value to their customers and larger profits to their shareholders.

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