Washington Technology

INDUSTRY OUTLOOK

Will talent headwinds slow growth?

By Ross Wilkers **Nov 01, 2019**

Public investors are expecting government services companies to post revenue growth for this year and next in line with an overall upturn in the federal market that has also seen award backlogs climb.

Some companies are showing growth after a cursory glance at our stories on corporate earnings reports over the past two years. But the story of growth appears to be much different on the staffing front, according to the Professional Services Council's latest research on how industry sees its overall health.

The Industry Outlook released Wednesday at PSC's annual Vision conference in Falls Church, Virginia, shows that overall headcount of seven publicly-traded government services businesses examined held roughly flat between 2015 and 2018 on a compound annual growth basis.

While that is a small sample size, that reading is a fair barometer for well-documented issues surrounding human capital in the government market: the shortage of technical talent and especially those with clearances, the backlog of people waiting to get those clearances, plus competition for that group of people from other industries are among the main issues.

Adam Harrison, who presented the PSC Vision Industry Outlook, pointed out that the dynamics were very different at the height of the market's downturn over 2012 and 2013 with sequestration and spending declines.

Harrison said that human resources strategies at that time were centered around cost-cutting and reducing headcount. But he added the reverse is true today as companies are more aggressive on the recruiting front through employee referral programs and other initiatives to staff up as they win contracts.

“A lot of awards expected, a lot of growth still expected over the next several years,” Harrison said with a question for attendees to ponder: “But yet, is there a potential capacity issue in terms of how to staff those positions?”

That was not the only question he posed for the audience to consider:

- As more awards come out the market grows, will the winners infuse more technology as an offset to the talent supply shortage?
- Will large companies with limited in-house talent capacity have to subcontract more work to small businesses and middle tier firms?
- Could profit margins take a hit as a result of the potential need to subcontract?

Earnings stories and transcripts of earnings calls also show that investors are paying attention and see the talent crunch as a potential headwind that could curtail growth.

Clearances are another issue altogether given the amount of time it takes to get one in a process that can take anywhere between 12 and 18 months. The government is reporting progress in taking down the backlog of those waiting for a clearance but companies and agencies both still say that is a work in progress.

Some GovCon firms headquartered in the Washington, D.C. area have increased their efforts to find new sources of talent outside of the region: many times near locations with a heavy government presence such as Texas or Colorado, but also in other regions not thought of as traditional hotbeds for talent in the industry.

“It’s also the as-a-service business model, where companies are building centers of excellence in remote locations as long as they don’t have to be on site with the customer,” Jean Stack, co-head of Baird’s government services investment banking practice, said in a panel discussion after Harrison’s presentation.

“The big question mark on that is, what government customers are willing to accept an employee base that’s not on site. The market is waiting for the government to figure out a way to gain more comfort with that approach.”

Pierre Chao, founding partner at Renaissance Strategic Advisors and veteran defense market watcher, said human capital is “for sure an area where you’re seeing innovation and differentiation in a place where I think you start to separate the winners from the losers.”

Chao said that differentiation is more pronounced in the private markets than among publicly-traded companies that are larger in scale, but hinted it is becoming clear where businesses sit.

“If your entire business is based in premise on the fact that I can rebadge the loser’s work and therefore it could also happen to me, you’re probably more at the commodity end of the business and you’d better start figuring out how you’re gonna start to differentiate,” Chao said.

About the Author

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