Incentivizing Competition:

Focus More on Results and Less on Regulations

By Mikhail Grinberg, Partner at Renaissance Strategic Advisors

The United States spent $511 billion on government services in 2023 across the Department of Defense (DoD) and Federal Civil agencies. The top 10 largest services contractors captured 10% of those obligated dollars. The rest was received by over 70,000 companies, 313 of which received more than $100 million in annual contract obligations. The professional services industry is now at a stable operating structure, after a decade of sequestration impacts and market consolidation.

It is also a structure that continues to be highly competitive. One problem, however, is that policymakers seem not to think so. Instead, they see scale and deal-flow as signs of excessive market concentration with possible anti-trust concerns.

Here are the signs of a vibrant market that indicate those anti-trust concerns are misplaced:

- Hundreds of new businesses are formed each year to compete for US government contracts.
- Commercial technology and services firms are entering the market.
- Private equity is actively investing in new companies.
- The volume of mergers and acquisitions is relatively high.

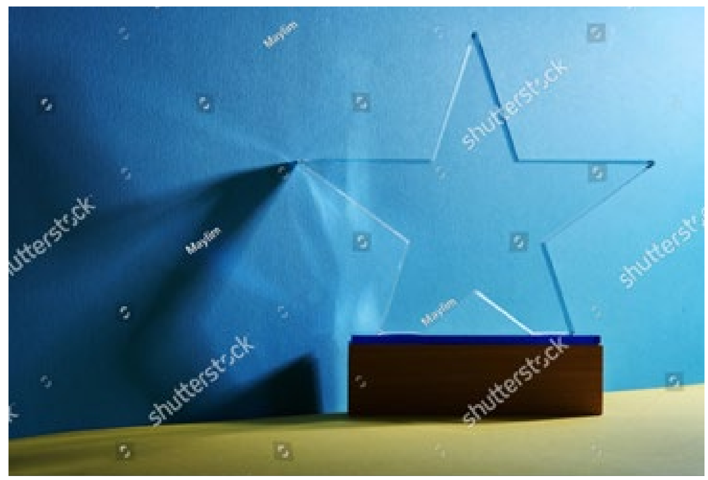
The services market is full of competition and innovation.

Let's look at the Department of Justice's own index for evaluating market concentration, which re-enforces the vibrancy of the services sector.

The Herfindahl-Hirschman Index[1] suggests that even if the top 5 largest managed services or IT modernization contractors merged, the consolidated result would still fall below "moderately concentrated thresholds," and if the top 3 firms combined, the resut would barely signal a need to review the transaction for "enhanced market power."

Of course, anti-trust reviews would go beyond the index, would be more precise and would focus on niche segments and customers. Still, these results indicate that government should focus less on anti-trust and more on creating the right incentives for the services industry to be even more competitive.

Here are three ways to do that. First, the government should reward companies that create solutions that solve a need but with less labor. Such firms should be able to retain their earnings while reducing headcount. This would incentivize contractors to solve problems and would increase talent availability in a tight labor market.



Second, the government can adjust its policies for organizational conflicts of interest (OCI). Agency-wide OCI restrictions prevent entire divisions of companies from competing. OCI restrictions should be stringent. However, contractors trusted with the nation's secrets should also be able to adhere to basic corporate firewalls, backed by severe penalties as a check.

Third, the government should clarify that profitability is desirable. Negative effects remain from excessive use of lowest price technically acceptable (LPTA) contracts, with too many services contract proposals awarded based on price alone, not results. Worse, many program offices judge contractors based on margin and profit rather than total cost. If contractor A can deliver a desired result for 10% less than contractor B but make 20% more on margin, this is a win for customers and taxpayers.

These approaches, focused more on outcomes and less on resumes, archaic rules, or margins, would incentivize competition and innovation and lead to better results. ■

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[1] The Herfindahl–Hirschman Index is a commonly accepted measure of market concentration. The HHI is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. See: https://www.justice.gov/atr/herfindahl-hirschman-index.

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