



CSIS | CENTER FOR STRATEGIC & INTERNATIONAL STUDIES

STRUCTURE AND DYNAMICS OF THE  
U.S. FEDERAL PROFESSIONAL  
SERVICES INDUSTRIAL BASE  
1995-2007

EXECUTIVE SUMMARY  
FEBRUARY 2009

DEFENSE-  
INDUSTRIAL  
INITIATIVES GROUP



# Structure and Dynamics of the U.S. Federal Professional Services Industrial Base, 1995–2007

## Executive Summary

David Berteau, Guy Ben-Ari, and Gregory Sanders

February 2009

The U.S. government has a permanent and growing reliance on contracts with the private sector for a wide range of professional and support services. For the past three years, CSIS research has tracked the trends driving the professional services industry since 1995. This report analyzes these trends through 2007, the most recent year for which reliable data are available. Data are from the Federal Procurement Data System (FPDS). As 2008 data are accumulated in the summer of 2009, we will update these analyses on our Web site ([www.csis.org/isp/diig](http://www.csis.org/isp/diig)).

On the basis of this analysis, we conclude that the macro trends of the past decade continued in 2006 and 2007. For the fourth year in a row, providing professional services to the federal government has represented a larger market than selling hardware to the government. This is a historic, unprecedented shift in modern times. However, growth in federal service contracts did slow between 2006 and 2007. That trend is more reminiscent of the mid-1990s than the 2002–2006 period and could indicate a leveling-off of the market.

On the policy level, the past few years have witnessed a growing awareness on the part of policymakers of the industry's magnitude and importance. Congress, the media, and even some voices inside the executive branch have raised significant policy questions about the government's reliance on, and the roles of, the private sector industry. Policy concerns are likely to continue and perhaps increase in 2009.

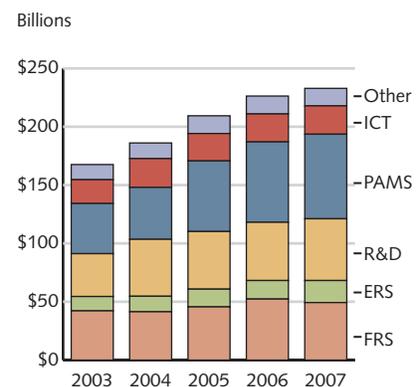
During the past 13 years, the industry expanded at a compound annual growth rate (CAGR) of 7 percent a year, from \$102 billion in 1995 to \$233 billion in 2007 [  ]. The past five years (2003–2007) saw a stronger 9 percent CAGR.

The fastest-growing segments during the past 13 years were professional, administrative, and management services (PAMS) and information and communications technology (ICT) services, both of which delivered an 11 percent CAGR. During the past five years, however, the PAMS segment grew by a CAGR of 14 percent whereas the ICT segment grew by 4 percent during the same period.

The research and development (R&D) segment also grew at a steady pace in 2003–2007 (10 percent CAGR) although the compound annual growth over the entire 13-year period has been 6 percent.

Expansion in the equipment-related services (ERS) segment was dramatic during the past five years, most likely driven by the current conflicts in Iraq and Afghanistan, and showed a CAGR of 11 percent. However, facilities related services (FRS) grew by less than 4 percent during that period. Details on these segments are found in the report.

Services Contract Spending, by Segment, 2003–2007



Source: Federal Procurement Data System; analysis by CSIS Defense Industrial Initiatives Group.

The largest segments within the federal professional services industry are PAMS, which accounted for \$72.5 billion worth of contracts in 2007, up from \$20.4 billion in 1995 [  ]; R&D, which accounted for just under \$53 billion in 2007 compared with \$26.5 billion in 1995 [  ]; and FRS, which grew to \$49 billion in 2007 from \$32 billion in 1995 [  ].

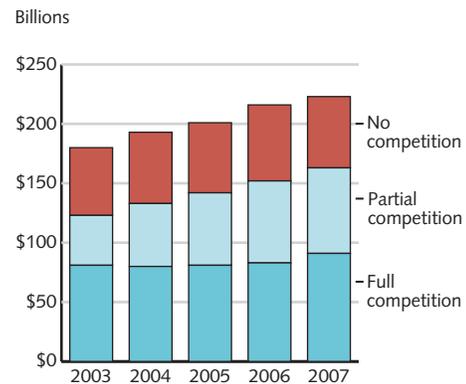
Given its large size and high growth rate, the PAMS segment is likely to remain the largest part of the industry. It is also the segment that will draw policy interest as the one with services most similar to those also provided by the federal government workforce.

The Department of Defense remains the biggest procurer of professional services, accounting for approximately 60 percent of total federal dollars spent on professional services in 2005, 2006, and 2007. Another stable trend during the past three years has been that the Department of Defense, the Department of Energy, and NASA have remained the Top 3 government agencies in terms of value of professional services contracts awarded; they continue to account for approximately three-quarters of the federal professional services market.

## Competition

We assessed contract actions by the amount of competition. Generally, contracts with high dollar values remain more likely to be fully or partially competed. Awards with full and open competition involving at least two bidders (which we refer to as “full-competition awards”) account for the greatest dollar amounts and the largest average awards. Partial-competition awards have seen strong growth during the past five years in dollars awarded and even stronger growth in the number of awards, with the result that the average contract action size during the past five years has actually shrunk by 8 percent annually. The number of awards without competition (which we refer to as “no-competition awards”) has risen significantly in the past five years, but the total dollar amount of these no-competition awards has grown less than the overall annual growth rate of 9 percent. The total amount of dollars awarded for no-competition actions has been relatively flat, and the average contract action size of no-competition contracts has fallen steadily, from \$771,000 in 1995 to \$153,000 in 2007 [  ].<sup>1</sup>

**Levels of Competition for Services Contract Actions, 2003–2007**



Source: Federal Procurement Data System; analysis by CSIS Defense Industrial Initiatives Group.

## Contract Type

We also assessed contract data by contract type: fixed-price or cost-based. As a proportion of awards, the dollar amount of all types of fixed-price contracts has decreased slightly during the past five years, from 40 percent to 35 percent of all contract action dollars awarded. All forms of cost-based contracts have also fallen, from 50 percent of contract action dollars in

2003 to 45 percent in 2007, with time-and-materials or labor-hours contracts increasing from 9 percent to 10 percent of contract action dollars. Overall, although fixed-price actions have been much more common in recent years, the dollars awarded through them have been relatively flat to declining, so the average contract action size of fixed-price contracts has fallen steadily from less than \$186,000 in 1995 to just over \$100,000 in 2007 [  ].<sup>1</sup>

## Contract Value

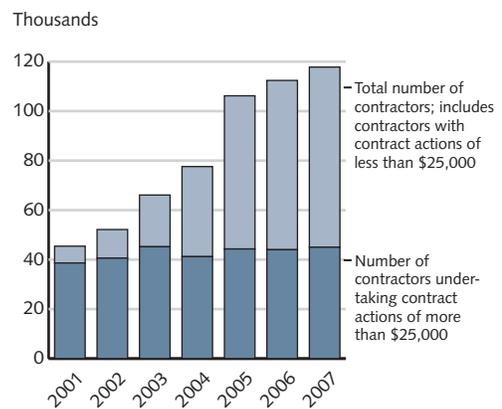
With the number of contract actions growing faster than the value of contracts awarded, the average value of contract actions has decreased from \$385,000 in 1995 to \$209,000 in 2007 [  ].<sup>1</sup> The value of the average contract has also dropped from \$1 million in 1995 to \$403,000 in 2007 [  ].<sup>1</sup> The declining contract and contract action values imply that firms often must compete more just to sustain steady revenues.

## Industrial Base

The number of firms in the professional services industrial base remained almost unchanged, at 45,000 contractors, between 1995 and 2001. Between 2001 and 2007, however, the total number of contractors in the industry increased from nearly 45,000 to 118,000 firms. A more detailed analysis of the contract base reveals that most of the growth has come from the entry of firms undertaking small (under \$25,000) contract actions. An analysis of the 2007 data indicates that out of the hundred thousand-plus professional services contractors, only 27,000 are not small companies (as defined by the Small Business Administration); of these, only 101 firms have \$100 million or more of services revenue (by comparison, in 1995 there were some 14,000 medium and large companies, and 101 with more than \$100 million of services revenue; in 1999 there were some 12,000 medium and large companies, of which 95 received more than \$100 million of services revenue). Examining the data from this perspective may imply that the vast majority of firms in the industry are small firms or perhaps medium-sized firms that undertake relatively little federal professional services work relative to their overall corporate size.

The industry has also become more horizontally integrated during the past decade. Firms in all segments of the industry have enlarged their presence in the PAMS segment, ICT companies are increasingly participating in the FRS segment, and the FRS providers are expanding their presence in the ERS segment. Examined differently, the professional services industry and the defense hardware–defense platform industry have become more intertwined as the large platform primes have made significant acquisitions and pursued work in the professional services market.

**Number of Services Contractors, 2001–2007**



Source: Federal Procurement Data System; analysis by CSIS Defense Industrial Initiatives Group.

The other major shift in the structure of the industry has been the increase in the number of heavy engineering and construction firms in the ranks of the Top 20 contractors, a trend likely driven by the reconstruction efforts in Iraq and Afghanistan.

Furthermore, critical mass has changed for the industry. In 1995, the 20th-largest contractor had \$360 million in professional services contract awards from the federal government (0.35 percent of the industry total), but in 2007 a firm needed almost \$1.4 billion of services awards to be the 20th-largest contractor (0.6 percent of the industry total). It is interesting, though, that the market share for the Top 5 services contractors has remained relatively steady: in 1995 it was 19 percent (with \$19.5 billion of service revenue), and in 2007 it was also 19 percent (with close to \$44 billion).

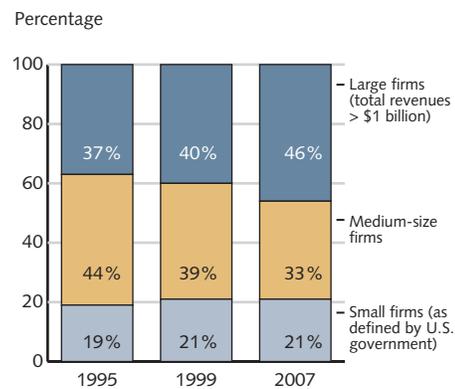
When the market shares held by the small (as designated by FPDS), large (that is, with an annual revenue greater than \$1 billion), and medium (any not classified as “small” or “large”) companies in the industry are examined, it is clear that those in the middle tier have suffered an erosion of their relative share. In 1995, middle-tier companies captured 44 percent of the total value of federal professional services contracts. By 2007, the middle-tier companies were able to capture only 33 percent of that value.

Small-business set-aside laws and other policies assisting small firms have clearly worked in the professional services industry. Small companies have sustained a 19–22 percent market share in the value of prime contracts, and their share of the market is larger if the value of subcontracts is included. The large companies in this industry have been particularly active via mergers and acquisitions and have been able to increase their market share from 37 percent of the total market in 1995 to 46 percent in 2007. Thus, the middle tier has been squeezed from above by consolidation and from below by small businesses holding on to their share of the market, and in 2006 and 2007 we saw the first decrease in the number of medium-sized companies undertaking significant (\$25,000 or larger) federal contracts. How to replenish the middle tier, thereby generating competition and innovation, remains a key strategic and policy issue for the industry.

The federal professional services market and the industrial base that supports it have experienced a big change in past five years. Furthermore, there is nothing in the FPDS data analyzed in this report that suggests that things are going to change in the near future.

The mid- to long-term analysis depends largely on developments in Iraq and Afghanistan. What happens after a significant drawdown of troops in one or both countries? This question remains open because we do not know whether the growth in business and in the number of new players in the federal professional services market has been driven by the complex nature of the work or the larger amounts of money available for undertaking it.

**Market Share of Small, Medium, and Large Firms by Value of Contract, 1995, 1999, 2007**



Source: Federal Procurement Data System; analysis by CSIS Defense Industrial Initiatives Group.

<sup>1</sup> The amount for 2007 does not include some 2.3 million contract actions awarded by the Department of Veterans Affairs for rental of medical equipment, which would have drastically skewed the analysis. See full report for additional details.