

TOP 3 PREDICTIONS FOR FEDERAL IT SERVICES IN 2022

Where the money flows, IT services follow

TECHNOLOGY BUSINESS RESEARCH 2022 PREDICTIONS IS A SPECIAL SERIES EXAMINING MARKET TRENDS AND BUSINESS CHANGES IN KEY MARKETS.

COVERED SEGMENTS INCLUDE:

CLOUD

TELECOM

DEVICES

DATA CENTER

▶ SERVICES & DIGITAL

Author: John Caucis (john.caucis@tbri.com),
Senior Analyst





FEDERAL SPENDING PRIORITIES SHIFTING TO FAVOR CIVILIAN AGENCIES




In three areas, the Biden administration's pivot from defense spending to shoring up civilian agencies will have immediate effects on the federally focused IT services vendors. First, accelerated cloud adoption and new spending bringing cloud to civilian agencies will create partnerships and acquisition opportunities, as well as additional revenue streams. Second, IT services vendors well positioned for that pivot will increase their market share. Third, increased AI, analytics and cybersecurity deployments, supported by new federal dollars flowing to civilian agencies, will further separate federally focused IT services vendors that have built capabilities and talent during the last several years.

Civilian sector IT spending has recovered vigorously from the COVID-19 trough in 2020, thanks to civilian agencies' ongoing drive to digitize their IT infrastructures, and the shifting budget objectives of the Biden administration will further accelerate civilian IT outlays. Health IT is emerging as a major growth driver on the civilian side, owing to ongoing COVID-19 response initiatives, electronic health record modernization, and IT projects to enhance the interoperability of health IT environments in the federal, state and local government sectors. Even amid the expected deceleration in defense spending, the Pentagon will leverage cloud infrastructures to connect IT platforms for combat operations across service branches, while cloud computing will become essential to transmitting, sorting and analyzing mission data.

Federal systems integrators also have an eye on the transformative technologies and methodologies that are becoming commonplace in the digital modernization of federal IT infrastructures. For example, federal IT services vendors will increasingly utilize low code as they execute cloud implementations, enabling the rapid development and scale-up of cloud-based software tools. Federal IT contractors are also pondering the effects of 5G and quantum on cybersecurity, while upgrading existing mobile and IT communications systems into more open and interoperable networks embedded with AI and analytics technologies.

▼ PREDICTIONS




INCREASED U.S. FEDERAL CLOUD SPENDING UPENDS THE IT SERVICES MARKET

-  **Trend:** Large U.S. federal systems integrators have begun partnering more closely with commercial cloud vendors, particularly Google and Amazon Web Services (AWS).
-  **Driver:** Increased technology spending on nondefense sectors has accelerated vendor investment in cloud computing.
-  **Result:** Federally focused IT services vendors will compete for talent to staff cloud-related engagements, further stressing a competitive field and potentially drawing talent, investment and partnership opportunities away from commercially focused IT services vendors in the U.S. market.

The increase in U.S. federal government dollars invested into nondefense-related cloud engagements has two distinct effects on the markets TBR covers. In federal IT, this budgetary increase bolsters IT contractors, provides them with new avenues for additional revenues, and sharpens their partnerships with the cloud giants, such as Google, AWS and Microsoft Azure. In the near term, all parties benefit, including the U.S. government agencies finally transitioning to cloud that will now have enhanced and accelerated access to the analytics, edge computing, machine learning (ML) and security capabilities of the commercial cloud providers. Over the longer term, the federally focused IT services vendors will develop skills and capabilities readily applicable to the commercial space, should they look to expand their nongovernment client book of business. The pandemic accelerated cloud adoption, and these vendors will benefit from a sustained and increasing stream of cloud-related revenues, provided they can bring a broad suite of commercially developed cloud technologies to the table.

TBR also tracks IT service vendors serving primarily commercial clients, and for these vendors the U.S. government's increased cloud spending potentially disrupts the market as they will face new competitors for talent and will see their cloud partners — again, AWS, Google and Microsoft — shifting investments and attention to the federally focused IT services giants. In this case, a rising tide will not lift all boats.




VENDORS PREPARED FOR FLATTENING DEFENSE BUDGETS AND ACCELERATING CIVILIAN SPEND WILL SEE EARLY GAINS

-  **Trend:** Federally focused IT services vendors read the (glaringly obvious) tea leaves and began expanding their footprints, where possible, with civilian agencies expected to receive budget increases under the Biden administration.
-  **Driver:** The new administration signaled its intention to shift spending from defense to civilian agencies; IT services vendors did not wait to shift their own focuses in the same direction.
-  **Result:** Financial performances will differ more wildly than in previous years as those vendors best suited for the pivot to civilian will make strong, early gains, while more defense-centric vendors struggle to keep pace.

While the U.S. federal government budget changes slowly and few items truly get eliminated, any pivot implies a massive change in financial flows. Most federal IT vendors have generated balanced growth across their respective defense and civilian operations for the last two to three federal budget cycles, though expansion has been tilted to the defense side. This is set to change as initial proposals for defense and civilian spending for federal fiscal year 2022 (FFY22) fulfilled expectations that the Biden administration will increase civilian spending at the expense of the defense budget: Proposed FFY22 budgets at many civilian agencies will increase by double-digit rates, while the administration's proposed FFY22 defense budget was essentially flat. Shifting budget priorities from the defense to civilian sector will require federal IT services vendors to adjust their staffing, capabilities and investments to ensure they are prepared. However, the will to digitally transform IT systems remains strong among civilian, defense and intelligence agencies, and opportunities for federal technology contractors to provide strategic, technical and program management to facilitate IT modernization will persist even amid shifting budget trends.

An upshot of increasing civilian IT spending will be the sustained active pace of acquisitions in a federal IT M&A environment that remains red hot. Accenture Federal Services, Booz Allen Hamilton and SAIC, among others, made strategic or near-strategic acquisitions in 2021 to expand market reach and capabilities in civilian IT (enhancing healthcare IT offerings was a significant subdriver therein). Federal IT executives are bullish about the federal M&A market, even with some current company valuations perceived as excessive. The M&A market in federal IT will remain active in 2022 as a high number of assets of all sizes are currently available and the accessibility of debt financing has significantly improved since the onset of the pandemic in 2020.

INVESTMENT IN ADVANCED DIGITAL TECHNOLOGIES WILL ACCELERATE ACROSS ALL FEDERAL SECTORS

-  **Trend:** Federally focused IT services vendors have consistently increased capabilities in AI and analytics and other digital technologies, through training, acquisitions, and better partnering with analytics vendors.
-  **Driver:** Digital solutions are increasingly being embedded across U.S. government IT infrastructure, providing greater insights and faster decision making, while also demanding more capable IT services staffs.
-  **Result:** IT services vendors capable of training federal employees, leveraging deployed analytics to accelerate decision making, and further embedding digital offerings into agencies' IT infrastructures will begin separating themselves from the also-rans in this space.

AI-related investments are ramping up rapidly across the federal defense, civilian and intelligence sectors alike. In the Department of Defense (DOD) alone, AI and ML spending is expected to approach \$3 billion by FFY23, up from \$973 million in FFY19 (implying a CAGR over 30% during the four-year period). The previous administration launched several initiatives intended to enhance the nation's AI and analytics capabilities and the leverage of these digital technologies in federal IT infrastructures, and the Biden administration is expected to maintain a strong commitment to AI and analytics investment. Within federal civilian agencies, AI and analytics technologies promise to enhance citizen services, as well as employee and citizen engagement. Across the DOD, the quantity of data generated continues to expand as operations increasingly extend across domains and branches of the armed forces and with U.S. allies, furthering the need to integrate analytics and automation-based systems across all military activities.

The adoption of 5G will accelerate concurrently with AI and analytics, as federal civilian and defense agencies turn to 5G to enhance the speed and resiliency of data transmission. Federal IT vendors will expand collaborations with smaller peers to optimize the security, scalability and resilience of 5G networks for the DOD and civilian clients. To speed the development of solutions for the DOD, federal IT contractors will increasingly apply digital engineering techniques to digitally map all aspects of a particular system from design to build to run, identifying shortfalls and defects along the way. The potential applications for quantum computing in the DOD are vast, as the processing speed of quantum systems and the ability to transmit and analyze larger volumes of data than ever before will accelerate military decision making and the development of battle strategies in real time.

▼ LEARN MORE



Reports:

Public Sector IT Services Vendors Benchmark

IT Services Vendor Benchmark

Interested in accessing our entire Public Sector research portfolio?

[Start your 60-day free trial today*](#)

*60-day free trial available to new customers only

ABOUT TBR

Technology Business Research, Inc. is a leading independent market, competitive and strategic intelligence firm specializing in the business and financial analyses of hardware, software, professional services, and telecom vendors and operators.

Serving a global clientele, TBR provides timely and actionable market research and business intelligence in formats that are tailored to clients' needs. Our analysts are available to further address client-specific issues or information needs on an inquiry or proprietary consulting basis.



FOR MORE INFORMATION

TBR has been empowering corporate decision makers since 1996. For more information, visit www.tbri.com.

This report is based on information made available to the public by the vendor and other public sources. No representation is made that this information is accurate or complete. Technology Business Research will not be held liable or responsible for any decisions that are made based on this information. The information contained in this report and all other TBR products is not and should not be construed to be investment advice. TBR does not make any recommendations or provide any advice regarding the value, purchase, sale or retention of securities. This report is copyright-protected and supplied for the sole use of the recipient. ©Contact Technology Business Research, Inc. for permission to reproduce.