

**CRITERIA FOR OVERCOMING THE PRESUMPTION  
OF SOCIAL DISADVANTAGE IS NEEDED**

**REPORT NUMBER 5-24**

**September 28, 2005**

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**U.S. SMALL BUSINESS ADMINISTRATION  
OFFICE OF INSPECTOR GENERAL  
WASHINGTON, D.C. 20416**

<b>MANAGEMENT ADVISORY REPORT</b>
<b>Issue Date: September 28, 2005</b>
<b>Report Number: 5-24</b>

**TO:** Allegra F. McCullough  
Associate Deputy Administrator for Government  
Contracting and Business Development

Albert B. Stubblefield  
Associate Administrator for Business Development

/S/ original signed

**FROM:** Robert G. Seabrooks  
Assistant Inspector General for Auditing

**SUBJECT:** Criteria for Overcoming the Presumption of Social  
Disadvantage is Needed

The Office of Inspector General (OIG) received an anonymous complaint regarding an 8(a) company's status in the 8(a) Business Development (BD) program. In response, we reviewed the owner's social and economic disadvantage status. While researching social disadvantage, we noted that although the regulations state that the presumption of social disadvantage for members of groups designated as socially disadvantaged may be overcome with "credible evidence to the contrary," the Small Business Administration (SBA) has not established criteria for "credible evidence." We believe this criteria needs to be established.

### **Background**

In 1970, Executive Order 11518 required SBA to "consider the needs and interests of minority-owned small business concerns and of members of minority groups seeking entry into the business community." During that year, SBA issued regulations stating:

To be eligible for an 8(a) subcontract, a concern must be owned or destined to be owned by socially or economically disadvantaged persons. This category often includes, but is not restricted to, Black Americans,

American Indians, Spanish Americans, Oriental Americans, Eskimos and Aleuts.

In 1978, Congress authorized the 8(a) BD program. Minority groups deemed by Congress to be socially disadvantaged included (but was not limited to) Black Americans, Hispanic Americans, and Native Americans. Congress subsequently designated members of the following groups as socially disadvantaged: Asian Pacific Americans (1980), Indian tribes (1986), and Native Hawaiian Organizations (1988). In 1982, SBA designated “Asian Indian Americans” as a socially disadvantaged group.

**Finding: SBA has not established criteria on “credible evidence” to overcome the presumption of social disadvantage.**

The SBA’s current regulations on social disadvantage state:

Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. The social disadvantage must stem from circumstances beyond their control. . . . There is a rebuttable presumption that the following individuals are socially disadvantaged: Black Americans; Hispanic Americans; Native Americans . . . ; Asian Pacific Americans . . . ; Subcontinent Asian Americans . . . .

The regulations continue, “The presumption of social disadvantage may be overcome with credible evidence to the contrary. Individuals possessing or knowing of such evidence should submit the information in writing to the Associate Administrator for 8(a) BD . . . for consideration.” There is no further guidance as SBA has not developed criteria for what constitutes “credible evidence” to overcome the presumption of social disadvantage. According to program officials and the Office of Hearings and Appeals, the presumed social disadvantage of a member of a designated group has never been successfully challenged.

Although the owner of the company we reviewed is a member of one of the designated groups cited in the regulations, and, thus, presumed to be socially disadvantaged, there are several circumstances that could potentially lead a reasonable person to question his socially disadvantaged status. For instance, he:

1. comes from a wealthy family, e.g., according to a newspaper article, since 1996, 3 companies his parents founded and were affiliated with were sold for approximately \$3 billion;
2. was raised in his parents’ home, which had an assessed value of \$5.2 million as of January 1, 2005;
3. lived in a school district where the public high school reports it ranks among the best schools nationwide that sends the most graduates to selective colleges;
4. graduated from a university highly rated in U.S. News;

5. was gainfully employed by the United States Senate, Goldman Sachs International, and a company where his father was a senior official and stockholder, among others;
6. began a business when he was in his mid-20s; and
7. has been assured that adequate capital for his business will be available from family and friends.

Additionally, the statement of social and economic disadvantage by the company's owner explaining why he is socially disadvantaged raises questions. He wrote, "My . . . ethnic background has caused me difficulty in soliciting capital to operate, maintain, and grow my business." However, in giving specific examples of difficulty, he only mentions his age and lack of tenure as a businessman:

Banks and other financial institutions have not been receptive to handing out loans to a . . . -year old [mid-20s] with only a fair credit rating. Private placement funding requirements are tightly focused on 'industry veterans.'

In the only specific example of discrimination, he states,

Over the past 3 years [mid 1999 – mid 2002], my salary has been \$41,000 from my last employer. I was entitled to a salary increase twice during that period but was told that adverse economic conditions in the . . . industry forced my employer to freeze salaries. I then watched as young, less experienced white men got the promotions and salary increases that I had been promised.

This claim, however, was not supported with evidence accompanying his 8(a) BD application. While working 11 of 12 months in 2000, his salary was approximately \$25,000; for part of 2000, his father was a senior official and a stockholder where he worked. In 2001, after his father sold the company, his salary increased to over \$40,000. Thus, he had to have received at least one significant salary increase in this 3 year period where he claims he was discriminated against.

While the circumstances for this applicant show that he had significant advantages, there is no guidance on what "credible evidence" is needed to overcome the presumption of social disadvantage. The lack of criteria allows people who may not be socially disadvantaged, despite their status as a member of a designated group, to enter the program without question. As a result, someone who is not socially disadvantaged could unfairly reap the benefits of the 8(a) BD program.

The Associate Administrator for Business Development (AA for BD) proposes that certification criteria used for admittance to the program and for continuing eligibility apply to all applicants and participants equally. If implemented, all 8(a) BD program applicants, regardless of whether or not they are members of groups identified as owning and controlling little productive capital, would have to demonstrate that they are socially and economically disadvantaged. According to Government Contracting and Business Development officials, the Office of Business Development has funded a study to

examine social and economic disadvantage—the study should be completed no later than March 2006. These officials believe that they will be able to determine what “credible evidence” is needed to overcome social disadvantage based on the study’s results.

## **Recommendations**

We recommend that:

1. The Associate Administrator for Business Development determine whether the program participant discussed in this report is socially disadvantaged.
2. The Associate Administrator for Business Development ensure that this program participant is terminated from the 8(a) BD program, if it is determined that he is not socially disadvantaged.
3. The Associate Deputy Administrator for Government Contracting and Business Development either (1) develop and implement criteria on what constitutes “credible evidence” for overcoming the presumption of social disadvantage, or (2) develop and implement criteria for social disadvantage that applies equally to all applicants.

## **Management Response**

At the exit conference, the Associate Deputy Administrator for Government Contracting and Business Development (ADA for GC/BD) and the AA for BD agreed that the regulations needed to change. The AA for BD also agreed to review the specific case discussed in this report to determine whether or not the individual is socially disadvantaged. Though requested, the ADA for BD did not provide written comments. The AA for BD did not have additional comments after reviewing the draft report.

\* \* \*

The finding included in this report is the conclusion of the Office of Inspector General’s Auditing Division. The finding and recommendations are subject to review, management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

Please provide us your management decision for each recommendation addressed to you within 30 days. Your management decisions should be recorded on the attached SBA Forms 1824, “Recommendation Action Sheet,” and show either your proposed corrective action and target date for completion, or explanation of your disagreement with our recommendations.

Should you or your staff have any questions, please contact Robert G. Hultberg, Director, Business Development Programs Group at (202) 205-[FOIA Ex. 2].

Attachments

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