

Testimony of

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**Before the
Committee on Small Business
U.S. House of Representatives**

on

Government Procurement Policies and Their Impact on Small Business

June 20, 2001

Good morning, Mr. Chairman and members of the Committee. My name is Susan Walthall and I am the Acting Chief Counsel for the Office of Advocacy at the U. S. Small Business Administration. I am pleased to address small business procurement issues with the Government's largest buying activity, the Department of Defense. As you may know, the Department of Defense's annual acquisition budget is nearly 65 percent of all goods and services purchased by the Federal Government. The balance, 35 percent, is distributed among the rest of the Federal agencies. In FY 2000 DOD spent \$122 billion for goods and services. Notwithstanding the enormous ability of DOD to do more for small business; Federal procurement policy issues such as bundling, Federal Supply Schedules, Government-wide acquisition contracts and agency downsizing of the acquisition work force impact the department's ability to do more. Small businesses are facing roadblocks throughout the Federal Government. My testimony will address the impact of these problems on small businesses. Before proceeding, however, I wish to

state that the views expressed here are my own and are not meant to reflect the views of the Administration or the SBA Administrator.

In 1953, your predecessors passed the Small Business Act, Public Law 163-83, Title II, Section 202, to address barriers to small business growth. The preamble to this historic law states:

The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well being but to the security of this Nation. Such security and well being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for property and services for the Government be placed with small business enterprises, and to maintain and strengthen the overall economy of the Nation.

“From the beginnings of our Nation, small business has provided us with some of our best ideas and inventions and it has considerably accelerated the growth of our industry and our science. Today, small business remains one of the strongest forces in the country.” These words hold as much truth today as they did when they were spoken by President Richard Nixon on August 1, 1973, 20 years after President Eisenhower signed the 1953 Small Business Act. Notwithstanding these monumental proclamations, small businesses have not been fully adopted as equal partners in this Nation’s economy. As such, Congress has to continue its vigilance to ensure a level playing field for small business.

Congress established the Office of Advocacy in 1976 within the U.S. Small Business Administration to be an independent voice of small business in the formulation

of public policy across the entire Federal Government. The Office is headed by a Chief Counsel appointed by the President and confirmed by the Senate. The duties of the Office are several, among which are (1) generating research on small business trends, characteristics, and contributions to the economy, and (2) monitoring agency compliance with the Regulatory Flexibility Act of 1980 as amended by the Small Business Regulatory Enforcement Fairness Act of 1996.

Since its establishment, the Office of Advocacy has been actively engaged in the analysis of Federal procurement policy and its impact on the small business community. A primary concern in recent years has been whether the top-to-bottom Federal acquisition reform of the mid-1990s in the form of the Federal Acquisition Streamlining Act of 1994 (FASA), the Clinger-Cohen Act of 1996 and the Federal Acquisition Reform Act of 1996 (FARA) has helped or hindered the Federal Government in achieving its mission as cited in the 1953 Small Business Act and subsequent amendments to this national policy statement.

As a brief recap, FASA repealed or substantially modified more than 225 provisions of law to reduce paperwork burdens, facilitate the acquisition of commercial products and enhance the use of simplified procedures for small purchases. FARA eliminated the procurement authority of the General Services Administration for information technology. FARA also repealed the authority for the General Services Board of Contract Appeals to decide bid protests for information technology acquisitions. The General Accounting Office was assigned to handle all bid protest disputes. Finally, the Clinger-Cohen Act of 1996 provided for the use of multi-agency contracts known as

Government-wide agency contracts (GWACs) for agencies to access each other's information technology contracts.

Mr. Chairman and members of the Committee, let me without reservation state that the Office of Advocacy supports appropriate and carefully implemented acquisition reform. Streamlining is important to small business as well as to the government. Many of the changes that have occurred in the Federal acquisition system as a result of the reform movement of the 1990s have been well intended. For example, today the use of the government credit card has increased by about 150 percent in a three-year period. In FY 1997 the Federal Government purchased goods and services worth about \$5 billion with credit cards. In FY 2000 the use had increased to slightly more than \$12 billion.

The Office of Advocacy is currently studying the effects of the use of government credit cards on small businesses. The study should be ready for publication by the end of this year. We can, however, say at this time that small businesses do not appear to be getting a fair or proportional share of these Federal dollars. The following supports this preliminary conclusion:

- (1) Prior to acquisition reform, micro-purchases of \$2,500 or less were reserved exclusively for small businesses. Today, these purchases are no longer reserved for small businesses because many of these purchases are being acquired through the use of the government credit card. Nearly one-half million Federal employees may use the government credit card with any authorized merchant. There are few if any acquisition controls on the use of the card. Other than convenience, there is very little data to reveal that the Government is getting the best price with the use of the credit card.

(2) In FY 1995, small business received 72 percent of small purchase dollars, compared with 65 percent of small purchase dollars in FY 2000. During the same period, the number of small purchase actions decreased from 9,959,358 in FY 1995 to 3,794,647 in FY 2000. The data strongly suggest that the credit card has had a dramatic impact on the downward spiral of small purchases from small businesses.

Small purchases and the number of small businesses participating in the Federal marketplace are decreasing. At the same time, the dollar value of contracts is increasing, thus freezing out entry-level small business participants. As previously stated, the use of multiple award contracts (MACs), Government-Wide Acquisition Contracts (GWACs) and Federal Supply Schedules is primarily the product of acquisition reform. Agencies are using these tools to fill requirements quickly by simply issuing orders against these contracts rather than starting a new procurement action. MACs and GWACs reduce opportunities for small business in part because they are usually too large in scope for small businesses to participate in the competition. Moreover, these procurement tools make it particularly difficult for small businesses to increase capacity and capabilities because the smaller contracts which traditionally allowed them to gain a foothold in the Federal market are disappearing.

The Federal Supply Schedule has also hurt small business. The use of this acquisition tool has increased dramatically, from \$2.8 billion in FY 1996 to \$10.2 billion in FY 2000. Although the Small Business Act specifically requires that purchases of goods or services between \$2,500 and \$100,000 be reserved for small businesses, orders

from the Federal Supply Schedule do not follow this requirement. Further, in most cases, the General Services Administration (GSA) does not restrict Federal Supply Schedule contracts to small businesses as required by the Small Business Act. Even though 70 percent of the vendors are small businesses, they received only 38.7 percent of the \$10.2 billion spent in FY 2000 on the Federal Supply Schedule. Prior to procurement reform, small purchases of less than \$25,000 were primarily restricted for small business awards, giving them close to 75 percent.

These procurement reform tools have had a dramatic impact on the number of new contract actions. As noted earlier, the number of new small purchases (or simplified acquisition actions) has decreased significantly to about one-third of the level of five years ago. Similarly, the number of new contracts above \$25,000 has also significantly decreased. This number has declined from a high in FY 1995 of 70,088 to a low in FY 1999 of 41,075. There has also been a corresponding decrease in dollars relating to these contracts from 23 percent in FY 1995 to 16 percent in FY1999. Federal opportunities for small businesses are dwindling, making new small businesses less likely to enter the Federal marketplace. This results in a concentration of awards to fewer small firms thus reducing competition and potentially raising costs.

Mr. Chairman, the Office of Advocacy has also examined the buying habits of Federal Procurement Centers across the United States. There are approximately 2,235 procurement centers in the United States. Advocacy's study ranked the small business friendliness of these centers based on the percentage of their spending awarded to small firms in FY 1998. The study also provided a list of the major types of industries supplying the goods and services.

This study was designed to assist small business owners in marketing to the Federal Government. Almost two-thirds of the Federal prime contract dollars spent in FY 1998 were controlled by the Federal Procurement Centers that awarded the least to small firms. The summary findings of the study are: (1) 260, or 11.6 percent, of the centers did no prime contract work with small business. Of these centers, about 150 belonged to the Department of Defense. Together, these 260 centers controlled more than 6 percent of all prime contract dollars spent in FY 1998. (2) Of the 2,235 centers studied, only 213, or 9.5 percent, awarded 100 percent of their prime contract dollars to small firms.

The results of the procurement centers study raised additional questions regarding the impact of acquisition reform on small businesses in the Federal marketplace. Of specific concern was whether the Federal Government was in fact meeting its statutory procurement goal mandating that 23 percent of prime contract dollars be awarded to small business. Two different methods were used to measure the attainment of the 23 percent goal:

- (1) Congress in 1988 established an annual Government-wide goal of awarding not less than 20 percent of all prime contract dollars to small businesses without exclusion. In 1997 Congress increased this goal to 23 percent. Discretion was built into the goaling guidance process to the point that some contracts are specifically excluded. The exclusions include, among other things, contracts for foreign military sales, contracts with directed sources of supply such as the Committee for Purchase from the Blind and Severely Handicapped, contracts to the Federal Prison Industries, and contracts with an award

performance outside the United States. The rationale for these exclusions was the belief that there were certain types of contract work that small businesses could not perform as prime contractors, and that the base for measuring goal achievement should reflect that fact.

- (2) Advocacy assesses whether the agencies met the 23 percent goal, without the exclusions.

Thus, the Government's basis of total contract dollars available in a fiscal year is lower than Advocacy's. As an example, in FY 1998 all Federal agencies reported \$197.3 billion in Federal contract dollars being spent. Based on the Goaling Guidelines, which included the exclusions, the total base was \$181.8 billion or about \$15 billion less. Notwithstanding this difference in measurement, the Office of Advocacy's assessment revealed that both measurements indicate a decline in the percentage of prime contract dollars to small business. The Government's percentages have been declining from a high of 25.5 percent in FY 1996 to a low of 22.3 percent in FY 2000. In looking at the goaling process, the Office of Advocacy also reviewed the percentage of awards from the largest buying agency, the Department of Defense. The Department of Defense percentage also declined during this same period from a high in FY1996 of 23.3 percent to a low of 21.9 percent in FY2000.

While agencies are finding it more difficult to meet the Government-wide procurement goal of 23 percent, they are also failing to meet their other socioeconomic program goals. The HUBZone and women-owned business goals are not being met. As an example, the Department of Defense has yet to achieve its 5 percent goal for women-

owned businesses. In FY 2000 the Department of Defense awarded only 2.1 percent of its procurement dollars to women-owned businesses. In a similar context, the DOD dollar amount being awarded to 8(a) companies has been on the decline since FY 1996, which was the high point for 8(a) contracts. In FY 1996, DOD awarded \$3.6 billion to 8(a) companies. By FY 2000 this amount had dropped to \$3.2 billion. Another figure that gives rise to alarm is the percent of contracts being awarded by DOD under the small business set-aside program. In FY 1995 DOD awarded 9.1 percent of its contracts through this mechanism. By FY 2000 the percent had dropped to a low of 6.3 percent or \$7.7 billion of a total \$26.8 billion awarded to small businesses. This low of 6.3 percent was below DOD's negotiated goal of 7 percent for small business set-asides.

Procurement reform has made it more difficult for small businesses to challenge questionable decisions by procurement officials. According to Prof. Steven Schooner of George Washington University Law School in an article in the March 2000 issue of *Government Contractor*, "while each reform initiative or event has merits, and most serve important purposes, the cumulative effect is a weakened oversight function. (1) The confluence of micro-purchases authority and purchase cards has rendered tens of millions of smaller transactions (which soon will account for 10 percent of the procurement budget) immune from competition requirements and meaningful procurement oversight. (2) The rapid growth of multiple-award task and delivery order contracts permits billions of dollars in information technology to be procured without meaningful competition at the task order level; moreover, these procurements are not subject to protest. (3) More than 10 million purchases each year above \$2,500, but below the simplified acquisition threshold of \$100,000, can be awarded based upon three phone

calls. Absent the standard *Commerce Business Daily* notice of these procurement actions, contractors have no knowledge when they are denied an opportunity to compete and, accordingly, lack meaningful protest rights.”

The General Accounting Office has reported in a recent study that the number of bid protests has declined. This further supports the observation that the implementation of procurement reform has not been a totally positive experience for small businesses. Another unfortunate statistic is the reduced number of Certificates of Competency (COC) that contracting officers have requested from SBA. The number of COCs has dropped from a high of 1,257 in 1996 to a low of 531 in 1998. The procurement reforms of the 1990s simply do not encourage a contracting officer to refer these cases to SBA. Thus, small businesses never get a chance to compete for the Federal procurement dollar.

Mr. Chairman, it is recognized that small business participation is vital to the growth of this Nation’s economy. America’s small businesses generate more than half of the Nation’s gross domestic product and employ more than 50 percent of the domestic work force. If given a chance, small business can be competitive both in terms of cost and quality. The opportunity for small businesses to remain this Nation’s economic backbone is being eroded, not only by the areas previously discussed, but also by other overwhelming acquisition forces. One of the most prominent forces today is “bundling,” contract consolidation or umbrella contracts.

Bundling is defined as the consolidation of two or more smaller contracts into one very large contract. The SBA Reauthorization Act of 1997 established guidelines to assist agencies in evaluating their planned bundled acquisitions. The statute provides that

consolidation of contracts is permissible when the agency proves that there are measurable substantial benefits associated with bundling the contract.

Evidence of the negative impact of contract bundling on small business was first presented in the U.S. Small Business Administration's 1993 report, *Study of the Impact of Contract Bundling on Small Business Concerns and Practical Recommendations*. The study relied mainly on a survey of small business owners and others involved in the Federal procurement process. The study recommended more systematic and detailed analysis of prime contract data to substantiate or disprove the claims of small business owners that umbrella contracts were harming their companies.

The Office of Advocacy contracted in 1997 with Eagle Eye Publishers, Inc. to develop new analytical techniques in an effort to fulfill the mandate of the SBA study and to analyze the impacts of bundled contracts. This study revealed a number of important facts. First, despite the overall drop in Federal spending FY 1991-1995, large contracts greater than or equal to \$100,000 constituted a significantly larger percentage of all contracts in FY 1995 than they did in FY 1991. Second, between FY 1991 and FY 1995 small businesses, which make up the majority of small business Government contractors, saw total dollars, market share and numbers of contracts decline, while average contract size increased. Third, in FY 1992, there were 37,906 small businesses doing work for the Federal Government that had not done work in the previous year. From there, new small businesses proceeded to decline to 37,380 in FY 1993, 25,160 in FY 1994 and finally to 21,058 in FY 1995, a four-year loss of 44 percent. If bundling was occurring, one of the negative impacts would be the decrease in the number of new small businesses entering the Federal marketplace as demonstrated above.

The Office of Advocacy went a step further in 1998 and contracted with Eagle Eye Publishers, Inc., to update the above study on contracting bundling. This new study was for the period of FY 1992-FY 1999. The results were published in the year 2000 under the title, *The Impact of Contract Bundling on Small Business: FY 1992-FY 1999*. The findings of this new study were more critical of bundling than was the first study. The following are highlights: (1) The average bundled contract was valued at \$8 million in FY 1999, representing a 21 percent increase in the value of the average contract award over the past eight years; (2) for every increase of 100 bundled contracts, there was a decrease of more than 106 individual contracts awarded to small firms; (3) in FY 1999, large businesses received 67 percent of all prime contract dollars and 74 percent of all bundled dollars. Small firms received 18.7 percent of all contract dollars and 15 percent of bundled contracts; and (4) the two areas fueling the growth of contract bundling are construction and non-research services—both sectors dominated by small businesses.

Contract bundling or contract consolidation does not make good business sense when savings are not available. The cost to the American taxpayer for senseless bundling and consolidation is far more than the cost of the contract. The American taxpayer absorbs a long-term debt with the decline in small business participation in government contracting.

Mr. Chairman and members of the Committee, it is clear that aspects of the acquisition reform movement of the 1990s have had a detrimental impact on the survival of small businesses in the Federal marketplace. This negative impact is not only harmful to small businesses, it is a strike at the heart of this Nation's industrial military base. If small businesses are no longer running tool-and-die shops, spare part shops, electronic

components firms and other critical devices to keep our planes flying and our ships afloat, then who is? Mr. Chairman and members of the Committee, there are alternatives to this negative decline in the number and percentage of dollars being awarded to small business firms.

- **First**, each agency should include in its strategic and annual performance plans a commitment to achieve their small business goals. Each senior manager involved in acquisition should have a performance appraisal that includes a performance element relating to the small business goals. This should be the case particularly for Federal Procurement Executives and Program Managers. It is my understanding that the U.S. Department of Transportation (DOT) currently uses this approach, and has had very good results. In FY 2000, small business participation at DOT was 53.45 percent of direct prime contracts awarded.
- **Second**, Congress should not exempt agencies from complying with the Federal Acquisition System and the Small Business Act as amended.
- **Third**, a more modern-day balance must be achieved between competing entities such as the mandatory sourcing of the Federal Prison Industries and small businesses.
- **Fourth**, Streamlining and implementing commercial-like procurement practices in the name of Acquisition Reform should not be at the expense of small business. Bid protest, Certificate of Competency and other such tools have had a historic role in helping small businesses maintain a competitive

playing field. To stem the tide of a decline in small business prime contract dollars, these tools must be reinvigorated.

Finally, Mr. Chairman, let's not forget that if Congress had not aggressively acted on behalf of small business owners, then we would not have such companies as Microsoft and Federal Express and such products as the airplane, personal computer, pacemaker, optical scanner and many more. Until the time arrives that small businesses are co-partners in this Nation's economy, the Office of Advocacy looks forward to working with you to explore ways of achieving this goal.

This concludes my testimony. Mr. Chairman, I am also joined by Mr. Major Clark of my staff who is the Assistant Advocate for Procurement and Mr. Paul Murphy, President of Eagle Eye Publishers, Inc., primary author of our bundling studies. We will be happy to answer any questions you may have.