UNITED STATES SENATE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

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MINORITY ENTREPRENEURSHIP: ASSESSING THE EFFECTIVENESS OF SBA'S PROGRAMS FOR THE MINORITY BUSINESS COMMUNITY

Congressional Testimony Of:
Fernando V. Galaviz
Chairman
Small Business Association for Technology
1940 Duke Street, Suite 200
Alexandria, VA 22314

Contact:
David E. Cintron
Executive Director
Phone: (703) 946-8099
Email: cintrond@centechgroup.com

Fernando V. Galaviz
SMALL BUSINESS ASSOCIATION FOR TECHNOLOGY

Good morning Chairman Kerry, Ranking Minority Member Snowe, and distinguished members of the Committee, I am pleased to appear before you today to discuss minority entrepreneurship in federal contracting and the usefulness of existing Small Business Administration (SBA) regulations.

On behalf of the minority-owned small business community, we appreciate the opportunity to discuss today's issues to find fundamental solutions to the various problems facing the Small disadvantaged business (SDB) community.

I am Fernando V. Galaviz, the chairman of the Small Business Association for Technology (SBAT); founder of the National Federation of 8(a) Companies; co-founder of the Asian Pacific American Chamber of Commerce; founding member of the Latin American Manufacturing Association; and president and CEO of THE CENTECH GROUP, Inc. (CENTECH).

I am here to report that the current status of SBA programs is ineffective and is making insignificant progress to increase small business federal contracting opportunities. Even though, there is considerable evidence that minority-owned small businesses significantly contribute to the nation's economic productivity creating innovation and providing more jobs.

Considering these realities I will focus on two main topics related to federal contracting that have become deterrents and caused limitations for the development of minority-owned small businesses: Contract bundling and subcontracting regulations.

CONTRACT BUNDLING

There have been attempts by federal agencies to encourage large business corporations that have been awarded bundled contracts to provide subcontracting opportunities to minority businesses. However, the large majority of government subcontracting programs have not provided subcontracting opportunities to small disadvantaged businesses because large corporations do not fully comply with these subcontracting regulations.

In most cases, contract bundling as a business practice is a cost effective and efficient process of managing the important work that government agencies must perform. On the other hand, the current practice of contract bundling in the federal procurement process has contributed to the loss of market share for many minority-owned small disadvantaged businesses.

According to the Small Business Act, "bundling of contract requirements" is the consolidation of two or more procurement requirements for goods or services previously Provided or performed under separate smaller contracts into a solicitation for a single contract that is likely to be unsuitable for award to a small business concern due to: (1) the diversity, size, or specialized nature of the elements of the performance specified; or (2) the aggregate dollar value of the anticipated award; (3) the geographical dispersion of the contract performance sites; or (4) any combination of the preceding three factors.

Over the past five years, total government contracting has increased by 60 percent, while the number of small business contracts has decreased by 55 percent. Actually, the federal

government spent over $417 billion in Fiscal Year 2006. However, of the total prime contract obligations solicited by the federal government in FY 06 only 4 percent were obtained by SDBs and 7 percent by minority-owned businesses in contrast to 88 percent obtained by large businesses.[1]

Subsequently, the federal marketplace continues to expand and contract bundling is vital to the viability and business growth of small government contractors, but data reporting by agency procurement officials is unreliable and inconsistent. In FY 06, only 43 contracts over $5 million were reported as bundled or consolidated and these 43 contracts accounted for $5.7 billion.[2]

In May 2005, the Office of Inspector General (OIG) of the Small Business Administration (SBA) completed an audit survey of the contract bundling process to determine whether SBA is properly receiving and reviewing all bundled contracts. The audit report stated that (1) SBA did not review the majority of bundled contracts reported by procurement agencies, and (2) the Office of Government Contracting was not in compliance with various requirements concerning contract bundling.

SBA reviewed 28 possible contract bundlings for the period FY 2001 through FY 2004, but OIG identified 220 possible bundlings, or eight times the number of possible bundlings that SBA reviewed. In particular, 87% of the reported potential bundlings (with a value of at least $384 million) identified in the survey were not reviewed by SBA, though procuring activities must provide, and SBA must review proposed bundled acquisitions.[3]

As a result, SBA's ability to protect the interests of small disadvantaged businesses was hindered. One hundred ninety-two contracts identified by procuring agencies as bundled were awarded without SBA's review, with a minimum of $384 million of potential lost revenue to eligible small businesses.[4]

Moreover, unnecessary bundling displaces entrepreneurial contractors and discourages competition. It also undermines a congressionally mandated goal that at least 23 percent of the nearly $200 billion spent each year by the federal government on goods and services go to small businesses.

The Small Business Act, Title 13 of the CFR and the Federal Acquisition Regulation (FAR) require procuring agencies to notify SBA of all proposed contracts that would be considered bundled.

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[1] INPUT company generated government market information for CENETCH, May 2007.
[2] Statistics generated using Federal Procurement Data System,-Next Generation (FPDS-NG), May 18, 2007, that contains detailed information on contract actions over $25,000 and summary data on procurements of less than $25,000. The system is intended to identify who bought what, from whom, for how much, when, and where.
[3] SBA OIG, *Audit of the Contract Bundling Process*, Audit Report No. 5-20, p. 4, May 20, 2005.
[4] Since SBA does not have a database with the actual number of bundling, OIG cited the number of bundled contracts identified, but were not reviewed by SBA. According to the FAR § 7.104, the minimum contract dollar amount for a bundling is typically $2 million dollars. If one $2 million contract was lost to small business on each of the 192 bundled contracts SBA did not review, $384 million in Federal contracts would have been lost for small business.

Title 13 CFR§125.2(b) (1) also states that "PCRs are responsible for reviewing all acquisitions not set-aside for small businesses to determine whether a set-aside is appropriate and to identify alternative strategies to maximize the participation of small businesses in procurement."

Additionally, according to a report prepared for SBA's Office of Advocacy, for every 100 bundled contracts, 106 individual contracts are no longer available to small businesses. Likewise, for every $100 awarded on a bundled contract there is a $33 decrease in small business awards.[5]

In March 2002, as part of the Small Business Agenda, the President called upon OMB to prepare a strategy for unbundling Federal contracts. One of the strategies in the October 2002 OMB Report, "*Contract Bundling- Strategy for Increasing Federal Contracting Opportunities for Small Business,*" states that SBA should "Identify best practices for maximizing small business opportunities."

The recommendation within the strategy states that: In cooperation with department and agency procurement executives and Office of Small and Disadvantaged Business Utilization (OSDBU) directors, SBA will collect and disseminate these examples and incorporate them in appropriate training courses and materials.

To my knowledge, SBA has not finalized nor distributed a best practices guide, even though several years have passed since issuance of the OMB report. This failure is also stated in the Government Accountability Office's (GAOs) May 2004 report "*Contract Management: Impact of Strategy to mitigate Effects of Contract Bundling on Small Business is Uncertain,"* that SBA had not complied with the OMB recommendation. GAO recommended "that SBA will disseminate best practices to maximize small business contracting opportunities, as required…"

Pursuant to Standard Operating Procedure (SOP) 60 02 06, "*Responsibilities of the PCR*": You [PCR] will interface with all of the contracting activities assigned to you and establish a written operating plan. The plan should include the following…A description of the items/services purchased by the contracting activity; Procedures for review of purchase requisitions, solicitations (including electronic solicitation systems), and subcontracting plans…[6]

I concur and recommend that the Associate Deputy Administrator for Government Contracting and Business Development implement current operating plans in accordance with Standard Operating Procedure SOP 60 02 and establish procedures with each of the 23 major procurement agencies' Offices of Small and Disadvantaged Business Utilization (OSDBU).

I further recommend establishing a process to hold procuring agencies accountable for unreported bundlings, (e.g., options cannot be exercised on bundled contracts not reported to SBA). Furthermore, I urge SBA management to disseminate a best practices guide to maximize small business contracting opportunities as required by OMB.

[5] *The Impact of Contract Bundling on Small Businesses FY 1992 – FY 1999* (Eagle Eye Publishers for the U.S. Small Business Administration, Office of Advocacy, September 2000).
[6] This Standard Operating Procedure (SOP) under SBA was updated in October 2004

These recommendations and procedures should identify what constitutes possible bundling, when and where proposed procurements must be referred to SBA for review, and consequences for procuring agencies that do not notify SBA of proposed acquisitions involving contract bundling.

Certainly, regulatory changes, especially those related to oversight, have the potential to promote greater small business opportunities. For example, the regulations now require agencies' Office of Small and Disadvantaged Business Utilization (OSDBU), an agency's advocate for small business, to conduct annual assessments of (1) the extent to which small businesses receive a fair share of federal procurements, (2) the adequacy of contract bundling documentation and justifications, and (3) the adequacy of actions taken to mitigate the effects on small businesses of necessary and justified contract bundling.

However, the regulations do not establish metrics to measure the extent to which contract bundling is occurring, or the extent to which bundling impacts small business contracting opportunities. Consequently, it will be difficult to gauge agency efforts to identify and eliminate contracts that are unnecessarily bundled and, thereby, increase small business federal contracting opportunities. This weakness is not new; past data on bundling and the effects of consolidating requirements on small businesses have been limited and unreliable.[7]

SUBCONTRACTING PROGRAMS

The federal government subcontracting regulations consist of essential programs that contribute to the building of capabilities and resources to minority-owned small businesses. To restate, small disadvantaged businesses are a critical part of productivity, growth, and innovation to the economic base of the United States.

Historically, small businesses in the United States have received a share of federal procurement dollars not quite commensurate with their relative importance in the U.S. economy. While 99.7 percent of all employer firms are small, they receive about 23 percent of direct federal procurement dollars and almost 40 percent of subcontracting dollars. While subcontracting has been a part of the federal procurement framework, it has not received the same focus and attention as the prime contracting program.[8]

The federal government promotes small business procurement opportunities at both the prime and subcontracting levels; and with the enactment of Public Law 95-507, this legislation was extended to include small socially and economically disadvantaged small businesses as well. Public Law 95-507 was enacted in 1978. Specifically, Section 211 which established subcontracting has not been effective to date.

Provisions within the subcontracting authority of Public Law 95-507 that allows major corporations to subcontract to small and small disadvantaged businesses for contracts that are

[7] *Small Businesses: Limited Information Available on Contract Bundling's Extent and Effects*, GAO/GGD-00-82 (Washington, D.C.: Mar. 31, 2000).
[8] SBA Advocacy, *The Government's Role in Aiding Small Business Federal Subcontracting Programs in the United States*, September 2006.

over $500,000 or over $1 million for construction contracts. It is unfortunate that I report to you today that over the last 2 decades, there has been a consistent practice of major corporations not complying with the commitments outlined in their subcontracting plans which adversely impacts the market share for minority, small and small disadvantaged businesses.

Furthermore, it is unfortunate that I report that Federal government contracting officers have not been consistent in enforcing the subcontracting plans of major corporations even though Congress approved liquidated damages as remedy to penalize large corporations for failing to comply with subcontracting regulations. Although there have been thousands cases where large business corporations have not complied with subcontracting plans, we, can count on one hand when the liquid damages remedy has been enforced.

There are inconsistencies in the regulations that could affect small business procurement. Both the Small Business Act and the FAR state that acquisitions exceeding $2,500 but not greater than $100,000 are "reserved exclusively for small business concerns" with one exception: The Small Business Act exception reads, "Unless the contracting officer *is unable to obtain* offers from two or more small business concerns." The FAR exception reads: "unless the contracting officer determines there is not a reasonable expectation of obtaining offers from two or more responsible small business concerns."[9]

This difference can be interpreted to mean that, according to the Small Business Act, the contracting officer must at least attempt to award the contract as a set-aside. If two or more competitive offers are not received, then the award does not have to be reserved for a small business.

The FAR on the other hand allows the contracting officer to avoid the set-aside based solely on the "reasonable expectation" that two or more competitive offers from small business concerns will not be received. The SBA's exception offers small businesses greater protection. Therefore, SBA should ensure that the language in the Small Business Act is implemented in the FAR.

Recent studies by the Government Accountability Office, SBA's Office of Inspector General, and SBA's Office of Advocacy have found that agencies are counting awards made to large firms towards their small business procurement goals. Another problem with the MAS Program is that GSA classifies firms as small for the contract even though the firms may not be small for all of the contract's goods or services.

As a result, agencies may obtain small business credit for using a firm classified as small even if the firm is not small for all of the procured goods or services. This is contrary to SBA regulations, which require that a contractor meet the size standard for each product or service for which it submits an offer (13 CFR § 121.407).[10]

[9] SBA OIG, *SBA Small Business Procurement wards are not Always Going to Small Businesses,* Report No. 5-14, February 24, 2005.
[10] SBA OIG, *New Management Challenge: Large Businesses Receive Small Business Awards,* Report No. 5-15, February 24, 2005.

As you may recall, due to the Supreme Court's 1995 decision in *Adarand Contractor, Inc. v. Pena (Adarand),* the Federal Government Direct Contracting Program for small disadvantaged businesses was reduced. The Supreme Court held that federal programs using racial and ethnic bases in decision making must serve a compelling government interest and be narrowly tailored to meet that interest.[11] Under this standard, federal agencies must seriously consider race-neutral alternatives to race-conscious procurement programs.

Ten years after the *Adarand* decision, in September 2005, the U.S. Commission on Civil Rights issued a report finding that federal agencies still largely fail to comply with the rule in *Adarand* and consider race-neutral alternatives as the Constitution requires.[12] This report measured federal agencies' compliance with this constitutional requirement. The Commission reviewed relevant aspects of seven agencies' procurement programs: the Departments of Defense, Transportation, Education, Energy, Housing and Urban Development, and State, and the Small Business Administration. Significantly, the agencies under review neither provide clear recourse for contractors who are the victim of discrimination nor guidelines for enforcement.

Specifically, the Commission found that these agencies do not seriously consider race neutral alternatives before implementing race-conscious federal procurement programs. In addition, that such consideration is required by the strict scrutiny standard under *Adarand* and other Supreme Court decisions. Although the Commission identified some race-neutral programming efforts, agencies do not engage in the activities that constitute serious consideration, such as program evaluation, outcomes measurement, empirical research and data collection, and periodic review.

Among recommendations, the Commission urged the Department of Justice to offer clear and specific guidance on the government wide obligation to consider race-neutral alternatives. The Commission also asked the White House to assemble a task force to determine what data are required to measure the effectiveness of race-neutral alternatives. Finally, the Commission asked Congress to enact legislation expressly prohibiting race discrimination in federal contracting and to establish effective remedies and enforcement procedures.

With all due respect to committee members, has Congress enacted any legislation to remedy the bias in federal procurement agencies and eliminate race discrimination in federal contracting? After more than a decade of this milestone Supreme Court decision in *Adarand* , there have been no effective steps taken by the agencies under review, and these agencies still do not provide clear recourse for contractors who are the victim of discrimination nor guidelines for enforcement.

Therefore to increase chances of subcontracting with government contractors and become more viable, the minority-owned small business community is left with SBA's 8(a) Business Development Program, Mentor-Protégé Program, and SDB certification rules that are poorly monitored, implemented, and evaluated by SBA officials.

Using the 8(a) program as an example, subcontracting opportunities are extremely important to the development and support of minority small disadvantaged businesses. The 8(a) program, as a

[11] Adarand Constructors, Inc. v. Pena, 515 U.S. 200 (1995) (hereafter cited as *Adarand*).
[12] U.S. Commission on Civil Rights, Federal Procurement After Adarand, (September 2005).

part of its graduation strategy, requires a small business concern to have a business mix that includes non-8(a) sales. Most small business firms in the early stages of their development do not have adequate resources to compete for direct contracts in the Federal marketplace in open competition. Therefore, assuring major corporations comply is critical to provide business opportunities to minority, small and disadvantaged businesses.

Case in point, CENTECH was awarded a major Air Force contract that included an innovative small business concept of formal joint venture provision of the AF policy on small business contracting. In order to proactively assist minority and small businesses, the U.S. Air Force (USAF) developed a concept through which minority and small businesses could organize into a formal joint venture concept in order to meet the 50% work share requirements in order to demonstrate capabilities and be competitive for major bundled contracting opportunities. Years after the implementation of this proactive small business user-friendly contract bundling business strategy, the Small Business Administration (SBA) indicated that the Air Force did not have the authority to implement this very useful and effective initiative.

However, after CENTECH was awarded the contract, the Air Force, as referenced above, was forced to rescind its policy under pressure from the GAO and SBA. The SBA did not take any action to remedy the negative impact on small businesses that had followed the rejection of the Air Force's policy citing the absence of enabling legislation permitting it to do so.

Presently, this process is costing small and minority owned small businesses a significant amount of business primarily as a result of 1) the lack of agreement between the USAF and the SBA on the formal joint venture concept, and 2) jurisdictional disputes between the GAO and the SBA concerning who has the authority to decide whether a small business bidder complies with work share allocation requirements applicable to SB set aside contract opportunities.

Therefore, we recommend that the SBA should adopt and implement this proactive small business-friendly contract bundling business strategy so that SDBs can compete for major bundled procurements, and also we recommend that that Congress act to clarify that the SBA is the sole arbiter to determine whether or not a small business bidder complies with limitations on subcontracting provisions and other laws and regulations relating to small business.

At this time, Mr. Chairman, we are pleased to inform you that we have an innovative solution that we recommend that gets strongly implemented into law. We have learned in life that difficult problems and challenging circumstances can indeed be resolved by using common sense and simplicity.

Therefore, we are proposing that there is no need for the federal government and the taxpayer to be paying a significant amount of money to have federal managers going across the country determining whether large business corporations are complying with their subcontracting plans. We recommend the elimination of subcontracting plans.

Instead, with respect to prime contract awards over $2 million the federal government should require in the Request for Proposal's (RFPs) that large business acquisition bidders do the following:

1) Identify the subcontractor;
2) Identify the subcontractor's specific scope work to be performed;
3) Identify the specific dollar amount that will be awarded to the Subcontractor in the subcontract agreement;
4) Mandate that the prime and subcontractor execute a subcontract agreement prior to the proposal submission;
5) Mandate that a copy of the fully executed subcontract agreement executed between the prime and subcontractor be included in the bidder's proposal submission.

The subcontract agreement would only be in effect if the bidder is awarded the prime contract. Since there is no privity of contract between the government and the subcontractor, there would be no need for government intervention if the prime contractor breaches the subcontract agreement because the subcontractor would have a means to enforce the subcontract agreement through the legal system.

It is the current practice for prime contractors to enter into teaming agreements where the major corporation as a prime contractor indicates a percentage of work to be performed and a certain dollar amount that will be awarded. Subsequent to contract award, prime contractors enter into subcontract agreements with subcontractors but in most instances subcontractors are offered less work share and less dollars in the subcontract agreement as what was indicated in the teaming agreement.

For example, under the present system, the major prime contractor can be awarded a $200 million contract on the basis that the prime contractor will be subcontracting 20% ($40 million) of the award to minority, small and disadvantaged business. However, in actuality, subsequent to contract award, the prime contractor may only award the small business subcontractors $8 million worth of business, leaving the remaining $32 million dollars to be awarded in the future. Currently, the Federal government is not fully aware whether large business corporations are complying with their subcontracting plans. Would you buy a home without looking at the master bedroom or kitchen? It's no different with Federal government contracting.

It is for this reason that we believe our recommendation for subcontracting compliance is viable and will benefit minority, small and disadvantaged business subcontractors. This strategy will be market driven because in order to be competitive, prime contractors will be need to select the best qualified subcontractors. This strategy will also afford the Federal government contracting agency the opportunity to fully evaluate all vendors at all tier levels performing on the contract.

Thank you for the chance to work in partnership with the committee to identify best practices and solutions for maximizing small business federal procurement opportunities, and undertake the effort to stop the hemorrhaging and languishing of minority-owned firms that continue to lose ground on the government contracting playing field.