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RANKING MEMBER

Congress of the United States

U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, Small Business Committee

From: Committee Staff

Re: Hearing: "Beyond the Size Standards: Sustainability of Small Business Graduates"

Date: September 8, 2011

On Wednesday, September 14, 2011, at 1:00 pm in Room 2360 of the Rayburn House Office Building, the Committee will meet for the purposes of reviewing proposals to create a medium-sized business contracting program. Congressman Mike Rogers will be participating in the hearing, and witnesses will include Congressman Gerry Connolly; a representative from Mid-Tier Advocacy; Christopher Yukins, Professor of Government Contracts Law and Co-Director of the Government Procurement Law Program at George Washington University, and a Michael D. Frisbey of Government Suppliers & Associates in Knoxville, Tennessee, testifying on behalf of the National Small Business Association. Any questions regarding this hearing should be addressed to Emily Murphy, Senior Counsel with the Committee, at 202-225-5821.

I. Definition of Small Business

Before discussing medium-sized businesses (MSBs), it is important to first understand what constitutes a small firm, and the importance of this definition in terms of federal procurement. Next, this memorandum will discuss why firms that the Small Business Administration (SBA) deems to be other than small are of interest to this Committee.

Section 3(a)(1) of the Small Business Act, 15 U.S.C. § 632(a)(1), provides, in pertinent part:

> [a] small business concern ... shall be deemed to be one that is independently owned and operated and which is not dominant in its field of operation.

The Act does not define the terms "independently owned and operated" or "dominant in its field of operation." Instead, the Small Business Administration (SBA) is authorized to "specify detailed definitions or standards by which a business concern may be determined to be small for purposes of this Act or any other Act."[1] The Administrator is authorized to consider number of employees, dollar volume of business,[2] net worth,[3] net income, other factors, or any combination of those factors. In short, Congress has granted the Administrator substantial discretion in the factors that will be utilized in calculating the size of a small business. The SBA's discretion is tempered by the fact that any size standard determined by the factors set forth in § 3(a)(2) of the Small Business Act must meet the overarching principle – the business must be independently owned and operated and not dominant in its field.

The SBA size standards establish eligibility for a variety of programs, such as financial assistance, entrepreneurial development training, and, most important for this hearing, a panoply of government contracting programs aimed at getting small businesses more federal government contracts. Given the complexity and life cycle of federal procurement, small business participants in contracting tend to be more sophisticated and larger than the prototypical business the average person considers to be small. In addition, unlike loan guarantees and entrepreneurial assistance, there are always disappointed small business bidders in federal government contracting. Thus, the pressure to implement the correct size standard receives greater scrutiny from the federal contracting community, where a business receives a competitive advantage if it is deemed small and its competitor is deemed large.

Currently, there are roughly 1100 industrial classifications for which the SBA has 41 separate size standards. These standards are based on either the number of employees, gross revenue, or other factors[4] that the SBA believes reflect the correct size of the business. However, to simplify the size standards, SBA has proposed selecting future size standards from a limited number of fixed size standards. While the current standards range from $750,000 to $33.5 million in revenue, or 50 to 1500 employees, under the revised size standards the eight revenue-based standards will range from $5.0 million to $35.5 million, and the eight employee-based standards will be between 50 and 1,000 employees. The SBA will transition to these size standards over the course of five years, as it conducts a systematic review of all its size standards.

II. Tension Arising From Size Standards.

The volume of dollars involved in federal contracting mean that each and every firm is looking for a competitive advantage, and the size programs are one way to obtain that advantage. Contracting preferences have been extended to small businesses, participants in the 8(a) Business Development program, the HUBZone program, the Service Disabled Veteran-Owned Small Business program, and the Woman-Owned Small Business Program, in order to diversify the

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1 15 U.S.C. § 632(a)(2)(A)

2 Current SBA size standards use gross revenue as a measure of dollar volume. Nothing in the Act requires reliance on dollar volume and other measures could be used.

3 The net worth standard is used, for among other purposes, to determine eligibility for investments made by small business investment companies, loans made pursuant to Title V of the Small Business Investment Act of 1958, and for participation in the program established by § 8(a) of the Small Business Act.

4 For example, asset size is used to determine whether a bank is small.

industrial base, create jobs, and increase competition.[5] In FY 2010, small firms were awarded over $109 billion in prime contracts – 20.34% of the $536 billion the federal government awarded in prime contracts that year.[6] This still fell short of the 23% prime contract goal established by the Small Business Act, pursuant to which at least another $14 billion in prime contracts should have been awarded to small firms.[7]

However, in a hearing on the changes to the size standards earlier this year, the Subcommittee on Economic Growth, Capital Access and Tax heard testimony that these size standards fail to encompass many firms that are independently owned and operated and not dominant in their field of operations. Specifically, Congressman Kurt Schrader provided a witness, Mr. Odysseus Lanier, a founding partner in the third largest African American-owned accounting and consulting firm in the United States, with over 180 full-time employees and average receipts of $17 million.[8] As such, Mr. Lanier's firm is considered other than small by the SBA. However, Mr. Lanier pointed out that the "nuance in [his] business is the largest firms are the big four, which average about $6.8 billion in revenue. Seventeen million does not compete with 6 billion when you classify it as large."[9] This raises the question central to this hearing: what, if anything, should be done with firms that do not fit within the SBA's size standards, but still meet the Small Business Act's definition of small?

III. Proposed Solutions

To address this problem, legislative and policy solutions have been proposed. Each of these proposals address only contracting programs – none suggest that MSBs qualify for the financial, developmental, or other assistance programs available to small businesses. While many suggest that the size standards themselves should just be increased to allow these firms to qualify as small,[10] the Committee has resisted introducing larger companies into size standards where small businesses are successfully competing for government contracts and thereby ceding the remaining 77% of prime contract dollars to the largest firms.[11] Alternately, Congressmen Mike Rogers and Gerry Connolly have each proposed legislative solutions that give MSBs some form of contracting preference.

On May 20, 2011, Congressman Rogers proposed an amendment to the National Defense Authorization Act (NDAA), H.R. 1540, which would have created a MSB pilot program at the Department of Defense (DoD). The program would have granted a contracting preference to any firm with fewer than 2,500 employees that is independently owned and operated and which is not dominant in its field of operation. Pursuant to the pilot, competition could have been restricted to these firms when the contract opportunity exceeded $25 million and which was not otherwise suitable for award to a small business. The set-aside only could occur if two or more firms were expected to compete, and award could be made at a fair and reasonable price. The winning firm, along with its small business subcontractors, would be required to perform a minimum of 50% of the work. Small firms would be

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[5] 15 U.S.C. § 631(a), 644(a).

[6] Federal Procurement Data System (FPDS), *available at* www.fpds.gov (visited April 12, 2011).

[7] 15 U.S.C. § 644(g)(1).

[8] *Professional Services: Proposed Changes to the Small Business Size Standards before the Subcommittee on Economic Growth, Tax, and Capital of the Committee on Small Business*, 112th Cong. (2011) (statement of Odysseus Lanier.

[9] *Id.*

[10] *See, e.g., IT Industry Group Wants Increase in Size Standards,* Set Aside Alert (July 28, 2006)

[11] While the push to increase size standards occurs in all NAICS codes, in most frequently targets professional, scientific and technical size standards, yet 1 out of every 3 dollars awarded to small businesses was is in this sector.

allowed to compete for these contracts, and DoD would ensure that the pilot program never superseded the small business contracting programs. The Committee on Rules found the amendment to be non-germane, so it was not ultimately made in order for consideration when H.R. 1540 went to the floor.

On May 10, 2011, Congressman Connolly introduced the Small Business Growth Act, H.R. 1812, to create a MSB pilot at the General Services Administration (GSA). Like Congressman Rogers' NDAA amendment, GSA would be allowed to set aside work for MSBs if two or more firms were expected to compete, an award could be made at a fair and reasonable price, and the work would not otherwise have been awarded to a small business. However, there are important differences between the two proposals. For the GSA pilot, firms would be required to have fewer than 1,500 employees, and the contract size need only exceed $150,000. Furthermore, the GSA pilot would require that MSBs be participants in GSA's Mentor-Protégé program, and be actively mentoring small contractors. There are no limitations on subcontracting provisions, nor are there affirmative protections for small businesses. The bill has been referred to the Committee on Oversight and Government Reform, but no hearings have been scheduled.

From these two different approaches, it is clear that two Members of Congress, acting independently, both perceived a need to address the problems of MSB, yet they defined MSB differently, created different parameters for their pilots, and staged them at different agencies. Irrespective of the language of the already introduced legislation on this subject, none address major concerns about the development and implementation of a MSB program. It is to those issues that we now turn.

IV. Issues Before the Committee

Before this Committee will consider any proposals to create a MSB program, four key questions and one guiding principle need to be addressed. Specifically, the four major issues that must be addressed in the creation of a MSB program are: (1) the definition of MSBs; (2) the basis for award under a MSB program; (3) interaction with other federal procurement initiatives, including small business programs; and, most importantly, (4) the benefits to the government and taxpayer, if any, derived from MSB program. The guiding principle is that before any MSB program is considered, the Committee must be satisfied that it will not harm the small businesses currently participating in federal contracting.

A. Definition of Medium-Sized Firms

At the heart of any MSB program is the question of what is a MSB. Both legislative proposals suggest a one-size-fits-all approach: a 1,500 or a 2,500-employee standard. While simple, the one-size fits all approaches have their own problems. For example, Congressman Connolly's bill would not assist businesses in which the size standard for a small firm is 1,500 employees, such as in telecommunications or aerospace research. Similarly, Congressman Rogers' approach selcts an arbitrary employee number which in certain fields might incorporated all businesses, and thus provide no help to any MSBs.

SBA's separate size standards for the 1,100 industrial classifications exist because industries are so different that it would be inappropriate to develop one applicable size standard for all small businesses. If that is the case for small businesses, the same rationale would apply for larger enterprises. Take, for example, architectural firms, which currently have a size standard of $4.5 million. According to the 2008 data, the Census Bureau counts 23,581 firms providing

architectural services. Of those, 23,528 have less than 500 employees, leaving only 0.02 percent of firms exceeding 500 employees and making it highly probable that many, if not all of those would have less than 2,500 employees. As a result, all architectural firms above the current SBA size standard would qualify as MSBs, thereby being forced to compete against the largest architectural firms in the world. Thus, no medium-size architectural firms would obtain any benefit from this program. This scenario is likely to duplicate itself in numerous other industrial classifications. Thus, any MSB program (as with the current small business programs) must account for these difference if the program is to be of utility to MSBs.

If size standards need to be tailored to address specific industry characteristics, the question then becomes who creates the specific definitions. If the MSB program is agency specific, such as with those offered by Congressmen Rogers and Connolly, a logical choice would be for the agency charged with the pilot program to define MSBs. However, there are two problems with that approach. First, no agency other than SBA has any expertise in the economics of size standards. Consequently, the agencies would have to hire new employees, at an expense to the taxpayer. Secondly, allowing other agencies to determine who is a MSB encroaches on the statutory obligations given to the SBA pursuant to the Small Businesses Act (of determining what is small for purposes of any other act), and raises the potential for different methodologies leading to conflicting standards. However, while requiring SBA to designate the MSB size standards would lead to consistent methodologies, it would further tax SBA's limited resources. A possible compromise would be to apply a multiplier to the current small business standards to determine a MSB size standard. While this is not as thorough as individual analysis of each industry by SBA, it is at least somewhat tailored to previously established industry characteristics.

Even once the MSB size standards are established, questions still will exist as to what business qualifies as a MSB. For example, large firms cannot create subsidiaries that qualify as small for purposes of the Small Business Act, because the Act requires that small businesses be independently owned and operated. To meet these requirements, a body of regulations and administrative decisions on the principles of affiliation has been created. However, any pilot program would be in a stand-alone piece of legislation. If the MSB program is intended to benefit independently owned and operated MSBs, then any program must either reference the Small Business Act to incorporate the rules of affiliation, or independently attempt to create their own standard of affiliation.

Once the issues of size standards and affiliation are addressed, the question becomes which agency determines whether a business concern is a MSB, how is that status recorded, and what agency hears challenges to that status? Again, due to issues of expertise and resources, the obvious answer is SBA – no other agency has expertise in analyzing compliance with size standards, and any other agency would need to hire employees with such expertise or allow self-certification.[12] The certification itself would either need to take place through agency-specific form or through the Online Representations and Certifications Application (ORCA).[13]

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[12] When small business programs have used self-certification, the programs are fraught with the danger of fraud. *See, e.g.,* GOVERNMENT ACCOUNTABILITY OFFICE [GAO], HUBZONE PROGRAM FRAUD AND ABUSE IDENTIFIED IN FOUR METROPOLITAN AREAS (March 2009) (GAO-09-440); GAO, SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM: FRAUD PREVENTION CONTROLS NEEDED TO IMPROVE PROGRAM INTEGRITY (GAO-10-740T) (May 24, 2010).

[13] As authorized by 48 C.F.R. § 4.12, the system is available at https://orca.bpn.gov/.

In any case, all MSBs would need to be put into a database of some sort, so that contracting officers could conduct market research. Presumably, this would occur through a modification to the Central Contractor Registration (CCR), which has associated costs. A logical follow-on would be a similar modification to the FPDS, which tracks contract awards, so that the success of the MSB program could be gauged. However, this also would incur costs.

Existing small business government procurement programs vest SBA with the power to determine whether a business is small. This occurs either upon application from a federal contracting officer or a protest by a competitor. SBA has the power to determine whether a business is small and its determination is conclusive with respect to contracting officers.[14] Since a MSB pilot would stand-alone, it remains unclear whether size protests would be available, and if they were available, which agency would handle MSB claims: the agency hosting the pilot, or the SBA. The absence of protests potentially allows ineligible businesses to potentially benefit from the program, which in turn would undermine any benefits to legitimate MSBs. If pilot agency hears the protests, the agency would have to develop an infrastructure to hear such claims because it has no such infrastructure.[15] If it is the SBA, then the legislation must detail whether the protests would be handled in the same manner as extant small business size protests or some other procedures would apply.

B. Basis for MSB Program

Small business procurement programs enable sole source contracting (on a discretionary basis), allow restricted competition only among small businesses, or provide price preferences known as Price Evaluation Adjustments (PEAs) to help small businesses win contracts when small and large enterprises are competing. A MSB program could use any or all of these alternatives. However, it is not evident a priori which of the alternatives or a combination would be what is needed to benefit MSBs. Specifically, it needs to be decided whether MSB programs would be restricted on solely to MSBs, whether the "Rule of Two"[16] would apply, and whether that or other mechanisms would trigger the MSB program.

If a program is started to support MSBs an open question concerns whether small businesses or medium-size businesses will be favored in the procurement. Assume for the moment that there are at least two eligible small businesses and two eligible MSBs. There is a significant question whether such procurement should be restricted to small or MSBs. If MSBs are favored, then the federal government, which does not meet existing small business goals, will have an even harder time in meeting those goals, thereby seriously harming small businesses. In essence a major issue remains unanswered that has already been alluded to elsewhere in this memorandum – the appropriate trigger

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[14] Although there is no further administrative challenge to a SBA size determination, an affected party does have the power to challenge that decision in the Court of Federal Claims under the Contract Disputes Act or in federal district court pursuant to federal question jurisdiction of Title 28, United States Code.

[15] This infrastructure would include substantial costs, among which are the cost of training officials to handle size protests, providing a mechanism for formal appeals, and the hiring of administrative law judges to handle such formal appeals.

[16] The Rule of Two states that contracts may be set aside for small businesses if the contracting officer has the reasonable expectation that two or more small businesses will be technically capable of performing the contract a fair market price. Technically, the contracting officer must find two responsible small business bidders willing to provide the good or service at a fair market value. 48 C.F.R. § 19.502-2(b). Responsibility is a term of art whose full delineation is far beyond the scope of this memorandum.

for using the MSB program and its effects on small businesses. Ultimately, unless the federal government meets all of its small business goals, including the sub-goals for the various contracting programs, the MSB program risks taking contracts from small businesses and give them to what are now considered large businesses. Except for the 8(a) program, the small business contracting programs generally required that the Rule of Two be met as a trigger. Existing small business procurement programs limit participation to specified entities. Competitions may be restricted to HUBZone firms or 8(a) firms, or women-owned small businesses or may be open to all small businesses. However, small businesses also are capable of winning contracts in open competitions when bidding against large businesses. In order to protect small businesses, any MSB program would need to include a requirement that small business programs always take precedence over MSB programs if these goals are to be met.

Assuming that the Rule of Two applies to the MSB program, it is necessary to then address whether small businesses should be allowed to compete in a procurement if a contracting officer found that one small and two MSB were capable of performing a contract at a fair market price. If the guiding principle is to do no harm to small firms, it would follow that small firms should be allowed to compete for any contract where they are qualified to perform, even if the agency designates the opportunity as suitable for award to MSBs. Allowing small firms to compete for MSB contracts could benefit these small firms in cases where the requirements of the Rule of Two for small firms are not met, as competition would still be restricted to a more limited number of competitors. Of course, that reduces benefits to MSBs from having a MSB program.

If the Rule of Two is not the trigger for the MSB program, there are other alternatives. The program could provide for a statutory goal of awarding contracts to medium-sized enterprises. The question then would be what the appropriate percentage would be, and whether the goal itself would be a disincentive to awarding the maximum amount practicable to MSBs.[17]

Another possibility is the use of a price evaluation adjustment (PEA). Currently, HUBZone small business concerns are eligible for a price evaluation factor of 10 percent when they are competing in full and open competition and the two highest rated offers are a HUBZone concern and a large business.[18] A PEA is best applied to procurements where price is the determining factor for award, which is less likely to be the case for MSBs where procurements often involvement complicated evaluation factors, and the good or service being sold is not a standardized commodity.

Finally, the program could incorporate the MSBs into the goals set forth in the Small Business Act. However, that would mean that existing small businesses would lose federal government contracts. As such, this would violate the underlying principle for any MSB – it would harm existing small firms.

C. Interaction with Other Contracting Requirements

To this point, this memorandum has focused on any MSB program's interaction with programs where small businesses are the prime contractors. However, the Small Business Act also

[17] The Small Business Act sets forth goals for each of the various small business contracting programs. When contracting officers reach these goals, they do not have an incentive to invoke those programs to meet or exceed the statutory goals; this constitutes as a de facto cap on the total number of contracts awarded to small businesses.
[18] 48 C.F.R. § 19.1307.

expresses a goal of increasing opportunities for small businesses that are not prime contractors. Furthermore, the Small Business Act addresses the crafting and identification of requirements with the goal of assisting small businesses, and the Federal Acquisition Regulation has provisions that seek to reduce the barriers to small business participation in federal procurement. These additional incentives to assist small businesses also must also be addressed in any MSB program.

First, there are requirements regarding how MSBs relate to other firms. For example, § 8(d) of the Small Business Act mandates that every business obtaining a contract from the federal government that is other than small must submit a subcontracting plan. MSB are, by definition, other than small. Presumably they still would have to submit subcontracting plans; otherwise the program would reduce the universe of firms vending goods and services to the government for which small businesses can be subcontractors.

This requirement for MSBs to submit subcontracting plans becomes trickier in light of limitations on subcontracting in the Small Business Act. Current law mandates that a small business must perform at least 50 percent of the work set forth in the contract if the concern won the contract as a result of its status as a small business.[19] If a similar parallel applies to a MSB program, then it could not award subcontracts for more than 50 percent of its work. This contradicts the other obligation – to subcontract as much as possible with small businesses. The tension between these approaches Is exacerbated by the fact that if Congress reduces the limitation on subcontracting, it would allow MSBs to subcontract with large firms thereby defeating the purpose of economically benefitting medium-size enterprises.[20] One potential solution s to remove the limitation on subcontracting for MSBs as it applies only to small businesses.

The issue becomes even further complicated when the subject of joint ventures is introduced. SBA size regulations permit two small businesses to create a joint venture and remain small for purposes of bidding on federal government contracts.[21] The premise is to ensure that small businesses remain competitive for larger contracts, i.e., ones that each small business individually would be technically incapable of performing. It is an open question as to whether similar joint ventures should be allowed in the MSB program and which agency would enforce any rules on the subject if the program is not tied to the Small Business Act. The joint venture of medium-size enterprises would allow them to compete for even larger federal contracts. However, the largest of such joint ventures would essentially be big businesses. On the other hand, such joint ventures would not be taking contracts from small businesses or even joint ventures of even smaller enterprises. Any MSB program legislation must resolve these joint venture issues.

In addition to considering the relationship between companies, any MSB program also would need to address contract bundling. Currently, federal agencies may not consolidate contract requirements into larger contracts unsuitable for award to small businesses absent a determination that bundling will provide substantial measurable benefits to the government. Since MSBs are not small businesses, the question is whether the same determination should be required when bundling makes

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[19] 15 U.S.C. § 644(o)(1). The restriction does not apply if the small business wins a contract under in open competition in which all sizes of businesses are eligible to compete.

[20] An additional issue is whether, in subcontracting plans, firms that are neither small nor medium must subcontract with MSBs as well as with small firms.

[21] Absent this exception, the SBA affiliation rules would combine the two firms and they would be other than small in many instances.

a procurement unsuitable for MSB. If the bundling requirements do apply, federal agencies must determine whether the existing standards for determining substantial measurable benefits applies with equal force to MSBs as they do to small businesses.

If the bundling provisions, in some form or fashion, do apply to protect MSB, then another issue arises concerning the roles of the Procurement Center Representative (PCRs)[22] and Offices of Small and Disadvantaged Business Utilization (OSDBUs) in these procurements. Specifically, should PCRs review proposed contracts to see if work could be broken out for MSBs, as they currently do for small businesses? PCRs are employees of the SBA and there are an insufficient number of PCRs now; new requirements will undermine the PCRs' ability to assist small firms.

Similarly, the OSDBUs are statutory offices within each agency charged with advocating on behalf of small businesses for purposes of federal contracting, including reviewing acquisition strategies to improve small business participation. If a MSB program is established, should OSDBUs work on procurement strategies to encourage MSB participation? Given the limited resources available to the OSDBUs, there is a concern that the OSDBUs would limit use by small businesses as resources were devoted to assist MSBs.

The question also remains as to whether MSBs would enjoy some of the same protections or exemptions as small businesses. For example, consider the cost accounting standards. In certain cases, a business's status as small exempts it from the very expensive cost accounting standards required for some contracts,[23] but MSBs do not currently enjoy a size-based exemption. Applying the same exemptions to MSBs would represent a beneficial cost savings to these firms, particularly new entrants into government contracting, and give them a competitive advantage against large firms required to use a cost accounting system. On the other hand, MSBs are more likely to engage in the types of contracting target by the cost accounting standards: in time and material, research and development, and cost based contracts. In such cases, an exemption could lead to waste in federal contracting – the cost accounting standards help ensure that the federal government pays a fair and reasonable price, and limits exorbitant profits. Thus, a blanket exemption of MSBs, especially joint ventures of MSBs, could lead to increased costs paid by agencies, and a loss of value to taxpayers.

Likewise, all federal agencies have special provisions to ensure prompt payment to small businesses. These rules ensure that small businesses will be paid within 30 days. Some agencies allow small businesses to have accelerated progress payments. Clearly, this is a benefit to federal contractors but it remains unclear whether MSBs would be eligible for either program. Thus, the question remains as to how similarly small and MSB concerns should be treated in federal contracting.

D. Benefits of the Program

Proponents of a MSB program argue that it will improve the health of the industrial base, increase competition resulting in lower prices, and create and preserve jobs. Conversely, opponents argue that it will overcomplicate the procurement system, will create a new program during a time of shrinking government, and will reduce competition. There is an expectation that the witnesses

[22] PCRs review statements of work that are not set aside for small businesses to see if work can be broken out from these requirements in order to promote small business participation.

[23] *See* 48 C.F.R. § 31. Commercial type and some fixed price contracts are also exempt from these requirements.

will address these issues in depth, but this memorandum will present a consolidated version of the arguments on each side.

1. Industrial Base

Proponents of a MSB program argue that medium-sized firms are disappearing, as small firms that outgrow the size standards either go out of business or are acquired by large firms. A recent study by the Center for Strategic and International Studies (CSIS) compared DoD's industrial base for FY 1999 and FY 2009. CSIS found that, "there was a 'squeezing' of mid-sized contractors," which they found to be particularly problematic in terms of research and development dollars, noting that "the same 4 large contractors dominated the R&D market for the last 10 years, and nearly 76 percent of contract dollars were awarded to the top 20 contractors in FY 2009."[24] Additionally, they found that the top 20 contractors are increasing their market share, from 41 to 43 percent of DoD's prime contract dollars over the decade.

An earlier study found that middle-tier professional services firms have suffered an erosion of their relative share of the federal market, noting that in 1995, MSB captured 40 percent of dollars spent on federal professional services contracts, but by 2009 MSBs captured only 30 percent, concluding that "the middle tier has been squeezed from above by consolidation and from below by the slight growth in small contractors' share of the market."[25] However, despite these statistics, CSIS did not find a reason to be concerned about the health of the industrial base, concluding instead that, "[t]hese data indicate a positive development, however, as it appears that the government's small business set-aside program is succeeding."[26]

2. Competition/Price

Another argument made in favor of a MSB program is that an increase in MSB presence in the market will increase competition, thereby decreasing price. This is similar to the argument made for the small business set-aside programs – attracting small companies to the marketplace brings additional competition, and small firms win approximately half of the contracts without relying on set-aside programs. If the same were true of MSBs, the increased competition could indeed bring down prices. However, no data exists on whether a MSB program would provide incentives for new market entrants into the federal procurement market or simply benefit existing firms by establishing a program that favors them.

3. Creation/Preservation of Jobs

When MSBs are acquired by large firms, the large firm normally sheds the administrative side of the businesses – the human resources, accounting, marketing, legal, and other functions which are often duplicated at the acquiring company's office. Thus, these jobs are lost. In creating a MSB program, proponents argue that MSB owners would be less likely to sell, therefore preserving jobs.

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[24] CSIS, DEFENSE CONTRACT TRENDS: U.S. DEPARTMENT OF DEFENSE CONTRACT SPENDING AND THE SUPPORTING INDUSTRIAL BASE, 35 (May 2011), [hereinafter DEFENSE CONTRACT TRENDS].

[25] CSIS, STRUCTURE AND DYNAMICS OF THE U.S. FEDERAL PROFESSIONAL SERVICES INDUSTRIAL BASE 1995–2009, XV (Nov. 2010).

[26] DEFENSE CONTRACT TRENDS at 35.

Further, they argue that if the MSB continues to grow, it will also continue to add jobs, pointing out that many firms that they consider MSBs have fewer than 500 employees, and that these are the firms credited with high job creation. However, creating additional contracting opportunities for MSBs does not prevent mergers, nor is it appropriate to favor a policy that unilaterally encouraged growth through acquisition. Finally, a MSB that wins a contract under a MSB program means a large business lost the contract and may have to reduce personnel as a result. Absent some growth in Federal contracting dollars a MSB program may not result in employment gains.

4. Confusion in the Procurement System

Contracting officer are responsible for five small business contracts programs, the Ability One program to address contracting with organizations employing the blind and severely disabled, Unicor contracting requirement for purchasing the products of federal prison labor, the Randolph-Sheppard Act, which gives preference to concessions in federal buildings to the blind, and a myriad of other programs even before the complexities of the actual requirement are considered. At the same time, over the past decade the number of contracting professionals has remained constant while the number of dollars spent has doubled. Thus, an additional program may further burden the acquisition workforce. Increasing the workload further may lead to avoidable mistakes, the cost of which will be borne by the taxpayer. As a result, an overriding principle in the creation of a MSB program must be that the burden of rushed decisions by contracting officer does not adversely affect the federal fisc.

5. Cost of a New Program

Even with the ideas presented in this memorandum to reduce the cost of a MSB program, such as using SBA personnel for hearings and tying size standards to the current small business goals, some costs are inherent in any contracting program. First, a new course would need to be developed by the Defense Acquisition University and the Federal Acquisition Institute so that contracting officers would be able to implement the new program. To save funds, this could be done using money from the Acquisition Workforce Training Fund,[27] which takes a percentage of all GSA fees to pay for training. Next, FPDS, CCR, and ORCA will need to be modified. Taken together, it remains unclear what the cost will be even if the SBA performs many of the administrative functions. If SBA does not perform those functions, the cost will be considerably higher.

V. Conclusion

As alluded to elsewhere in this document, even with the best of intentions, small businesses may be inadvertently harmed by the creation of a MSB program. As the Committee weighs the potential costs and benefits of a MSB program, and considers the technical questions involved in creating such a program, first and foremost the goal must be to never harm those firms that currently qualify for the small business contracting programs.

[27] 41 U.S.C. § 433(H)(3)