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

MEMORANDUM

To:	Members, Subcommittee on Contracting and Infrastructure
From:	Jared Golden, Chairman
Date:	July 16, 2019
Re:	Subcommittee Hearing: "Challenges and Opportunities in the Federal Procurement Marketplace"

The Committee on Small Business, Subcommittee on Contracting and Infrastructure, will meet for a hearing titled: "Challenges and Opportunities in the Federal Procurement Marketplace". The hearing is scheduled to begin at **10:00 a.m. on Tuesday, July 16, 2019 in Room 2360 of the Rayburn House Office Building**.

As part of the Subcommittee's ongoing efforts to improve the competitive viability of small businesses, the hearing will examine a variety of issues impacting small contractors. This hearing will allow members to take a look at some of the common challenges faced by small businesses in the federal contracting marketplace. Furthermore, the hearing will also provide an opportunity for small businesses to explain how these issues directly affect their daily operations and bring forward recommendations or potential solutions to address them.

The witnesses for this hearing will be:

- Ms. Belinda Guadarrama, Founder and CEO of GC Micro, testifying on behalf of GovEvolve- a group of small business IT value-added resellers
- Mr. Bruce Lansdowne, President and CEO of Trinity Technology Partners, testifying on behalf of the Montgomery County Chamber of Commerce
- Mr. Thomas J. DePace, CTS, COO and Sr. Engineering Manager, Advance Sound Company, testifying on behalf of National Electrical Contractors Association
- Ms. Dorothy Ann Callahan, Principal, D. Callahan, LLC

Background

America's 30 million small businesses are the engine of job creation and economic growth in this country, creating two thirds of net new jobs in the United States and employing nearly half of the nation's workforce.[1] In 1953, Congress passed the Small Business Act,[2] which authorized the U.S. Small Business Administration (SBA) to make sure that these businesses have the tools and

[1] SBA Office of Advocacy, *2018 Small Business Profile*, www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf. See also: SBA Office of Advocacy, *Frequently Asked Questions about Small Businesses* (Aug. 2018) https://www.sba.gov/sites/default/files/advocacy/Frequently-Asked-Questions-Small-Business-2018.pdf

[2] PL 83-163, as amended.

resources they need to start and expand their operations and create the jobs that support a growing economy and a strengthened middle class. The federal government is the largest purchaser of goods and services in the world, spending nearly $442 billion in FY 2017.

As part of the agency's core operations, SBA is responsible for ensuring that small businesses receive their fair share of federal contracting opportunities. Doing so not only guarantees an active U.S. industrial base but, generally, small companies have lower overhead than their corporate counterparts and can provide products and services rapidly and at the best value to taxpayers.

Small Business Contracting Programs

In order to maximize small business participation in federal contracts, SBA administers several government-wide small business set-aside programs. These programs basically reserve contracting opportunities for small businesses while allowing them to compete only with similar situated firms for federal awards. Moreover, these programs have been developed to break down barriers and to expand certain market segments, such as minority entrepreneurs. Specifically, the four procurement programs are the 8(a) Business Development program, HUBZone, Service-Disabled Veteran-Owned Small Business program (SDVOSB), and Women-Owned Small Business (WOSB) Federal Contracting program.

Furthermore, contracting opportunities with small businesses are further incentivized by setting forth the government-wide goal of awarding at least 23% of all federal contracting dollars to small businesses. The Act also sets the goal of awarding 5% of all prime contracting and subcontracting dollars to small disadvantaged businesses and women-owned businesses; and 3% for HUBZone and service-disabled, veteran-owned businesses.

During the last six years, the federal government has been successful in achieving the 23% goal, although the other contracting goals have not necessarily been met. Last year, for example, the federal government awarded 25% of all prime contracting dollars to small businesses and met the goal of awarding 5% and 3% of prime contracting dollars for small disadvantaged businesses and service disabled veteran-owned service businesses, respectively. However, the prime contracting goals for HUBZone small businesses and women-owned small businesses were not met.[3]

Despite the progress that has been made, small contractors are losing their foothold in accessing federal contracts. Multiple proposals, such as the 809 Panel proposal discussed below, claim to streamline the procurement process. However, if implemented they could potentially reduce the ability for small firms to do business with the government. Due to changing technology and contracting models, is important take a fresh look at set-aside programs to meet today's buying realities and improve the way the government does business with small contractors.

Size Standards

Small businesses play an important role in the American economy. However, defining what a small business is has long been a point of contention. Since SBA's inception, it has struggled to find a

[3] Small Business Administration, *SBA Beats Goal for Small Business Awards: $120Bn To America's Small Businesses*, press release 19-04, June 28, 2019. https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-beats-goal-small-business-awards-120bn-americas-small-businesses

numerical definition for small business, on an industry-by-industry basis, to establish eligibility for its programs.

Currently, size standards are based on four measures: (1) number of employees (used for 505 industries), (2) average annual receipts (526 industries), (3) average asset size as reported in the firm's four quarterly financial statements for the preceding year (5 industries), or (4) a combination of number of employees and barrel per day refining capacity (1 industry). As these numbers indicate, the employee-based size standard and the receipts-based size standard are the ones used the most to determine which firms qualify as small.

Currently, there are 16 receipts-based standards in effect: No more $0.75 million, $5.5 million, $7.5 million, $11.0 million, $15.0 million, $18.0 million, $19.0 million, $20.5 million, $25.0 million, $27.5 million, $29.5 million, $32.0 million, $32.5 million, $36.5 million, $37.5 million, and $38.5 million. Moreover, there are nine employee-based standards in effect: no more than 100, 150, 200, 250, 500, 750, 1,000, 1, 250 and 1,500 employees. As part of its methodology, The SBA conducts an analysis of multiple economic factors, such as each industry's overall competitiveness and the competitiveness of firms within each industry, to assign size standards to particular industries.[4]

In 2018, the Small Business Runway Extension Act modified the receipts-base size standard to take into consideration the average receipts of the previous five years, instead of the previous three, when assessing whether a particular firm classifies as small.[5] The purpose of the change was to assist rapidly growing businesses at the upper limit of their size standard that may be prematurely ejected from the small business category and into the open marketplace, where they will be unable to compete against larger firms. With this change in the calculation, small businesses are granted additional time to mature and develop the infrastructure they will need to successfully transition out of the small business category.

While the receipts-based size standard was modified last year, the employee-based size standard has remained the same. To determine whether a particular firm is small, the employee-based formula currently takes into consideration the average employment of the small business concern during the preceding 12 months. Because the increase was made to the receipts-based formula, increasing the employee size standard to allow for a longer term calculation may allow for additional transition time for small firms. However, it is necessary to also consider the impact of allowing firms that are large to count as a small business because it would further impede the ability of small contractors to win federal awards. The hearing will allow the Committee to ascertain if small businesses subject employee size standards face the same tipping point challenges as firms subject to the receipts based standard.

<u>Subcontracting Plans</u>

In addition to the prime contract goal of 23 percent to small businesses, section 15(g) of the Small Business Act requires that the Federal government also set goals for subcontracting to ensure that

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[4] ROBERT JAY DILGER, CONG. RESEARCH SERV., R40860, SMALL BUSINESS SIZE STANDARDS: A HISTORICAL ANALYSIS OF CONTEMPORARY ISSUES (UPDATED FEB 2019).

[5] P.L. 115-324.

these businesses are able to compete in the Federal marketplace.[6] When carried out properly and effectively, subcontracting has the ability to provide many small firms with business opportunities. However, there are many problems with the subcontracting system that make it difficult for small businesses to participate in the Federal marketplace.

Contracts over $700,000 ($1.5 million for construction) awarded to a medium or large business must have a small business subcontracting plan.[7] There are three types of subcontracting plans:

- Individual Subcontracting Plan: This plan covers the entire contract period, applies to a specific contract, and has goals that are based on the contractor's planned subcontracting efforts. A contractor may also develop a "master subcontracting plan," which is a template that includes all the information required for an individual plan except subcontracting goals. A master plan may be incorporated into an individual subcontracting plan, but a master plan cannot itself serve as a subcontracting plan for a contract.[8]
- Commercial Subcontracting Plan: This plan covers a contractor's fiscal year and applies to the entire production of commercial items sold by the contractor.[9] It applies to all Government contracts in effect during the contractor's fiscal year. The contracting officer who approves the plan administers the plan.[10]
- Comprehensive Subcontracting Plan: This plan is similar to a commercial subcontracting plan in that it applies to all of the contractor's DoD contracts in effect during the Government fiscal year. A comprehensive plan is administered by the Defense Contract Management Agency.[11]

If a subcontracting plan is approved, the prime contractor is required to submit periodic reports to the Electronic Subcontracting Reporting System (eSRS) during the course of the contract.[12] The contracting officers are then charged with reviewing these reports to ensure that contractors are adhering to their subcontracting plan.

One of the problems with subcontracting plans is that the eSRS system does not alert the contracting officer if the business is not filing reports or if the business is not meeting its contracting plan. Thus, the onus is on the contracting officer to go into the system to ensure that every contractor is filing the reports and accurately complying with the requirements, which can be an enormous task given the multiplicity of contractors and the already heavy workload of contracting officers. Also, it is unclear to what extent this mechanism is being monitored by SBA and the Offices of Small Disadvantaged Business (OSDBU) located within each agency.

Another challenge with subcontracting plans is they lack the "teeth" to ensure contractor's compliance. For example, if the prime contractor is found not to have made a good faith effort to comply with the subcontracting plan, the contracting agency may pursue liquidated damages equivalent to the amount by which the contractor failed to achieve its subcontracting goals.

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[6] Small Business Act, P.L. 111-240, § 15(g), 72 Stat. 384.
[7] Federal Acquisition Regulation (FAR) 19.702
[8] FAR 19.701 and 19.704.
[9] FAR 19.701.
[10] FAR 19.704.
[11] Defense Federal Acquisition Regulation Supplement, DFARS 219-702(1).
[12] FAR 52.219-9 (d)(10).

However, because this liquidated damages penalty is triggered by the failure to make a good faith effort to comply with a subcontracting plan rather than the failure to achieve the goals in the plan, the important issue becomes how the SBA defines a good faith effort. A prime contractor can demonstrate that it has made a good faith effort in one of three ways: (1) by meeting its goals; (2) by overachieving in some categories to make up for an underachievement in other categories; or (3) by performing one of a laundry list of actions.[13] This list of actions is so broad that it is almost impossible for a contracting officer to issue a notice that a large prime contractor has failed to make a good faith effort to comply with its subcontracting plan.

The hearing will allow Members to hear about potential solutions besides H.R. 6367, the Incentivizing Fairness in Subcontracting Act, which passed the House in January 2019. Members will hear about what steps must be taken to reform the subcontracting system so that contracting opportunities apportioned for small businesses are in fact given to small businesses.

Retainage

Progress payments can be made in fixed-price federal construction contracts. However, if satisfactory progress has not been made, contracting officers are authorized to, at their discretion, retain up to 10% of the amount of payment until such progress is achieved. Under the FAR, contractors can also withhold payments from subcontractors pursuant to the contract between the parties. If they do, they are unable to bill the government for said retainage. Subcontractors bear the biggest burdens of retainage provisions because primes tend to withhold more than what is being retained from them and often, the amounts retained are greater than the subcontractor's profit margins. This forces them to work at a loss, which puts pressure on their bottom lines. Also, because the retained amounts are not due until the work is substantially completed, subcontractors must wait a long time to receive the amounts retained. One of the biggest concerns regarding retainage is that retention release is delayed at unacceptable levels. Witnesses will discuss how retainage affects their ability to operate their business, employ workers, and maintain ongoing contracting projects.

809 Panel Recommendations

Preserving and expanding competition through small business concerns is one of the main pillars of the Small Business Act. To ensure this policy is implemented, the Federal Acquisition Regulation (FAR) requires setting aside contracting opportunities for small concerns under certain circumstances. In particular, for procurements under the simplified acquisition threshold,[14] the FAR states that those acquisitions are automatically reserved and set aside for small business concerns unless the contracting officers determines that there is no reasonable expectation of obtaining offers from two or more responsible and competitive small business concerns.

Similarly, for procurements over the simplified acquisition threshold, the contracting officer is generally required to set aside when there is a reasonable expectation that offers will be obtained by at least two responsible small businesses and the award will be made at fair and reasonable

[13] 13 C.F.R. § 125.3(d).
[14] The Simplified Acquisition Threshold (SAT) is the threshold up to which agencies can use simplified acquisition procedures or contracting methods designed to streamline the acquisition process. Currently, the SAT is $250,000.

prices.[15] Under this framework and because of all the different requirements that need to be met, the contracting officers have much discretion what is set aside or not.

The National Defense Authorization Act for Fiscal Year 2016[16] established an advisory panel currently known as the "Section 809 Panel" to provide recommendations about how to streamline and improve the efficiency and effectiveness of the Department of Defense's (DOD) acquisition process. Generally, the recommendations issued by the Panel regarding small businesses were welcomed by the industrial base until the issuance of Volume 3 earlier this year. In particular, recommendation #35 has created grave concerns. This recommendation proposes the elimination of small business set-asides as part of a new acquisition process that seeks to simplify and make more agile the procurement of what the Panel refers to as "readily available products and services, and readily available products and services with customization."[17] Instead, "mandatory" set-asides would be substituted for a 5% price preference and DOD would still be "required" to meet the small business goals.[18]

This recommendation has been subject to much debate and met with resistance from the small business community. If this recommendation were implemented, it would cause great harm to small firms and weaken the pool of contractors performing work for DOD. Furthermore, the set-asides are not mandatory, which makes a 5% price preference unfeasible for firms that will now have to compete with much larger companies. By essentially eliminating the voluntary goaling system at DOD, one of the largest and most successful avenues for small contractors working with the government would be in jeopardy. As Congress begins to consider these recommendations, the Committee will work to elevate the concerns of the small business contracting community to find ways to enhance, not eliminate, their opportunities.

Conclusion

This hearing provides Members with an opportunity to build rapport with the small business industrial base and understand some of concerns and challenges these firms face. It will also provide an opportunity for small businesses to explain what tools and resources they need to increase access to contracting opportunities with the federal government.

[15] FAR 19.502-2

[16] PL114-92, §809.

[17] Section 809 Panel defines "Readily available" as any product or service that requires no customization by the vendor and can be ordered directly by customers, to include products and services that only governments buy. Similarly, "Readily Available with Customization" includes the products and services that are sold in the private sector, including to other public-sector customers, for which customization or manufacturing that is consistent with existing private sector practices is necessary to meet DOD's needs. See Section 809 Panel, *Summary of Recommendations, Volume 3 of 3* (Jan 2019). https://section809panel.org/wp-content/uploads/2019/01/Volume-3-Summary-of-Recommendations.pdf

[18] Section 809 Panel, *Report of the Advisory Panel on Streamlining and Codifying Acquisition Regulations, Volume 3 of 3,* p.19 (Jan 2019) https://section809panel.org/wp-content/uploads/2019/05/Sec809Panel_Vol3-Report_JAN19_part-1_0509.pdf