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CONGRESSIONAL TESTIMONY

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

Testimony of

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Chairman Kerry, Ranking Member Senator Snowe, and distinguished members of the Committee, I am pleased to appear before you today to discuss minority entrepreneurship and federal procurement programs.

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, the founding member of the Latin American Manufacturing Association. On behalf of the minority, small and small disadvantaged business community, we are grateful for the opportunity to discuss issues that have harmfully impacted the federal procurement share of minority, disadvantaged and small businesses as a result of the federal government's management and oversight of contract bundling and subcontracting programs.

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, disadvantaged, and small 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.

The federal marketplace continues to expand and contract bundling is vital to the important business growth of small business. The federal government spent over $417 billion in Fiscal Year 2006.[1] However, 43 contracts over $5 million were reported as bundled or consolidated, and these 43 contracts accounted for $5.7 billion.[2]

In addition, 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.[3]

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.[4]

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.[5]

Moreover, unnecessary bundling displaces entrepreneurial prime 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 FAR require procuring agencies to notify SBA of all proposed contracts that would be considered bundled. For

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[1] Report generated using Federal Procurement Data System on May 18, 2007. On file with the spokesperson.
[2] Ibid
[3] *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).
[4] SBA OIG, *Audit of the Contract Bundling Process*, Audit Report No. 5-20, p. 4, May 20, 2005.
[5] Since SBA does not have a database with the actual number of bundlings, 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.

example, according to 13 CFR § 125.2(b)(3), *Prime Contracting Assistance*:

> A procuring activity must provide a copy of a proposed acquisition strategy (e.g., Department of Defense [DoD] Form 2579, or equivalent) to the applicable (Procurement Center Representative (PCR)) (or to the SBA Office of Government Contracting Area Office serving the area in which the buying activity is located if a PCR is not assigned to the procuring activity) at least 30 days prior to a solicitation's issuance whenever a proposed acquisition strategy: . . . (iii) Meets the definition of a bundled requirement . . . .

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 the procurement."

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 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 GAO's 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..."

I 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).

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 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.

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.

Specifically, Mr. Chairman, my company, The CENTECH Group, Inc. (CENTECH), was awarded a major Air Force contract that included the proactive small business-friendly informal 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 in an informal 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 Air Force and the SBA on the informal 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 minority and small businesses 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.

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[6] This SOP was updated in October 2004

SUBCONTRACTING

The federal government subcontracting program is an essential program that contributes to the building of capabilities and resources to minority, disadvantaged and small businesses. Small businesses are a critical part of productivity and innovation to the economic base of the United States.

Small business subcontracting programs are an important business growth element in the United States to maintain a vibrant and healthy economy. The central role played by small businesses is well established.

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.[7]

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 firms 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 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:

[7] SBA Advocacy, *The Government's Role in Aiding Small Business Federal Subcontracting Programs in the United States*, September 2006

"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."[8]

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. Thus, 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).[9]

Between various problems with the GSA Schedules, inconsistent regulations, and incorrect data in source lists, there are many factors affecting whether a small business procurement is awarded to a small business or to an "other than small business." Like all areas of federal procurement, issues related to small business awards are very complex, and resolving these issues will not be a simple task.

As you may recall, due to the ADARAND decision by the Supreme Court in 1995, the Federal Government Direct Contracting Program for small disadvantaged businesses was eliminated. Therefore, for more than a decade, there have been no direct Federal government contracting opportunities for small disadvantaged businesses.

Additionally, with respect to the subcontracting program and using the 8a Program as an example, subcontracting opportunities are of the utmost importance to minority, disadvantaged and 8a firms. The 8a Program, as a part of its graduation strategy, requires a small business concern to have a business mix that includes non-8a 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

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

competition. Therefore, assuring major corporations comply is critical to provide business opportunities to minority, small and disadvantaged businesses.

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 its RFP's that large business 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 opportunity to work in with partnership with your committees to ensure we stop the bleeding of minority, disadvantaged and small businesses who continue to loose market share of the federal government marketplace.