

Effectiveness of Small Business Programs

Second Acquisition Reform Event

July 29, 2014

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Effectiveness of Small Business Contracting:

Problems with Current Practices

1. Ineffective
2. Wasteful
3. Chill Competition
4. Inhibit Innovation
5. Disproportionate

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Problem: Ineffective

- **No “teeth” to small business goals**
 - not to agencies
 - not to large business
 - not in general
 - not on specific contracts
- **In megacontract small business set-asides, 51% of the dollars may not reach small business**
- **“Valley of death”** for winners of small business set-aside megacontracts. Note that capital markets discount the value of set-aside work because they do not believe it to be sustainable. When a set-aside megacontract ends, winners no longer qualify as small business but still cannot compete with larges.
- **Agencies typically fail to meet the small business participation goals, currently at 23%**

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Problem: Wasteful

- In a megacontract environment, any firm **MUST** be on a team to play at all
- Resources spent on teaming, negotiating, proposing among anywhere from ten to thirty team members on each team—these increase overhead
- Even if a small is on a winning team, all of this churn may not even yield work for the small
 - If the prime fails to use the smalls featured in its proposal
 - If the megacontract is an IDIQ and each task order must be bid on
- Subcontracting creates at least two levels of overhead and profit
- Toggling between larges and smalls for the same work creates chaos and instability in the industrial/services base
- Comparing proposals is complex; the easiest metric when comparing bundled services and items is price, especially in an LPTA environment—this drives to mediocrity

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Problem: Chill Competition

- **Bundling makes procurement personnel risk averse on prime contracts**
 - high dollar value = high risk
 - procurement personnel take the safe route (large firms that are familiar)
- **But when small business participation is outsourced through subcontracting goals**
 - large business owes a duty to shareholders to protect market share and maximize shareholder value
 - large businesses are often incentivized to use small businesses of limited or lesser quality that don't threaten their market share in the long term, (especially in services, which represents 42% of all contracting dollars)
 - also, subcontracting offers an opportunity to buy cheap, sell at retail, and make up lost profits on the prime's own work
 - therefore, subcontracted labor and items become commoditized and "just good enough"
 - so in practice, the gatekeepers can shut their best competitors out
- **Subcontracts and teaming agreements**
 - often restrict contact between the small subcontractor and the client
 - often prohibit the small subcontractor from working for the client directly

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Problem: Inhibit Innovation

- *Innovation is inherently a high-risk, small-scale endeavor, but small contracts are not worth the effort for procurement personnel;*
- *The cumbersome contracting process prevents fast and flexible R&D activities—one reason why the government is no longer the primary incubator of innovation*
- *Small business subcontracting goals along with price pressures contribute to commoditization down the subcontracting chain, instead of innovation*
- *Bundling discourages specialization*

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Problem: Disproportionate

- Large companies should be managing very large scale projects. They have built up the appropriate infrastructure and reach.
- Megacontract set-asides create a spike/collapse path (the “Valley of Death”).
 - Megacontract set asides are often disproportionate to the management abilities of smalls, and set them up for failure.
 - In fact the winning smalls often turn back around to the incumbent larges and cede control to them.
 - The ramp-up on small business set-aside megacontracts is inorganic and often unsustainable; e.g. scaling up from \$2M to \$4M is reasonable; from \$2M to \$50 M incurs unnecessary risk for the small and the government
- Smalls should be managing smaller projects that set them up for success and competition at the next level.
- But when scopes of work of various sizes are all bundled together in megacontracts, small and medium-sized solicitations disappear; there is no growth path from small to large.
- NAICS code definitions of small businesses are outdated and diffuse (1100 industry standards!)

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Adverse Consequences

- Loss of credibility for Small Business programs
- Failure to meet small business goals
- Drive to mediocrity on megacontracts
- Drive to mediocrity in subcontracting
- Inhibition of Innovation
- Self-selection of energetic smalls out of government service
- Loss of leadership on innovation and R&D
- Loss of opportunity to develop the next generation of great firms to sustain competition
- Chaos and instability at the industry level, the company level and the employee level
- Unnecessary risk to the government in megacontracts
- Unnecessary cost to the government across all contracting
- Compromise of force readiness/government operations

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An environment where small business can thrive

- **Short feedback loop:** A structure where good small businesses “bubble to the top”
- **Direct client access:** No market distortions in the wasteful layer between the government and the small
- **Sustainable growth:** Grow smalls in sustainable increments
- **Fail small:** Take small risks on new companies, innovation, and R&D; fund R&D incrementally.
- **Simplified acquisition for small business set-asides:** Empower clients and procurement personnel to contract directly with smalls quickly and efficiently

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Solution: Six-part Plan

1. **Unbundle megacontracts**
2. **Shift responsibility for small business participation goals from large prime contractors to the agencies**
3. **Streamline acquisition for small business set-asides**
4. **Limit small business set-asides to 2 times the revenue or FTE-based NAICS definition of small business**
5. **Modernize NAICS code definitions of small business**
6. **Improve information**

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Solution: Unbundle Megacontracts

- Unbundle Indefinite Delivery/Indefinite Quantity contracts (NDAA 2013)
- Empower and guide procurement personnel to unbundle megacontracts generally
- Provide guidelines for identifying standalone pieces of work at the small and medium size
- Include smart unbundling as a metric in agency management performance reviews (NDAA 2013)
- Include OSDBUs in acquisition strategic planning process to identify unbundling opportunities (NDAA 2013)

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Solution: Shift Small Business Participation Goals

- Reduce small business participation goals on large business to 10% over a five year span, *but enforce them*
- In tandem, increase government small business participation goals at the agency level, over a five year span, *and enforce them*
- This would shift about \$40B in small business requirements from subcontracting to direct prime contracting
- Communicate strategically with procurement personnel about the benefits of manageably-sized contracts and guide them through a smooth increase in contract volume

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Solution: Streamline Acquisition for Small Business Set-asides

- Establish a Simplified acquisition process for small business set-asides
 - Reasonable ceilings, e.g. sole-source up to \$1.5M a year for services, limited competition up to \$7.5M for commercial items
 - Construction, Transportation, IT, manufacturing TBD
 - Awards should be non-protestable
 - Work can revert to full and open competition after contract termination, unlike 8(a) set-asides.
 - Certified tax returns and CPA certification on latest three years' revenue or FTEs establishes size
 - Accounting review certifying GAAP usage can serve as placeholder until DCAA/DCMA post-award audit
 - Fair and reasonable standard satisfied by comparable market prices, commercial prices, or GSA schedule prices
 - Documentation of firm's fitness to provide goods or services (key personnel's credentials are sufficient)
 - Program Manager (client) and COR must complete OGE 450 form on conflict of interest, certify to its absence
 - Enhance form OGE 450 (conflict of interest)—require more detail about contacts in contracting industry and their specific titles and business lines
- Modernize small business thresholds in NAICS to reflect current, technology-age capabilities of small business (NDAA 2013)
- Streamline the NAICS size variations to eliminate “code shopping,” enabling relatively large businesses (1,500 employees) to qualify as small businesses

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Solution: Improve Information

- Make CPARS reviews available for the government to review the performance of subcontractors
- Make CPARS reviews question prime contractors about meeting small business goals
- Employ strategic communication to reorient procurement personnel
- Use knowledge management tools (at acquisition.gov) to keep procurement personnel aware, empowered and up-to-date on regulatory change and guidance
- Empower and train procurement personnel to evaluate the reliability and viability of small set-asides for a given statement of work
- Increase the SBA's repository of information on doing business with the government for small business

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Appendix: Recent Small Business Participation

Small Business Program Performance History

Prime Contract Awards (Dollars in Billions)

Fiscal Year	Total Awards	SB Awards	% of Total	SDB Awards	% of Total	WOSB Awards	% of Total	HUBZone Awards	% of Total	SDVOSB Awards	% of Total
2012	\$275.0	\$56.10	20.40	\$20.10	7.3	\$9.30	3.38	\$6.0	2.20	\$6.4	2.33
2011	\$289.8	\$57.4	19.8	\$20.0	6.9	\$10.0	3.43	\$7.5	2.58	\$5.8	2.02
2010	\$291.9	\$61.1	20.94	\$20.8	7.1	\$10.5	3.6	\$8.8	3.0	\$5.3	1.8
2009	\$302.4	\$63.9	21.13	\$21.7	7.2	\$10.2	3.4	\$9.9	3.3	\$4.3	1.4
2008	\$314.6	\$62.5	19.86	\$19.0	6.05	\$9.3	2.95	\$7.5	2.39	\$3.3	1.0
2007	\$269.3	\$55.0	20.44	\$15.5	5.8	\$7.7	2.9	\$6.0	2.2	\$1.9	0.7
2006	\$235.0	\$51.3	21.8	\$14.7	6.3	\$6.9	2.9	\$4.7	2.0	\$1.6	0.7
2005	\$219.3	\$53.9	24.6	\$14.6	6.6	\$6.6	3.0	\$4.3	1.9	\$0.5	0.5
2004	\$194.1	\$44.8	23.1	\$12.0	6.2	\$5.3	2.8	\$3.1	1.6	\$0.5	0.3
2003	\$187.5	\$42.0	22.4	\$11.8	6.3	\$4.7	2.5	\$2.9	1.6	\$0.3	0.2

Subcontract Awards (Dollars in Billions)

Fiscal Year	Total Awards	SB Awards	% of Total	SDB Awards	% of Total	WOSB Awards	% of Total	HUBZone Awards	% of Total	SDVOSB Awards	% of Total
2012	\$158.50	\$55.70	35.5	\$7.5	4.80	\$9.00	5.70	\$2.20	1.40	\$3.00	1.90
2011	\$151.6	\$53.5	35.3	\$7.5	5	\$8.8	5.8	\$2.9	2	\$3.3	2.2
2010	\$139.5	\$52.2	37.4	\$6.9	4.9	\$8.7	6.2	\$3.4	2.4	\$2.6	1.9
2009	\$144.6	\$49.5	34.2	\$6.0	4.1	\$8.1	5.6	\$3.0	2.0	\$2.0	1.4
2008	\$160.7	\$50.9	31.7	\$5.9	3.7	\$8.4	5.3	\$3.0	1.9	\$1.6	1.0
2007	\$127.8	\$46.0	36.0	\$5.5	4.3	\$6.9	5.4	\$2.2	1.7	\$1.1	0.9
2006	\$106.6	\$39.6	37.2	\$5.1	4.8	\$5.8	5.5	\$1.8	1.7	\$0.7	0.7
2005	\$121.1	\$43.7	36.1	\$5.4	4.4	\$6.0	4.9	\$1.4	1.2	\$0.5	0.4
2004	\$101.8	\$35.2	34.5	\$4.1	4.1	\$5.0	4.9	\$1.1	1.1	\$0.4	0.4
2003	\$86.5	\$32.0	37.0	\$4.1	4.7	\$4.2	4.8	\$0.9	1.0	\$0.3	0.3

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Appendix: Department of Defense Small Business Participation

Department of Defense FY2012 Small Business Procurement Scorecard

B
91.66%

FPDS-NG Prime Contracting Data as of Mar. 15, 2013
eSRS Subcontracting Data as of Apr. 15, 2013

Prime Contracting Achievement:			72.66%
	2011 Achievement	2012 Goal	2012 Achievement
Small Business	19.80%	22.50%	20.41% (\$58.1 B)
Women Owned Small Business	3.43%	5.00%	3.38% (\$9.3 B)
Small Disadvantaged Business	6.90%	5.00%	7.30% (\$20.1 B)
Service Disabled Veteran Owned Small Business	2.02%	3.00%	2.33% (\$6.4 B)
HUBZone	2.58%	3.00%	2.18% (\$8.0 B)

Subcontracting Achievement:			9.00%
	2011 Achievement	2012 Goal	2012 Achievement
Small Business	35.20%	36.70%	35.50%
Women Owned Small Business	5.80%	5.00%	5.70%
Small Disadvantaged Business	4.90%	5.00%	4.80%
Service Disabled Veteran Owned Small Business	2.20%	3.00%	1.90%
HUBZone	2.00%	3.00%	1.40%

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Appendix: Guidelines for Identifying Standalone Scopes of Work

- Research how functions are divided in industry.
- Break work into modular components to increase competition and minimize risk as long as doing so does not reduce accountability.
- In general, system lifecycle phases (design, development, testing, operations and maintenance) can be separated but each phase should generally remain whole.
- Distinct pieces of work should not be combined unless there is a compelling cost or management rationale.
- Concurrent programs with substantial synergies or requirements for integration beyond the customer's organic capacity should be bundled.
- If government must act as a systems integrator, work should not be unbundled
- Work that can typically be separately procured includes consulting, analysis, audit, innovation, R&D and procurement or program management support.
- As procurement processes become streamlined, more items can be procured separately on a cost-effective basis.

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Appendix: Enforcement of Small Business Participation Goals

- Enforcing subcontracting goals
 - Ineligibility for option years on contract, if goals are not met in any given year
 - Specific question in CPARS meeting small business subcontracting targets
 - Downgrade performance rating for failure to meet targets
- Enforcing agency goals
 - Tie to performance reviews and bonuses of management (in 2013 NDAA)
 - Penalties

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Appendix: SBA Information for Small Businesses

- Please see suggested content in additional slide deck from Dr. Suzanne Sincavage.

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Appendix: Modernize NAICS codes

- Per the 2013 NDAA, the SBA must develop size standards that accurately define what is a small business for each of the over 1100 industries (each tied to a NAICS Code)
- Until now, small business size standards were set by the Small Business Administration for all for-profit industries, across a labyrinth of 1,100+ North American Industry Classification System (NAICS) categories, including both revenue and headcount limits. In addition to creating extra work, this overly complex methodology incentivizes procurement officials to “code shop,” enabling relatively large businesses (1,500 employees) to qualify as small businesses.
- Then small business size limits are out of date and do not reflect modern work processes as supported by technology, or the true capabilities of modern small businesses.

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Appendix: Current Government Efforts to Streamline Acquisition

- SBIR
- NeedipeDIA/Open Innovation Gateway (DIA)
- NASA SEWP
- GSA eBuy/SciTech
- DARPA/IARPA standards
- Rapid Acquisition Force (REF)
- 2.0 successor to PD²/SPS
- Systems that support purchasing optimization and other COTS

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Questions?

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