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BEYOND THE SIZE STANDARDS: SUSTAINABILITY OF SMALL BUSINESS GRADUATES

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BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

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BEYOND THE SIZE STANDARDS: SUSTAINABILITY OF SMALL BUSINESS GRADUATES

WEDNESDAY, SEPTEMBER 14, 2011

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1:09 p.m., in room 2360, Rayburn House Office Building, Hon. Sam Graves (Chairman of the Committee) presiding.

Present: Representatives Graves, Bartlett, Chabot, West, Ellmers, Hanna, Schilling, Velázquez, Critz, Altmire, Clarke, Chu, and Keating.

Also Present: Representative Mike Rogers of Alabama.

Chairman GRAVES. Good afternoon, everyone. We will call this hearing to order. And before we get started, I want to welcome our newest member to the Committee, Representative Bob Schilling from Illinois. He is a small business owner and should be a great asset to the Committee. Welcome, Bob, and glad to have you on board.

We are here today to talk about what happens to companies once they outgrow the Small Business Administration's definition of small. According to the Small Business Act, a small business is one that is independently owned and operated and which is not dominant in its field of operation. The Small Business Administration further restricts the definition by applying size standards which cap the number of employees or the annual—or the amount of annual receipts a firm may have if it wishes to qualify as small. One reason for the definitions is to establish which companies will have access to small business government contracting programs.

As our country spent over half a trillion dollars through Federal contracts last year, and given that there is a goal of awarding 23 percent of those dollars to small businesses, prime contractors, access to these programs translates into real opportunities for small firms and it also creates tension. What happens to firms when they no longer qualify as small, according to the SBA size standards, but which still meet the Small Business Act definition of small.

I am going to be joined today—or we are—on the dais by Congressman Mike Rogers, who has been detained right now at a markup. He should be here any minute. And our first witness is Congressman Gerry Connolly. Both of these gentlemen have seen the challenges faced by firms that are independently owned, operated, and not dominant in their field of operations when they outgrow the SBA size standards. Consequently, both of my colleagues have proposed pilot programs to address the challenges facing me-

dium-sized businesses. I look forward to hearing more about their proposals.

As this Committee considers these proposals, we do so with two mandates in mind. First, any medium-sized pilot must benefit taxpayers and the government. Even the best-crafted pilots will incur costs and create an additional requirement for contracting personnel.

The second mandate is fundamental to this Committee. We have to protect small businesses so that they continue to create jobs, introduce innovations and increasing competition. I strongly believe in the value of a vigorous small business contracting community and advocate increases in the small business goal from 23 percent to 25 percent. But at this time, the administration is awarding only as little as 20 percent of the prime contracts to small firms. Given that the current small business goals are not being met, we have to figure out how to ensure that a new program for larger businesses is not going to make it harder for smaller businesses to compete.

With that, I am going to thank ahead of time all of our witnesses for being here today on the first and second panel. I will now yield to Ranking Member Velázquez for her opening statement.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. For small businesses, having the Federal Government as a customer often means the difference between failure and success. For an early-stage firm, Federal projects can be a reliable revenue source, helping them stay solvent as they expand their client base. Equally important, unlike their larger competitors, when a small firm secures a Federal contract, the influx of new work inquires them to add employees to their payroll. If we want to generate new employment opportunities for Americans, breaking down the bias to small business competition in the Federal marketplace will be key.

Unfortunately, for entrepreneurs looking to tap into the Federal market, significant hurdles remain. The SBA's annual scorecard continues to find that the Federal Government is falling short of its 23 percent goals for procurement action that should go to small firms. In fact, for many agencies, the level of contracting for small firms seems to have dropped between fiscal year 2009 and 2010, exactly the direction we should not be headed in.

Agencies are also expected to meet certain goals for enterprises owned by women and service-disabled veterans, yet for prime contracts in 2010, the Federal Government came up short.

While the obstacles keeping smaller firms out of the Federal marketplace are many, the practice of contract bundling is one of the most prominent. When small firms' procurement actions are lumped together into a single large contract, it may result in less work for Federal bureaucrats, but also means less opportunity for small firms. In fact, for every $100 in contracts that are bundled, entrepreneurs lose $33 in business. That is adding up to billions of dollars that could be creating additional jobs for our Nation.

While this Committee wants to do everything possible to help businesses of all size foster job growth, the record makes it clear we must finish the task at hand, making the Federal marketplace fairer for small businesses. If we are to explore methods for creating new venues for larger firms,, it is critical that we keep in

mind a number of key principles. Size standards remain a critical measurement stake not only when it comes to competing for government work but qualifying for other benefits like technical assistance in government work, for qualifying for technical assistance or the SBA's capital access program. Any steps that begin undermining this system in order to generate new opportunities for medium-size companies run the risk of creating more problems than they solve.

It has also become clear, thanks to this Committee's work and numerous GAO investigations, that large businesses are siphoning off contracts which should go out to small business. The GAO has repeatedly found that the HUBZone program is rife with fraud and abuse. Even more disturbing, the Committee's investigative work has uncovered numerous cases where veteran entrepreneurs lose work to dishonest big companies that game the system. Given this shortcoming, it will seem that a more immediate priority may be needed to be ensuring current set-aside programs function as intended before we start creating new ones.

Mr. Chairman, in every previous recession, small business has been the drivers of our economy, creating new jobs and restoring America to prosperity. As we contemplate changes to the size standard system, and new initiatives for medium-size businesses, we can never lose sight of the vital role small firms play in our economy and how procurement policy can help them create new jobs. With that I yield back.

Chairman GRAVES. Thank you very much, Ranking Member.

And at this time, I am going to introduce our first witness, Congressman Gerry Connolly from Virginia. In addition to being sponsor of H.R. 1812, the Small Business Growth Act, Congressman Connolly is the ranking member on the Subcommittee for Technology, Information Policy and Intergovernment Relations and Procurement Reform on the Oversight and Government Reform Committee. He also serves as co-chair of the Smart Contracting Caucus. Welcome. And I look forward to hearing your testimony.

STATEMENT OF THE HON. GERRY CONNOLLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. CONNOLLY. Thank you, Mr. Chairman. And thank you for having me here today. Ranking Member Velázquez and members of the Committee, I really appreciate being here. I have a prepared statement and I am not going to read it to you. I will submit it for the record.

I listened carefully to the opening statements, particularly of Ms. Velázquez, and I looked at some of the testimony you are going to hear from. And let me just say that some of the fears expressed are understandable, but I think if you look at the respective bills Mr. Rogers and I have introduced, they are limited pilot programs and they keep the small business set-aside entirely intact.

You are going to hear testimony, apparently, from the Women's Chamber of Commerce. Their testimony, their assertions, are absolutely false. My legislation does not in any way change the size standards of the existing program and in fact explicitly has a provision that this pilot program at GSA for mid-tier companies to see if it works cannot take away any business that otherwise would go

to a qualified set-aside small business. Period. And I want to make that very clear from the outset.

I also want to talk about why I introduced this bill and I assume Mr. Rogers has a similar experience. His bill is limited to DOD. My bill is limited to GSA. And I had a number of small businesses, minority-owned businesses in my district, come to me and they have been successful. So they are graduating from the small business status and the problem is that we sent them into Federal contracting limbo on the next day. So they now find themselves still relatively modest in size, albeit successful, in part because of the programs this Committee has helped to create and foster and needs to do more of, as Ms. Velázquez says.

But now you have got a minority-owned business successful in that category that has to compete with the big guys. And what is very interesting is they don't get any help. They are now graduated. On day one. And frankly, many of them find themselves in an impossible situation because they are competing against multi-billion-dollar entities who have all the resources in the world to do red team, to put together professional proposal writing to make sure they are scouring for opportunities in the Federal Register and the like.

And what happens to these midterm companies? Often they get just bought up or they go out of business. And so all your hard work in fostering and encouraging, correctly, opportunities, diverse opportunities in America for smaller businesses, especially minority, female, and veterans-owned businesses, sometimes gets blown away the minute they graduate because there is nothing for them in terms of transition.

And so my minority-owned Federal contractors who have been part of the small business set-aside came and said, "Can't you try to address this? We are not asking for permanent help, but, gee, to become, say, a $30 million business and now we are expected to compete with a $20 billion business. Little wonder that your CSIS study shows—if you look at the bar graph they have in their study for this Committee, the big guys are crowding out everybody else. They are getting bigger. The small business set-aside companies are sort of holding their own in that bar graph. There may be a little improvement up and down a little bit, but holding their own.

It is the mid-tier category that is actually shrinking. The Federal Government doesn't keep accurate data on mid-tier companies, so it is a little hard to provide a lot of empirical data. But anecdotally I can tell you, at least in my district—and I represent a lot of Federal contractors—this is an increasing source of concern. So that was the genesis of the program. I took into account the concerns, legitimately raised by Ms. Velázquez and others. I read the Committee memo, and I thought it was a very thoughtful memo by staff, that there are still some issues that we want to work with you in terms of the definition of mid-size. I kind of looked at it from an IT perspective and kept the definition at the employee number size, because I am only dealing with GSA and I am largely dealing with IT contracts.

But I understand, as the staff points out in their memo to this Committee, well, there is a lot of diversity and there are a lot of different definitions. And I do actually take into account the staff's

concern about one size fits all. We can't do that. I understand that. You can't do it in the small business set-aside either.

There is a multiplicity of Federal agencies with lots of different realities in Federal agencies. But my plea to this Committee is can't we, on a very limited basis, create a pilot to see if we can do some good and that preserves and enhances the minority-owned companies you have worked so hard to incubate and foster, as opposed to just setting them out in a Darwinian world where, day one, they are expected to compete with big guys who have mega-resources, which frankly they cannot compete. I believe if we can do that and succeed in that goal, it is a good deal for taxpayers; it will foster innovation because a lot of times, especially with the smaller contracts, it is the smaller innovative companies that actually are the creative ones who are providing new solutions. And I think it would be win-win in terms of fostering and enhancing the legitimate goals of this Committee to create small minority-owned—female owned—veteran and disabled veteran-owned businesses as part of the fabric of American contracting.

With that, Mr. Chairman, I would be glad to entertain any questions.

Chairman GRAVES. Thanks, Congressman Connolly.

[The statement of Mr. Connolly follows on page 28.]

Chairman GRAVES. I will turn to Mike Rogers, our guest today. If you have anything, Mike, you want to add, or questions. And then I am going to turn to the ranking member.

Mr. ROGERS. Thank you very much, first, for letting me sit in on this hearing. And I share most of everything that he said, the same observations as Mr. Connolly mentioned. My amendment really only focuses with the DOD. And I don't represent a lot of DOD contractors, but we have a lot of them in Huntsville, a lot of missile defense. And exactly what Mr. Connolly said is happening. We have these very creative, very innovative technology companies that are nurtured under the current system, but once they cross that threshold of 1,000 employees or $30 million in gross revenues, they are on their own, and you can't compete with Raytheon or Boeing or one of these major corporations at that level yet. And invariably they get bought out and that stifles the very creativity and the flexibility small companies have. And frankly, they lose a lot of brain drain because a lot of their tech people don't want to work for a big company. They like being in the smaller environment.

So what I am after, as a member of the Armed Services Committee, is for us to nurture these companies to get up to around 2,500 where they can possibly be players in competition for large contracts, because the fact is in the DOD there are four or five companies and they own this place. And they need some competition. It is good. It makes them be better and it helps us, as the government, get better deals.

So that is my motivation and I hope that this Committee can embrace the concept and let us just see how it works for a few years. And with that, I yield back. Thank you again for letting me visit.

Chairman GRAVES. Ranking Member Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. And thank you, Mr. Connolly. I do share your concern, because thanks to the Committee work. And for 14 years I have been producing a scorecard

report and bringing in the administrator and all the big offenders, starting with the Department of Defense and Education, and even Small Business Administration, failing to achieve the contracting goals set up by Congress. But since it has been set up, it has never been achieved. And that means small business has been losing out; yet because of the proactive work of this Committee, they have been more responsive in achieving those contracting goals. And the latest one for 2010 was 22.6. So we haven't achieved the 23 percent. And it means that small businesses are losing out billions of dollars in contracting opportunities.

So my question to you is businesses that are other than small already receive 78 percent of Federal contracts, while small businesses have yet to attain the 23 percent goal. So the duration of your pilot program is 5 years. At the end of this period, how will you measure whether this program has been successful?

Mr. CONNOLLY. Well, I would want to—first of all, I take seriously your implied concern this could be a zero-sum game, and I don't want it to be. I believe the two, in fact, are extensions of each other. I think we can and should try to reach the 23 percent goal and try to help graduates of that program stay in business as minority, veteran-owned, female-owned businesses, as opposed to becoming——

Ms. VELÁZQUEZ. The question is: Is this the right place?

Mr. CONNOLLY. Is what the right place?

Ms. VELÁZQUEZ. To establish a pilot program that will take awards, contracts, away from small business.

Mr. CONNOLLY. No. I would say that it doesn't. I think you could have a pilot program that actually enhances—because you are trying to build on the successes you are creating and want to enhance on the small business set-aside. It is not a zero-sum game where if we create any kind of pilot program from mid-tier necessarily that takes away from small- and minority-owned businesses. I don't believe that is true. I believe experience will prove that it is not true.

Ms. VELÁZQUEZ. You are aware that GSA implemented a training program that is directed at providing technical assistance to those who graduate?

Mr. CONNOLLY. Yes, ma'am.

Ms. VELÁZQUEZ. Why can't we wait to see the type of results?

Mr. CONNOLLY. Well, again you could. It might be—all I can—Ms. Velázquez, just as your experience validates and directs where you go on issues, I have to tell you as somebody who has spent 20 years as a Federal contractor, including for big guys and including for little guys, and having to implement these goals and programs in the private sector until the day I got here, and now hearing from my constituents in a district that probably has more Federal contractors than anybody else, it is my small, minority businesses that are clamoring for some relief from the mid-tier category.

That is why I think there is a void that a pilot program, which is modest and not too dangerous or expensive, can address. And then we can learn whether it works or not.

Ms. VELÁZQUEZ. In other contracting programs such as the service-disabled veterans, GAO has found that there has been some problem with self-certification. In many cases, investigations have

shown that businesses did not meet all necessary eligibility requirements, even though they self-certified otherwise.

It appears that your program would allow for the same sort of self-certification. So my question, knowing that this problem exists with self-certification, how do you propose we ensure that the representations made by participants are accurate?

Mr. CONNOLLY. Ms. Velázquez, from my point of view, I would be guided by the wisdom of this Committee. So if this Committee were uncomfortable with the self-certification process and chose to do something else, I would certainly support that and welcome that. I am not going to—I am not on this Committee, and I would not substitute my judgment for that of this Committee. So obviously if that—if you have decided that that is a problem and has to be addressed, I would be supportive of that.

Ms. VELÁZQUEZ. Thank you. Thank you, Mr. Chairman.

Chairman GRAVES. Any other members wish to be heard, or questions?

Mr. CONNOLLY. Just for the record, Mr. Chairman, I want you to know my testimony roundly praises Mr. Rogers for his legislation. I thank all of you for your indulgence. I really appreciate it.

Chairman GRAVES. Thank you very much for coming and I appreciate it.

Mr. CONNOLLY. Mr. Chairman, one more thing. May I ask unanimous consent that a letter supportive of this effort by the Professional Services Council be entered into the record as part of my testimony?

Chairman GRAVES. Without objection.

Mr. CONNOLLY. I appreciate it. Thank you.

Chairman GRAVES. Thank you very much. We will go ahead and seat the second panel.

I want to welcome our second panel and our second group of witnesses. And we are first going to hear from Ms. Tonya Speed. She is the executive director of Mid-Tier Advocacy. Mid-Tier Advocacy represents a community of small- and mid-sized firms, providing goods and services to the Federal Government. Welcome. And I look forward to hearing your testimony.

STATEMENTS OF TONYA M. SPEED, EXECUTIVE DIRECTOR, MID-TIER ADVOCACY, (MTA); CHRISTOPHER YUKINS, PROFESSOR GOVERNMENT CONTRACTS LAW, CO-DIRECTOR OF THE GOVERNMENT PROCUREMENT LAW PROGRAM, GEORGE WASHINGTON UNIVERSITY; MICHAEL D. FRISBEY, GOVERNMENT SUPPLIERS AND ASSOCIATES, KNOXVILLE, TENNESSEE, ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION; AND MARGOT DORFMAN, U.S. WOMEN'S CHAMBER OF COMMERCE

STATEMENT OF TONYA M. SPEED

Ms. SPEED. Thank you, Mr. Chairman. Chairman Graves, Ranking Member Velázquez, and the esteemed members of this distinguished panel, I am honored to be here today as executive director of Mid-Tier Advocacy to discuss the disappearing mid-size firm and to support the Connolly bill, the Small Business Growth Act, H.R. 1812.

The MTA represents a community of small and mid-sized firms that provide employment for thousands of people across the United States and across multiple industries. MTA is an organization of the country's top veteran-owned service-disabled, HUBZone-certified, minority-owned and women-owned businesses. Mid-size or mid-tier refers to other than small businesses that may have exceeded the size standard for the industry as determined by NAICS code. They are seasoned businesses as a result of having been in the Federal market for 10 and sometimes 30 years or more. Their revenues may range from 10 million to 350 million and will likely employ from 100 to 2,000 people. They no longer are considered small businesses, but neither are they large in the Federal marketplace.

Our testimony today will attempt to focus on two points, the disappearing mid-size business and why Congress should protect its investment, also creating jobs to strengthen the industrial base. We believe the standards used to define small business by the North American Industry Classification System better known as NAICS, are inadequate because in most cases the NAICS code defines small business as a company that has less than a certain threshold in annual revenues over a 3-year average. The reality is that once any company surpasses this standard, it is considered other than small.

One of the greatest challenges for successful small business is to survive beyond the size standards. By its own admission, the SBA is responsible to the public for ensuring that size standard levels are rational and flexible enough to reflect the effects of inflation and changing economic conditions while promoting competitive viability among small businesses.

We believe that the current NAICS codes classifications fail that standard and fail the successful small emerging business. Small businesses that grow beyond the limits set by the NAICS codes are punished for doing what any business needs to do, and that is simply to grow. Once they become moderately successful in the Federal market, they are thrust into unrestricted labor market, they must compete without the infrastructure or the capital to compete successfully against significantly larger businesses.

And I do have a chart that I would like to share. Representative Connolly touched upon the differences among the very large companies and the small business concerns that we are really talking about. Most small businesses provide services where the NAICS ceiling is either at 7 million or 25 million, translating to roughly 100 to 150 employees, whereas on the chart you can see with the large integrators they have up to 136,000 employees, on average 130,000 employees. And these are in fact the people that—the businesses that we represent today are in direct competition with. It is not the very small concerns, but the much larger integrators or the giants in the industry.

Our concern is that thousands of small businesses who have graduated or matured have disappeared from the landscape of the Federal marketplace. The policies that drive the standards and the criteria and the entry level in developing firms unfortunately stifle many of them who are achieving some modest success. We believe

standards should encourage growth by securing balanced competition at all levels: set-up, developing, and our matured phase.

Under the Connolly bill, mid-sized contract opportunities would come from unrestricted procurement and not come from small business set-asides. We believe since the government invests in small companies, it should protect the investment and continue to support them or at least monitor their progress after they graduate. This makes perfect policy and economic sense. Taxpayers want to know what sort of return they are getting on their small business investment.

And finally, I will close by saying that MTA strongly supports the Small Business Growth Act, H.R. 1812, because it goes to the heart of the government can get a better return on its small business investment. And to quote Mr. Connolly's office: The success of these small businesses is what is helping to drive the economic recovery. And the loss of incentives is what is helping—is what is threatening not only their ability to compete but also their ability to hire.

And finally again, we will also quote Mr. Graves as saying that: The cost saving strategy can actually help Washington address our out-of-control Federal debt and help create jobs for all the reasons stated above. The establishment of a mid-size business category would ensure that government would get the best bang for its buck.

Thank you very much for allowing me to provide testimony.

Chairman GRAVES. Thank you, Ms. Speed.

[The statement of Ms. Speed follows on page 32.]

Chairman GRAVES. Next, we are going to hear from Professor Christopher Yukins. Professor Yukins teaches on government contract formations and performance issues, anti-corruption measures, bid challenges, and government contract litigation and comparative issues in public procurement at the George Washington University School of Law. Thank you for being here, Professor.

STATEMENT OF CHRISTOPHER YUKINS

Mr. YUKINS. Thank you, Chairman Graves, Ranking Member Velázquez, members of the Committee. Thank you for the opportunity to speak with you today regarding a potential preference for medium-sized businesses for H.R. 1812, Congressman Connolly's pending legislation.

As Chairman Graves alluded to, I am a professor at GW Law School and I teach procurement law there. And in the interest of full disclosure, I should say that Ms. Northcutt was actually counsel—is actually a former student of mine. I am very glad to see her here today.

The problem the Committee is addressing today, the problem of mid-sized firms in the government marketplace, really has two different aspects. First, there is a problem of graduating small businesses, which grow up under the protection of various small business preference programs and then must compete as mid-sized firms without any preferences or protections.

Second and more broadly, mid-sized firms face special competitive obstacles in the Federal procurement market, a market which sometimes favors the largest firms, in part because of its steep barriers to entry. There is a perception that mid-sized firms in general

face special difficulties in the government procurement marketplace because those mid-sized firms do not have access to the preferences enjoyed by small businesses and because the mid-sized firms lack the economies of scale and sheer economic and political muscle of the largest prime contractors.

There are three possible options to assist medium-sized businesses. First would be to create a preference category called medium-sized businesses. For the reasons that I will be discussing, this option, the option of creating a category called medium-sized businesses could create serious problems in our international trade negotiations.

The second option would be to expand to the small-business size standards to include medium-size businesses. This is a technical issue, not a legal issue. And it is an issue I will not be addressing today.

The third option is to use an innovative pilot program, such as H.R. 1812 outline, to leverage existing mentor protege programs to assist medium-sized firms.

Turning to the first option, the question of whether or not mid-size firms' access to procurement contracts should be resolved by creating a new category called medium sized enterprises, H.R. 1812 does not squarely present this issue. The bill does not create a new medium category of firms, but instead creates a special pilot program for certain medium-sized firms. But this issue is likely to arise as policy discussions continue.

The answer to this question, whether or not to create a special category called medium-sized firms, may lie buried in the World Trade Organization agreement called the Government Procurement Agreement. The WTO members, the World Trade Organization members, that joined the Government Procurement Agreement, which is a subset of the WTO, agreed to open their procurement markets to vendors from other members of the GPA. The United States is a leading member of the GPA. And in fact, the United States has been pushing this initiative to open up procurement markets since just after World War II.

China is negotiating accession to the GPA, and India is likely to follow China in joining the agreement. The Government Procurement Agreement, which has been an important part of U.S. trade policy for many decades, is arguably the cornerstone to opening world procurement markets for U.S. exporters over the coming years.

The United States, when it joined the GPA, made a number of reservations, including one vitally important to our discussion today. The United States reserved its right to give a preference to U.S. small businesses, even if that meant discriminating against foreign vendors seeking to sell to Federal agencies. The reservation which is set forth in the United States' general notes to the Government Procurement Agreement states that, quote, This agreement will not apply to set-asides on behalf of small and minority businesses. So while the United States opened up its procurement markets in general underneath the Government Procurement Agreement, it reserved its right to discriminate in favor of small- and minority-owned businesses.

The United States has not reserved a right to discriminate against foreign vendors from GPA nations with regard to medium-sized businesses. A new unreserved U.S. preference for procurement from medium-sized businesses would undermine the United States' negotiating position with China and other developing nations which are seeking broader protections for their own emerging industries before they agree to join the GPA.

Moreover, were the United States to create a preference for medium-sized business, that preference could trigger a challenge by the European Union or other GPA members under the WTO dispute process. In sum, it could create serious trade problems where we create this category of medium-sized businesses.

That leaves us then with the proposed pilot program for mentor protege participants. And I talked about some of the practical issues in my prepared statement.

I just want to briefly touch on a couple of the issues. The first one is whether or not the affiliation rules should apply to companies in the pilot program. The affiliation rules say that if a small business has an affiliation with another company, typically through joint control, that other company's resources should count and the small business should be considered essentially a larger business.

There are two ways this issue could possibly arise under this bill. The first one is if a medium-sized firm were to reach outside to a third party and affiliate with that firm. So a firm less than 1,500 employees, which is a medium-sized firm, would reach to another firm, for instance, to seek additional capital from that other firm. That could become a large business then. That would be a serious issue that the legislation should address.

Another possible form of affiliation, though, would be between a mentor firm and a protege firm. And that kind of affiliation is arguably something the legislation should encourage. So I would argue that the legislation should allow that form of affiliation between mentor and protege.

Mr. Chairman, I see that my time is up. I reserve the rest of my comments to my prepared testimony. Thank you.

Chairman GRAVES. Thank you very much, Professor.

[The statement of Mr. Yukins follows on page 48.]

Chairman GRAVES. Next we are going to hear from our third witness, Mr. Michael Frisbey, the founder of Government Suppliers and Associates, Inc., of Knoxville, Tennessee. Mr. Frisbey is testifying on behalf of the National Small Business Association. Thanks for being here.

STATEMENT OF MICHAEL D. FRISBEY

Mr. FRISBEY. Thank you very much. If you hear knees knocking, they are mine.

Good morning, Chairman Graves and Madam Velázquez. I want to thank you first for allowing me to be here and to talk specifically about the Small Business Growth Act. My name is Michael Frisbey. I am a member of the National Small Business Association. I am also a small-business government contractor and I have 40 years of experience in government contracting work. Again, I would like to thank you for being here.

Let me give you a little background on my company and why we are so opposed or why the NSBA is so opposed to this pilot program. I started the company in 2002. In 2004 we received our first prime vendor contracts with the Department of Defense. In 2009, those contracts, those first three contracts that we won were completed. In 2009, in open competition again, even against unrestricted businesses, we won two more prime vendor contracts. Those contracts today are worth $11 million.

In addition to the Department of Defense, we are a registered supplier to 15 allied Ministries of Defense around the world where we sell U.S.A.-made product in direct competition against Chinese, Korean, Bangladeshian and other foreign countries.

In 2008, my wife and I purchased the assets of Columbia Sewing and started a new company, Government Sewing and Apparel, LLC, which is located in Hope, Arkansas, and today employs approximately 80 people directly, and approximately 200 people through our subcontractors. I want to try to take this project and bring it back to reality for you. I believe that all of us agree in that Federal procurement, if it were not for that, there would be no small businesses.

We also believe that small businesses are a great balance and a needed necessity in Federal contracting. Yet we talk a lot about small-business creation. In 1997, as you mentioned, Ms. Velázquez, the act was passed at 23 percent, and since it was passed, we have not hit 23 percent yet. We do not need to divide 23 percent into a new category. If the category were to create a medium-sized program, we have no problem with it. But to take 23 percent that the government has not yet hit and divide it up and make it smaller, we see no value in.

I am going to give you a real-world example of what we are up against as a small business. In August of 2010, a solicitation was posted by the Department of Defense for a program called MOLLE. MOLLE stands for Modular Light Load-bearing Equipment program. This contract when awarded will represent $98 million a year, or $297 million over the 3-year life of the contract. MOLLE consists of 43 items, individual items just like the two I am holding here. Each of these has their own national stock number, each of them has their own specification number. Those 43 items are assembled into seven sets and used by the military: rifleman set, medium rucksack set, large rucksack set, pistolman set, grenadier set, medic set. All of them are individual components. They could be made by 43 individual small businesses, the entire set-aside.

When the set-aside—when the contract was issued or when the solicitation was issued, it was issued as unrestricted. The justification was that all of the items had to be interoperable and that by putting them into small businesses rather than letting one large contractor do them, we could not assure that these products would work together. The interoperability that they are talking about is actually nothing more than the purchase of a piece of 1-inch nylon elastic and being sure that that 1-inch nylon elastic from one product slips into the second product. That is interoperability. That is the justification for not having it as a small business set-aside.

I want to thank personally in this hearing, Congressman Mike Ross from the State of Arkansas, who worked diligently with us to

try to convince the Department of Defense to set aside a part of that contract. After much back and forth with DSCP, we were successful in getting a whopping 2.4 million, or under 2 percent of that contract set aside for small business.

That is what small business is up against today. That is why we don't hit 23 percent, because the large businesses do that. That is why we are so adamantly opposed to this bill, because we believe first and foremost, the Federal Government must hit the 23 percent level that it set for small business set-asides before it can consider any other type of category of business.

And we would encourage you, as was suggested by Chairman Graves, to not only increase—not only support the 23 percent, but increase it. I would beg you, increase it to 25 or 30 percent. Small businesses represent 50 percent of the GDP of this country. Small businesses represent 50 percent of the jobs in this country, and yet all we have is 23 percent of government contracts and that hasn't been met since 1997. I beg you, please, do not pass H.R. 1812. It will destroy small businesses in this country. I am a small business contractor and if it is passed, I can assure you I will be out of business within a year of it. Respectfully submitted. Thank you very much.

[The statement of Mr. Frisbey follows on page 75.]

Ms. VELÁZQUEZ. It is my pleasure to introduce Ms. Margot Dorfman. Ms. Dorfman is the founder and CEO of the U.S. Women's Chamber of Commerce. The Women's Chamber of Commerce represents 500,000 members, three-quarters of whom are small businesses and Federal contractors. Through her leadership, this organization has championed opportunities to increase women's business, career and leadership advancement. Additionally, Ms. Dorfman has done extensive background in business, including 10 years in executive positions with General Mills and other Fortune 500 firms. Welcome, Ms. Dorfman.

STATEMENT OF MARGOT DORFMAN

Ms. DORFMAN. Thank you. Chairman Graves, Ranking Member Velázquez and members of the House Small Business Committee, I am here today on behalf of the U.S. Women's Chamber of Commerce, under 500,000 members, three-quarters of whom are American business owners and Federal contractors.

The U.S. Women's Chamber of Commerce strongly opposes H.R. 1812, the Small Business Growth Act and other similar legislation. H.R. 1812 arbitrarily and unscientifically abandons the well-established small-business size standards methodology which is managed by the Small Business Administration, carving out a new contracting set-aside program for firms that are not small.

The SBA already has tools to assist small-business growth. First, SBA size standards methodology has scientific basis, ongoing oversight, and includes the specific objective to assure competition among industries. The methodology employed by the SBA to provide small-business size standards is scientifically sound, well documented, and includes a mandate to foster competition.

Through the size standards process, the SBA regularly examines the structural characteristics of industry as a way to regularly—as

a way to assess industry differences and the overall degree of competitiveness of an industry and of firms within the industry.

Industry structure is examined by analyzing five primary factors: average firm size; degree of competition within an industry; startup costs and entry barriers; distribution of firms by size; and small business share in Federal contracts. SBA also considers other secondary factors as they are relevant to the industries and the interests of small businesses, including technological change, competition among industries, industry growth trends and impacts on SBA programs.

At the core of the whole size standards philosophy and process is the intent of promoting industry competition, which is why the SBA includes industry competitive analysis through the measurement of concentration or market power to determine the extent to which a particular industry is dominated by a few large firms. This is also why the SBA recently increased and continues to adjust the employee and/or revenue size number of industry size standards, appropriately fine-tuning industry size standards to reflect the current competitive landscape.

In other words, the SBA is already making sure that the definition of "small" for each industry encompasses the larger firms so as to assure a strong competitive climate.

Additionally, the Federal Government is not meeting its statutory obligations and goals for contracting with small businesses. These ongoing shortfalls should be of paramount concern for Congress. Over the last 5 years alone, American small businesses have lost $22 billion in revenues as the Federal Government has consistently failed to achieve the statutory requirement to place 23 percent of prime contracts within small businesses. This is a horrific loss of opportunity for small businesses, their employees, their families, their communities and the American economy. And within the prime contracts that are placed with small businesses, the goals for emerging market businesses like women-owned small businesses, are missed year after year.

Over the last 5 years, American women-owned small businesses have lost over $29 billion in revenues as the Federal Government has failed to achieve the goal of 5 percent prime contracting with women-owned firms.

So what can be done to assure the growth of small businesses that fall within industry size standards? Congress can take action in a number of ways to support businesses that do qualify as small to assure maximum growth:

First, take the caps off the contracting limits within the women-owned small business set-aside program.

Increase the overall goals for contracting with American small businesses to a percentage that is more in alignment with our numbers.

Increase small business access to capital and compel banks to lend.

Continue to fight to eradicate bundles, big business sole-source contracts and fraud.

And stop inappropriate in-sourcing. This practice is destroying opportunities for thousands of American small businesses. And finally, remove the goaling exclusions that limit the "small business

eligible" dollars and drive down our opportunities for growth. And I have a list of these at the end of my testimony.

Thank you for the opportunity to share our views. We strongly encourage Congress not to step outside the well-established small business size standards. Instead we ask you to focus on assuring that businesses that are small secure access to larger contracts so that we might continue to grow and prosper and drive economic growth for the American economy. Thank you.

[The statement of Ms. Dorfman follows on page 70.]

Chairman GRAVES. Thank you to all of our witnesses. We are going to start questions with Mr. West.

Mr. WEST. Thank you, Mr. Chairman and Ranking Member Velázquez. And, Mr. Frisbey, go Big Orange. It is football season. We have got to beat these Gators this weekend.

As I sit here and listen to the testimony, in my simple Southern way, it seems like we are talking about hell, purgatory and heaven. Small business owners operate, it seems, in a hell. And we have got to make sure that we prop them up and we protect them and enable them to be successful. Because as you say, they are an economic engine.

But yet I would think that we have some of these small businesses that do want to graduate maybe out of hell and get to purgatory; but yet in purgatory they find themselves, you know, kind of left out to hang. And I don't want to see us create this gap where all of a sudden these businesses that have grown become mid-size businesses and then they fall off the map and then that creates a new problem. And, of course, heaven represents the big guys.

So I guess, as my question is to the panel, what do we do to make sure that we continue to protect—we have got to get to those right levels, the 23 percent contracts for small businesses as you talked about for women-owned businesses.

But what do we do to also make sure that we incentivize growth for small businesses to get out of hell, to get into purgatory, and they can stay there and at least we can have that vibrant—if we wanted to talk about a middle class—but a middle operating range for businesses here in America.

So my question is: What do we do to make sure we are incentivizing coming out of that small business to get into the medium-range business, but then not taking away from those small businesses?

Mr. FRISBEY. Could I respond to that?

Mr. WEST. Any way we want. Of course, you are a Tennessee Vol, so you get to go first.

Mr. FRISBEY. I think that if you look at what we talked about before, you have got 23 percent for small business and the balance for large business. To create a medium-size category, to me in my mind, makes perfect sense. But it needs to be a separate category. It does not need to come out of the 23 percent, that small business set-aside. If we were hitting 23 percent regularly and had done it for a number of years, you wouldn't hear from me because I would say that is—we are accomplishing our objective. But when you haven't hit the 23 percent, to turn around and take that large business category and let them compete on ours, just to make the number, makes no sense.

And I will put it in perspective for you. When we talked about 1,500 people—now, I don't know the category, but I am out of the textile clothing and uniform business—there are four large companies that dominate the uniform and textile and clothing business as primes to the Department of Defense, companies like American Apparel and Proffer, for example. At 1,500 people, guess what? They are now small. They just wiped us out. We don't even exist anymore, because there is no way I can compete with them.

Ms. SPEED. May I also respond?

Mr. WEST. [Nonverbal response.]

Ms. SPEED. In all due respect to my esteemed panelists here, and to Mr. Frisbey in particular, as Mr. Connolly described his bill, H.R. 1812, and as we interpret it, it doesn't take from small business concerns. First of all, what the bill is attempting to do is to allow a growth path or a transition for companies who have already exceeded their NAICS codes. They are no longer considered small, but they are not large enough to compete on the large-scale business with Northrop Grumman and SAIC and others.

So what we are looking at is—I think I am hearing from most of the folks here today, the goal is one issue, and that needs to be addressed. But how we allow businesses to grow is yet in itself another issue. And this bill is a pilot which simply is designed to protect small business by allowing small business to continue to grow up to 1,500 based on an employee-sized standard that currently I believe falls in telecommunications today. So it is not even a new standard. It is something that does exist. But now we are utilizing it in this pilot to allow more businesses to grow up to 1,500.

They are also required under the pilot to mentor to other small business. Mentoring is important because it allows for that business to gain the necessary infrastructure. What we find in this range of mid-sized companies or larger "smalls" is that they have added benefit in terms of their accounting systems and infrastructure, and they can reach back to help other small businesses to be able to gain those same types of things, to strengthen their infrastructure.

And I believe someone mentioned the business breakthrough at GSA. That is aimed at those businesses, by the way, that were small, and they accelerated so quickly, they blew through their NAICS Code size standards, but they still operate as a small business but not as a medium-sized business. They don't have the infrastructure in place.

And so the business breakthrough program is designed to aid those businesses with needed technical assistance and the types of things that they can't get otherwise, because they no longer qualify as a small business. So we are really looking at a growth path. And I recede.

Ms. DORFMAN. I would say the core issue is the bundling issue, because the contracts have been set aside for small businesses, and then those that are not set aside for small businesses are typically quite large, and a medium-sized business could never attain that. So I believe that we keep the small business set-asides for small businesses and then take care of the anti-bundling, remove the bundling as an issue. Then those who do graduate into a larger

business, but not the super-large, would have a vehicle to then grow their business.

Mr. FRISBEY. Ms. Velázquez also hit the nail on the head. I have got 40 years in the defense business. I have seen firsthand the fraud and the manipulation that goes on. When you have got a company that goes out of the small business category—there are a number of them and I am not going to name them here—but there are a number that will try to set up businesses under wives, kids, family members, other company names, just to try to get around the small business standards.

I have seen factories where orange construction barrier tape was run through the middle of the factory, 200 operators on one side, 200 on the other. When you push to find out why that is there, they are mentoring another small business on the other side of the construction barrier tape. There is not the enforcement there to even really aggressively go after enforcing the small business standards and we compete against it all the time.

Mr. WEST. Thank you, Mr. Chairman. I yield back.

Chairman GRAVES. Ms. Velázquez.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman. Mr. Yukins, under the Women's Procurement Program, the contracts eligible for restricted competition are limited to those valued at less than 5 million for manufacturing and less than 3 million for all other contracts. The mid-tier contracting programs that have been suggested have no caps on the value of contracts that can be awarded through restricted competition methods.

Can you think of any policy that will justify why mid-sized companies should be allowed to receive contracts of unlimited value through restricted competition, and the value of contracts that can be awarded to small businesses through these methods are constrained?

Mr. YUKINS. The problem is even bigger than that, which is that the way that the pilot is set up, all contracts will be subject to full and open competition, which will presumably exclude the IDEQ and the GSA schedule contracts. All contracts that are subject to full and open competition would presumptively have to be considered first for this program. So you could have a huge—potentially billions of dollars for contracting funneled through this program.

It would be very important for the Committee to consider ways to constrain, because otherwise you could have a few firms that are inside the mentor protege program suddenly become enormously wealthy. It is as though you are taking a river and channeling that river through a very small little stream. And the people who happen to be sitting in that stream are suddenly very, very wealthy. So your question is very important because the way the legislation is set up right now, all the contracts are pushed through that little tiny stream, the mentor protege program.

Ms. VELÁZQUEZ. Thank you. I raised the issue with Congressman Connolly about the fact that large businesses have presented themselves as small businesses and are taking contracts away from small businesses. And this has happened, and it has been documented with an investigation conducted by the GAO and the SBA's IG. So this is all happening despite the fact that there are several

monitoring devices in the program, such as annual audits and site visits.

So my question to you is: What kind of fraud prevention tools would be necessary in this pilot program to ensure that the targeted mid-sized businesses are receiving the contracts instead of large cooperations?

Mr. YUKINS. The logical solution would be to subject the companies in this program to size protest, a normal SBA size protest process.

Ms. VELÁZQUEZ. Okay. So my question to you is: Which agency will handle that?

Mr. YUKINS. The size protest could be handled in the first instance by SBA. The problem is that SBA—the size standards that you would apply only apply to small businesses, so the size standards would have to be revised. And then when you apply the size standards to these mid-sized companies, the size standards are incredibly complex and it adds a layer of complexity of management difficulty for those mid-sized companies.

Ms. VELÁZQUEZ. Given the constraints, budget-type constraints of the Small Business Administration, they don't have the resources and manpower to monitor and make sure that the 23 percent contracting goal is achieved. So now we are going to give this other responsibility.

Mr. YUKINS. That is definitely an issue with whether or not they have the capacity, and also whether or not the mid-size firms have the capacity to deal with the very complex size standards.

Ms. VELÁZQUEZ. Okay. Thank you.

Ms. Speed, in your testimony you mentioned that a mid-tier program will strengthen the industrial base of these businesses, create jobs and encourage competition.

Has your organization done any research as to how significant impact of changes we can expect to see with the introduction of these types of programs? What hard data do you have? What type of research has been conducted?

Ms. SPEED. That is a wonderful question, Ms. Velázquez. I would say we haven't done internal research per se, but there is anecdotal research based on other relationships that have been built. Again, these companies and MTA is comprised of are very mature companies; they have been around 10—some almost 30 years, and they have understood and have operated even with the constraints that policy has today, that it is all about building relationships. And along the way, what we have gleaned from that is in terms of mentoring other companies, that gives the assistance that they need, that lends itself to greater capacity for those smaller firms. But also with the medium-size firm, they are the ones who can actually go out and hire. When a contract is awarded, and I believe there have been several in the past, that are larger-sized contracts from the unbundling days—but now they are all bundled—there was work. And the bottom line is there just isn't enough work.

Ms. VELÁZQUEZ. Ms. Speed, in a recent article in Washington technology, you stated that mid-sized companies were a key element to the Federal marketplace, and these companies are apt to hire more people than small businesses. However, research has

shown that small businesses have created more than two-thirds of new jobs in the last 15 years.

Additionally, in a study referenced by Professor Yukin's testimony, job losses were found to be attributable to low-impact firms with more than 500 employees. Thus, following your logic, shouldn't we instead put renewed effort in small business contracting programs since these are the companies that are responsible for most of the job creation in this country?

Ms. VELÁZQUEZ. So one of the imperatives that we are faced with here in this Committee is how can we get the best bang for the buck, right? And the President announced his proposal and initiatives. We need to create jobs. So based on the data that we have, it seems to me that resources will be better and more productive if we target small companies that are the ones creating the jobs that we think we need at this moment to get the economy growing again.

With that, thank you, Mr. Chairman.

Chairman GRAVES. Mr. Rogers.

Mr. ROGERS. Thank you, Mr. Chairman. And thank you for calling this important hearing. In listening to the witnesses—you know, I know there has been a lot of talk about Mr. Connolly's bill. But I have got the one that goes just to the DOD. And I talked a little earlier about, you know, my focus has to do with missile defense. I am on the Strategic Forces Subcommittee. This is a real issue in the missile defense industry.

Ms. Speed, in your comments you talked about Mr. Connolly's bill. Do you see any problems with the DOD pilot study that I am proposing to nurture these mid-sized companies?

Ms. SPEED. Thank you, Mr. Rogers. Actually, no. We are in support of both approaches. In fact, whether it is DOD, GSA, or possibly even DHS, the idea is to allow these companies the ability to continue to be able to have the necessary infrastructure and resources without being restricted. I heard earlier of the disincentivizing of companies—I believe Mr. Frisbey made the point. Some companies are trying to do all they can to remain small. It is all about work and the employees that you have. So we do support you and support your approach as well.

Mr. ROGERS. Ms. Dorfman, you made reference to the fact that size standards are being reviewed regularly and adjusted by the SBA. Not in the missile defense industry. They have not changed the size standards or the volume of revenue that you can generate in decades.

Ms. DORFMAN. Well then, if that is the case, then they obviously need to focus in on that. But we do need to adhere to the size standards. Otherwise, small businesses will be usurped by the larger businesses.

Mr. ROGERS. Well, here is what I am trying to get at: We are not dealing with small businesses in my proposal. We are saying, over and above what is set aside for small businesses. So the concern that Mr. Frisbey had is not a concern in the bill that I proposed because we aren't going to penetrate down into that 23 percent. This is over and above that, because the truth is Mr. Frisbey one day probably would like to be a little bit bigger business and then

be able to nurture that next level. So I guess I am trying to figure out what is your opposition about the proposal?

Ms. DORFMAN. Our focus is making sure that we get the emphasis on the small business goals. They need to be met. And that is our first concern.

Mr. ROGERS. And I agree with that. So what is your opposition to that?

Ms. DORFMAN. So then the secondary nature is when we take a look how to move forward, I agree we do have to help small businesses get to that next level; but in doing so, we feel that we have to make sure that there is a sound technique that is put in place and that the small business size standards are included in that process because they have been there and they have worked.

Mr. ROGERS. My proposal is a pilot study. That is the whole purpose of a pilot study is to find out where the bump in the road is and what works and what doesn't. So why would you oppose a pilot study?

Ms. DORFMAN. Again, we would like to see Congress work on making sure that the small business goals are being met. And I believe that the larger firms can access the contracts if they were put together in a way that was not in the bundling fashion, where they are so large that they can't access them.

Mr. ROGERS. So you don't have any amendment language that you would like to see incorporated to make you happy? You are just against it is what you are saying?

Ms. DORFMAN. At this point, yes.

Mr. ROGERS. That is unreasonable. As I told Chairman Graves, I am open to any kind of amendment that calms the concerns of any sector. But I am not okay with just obstructionism. And that is what I am hearing. Mr. Frisbey seems fine, as long as his concerns are met. But it sounds like you are saying you don't care what concerns are met, you are against it. And that is a reasonable position, I guess, in your view, but it is not reasonable to me. I am hoping this Committee will make any kind of changes you want to make. But we ought to at least look at nurturing these businesses up to this next level, particularly in missile defense because this is serious stuff.

And right now when it comes to the big guys, Raytheon and Lockheed and Boeing, they don't have competition.

Ms. VELÁZQUEZ. Would the gentleman yield?

Mr. ROGERS. Absolutely.

Ms. VELÁZQUEZ. Thank you for yielding. My question is, do you have small businesses that grew and that are mid-sized?

Mr. ROGERS. Oh, absolutely.

Ms. VELÁZQUEZ. And that you feel that they have problems with the size standard?

Mr. ROGERS. Absolutely. That is the problem. They are being bought up once they go over 1,000 employees.

Ms. VELÁZQUEZ. So two things could happen. One is that those businesses that feel that the size standard needs to be changed or adjusted should apply to SBA to get that reviewed; but also SBA, as we speak, is reviewing the size standard issue. So there is nothing that will prevent those businesses in your district from requesting SBA to look at the size standard issue.

Mr. ROGERS. I thank the gentlelady. The fact is, that gentleman right there would object to that, if they wanted to raise that size standard so that companies that went over 1,000 employees could now compete for this 23 percent. And the fact is that the companies that I—and I don't represent them, I wish I did, but they are in Huntsville, can't get SBA to even consider those adjustments. So I am just trying to figure out how we can solve the problem and I hope you all work with me in any way, and I am amenable to any kind of amendments you all want to make. Thank you.

Chairman GRAVES. Ms. Chu.

Ms. CHU. Thank you Mr. Chair. This question is for Ms. Dorfman. Of course we know that the Federal Government has a 5-percent goal for contracts to be awarded to women-owned small businesses. But it has taken 10 long years after the legislation authorizing the program was passed to get the women's procurement program in place. Now women's businesses are able to compete. But the program still has a ways to go.

And so considering the 5-percent goal that has yet to be achieved, if a mid-sized program were to be implemented, how do you think it would affect the ability of women-owned small businesses to get contracts and meet the 5-percent goal?

Ms. DORFMAN. It would actually be devastating for our members simply because it has been actually 17 years since the goal has been put into place. The Federal Government has never met that. You have to understand, women-owned firms represent one-third of all businesses in the United States. The goal of 5-percent can't even be met. The goal really should be, if we are playing fair, 30-percent. So it is very important that we make sure that women-owned firms and small businesses overall have access to these contracts and the goals are achieved.

Ms. CHU. And how many women-owned firms are mid-sized? Are there examples of mid-sized women-owned firms that have been successful in receiving Federal contracts? And where is the critical need for women-owned businesses right now?

Ms. DORFMAN. At this point, what we are seeing is the critical need is making sure that the program is up and running, where they are accessing the contracts as it is. We have a number of different levels of firms, from the small to up to $30 million in revenues, that I have seen. We had done a survey last year. And what was interesting about the survey is that actually the larger mid-tier firms, when you looked at job creation, they would hire one person, where the smaller ones were poised to grow and they would commit to hire three to four people if they had the proper funding and the proper access to contracts.

So I think you can see why I am really focused on making sure that the small businesses, as a whole, have access to the contracts and we meet those goals.

Ms. CHU. You mentioned a way of assuring growth is to take caps off the contracting limits within the women-owned small business set-aside program. Can you expand on this? Would this include increasing the size limit of women-owned firms allowed to compete for the same contract and opening the field to small, mid, and large? And basically is there a way to improve the way that this program is implemented?

Ms. DORFMAN. Right. The caps were part of the original legislation where a women-owned firm contracting officer would set a contract aside for a women-owned firm and $3 million would be the largest contract you could have unless it was manufacturing, and then it would be $5 million. The problem with the caps is that it does not allow women-owned firms to grow their businesses, and it keeps them small. So that is why we are asking for those caps to be removed.

Ms. CHU. Are there other ways to improve the implementation of this women procurement program?

Ms. DORFMAN. Absolutely. One of the things that we have seen is that the leaders—and I would say, you know, Congress and the executive branch have the oversight to ensure that the agencies meet their goals. And it would be very helpful if the agency heads were held accountable for not meeting their goals of women-owned firms and small businesses. And I think that is paramount because it starts at the top. If there is not a commitment from the Secretary, it is not going to happen.

Ms. CHU. And one question for Mr. Frisbey. In this pilot program created by the bill, by Mr. Connolly's bill, small businesses will be excluded from participation if it was found that the rule of two is not satisfied. That is under this rule, where contractors have to set aside a contract requirement that says that if two or more small businesses are capable of performing the contract, then—but so therefore they couldn't compete. But there are small businesses that are able to win contracts in full and open competition with larger companies. So would small businesses lose contracting opportunities under this rule?

Mr. FRISBEY. Yes, ma'am. The rule of two is absolutely critical to small business contracting. It is one of the few things where we have a chance to—before the formal solicitation goes out, to go back and challenge the contracting officer and basically say, hey, wait a minute; here are two companies or here are three companies that are capable of handling this program as it is structured; and because of that, they are both small businesses or they are both HUBZone businesses or they are both women-owned businesses; and therefore this should be set-aside for it. So that rule of two is a critical element in giving us a chance to fight to try to get a part of those contracts, even though they are under the 23 percent. And I just want to comment, one of the reasons that they don't get to the 23 percent is because there is absolutely no penalty. Okay, so what, I don't get the 23 percent. I don't get coffee this week, or whatever the—there is no attention. There is no focus or requirement to do that. A little bit of pressure that you guys are able to create, but there is no punitive action. It doesn't go against their reviews. It doesn't go against their performance. It is just one of those things that—it is kind of like I have got to do it.

And that is one of the key reasons why that 23 percent doesn't get met at all levels, because there is no enforcement. And that is why—and I appreciate it. That is why the Small Business Administration, the national Small Business Administration is so opposed to this bill is simply because we see it just continuing to chip away at the 23 percent, rather than growing the 23 percent to 30 or 35 percent or 25 percent, as Mr. Graves suggested. It just chips away

at the 23 percent. We would like to see that percentage increase to represent more of what small businesses in this country really represent.

I am not sure, did I answer your question correctly?

Ms. CHU. Yes. I yield back.

Mr. GRAVES. They are going to call votes pretty quickly. So I want to try to accommodate Mrs. Ellmers and Ms. Clarke.

Mrs. ELLMERS. I just have a couple of quick questions. I have heard repeatedly that the 23 percent limit has not been hit. Where are we then? I mean how far away from that 23 percent are we?

Mr. FRISBEY. We are 22.6 in total right now. That is why I brought up specifically the example of MOLLE because there is a $98 million contract that could be all small business. But for the contract officers, it is easier to administer one contract than——

Mrs. ELLMERS. Rather than——

Mr. FRISBEY [continuing]. Than five or four or three or anything else. So if I can get just one company, I have done my job. The contract is let, so be it, and move on.

Mrs. ELLMERS. Just streamline it and try to get it through. And again, there is a 5 percent for women-owned contracts. How far away are we on that?

Ms. DORFMAN. Well, I think at the last count, the SBA said we were about 4 percent. What we have to understand is that the data that has been out there has been flat over the years, so we don't know what is accurate. We did a study a few years back, and 2 years running, SAIC was the number one women-owned firm accessing contracts—not that they were a women-owned firm, but they were shown. So the number was skewed.

And then last year also, the inspector general for the SBA came out and said that the error rate was about 96 percent in the data for the SBA. So we don't really know what the true data is. That is kind of what it is. And then when you take a look at the 23 percent, again, it doesn't include the exclusions which we calculated over the last 5 years as about $60 billion in lost opportunities for small businesses.

Mr. FRISBEY. I would usually say they are cooking the books on 10 percent.

Mrs. ELLMERS. Therefore, that is one of the issues that we need to really be looking at then, to make sure we are getting accurate data based on what is out there.

The other issue—and I know we have addressed this considerably. For those small business owners who have performed so well at that level and they have basically grown into that mid-level size and now, unfortunately, they are competing with those much larger entities and they just simply can't compete, Ms. Speed, what would you say? What is an answer there for that? What can we be doing to help that situation?

Ms. SPEED. I think we should look at both pilots that Mr. Rogers and Mr. Connolly both have. They both are sound legislative vehicles for looking at how we grow business. But I also want to just talk—just one more point about the pilot that we really didn't get a chance to address, and that is, in the pilot and in the concept of it, the ability to grow; for the small companies, they can continue to bid up. That is something we did not talk about.

But in terms of the larger ones and the mid-sized ones who are emerging, they don't bid down. So in effect if there is a contract award that goes out on the street, small businesses can still team and align themselves in all the ways that are under SBA's guidance and rules which we, I think, are hearing today should be applied to the mid-sized as well and the emerging firms. Then what we should be doing is allowing companies to continue to grow and bid up and not have the larger ones coming down, which is what we are seeing from the very large integrators.

Mrs. ELLMERS. And Mr. Yukins, you are the only one that hasn't commented. What would you say to that?

Mr. YUKINS. In terms of increasing opportunities?

Mrs. ELLMERS. Yes. Just in making sure that those companies that have moved their way up and now they are unfortunately lumped into that much larger group and are really incapable of competing with that larger entity, do you see solutions there that we can be approaching?

Mr. YUKINS. Yes. The Europeans have dealt with exactly this same question over the last few years. For internal political reasons, the Europeans can't have a category called "small business" that they give preference to. So what they did is they did a comprehensive review of their procurement rules and they said, What can we do to make life easier for small- and medium-sized businesses, not necessarily creating rigid preferences, but how can we facilitate their involvement in this marketplace? And those efforts are ongoing in Europe right now. We should do the same thing here. It is what the Obama administration is doing with his business breakthrough program. But expand that. Do a comprehensive review of the rules and figure out how do we make life easier for small- and medium-sized businesses.

Mrs. ELLMERS. Thank you very much. I yield back the remainder of my time.

Chairman GRAVES. With the Committee's information, I can tell you that the number is closer to 20 percent on small business contracts. The SBA, they get a little creative with the math to make the percentage look higher than it is.

Mrs. ELLMERS. The more accurate number is about 20 percent?

Chairman GRAVES. Yes, absolutely. Ms. Clarke.

Ms. CLARKE. Thank you, Mr. Chairman. And thank you, Ranking Member Velázquez. I want to thank the panelists because this has been a very, very good discussion. I am not quite convinced, however, that there is not a need for a graduated process. When I think about the businesses in my district, particularly small businesses, and as they grow and they sort of hit the glass ceiling, I have found that they either get bought out or they die. And for small businesses like the ones that you are advocating for, what do you see as the remedy for that?

I mean, certainly, Mr. Frisbey, if your business now gets to the point where it can no longer avail itself of the procurement opportunities as stimulated under an an 8a program or any other program, what would you suggest would be the next step for yourself? I want you to consider that. And then I want to put it out there for the rest of the panelists because it has been my experience that there hasn't been another rung on the ladder that enables a small

business to really compete out there against some of these companies that are, you know, basically preeminent in the space.

So I would like to hear some of your solutions or some of your ideas around how we bridge that gap, because it is significant and we—I don't think we should be blind to it, which is sort of where I have heard us going here. It is like small business, let's preserve our domain. But small businesses grow. And you reach that point where that growth either takes you where you need to go or it kills you on the vine. Let me end my comments there.

Mr. FRISBEY. Let me try to respond to your question, then. And one of the gentlemen said it earlier; yes, I would definitely like to grow. I must be missing something somewhere along the line because to me, it seems quite logical to have a second rung on the ladder called mid-tier that is above small businesses. Leave the percentage—increase it to 25 percent, but then set aside a second tier on the ladder for another 10 percent and call it medium businesses. Why can't we do that? If that is an issue with the trade issues, then deal with it through the trade issues and negotiate it that way. It makes perfect—maybe I am missing something. But yes, I think there should be another rung on the ladder and I think that would be an appropriate way to do it.

But my opposition is, because I have seen it happen so many times, the manipulation by large businesses coming down and chomping out another big chunk of the small business set-asides, and that is exactly what is going to happen if this bill goes through, because every one of the large businesses is going to turn around and mentor their wife or their cousin or their son or whatever in a small business and they are going to get the small business set-aside.

Ms. SPEED. If I may also address your issue and your statement. And it is absolutely as you describe, as these businesses continue to grow, graduating from NAIS code they say is like falling off a cliff because there is no transition currently. And we believe that the pilot provides a venue, an opportunity. And what are the parameters again of the pilot? It allows you to gather the data. Currently there is no data on mid-sized companies, how many are out there. We know they are shrinking. But we can't even track how many actually graduate and survive to begin with.

We have some sense of that through the CSIS study which showed that there were at least 2,700 still existing. And that is a far short number of how many small businesses you have that you would hope are able to continue growing within that space. And if they are not growing, then there are also some disincentives, we believe, that are in place that are preventing that.

And I go back again to what Mr. Frisbey contends, that a number of businesses are spinning off and trying to remain small. They are doing all these things. The idea is not just to keep them in a category or a subcategory all their lives. They should eventually become prime contractors, which is what we are trying to suggest today; that when you get to that glass ceiling, there should be an opportunity for you to break through, along with all of the training and technical assistance that you can get based on where you were. You were getting it the day before. Now you are too large, and you

can't get anything and you are expected to compete against the integrators.

So we believe the pilot allows, first of all, to test it. Let's test and see what is going on with these mid-sized companies so that we can come back and make great sound policy decisions around the actual sizes that they should become.

That is something that your Committee, I believe, Mr. Graves and Ms. Velázquez, can quite clearly easily do and we really are looking forward to how this moves forward with your assistance. And we are here to lend our support. Several of our MTA CEO Roundtable members are here and sitting behind me. They have been passing me notes to help me on technical questions. So I really thank you.

Ms. CLARKE. Ms. Dorfman, I know my time has run out; but, Mr. Chairman, I would be interested in a woman's perspective, if you would indulge us?

Chairman GRAVES. Sure.

Ms. CLARKE. Ms. Dorfman.

Ms. DORFMAN. Sure. I agree there is an issue for the small businesses trying to jump into the next tier. What we have been hearing today is, it is not a formulated process that is going to protect small businesses. It really is a pilot program that doesn't have any parameters. Out of the GSA, there is no Small Business Administration involvement; there are no protections really for small businesses.

What we see right now is if you use what we have for the Small Business Administration, they have parameters set that will protect small business interests, and we need to make sure that they are used and enforced. I think a big issue right now for those who are trying to make that leap is the bundling issue. And the bundling that happens is, you really have the set-asides for small businesses or you have the super-sized contract that a mid-tier cannot actually access. So if we can break apart those contracts and provide different sizes of contracts appropriately, I think that would answer all the questions, including Mr. Roberts with the DOD issue.

Ms. CLARKE. Thank you very much, Mr. Chairman. I yield back.

Chairman GRAVES. Thank you all for participating in today's hearing. I appreciate the fact that we had a broad spectrum of opinions, obviously, represented in your testimony. It is going to help us better understand the challenges that are facing the smallest of our government contractors as well as those just emerging from the small business contracting firms.

I ask unanimous consent that all members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

[The information follows on page 74.]

Chairman GRAVES. This hearing is adjourned. I thank you all for coming out very much.

[Whereupon, at 2:35 p.m., the Committee was adjourned.]

SAM GRAVES, MISSOURI
CHAIRMAN

NYDIA M. VELAZQUEZ, NEW YORK
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

House Committee on Small Business
"Beyond the Size Standards: Sustainability of Small Business Graduates"
Wednesday, September 14, 2011, 1:00 P.M.
2360 Rayburn House Office Building

Witness List

Panel I

The Hon. Gerry Connolly
U.S. House of Representatives
Washington, DC

Panel II

Tonya M. Speed
Executive Director
Mid-Tier Advocacy (MTA)
Washington, DC

Christopher Yukins
Professor of Government Contracts Law
Co-Director of the Government Procurement Law Program
George Washington University
Washington, DC

Michael D. Frisbey
Government Suppliers & Associates
Knoxville, Tennessee
Testifying on behalf of the National Small Business Association

Margot Dorfman
US Women's Chamber of Commerce
Washington, DC

Statement of Congressman Gerald E. Connolly
Small Business Committee hearing on Mid-Tier Companies
September 14th, 2011

Thank you Chairman Graves, Ranking Member Velázquez, and members of the Committee for the opportunity to testify today. I appreciate your commitment to the viability and growth of small businesses in America. Federal contracting is to my district what auto manufacturing is to Detroit. My constituents own or work for small, medium, and large businesses, primarily contractors supporting every agency of the Federal government. I co-chair the House Smart Contracting Caucus with Congressman Rob Wittman and worked for 20 years in the contracting industry prior to my election to Congress. I strongly support the existing federal small business programs and believe that we should more effectively support those small businesses which grow beyond the SBA's established size standards, sometimes referred to as "mid-tier" or "mid-size" businesses.

During my first term in Congress, a group of minority owners of recently graduated 8(a) companies approached me to discuss mid-tier contracting policy. These are successful small businesses that had grown slightly beyond their small business size threshold in their primary line of business but were still much smaller than the larger federal contractors. These business owners found that, upon their graduation from the small business programs, they were effectively left with no support to transition into the full and open competitive federal market. Forced to compete with the giants in their field, coupled with the federal government's small business contracting programs, these growth-oriented firms found themselves in federal contracting limbo. Since the federal procurement system is binary, firms are either a small business or are "other than small," which means that once a small business exceeds its primary size standard, even if it is only by one dollar, they must compete with the largest, most dominant, firms in their industry. Contracting officers have no mechanism to structure Requests for Proposals in a manner that would allow these mid-tier firms to effectively compete for them. Larger firms now are also competing for those same opportunities to maintain market share and customer support, thus either excluding mid-tier firms from the marketplace or reducing competition.

Without a meaningful business base to pursue, I learned from my constituent companies that most mid-tier companies like them either went out of business or were acquired and consolidated into much larger contractors. While being acquired could be a success story for some of these businesses, their owners tell me frequently that they sold because of a lack of better options, at the ultimate expense of taxpayers. For example, a successful mid-tier company may have two or three medium-sized IT contracts with a federal agency. Since it has relatively few contracts, it focuses closely on them and provides great value to the agency and the taxpayer. In contrast, a very large contractor might compete for these contracts to keep market share relative to their competitors but a $20 million contract for a firm with billions in federal work may not be as significant and the agency may not receive the customer focus that it would from a mid-tier company.

After studying the policy issues involved and the challenges mid-tier companies face, earlier this year I introduced the Small Business Growth Act, H.R. 1812. My bill creates a pilot program to provide small businesses with a growth path once they exceed the small business size standard for their industry. I drafted this legislation in consultation with small and medium sized businesses from my district, based on the following principles:

1. Expand business opportunities for mid-tier businesses without diverting any contracting opportunities from small businesses or undercutting the current federal small business contracting programs

2. Improve competition for federal contracts in order to provide better products and services to federal agencies and a better value for taxpayers
3. Strengthen and expand the federal contracting industrial base
4. Preserve and create private sector jobs

In May, as part of the House consideration of the fiscal year 2012 National Defense Authorization Act, our colleague, Congressman Mike Rogers, filed an amendment that addressed a similar concern for the plight of the mid-tier firms but his solution was focused exclusively on contracting in the Defense Department; regrettably that amendment was not made in order under the rules for consideration of that bill. While his legislation is structured differently from mine, I believe that they are based on the same objectives, particularly for improving federal contract competition. I appreciate Congressman Rogers' leadership on this important subject and look forward to working with him on it.

I also appreciate this Committee's interest in this important segment of federal contracting and I would appreciate the opportunity to work with you to improve this bill, synthesize it with Mr. Rogers' legislation, or work to draft different mid- tier legislation that are consistent with the four principles above. Your expertise on small business issues will be essential in refining or crafting legislation to meet our shared objective of helping to grow small businesses and preserving the important and appropriate investments our nation is making in small businesses to fulfill the directive of the Small Business Act.

The existing small business set-aside programs represent a balanced program designed to foster the economic opportunities for small business, improve competition for federal agency work and obtain the best value for taxpayers. In crafting the Small Business Growth Act, I was especially careful to preserve all of the existing small business incentives. As written, my bill would only permit mid-tier companies to obtain federal contracts if those contracts would not otherwise be procured through any of the small business set-aside programs; the legislation explicitly prohibits mid-tier companies from competing for protected small business contracts, ensuring that existing small business set asides are preserved. .

In addition, the only mid-tier companies eligible for this program under my bill would be enrollees in at least one of the federal agencies' mentor-protégé programs for contracting; this provision ensures that mid-tier businesses do not act as pass-throughs for larger businesses. As a further limitation on eligibility to ensure that the legislation directly benefits only "mid-tier" firms, my bill caps the size of a mid-tier company at 1,500 employees to ensure that large companies do not take unfair advantage of the program. In summary, this legislation preserves existing small business incentives and then adds a new incentive for growth-oriented small businesses.

In its memorandum for this hearing, your Committee staff identified four issues for consideration in revising or drafting mid-tier legislation: the definition of mid-tier businesses, the basis for contract awards to mid-tier companies, its interaction with other federal procurement programs, and benefits to the government and the taxpayer. With respect to the definition of mid-tier firms, I appreciate the staff's thoughtful suggestion that the size threshold for mid-tier firms be proportional to particular industry size standards As the committee is aware, there is no existing uniform definition of the term "mid-tier" in federal contracting so I used an employee-based standard taken from an existing SBA size standard that is commonly used in the federal information technology procurement arena. I recognize that some industries are measured in the small business program on their

number of employees while others are based on average annual revenues. I am not wedded to any specific definition as long as it provides broad opportunities for qualified firms in multiple industries to participate in any such program and I look forward to reconciling this staff suggestion with the language in my bill.

With respect to the basis for awarding contracts to mid-tier firms and interaction with other procurement programs, I strongly believe that we must first protect the existing small business preferences and my legislation is intended to do just that. After meeting that standard, the basis for awarding contracts to mid-tier firms should be on improving competition, job preservation and creation, and strengthening the industrial base. Today, there is often limited competition for many contracts among a few very large firms. By creating a meaningful mid-tier program, we can create more private sector jobs while diversifying and strengthening the industrial base. Of course, by allowing mid-tier firms to compete with large firms on a level playing field, we can also improve the competition for federal opportunities and thus improve the value to the taxpayer. In this context, it would be appropriate for any mid-tier program to allow subcontracting, teaming, or joint ventures among multiple mid-tier or small businesses but not with larger companies.

As I noted earlier, prior to my election to Congress I worked in the federal contracting industry. In my experience, as I'm sure many of you are well aware, some of the most innovative ideas come from our small business federal contractors. While it is true that we can improve competition, strengthen the industrial base, and create more jobs through mid-tier federal contracting programs, perhaps the greatest benefit would be the promotion of innovation from which the federal government and taxpayers will benefit. We cannot afford to lose the next great idea because a mid-tier firm was bought up or went out of business. By providing a growth path for these successful small business federal contractors, I am confident that we can deliver best value for the taxpayer while promoting small business growth and competition.

Thank you again for the opportunity to provide this statement. I look forward to any questions you may have about my legislation and to the opportunity to work with this Committee and other members of Congress to further this important objective.

Testimony on behalf of Mid-Tier Advocacy (MTA)

IN SUPPORT OF H.R. 1812, The Small Business Growth Act

Before the House Small Business Committee

Tonya M. Speed

"Sustainability for Small Businesses"

September 14, 2011

For Questions Please Contact:

Tonya M. Speed

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Mister Chairman, and members of the committee, I am honored to come before you today representing Mid-Tier Advocacy (MTA) to discuss the current size standards policy environment leading to the disappearance of a group of federal businesses often termed "mid-size" firms. "Mid-size" or "mid-tier" refers to "other than small" businesses, having outgrown their NAICS revenue/employee ceilings, which, but not large enough to successfully compete against the largest integrators in the federal market place. Without any federal assistance but lacking competitive infrastructure to sustain themselves, these businesses are quite literally between a rock and a hard place and therefore some face the threat of going out of business altogether. Because mid-size firms are often an acknowledged source of innovation and jobs, this disparity affects the very health and vitality of our national economy.

The MTA directly and indirectly represents a community of small and mid-size firms that provide employment for thousands of people across the United States and across multiple industries including, but not limited to, information technology, engineering, logistics, facilities management, operations and maintenance, international development, scientific research, resource management, construction and more in support of both the public and private sectors. As an organization of the country's top veteran-owned, service disabled, hub-zone certified, minority-owned and woman-owned businesses, we believe that most concerns are well represented as it pertains to small business.

In the last 40 years, the federal government has had a significant positive impact on the development of small businesses in our country. In particular the Small Business Administration (SBA) and its' numerous programs' contributions to expand the United States economic base with fundamental support to small business, in the areas of federal procurement has been a tremendous asset to small businesses across the nation.

However, Mister Chairman, thousands of small businesses, who have graduated and/or matured, have disappeared from the landscape of the federal marketplace over the last three decades. The policies that drive the management of size-standard criteria help the entry-level and emerging firms; however, the same policies that make it possible for start-up firms to succeed, also eventually stifle many of them after the businesses achieve some modest success in the federal marketplace, i.e., once they have outgrown their small-business status. As a consequence, a significant number of mid-size businesses are faced with the decision of either:

(1) selling their companies, often on less than desirable terms, to large corporations, or

(2) Going out of business altogether.

Most small business entrepreneurs prefer to grow their businesses in order to increase value for themselves and their families, as well as their employees and they seek the support of government to create an environment in which they can succeed.

What is the Definition of a Mid-Size Firm?

A mid-tier company may have exceeded the largest size standard that is associated with the NAICS codes governing SBA small business categories. They are seasoned businesses as a result of having been in the federal market for 10 to 30 years, or more. Their revenues may range from $10M to $350M and they will likely employ from 100 to 2000 people. They are no longer considered small businesses, but neither are they large enough to compete for and win contracts against the multi-billion dollar businesses that dominate the federal market place and in light of the current economic hardship pursue contracts of even the smallest size, stiffening competition for mid-tier and small businesses.

Our testimony today will focus on:

1) Why We Believe Small Mid-Size Businesses Save Money
2) Why Congress Should Protect its Investment
3) Why We Believe the Pilot Will Assist Small Business Growth, Create Jobs and Strengthen the Industrial Base

"Challenges"

Challenges to Small Business Growth in the Federal Marketplace

I will start with a discussion of the current and, as we believe, restrictive policies that include inadequate standards used to define all small business by the North American Industry Classification System (NAICS[i]). We say "inadequate" because in most cases the NAICS codes define small business in the federal market place as a business with less than a certain threshold in annual revenues over a three year average. Additionally, the size standards are inconsistent with what is happening in the current business environment. For instance, a business that specializes in training, only qualifies as small if it has a three-year average sales of $7M or less, and in information technology if sales are less than $25M. Once they surpass this average, becoming moderately successful in the federal market place, they are considered *"other than small" and* thrust into the unrestricted labor market without the infrastructure and capital to compete successfully against *significantly* larger businesses. Consequently, one of the many challenges for a 'small business' is to **survive beyond the size standards**.

> *The Small Business Administration (SBA) recently proposed updates to the NAICS standards for a substantial number of industries in Sectors 54 and 81. MTA appreciates SBA's commitment to updating these long-over-due NAICS size standards however MTA also believes the proposed updates fell considerably short and will preclude many small businesses that should continue to qualify in an appropriate category from competing for contracting opportunities. Specifically, SBA's proposed 2% raise in the size standards for IT-related services from $25 million to $25.5 million is inadequate.*

Small businesses that grow beyond the limits set by the NAICS codes are in fact **punished for doing what any business aims to do and that is to grow**. At the same time, the unprecedented growth in the size and number of federal contracts restricted to small businesses is providing tremendous growth for small businesses, but is also reducing the time required to graduate from small business status.

As a negative, emerging *"mid-size firms"*, are, unfortunately, simultaneously accelerated to the point where they **are no longer able to effectively compete.**

Upon out-growing the size standards for their primary NAICS code, any business, even if it only has $8M per year in sales in the training industry, has to directly compete with the top federal government systems integrators such as Northrop Grumman, Lockheed Martin, SAIC, EDS-Hewlett Packard, and General Dynamics with average sales of $30B per year and 130,000 employees **(see Tables 1 & 2 below).**

Just as nobody would expect a $250,000 start-up business to beat a $50 million dollar firm in competition for contracts, it is unrealistic to expect matured small firms or emerging mid-size firms to successfully compete against such corporations in the long run.

Table 1

GRAPHICAL VIEW OF SMALL BUSINESSES COMPETITION AGAINST LARGE BUSINESSES DAVID vs. GOLIATH					
LARGE SYSTEM INTEGRATORS		**SMALL/MID-SIZE FIRMS**		**LARGE SYSTEM INTEGRATORS**	**SMALL/MID-SIZE FIRMS**
Company Name	**Annual Revenue in BILLIONS**	**NAICS Ceiling on Revenue in MILLIONS**		**Number of EMPLOYEES**	**NAICS Ceiling on EMPLOYEES**
Northrop Grumman	$33.8	$7 – 33.5M		120,000	500 - 1500
Lockheed Martin	$45.189			136,000	
General Dynamics	$31.981			91,200	
EDS (not part of HP)	$22.1			136,000	
CSC	$16.740			95,000	
Average	**$29.962**			**130,040**	

Mister Chairman, the above table clearly demonstrates how imbalanced the federal policy on size-standard is as it relates to the ability of "small/mid-size firms to protect and further develop their businesses.

To make this point even more clearly, let us assume the above sales standards were (4x times) what they currently are: Instead of a $7M ceiling, the NAICS small-business restriction would now be $28M and instead of $25M, the restriction would be capped at $100M. The sales differential between a large corporation and a matured small or mid-size business would still be nearly $ 29.934B and $ 29.862B respectively – almost $30B. With such a stark difference, how is it possible that two such businesses, in all fairness can be placed in competition with each other for federal contracts?

The fact remains, that doing business in the federal market place is very different from doing business in the commercial sector. Businesses in the federal market place are limited by government requirements on yearly submissions of General and Administrative (G&A) budgets to be approved by the Defense Contract Audit Agency (DCAA). These budgets define the amount of money a business can utilize for its growth expenses. For example, if a business with a 10 percent G&A budget and sales of $1M will have a $100,000 G&A with which it must cover all of its corporate management costs, including accounting and finance, HR, contracts administration, security risk management, quality assurance, internal logistics and business development (sales representatives and proposal development). To compare, a $25M firm with a 10 percent G&A budget will have $2.5M to cover the same functions. This, to an inexperienced business person might appear to be an abundant sum to operate such a firm. But consider the cost of qualified management personnel in the federal market place as reflected in the following estimated annual base salaries:

General & Administrative (G&A) Expenses – A Business Model

CFO	$175,000
Director of Administration	$125,000
Chief Technical Officer	$150,000
Business Development Manager	$175,000
Business Development Specialist	$120,000
HR Director	$120,000
Contracts Administrator	$135,000
Quality Assurance Manager	$120,000
***Total**	**$1,120,000**

**The above salaries are estimated at the lower end of the competitive range.*

***To this, we must add Health/Retirement Benefits and Overhead Costs:*

Benefits (35 percent)	$392,000
Overhead (25 percent)	$378,000
**Total	**$1,890,000**

According to this model, just the leadership costs for a $25M business amounts to $1.89M, leaving only about $600,000 of the $2.5M budget. This sum must pay for staff support in accounting and finance, HR and project operations support, business development and proposals and of course, the owner, or CEO, who is leading the organization.

Restrictive Policies: Unintended Cap on Small Business Development

We often hear from economists and government officials that small business is the backbone of our economy. Perhaps a broader and more accurate view is that small business and "mid-size" business are the backbone of the economy. Yet, government policy often proves to be a barrier to small and mid-size business growth rather than encouraging a logical growth pattern. While there are notable examples of a small business developing into a sustainable large business within a relatively short period of time, the usual small business life cycle includes an intermediate mid-size phase. At this point in their life cycle, the business owner faces a choice, sell out, or due to the NAICS size standard impediments face reversion to small business status and disappearance from the marketplace, if, however, the choice is to grow and compete with the big companies, the small business must have a unique service or product that government customers need.

Otherwise the competition will be with $30+ Billion multinational companies with thousands of employees that have huge business development infrastructures. Unlike small businesses, their staffs may include a variety of marketing researchers, high-powered lobbyists, business capture specialists, proposal writing experts and former high level government officials with relevant contacts in government agencies.

Imagine a $30 Million company competing against a $30 Billion company for the same contract. It usually turns out to be a one-sided contest with the small business spending more than it can afford to write the proposal and the large business being awarded the contract. The small business will not be able to survive very long.

One alternative is to cut its losses and agree to be acquired by a large business. More often than not, the decision is to sell rather than fight a losing battle. While this may be one solution for the owner under the circumstances, we believe there should be other alternatives. The pilot that is being considered would provide the needed growth path and transitional period for a small mid-sized firm that is growing, but still needs capacity and infrastructure to be sustained over time. In the first scenario, the economy loses a mature and proven small business which usually offers more innovation and better value to the government than many large businesses do. When this scenario is multiplied, this loss of mature small businesses (with their flexibility, quality, responsiveness, and good value) has a dampening effect on economic growth. Also, when large businesses buy small businesses, they tend to primarily hire contract direct labor personnel and release indirect labor personnel who would duplicate their existing staff. The result of these layoffs is an increase in the ranks of the unemployed.

"Opportunities"

Mid-Size Businesses Strengthen the Industrial Base, Create Jobs and Encourage Greater Competition

Large businesses often buy small businesses in order to get bigger (with higher rates) and to reduce the competition in the government marketplace. The purpose of size standards is to provide a means of setting aside a portion of government contracts for exclusive competition among small businesses within specified industrial classifications. (Mid-size businesses are NOT recognized in the present NAICS size standard system). It is within the interest of the federal government to contract with the small business and mid-size communities because these businesses bring innovation, flexibility, and lower prices than most large businesses. The fact that small and mid-size businesses expand the economy by providing more jobs at a faster rate than large business is significant.

Recognizing the value of competition at all levels of federal contracting will maximize the taxpayer's return on investment

Since the government invests in small companies, it should "protect its investment" and continue to support them – or at least monitor their progress - after they graduate. This makes perfect policy and economic sense: as a taxpayer, I want to know what sort of return I am getting on my small business investment. Secondly, protecting "small" medium-sized companies is important. Small companies are good at "invention" (coming up with new products, services and processes) but medium companies are required for "innovation" (taking new products, services and processes to a mass market). A small company does not possess the capacity to truly leverage the economic benefits of an invention – it needs to grow in order to do that. If it cannot grow, innovation is being stifled.

Currently published size standards are based upon either the most recent 3-year average revenue or 3-year average number personnel employed by a small business, depending upon the industry. For example, the size standard for information technology NAICS is $25M and the size standard for telecommunications NAICS is 1500 employees. This means that the average revenue for companies eligible to receive small business set aside contract awards in the information technology category cannot exceed $25M. However, the limit for contracts assigned a telecommunications NAICS can exceed $25M as long as the company receiving the contract does not have more than 1500 employees.

SBA's most recent proposed rule on NAICS size standards closed for public comment in June 2011. With respect to SBA's proposal to reduce the number of size standards within Sector 54 to 8 anchor size standards, it appears to be a logical and sound approach provided that the sizes are large enough for small businesses to grow and still be considered small business. For example, the standard for financial management including budgeting, accounting and auditing is only $7M. The market for such services, including high salaries for professional employees, makes this an unrealistic ceiling if such a business is to grow.

The same is true for information technology services that were increased from $25 to $25.5M. The value of such a small increase makes little difference in the ability of small business in this category to grow and still be considered small.

In our view, however, the answer to this problem is not to have the $7M or $25.5M firm to "graduate" from small business and compete in the unrestricted category. When that occurs, the mid-size small business has few choices than to remain small within the size standard or sell to a larger firm. When that happens, the federal government loses because the country will have fewer mid-size businesses that create jobs faster, and who provide quality goods and services at lower rates. Some say that graduation from small business NAICS codes is like *"falling off a cliff"*. A further indication of the current trend is a 2010 Center for Strategic and International Studies (CSIS) study which showed that government **spending on start up and small business areas was quite healthy during the past 10 years, but showed a steady decline for mid size businesses**.

We should also be mindful of the tremendous difficulty in establishing size standards that will apply equally to the private sector market and the federal market space. The differences in contract revenue and staffing levels vary so widely that efforts to force them into the same size categories would be like mixing apples and oranges and calling them the same. We are encouraged to see that the SBA draft recognizes the difference and look forward to its early analysis of the problem which, hopefully, will lead to separate size standards for the private and public sectors. Until this occurs, however, we continue to work within the constraints of the present NAICS size standards that apply to both sectors.

The current system does not recognize the reality of how a small business grows into a large business. A small business does not normally transition even from the largest NAICS size standard of $35.5M (except for $175M minimum assets required for banks and financial institutions) and compete against multi-billion dollar large businesses. Being a small business one day and graduating to a large business the next day is

unrealistic, although the present NAICS size standard system appears to assume otherwise. It is true that some small businesses have competed and won contracts against large businesses, but they usually lose in view of the vastly superior business capture resources that large businesses devote to winning.

Training and Infrastructure Critical to Small Businesses to Grow to the Next Sustainable Level

A small business normally grows into mid-size where additional infrastructure is added for internal strength and other resources are devoted to influencing the external political environment. The mid-size business is characterized by greater involvement in high-fee associations that facilitate access to decision-makers and increased participation in high level seminars and fund raisers where it is possible to meet prospective customers on a social basis. This mid-size phase of growth is where sufficient resources for individual and team training are available, as well as the use of consultants for better strategic planning and the development of more competitive personnel, operations, and information systems. The mid-size phase provides the foundation for competing with large business for unrestricted solicitations.

Mid-size businesses are important to government because they continue to show the innovation, lower prices and agile adjustment to the changing federal environment. These businesses are sometimes described as "too big to be small and too small to be big." They bring significant value to procurements that may be too large for small business but would be too expensive if performed by large business.
The point is that government could save money by developing policies that encourage the growth of mid-size businesses because they are capable of performing services that large businesses perform, but at lower rates. The government should recognize the mid-size as a necessary phase of business growth and should identify and reserve procurements for competition within the mid-size in a similar manner as small business. Mid-size contract opportunities would come from unrestricted procurements and not come from small business set asides. Small business procurements would **not be affected** by the recognition of the mid-size category.

Another benefit would be required mentoring of small businesses by mid-size businesses which would help them grow and contribute more significantly to the economy. Mentoring would provide an opportunity for mid-size businesses to give back to smaller businesses some of the valuable lessons they have learned along the way. Helping protégés to avoid some of the pitfalls of marketing, operations, and finance would also result in faster growth so that the small small business can do their part in growing the economy earlier than would normally be expected.

Recommendations for Enhancing Small Business Growth and Immediately Creating Jobs

We recommend a five year *pilot* like the one that is being proposed in the Small Business Growth Act, H.R. 1812 by Representative Connolly and a similar amendment by Representative Rogers. The proposed Small Business Growth Act legislation allows Contracting Officers to elect to use the number of employees to determine small business status. This pilot aims to provide an even playing field by building upon the concepts already in place by using an employee size-standard that is already being used, for instance, in the telecommunications and telephone support industry, where a business is still considered small if it employs fewer than 1,500 people, regardless of its three-year average sales. Several economists have concluded that using just "average revenue" is an *inadequate measurement of business size without other considerations*. For example, many of the contracts awarded to small businesses are for provision of supplies, and value added reselling.

These contracts provide only a small profit margin, but have the potential to rapidly increase the businesses revenue stream and thereby accelerate its graduation to the unrestricted or "full and open" category.

Similarly, small businesses that serve as prime contractors on supply and value added resale contracts are credited with the total revenue expenditure for that contract. However, in reality the small business must partner, team and enter mentor protégé

relationships with other small and large businesses to successfully compete on these types of contracts and must disperse a considerable amount of revenue to subcontractors. The amount of monies dispersed to subcontractors can be as much as 80% of the total contract value which only leaves 20% for the prime, but 100% of the revenue gets added to prime contractor revenues. Using a pilot program provides the flexibility to make interim adjustments in response to changes in the business environment and to leverage lessons learned. It also provides the opportunity for more businesses to become prime contractors, thus creating greater competition and enhancement to the overall industrial base.

The small/mid-size firm has done everything they have been asked to do and often more than. Now they are penalized for their successful performance and support to the customer. The dominance of large corporations is so overwhelming because they continue to absorb the 'small/mid-size businesses' share of the market place, which they achieve not only through outcompeting the smaller businesses but also by acquiring them.

Infrastructure Capacity Affected by "Graduation"

Businesses need strong and stable infrastructure to grow. Infrastructure includes DCAA accounting systems, human resources systems, intellectual capital (especially at the executive levels) technology systems, strategic planning processes, and other industry specific standard business processes. The key word is stable, because as business size fluctuates, so does its infrastructure, and like a physical building, as the infrastructure weakens, so does the entire business, which may lead to an early death.

A study of the annual receipts of small firms shows there is a significant decline in businesses across all industries when the annual receipts go from $1- 5M to $5 – 10M. For example, in 2002, the Information Industry (NAICS 51) shows that in the first category ($1 – 5M) there were 13,263 firms, but in the second category ($5-10M) the number firms declined to 2,572, which represents an 80% drop.[ii] The Professional, scientific and technical services industry (NAICS 54) shows an 88% drop in firms.

Note: These figures are for ALL firms in an industry. Small government contractors represent a subset of these firms.
Source: U.S. SBA, Office of Advocacy, based on data provided by the U.S. Census Bureau.

We understand that this decline could be due to a number of things including the usual spasms associated with business growth and development, and that the Census data is for all businesses and not just federal government contractors. But, the drop is so significant as to lead one to believe there may be a relationship between the most common small business NAICS with a revenue ceiling of $7M and this drop in revenue. This data lends support to our contention that just as a firm reaches a level of stabilization in its revenues and infrastructure; it is no longer eligible for the support provided to other small businesses.

MTA strongly support the Connolly bill H.R. 1812 because it goes to the heart of how the government can get a better return on its small business investment. To quote Mr Connolly's office, *"The success of these small businesses is what's helping to drive the economic recovery, and the loss of incentives threatens not only their ability to compete but also their ability to hire. Furthermore, federal agencies would lose a valuable pool of small and mid-tier firms that compete for relatively small contracts."* We could not agree more.

This pilot program within GSA would create a separate opportunity for "mid-tier" small businesses to compete for select IT contracts only after other small businesses have had an opportunity to compete for them but before the contracts would be open to broader competition. Further, The MTA agrees that small business concerns should be protected from unfair competition. Under this recommended approach the agency/department would be directed to consider other small business programs [8(a), HUB Zone, SDVOSB, and traditional SB] *before* considering the small business growth pilot, thus "protecting" smaller firms and paving the way for these companies to work on

the appropriate "medium size" contracts. This would preserve incentives for small businesses while helping to sustain opportunities for these growing mid-tier companies who bring savings and value to the government.

We recommend the passage of H.R. 1812. We further recommend that this Committee direct development of a study to determine the impact of graduation from current small business categories on small business infrastructure and revenues.

Summary and Conclusion

The federal government's small business development programs and the esteemed members of the Small Business Committee do an excellent job of supporting and overseeing the establishment and growth of small businesses. We believe that it is fair to say, however, that the record of viable small businesses after 8(a) and other small business program graduation is not nearly so good.

The federal government has invested millions in dollars in support of small business development. Therefore, it is in the best interest of the taxpayer and the government to protect its investment by ensuring that businesses that have grown to the maturity phase are allowed to continue to grow and mature. We contend that the federal government has single-mindedly focused on the start-up and growth phases of business development while ignoring the maturity phase. **We also suggest that in this time of economic challenges, the government cannot afford to let any business decline which will ultimately lead to more unemployment.**

MTA recommends the following:

- Passage of H.R. 1812, which has a five year *pilot* that promotes small business growth and increases options for subcontractors to become prime contractors.
- Development of a study to determine the impact of graduation from current small business categories on small business infrastructure and revenues.

Finally, we strongly support the chairman's recent comments challenging elected officials and constituents alike ... *"to view small business contracting as one of the best possible uses of government expenditures. This cost-saving strategy can actually help Washington address our out-of-control federal debt and help create jobs."* For all the reasons stated above, the establishment of a mid-size business category would insure that the government would get the best bang for its buck, because they deliver greater value.

Mister Chairman, we sincerely appreciate the opportunity to provide testimony before the Committee today. We are prepared to answer questions and welcome your suggestions on any further actions that could result in policy changes to support small and matured small businesses.

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[i]U.S. Census Bureau, North American Industry Classification System. http://www.census.gov/eos/www/naics/

[ii]U.S. Small Business Administration. Employer Firms, Establishments, Employment, Annual Payroll, and Receipts y Receipts Size of Firm and Major Industry using NAICS, 2002. http://www.sba.gov/advo/research/us_rec_mi.pdf

Statement of

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Before a Hearing of the

U.S. House of Representatives Committee on Small Business

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

Wednesday, September 14, 2011, at 1 pm.

Rayburn House Office Building 2360

Washington, D.C.

I. Introduction to GWU Law School's Government Procurement Law Program

Established in 1960, the Government Procurement Law Program at The George Washington University Law School is the only one of its kind in the United States. A broad range of faculty teach, speak and write on federal contract formations and administration, anti-corruption issues, bid protests, claims, cost and pricing, small business programs, procurement reform initiatives, and international and comparative law. The procurement law program at GWU Law School offers unparalleled faculty resources, course offerings, and professional development opportunities. The program's faculty bring with them years of experience in the federal government and in the private sector. In addition to our classes, a sponsored moot court competition and the *Public Contract Law Journal*, the program also hosts colloquia and symposia addressing evolving issues in procurement reform, and presenting esteemed speakers from government, industry, academia and private practice.

II. The Competitive Problem for Mid-Sized Firms in the Procurement Market

The problem the Committee is addressing today -- the problem of mid-sized firms in the government marketplace -- really has two aspects. First, there is the problem of "graduating" small businesses, which grow up under the protection of various small business preference programs and then must compete as mid-sized firms, without any preferences or protections. Second, and more broadly, mid-sized firms face special competitive obstacles in the federal procurement market, a market which sometimes favors the largest firms, in part because of its steep barriers to entry.

Sustaining Small Businesses That Grow Beyond Preference Programs: A key problem that has emerged in the U.S. small business program is how to sustain growth in those small businesses, nurtured by the U.S. small business preferences in procurement, which grow into "medium"-sized firms and so are no longer eligible for small business preferences. This issue has been an open one for many years. *See, e.g.*, N. Eric Weiss, *Possible Small Business Issues in the 110th Congress*, Congressional Research Service (CRS) Report No. RS22589, at 4 (Feb. 27, 2008).[1]

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[1] This issue of constrictive size standards is not new to the 112th Congress. For example, the Congressional Research Service reported, in 2008:

> Revisions to the Definition of Small. There is no uniform definition of "small" business. The SBA determines a *size standard* on an industry-by-industry basis, weighing the number and size of firms in an industry, the degree of competition, barriers to entry, and start up costs. The size standard must be small enough exclude any dominant firms in the industry. Depending on the industry, the SBA sets the size standard based on a firm's number of employees or revenues. For example, the size standard for new single family home construction businesses is $31 million of annual revenue, and for iron and steel mills the standard is 1,000 employees.5
>
> **There have been proposals to increase the size standard to make larger businesses eligible for small business programs.** For example, the Department of Defense (DOD) has suggested increasing the size standards because defense contracts frequently push the winning small business over the size standard. This limits a small business to one DOD contract, and the Pentagon would like the flexibility to award additional relatively large contracts to a firm. Many small business advocacy groups have opposed this. On the other

Footnote continued on next page

General Competitive Problems for Mid-Sized Firms: There is also a perception that mid-sized firms in general face special difficulties in the government procurement marketplace, because those mid-sized firms do not have access to the preferences enjoyed by small businesses and because the mid-sized firms lack the economies of scale, and sheer economic muscle, of the largest prime contractors.

To even the competitive playing field for those mid-sized firms, the Obama administration launched the **"Business Breakthrough Program"** in March 2011, through the U.S. General Services Administration (GSA). *See* Press Release: *White House and GSA Launch New Program to Give Companies a Leg Up in Federal Contracting: New GSA Program to Help Companies Secure and Keep Government Contracts,* GSA No. 10780, Mar. 10, 2011, http://www.gsa.gov/portal/content/241485. The program is to provide training and outreach, but *not* any special preferences. The "Business Breakthrough Program" targets "midsize firms that can get lost in the shuffle between industry goliaths and undersized firms that qualify for Small Business Administration socioeconomic set-aside contract opportunities," according to GSA. *See* Robert Brodsky, *GSA Launches Program To Educate New and Emerging Contractors,* Gov. Exec., Mar. 10, 2011, http://www.govexec.com/dailyfed/0311/031011rb2.htm. According to one White House adviser involved with the program, "'We have heard from medium-sized businesses that they are falling through the cracks here. They did not fit the SBA programs, which are geared toward how to get certified as an 8(a) [small business contractor] or as service disabled or women-owned.'" *Id.* (quoting Ginger Lew, senior adviser to the White House National Economic Council). According to GSA Associate Administrator Jiyoung Park, the goal of the program is "'to increase competition in contracting governmentwide,'" though without any new preference for mid-sized firms. *Id.* The Business Breakthrough Program, which is essentially an intensive training program, emphasizes GSA's "Mentor-Protégé" Program, and is described at http://www.gsa.gov/portal/content/239329.

Mentor-protégé programs, which are sponsored in different forms by different agencies, are generally designed to accommodate both small businesses (the "protégés") and the larger firms that enter into formal agreements to assist those small businesses (the "mentors"). The General Services Administration notes that its mentor-protégé program seeks "to assist small business, including small disadvantaged business, veteran-owned, service-disabled veteran-owned, HUBZone, and women-owned small business in enhancing their capabilities to perform contracts and subcontracts for GSA and other Federal agencies." Successful mentor-protégé arrangements, GSA has said, "represent opportunities for creating access for small business to GSA contracts and awards." 74 Fed. Reg. 41060, 41061 (Aug. 14, 2009).

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hand, there are also proposals to reduce the size standard, in order to eliminate larger small businesses from small business programs.

H.R. 1332, as reported out of committee on May 25, 2007, would direct the SBA to create a size standard based on maximum tangible net worth and average net income in addition to the current standard based on either revenue or number of employees.

Id. at 4 (emphasis added).

GSA's mentor-protégé program has been criticized for offering too few incentives for larger businesses to join the program. 74 Fed. Reg. at 41061; *see also* General Services Acquisition Manual (GSAM) 519.7004 (discussing incentives for prime contractors to join mentor-protégé program); Anthony Eiland, GSA, Presentation: *The GSA Mentor-Protégé Program*, http://www.gsaopeningdoors.com/pdfs/Eiland,%20Tony%20GSA.pdf (discussing practical and legal benefits of joining program). The Department of Defense's mentor-protégé program, which is statutorily authorized, in contrast provides greater incentives for mentor firms to join. *See generally* U.S. Government Accountability Office, Report No. GAO-11-548R *Federal Mentor-Protégé Programs* (June 15, 2011) (discussing various agencies' programs); *GSA Mentor-Protégé Master Participation List*, http://contacts.gsa.gov/graphics/staffoffices/Mentor-ProtegeParticipationList_10AUG11-EXTERNAL.doc (GSA reports 76 mentor-protégé agreements);. The legislative proposals the Committee is discussing today, which would create special procurement preferences for participants in mentor-protégé programs, would offer strong new incentives to join those programs.

III. The Proposed Legislation

The Committee's hearing today will examine proposals for a medium-sized business program, with a specific focus on H.R. 1812, the Small Business Growth Act, and other legislative proposals. According to the Committee's hearing notice, the hearing is to analyze the desirability of a medium-sized business program, the effect of such a program on current small firms, and the fundamental issues any such program must address.

Today's hearing focuses, as noted, on H.R. 1812, introduced by Congressman Gerry Connolly (D-VA), which would address the problem as follows:

- H.R. 1812 would direct the Administrator of General Services to establish a five-year **small business growth pilot program**.
- **To be eligible to participate in the program**, an entity would have to:
  - be **enrolled as a mentor or participating in the GSA's Mentor-Protege program**;
  - **if participating as a mentor**,[2] have at least one protege that was a small business;
  - have **fewer than 1,500** employees; and
  - **not be a small business**.

[2] While technically a protégé would also qualify for the program, because mentor-protégé programs typically accommodate small businesses as protégés, and small businesses could *not* qualify for the preference under H.R. 1812, the discussion below will assume that *mentors*, not protégés, would take benefit from the program in the first instance.

- **Competitions for GSA contracts could be limited to entities eligible** for the program **if**:
    - The anticipated award price of the contract (including options) was reasonably expected to **exceed the simplified acquisition threshold** (currently generally $150,000, per FAR 2.101, 48 CFR § 2.101);
    - The contract would **otherwise likely be awarded to other than a small business**;
    - There was a reasonable expectation that **at least two program participants** would submit offers; and,
    - The contract could be awarded at a **fair market price**.
- **Contracting officers would be required to consider awarding contracts under the pilot program**, before awarding the contract under full and open competition, and could be required to report as to why contracts were or were not awarded under the restricted program.

Congressman Mike Rogers (R-Ala.) offered an amendment to Title VIII of H.R. 1540, the pending defense authorization bill, as reported, which would establish a similar program in the Defense Department, though there for contracts over $25 million.

Other pending legislation would also address small business size standards. *See* H.R. 585 (would amend the Small Business Act to provide for the establishment and approval of small business concern size standards by the Chief Counsel for Advocacy of the Small Business Administration).

IV. Key Issues to Address in Proposed Legislation

While the legislative proposals outlined above are relatively modest in scope, as noted they stem from a much broader question: how to address the special hurdles that medium-sized firms face in the procurement marketplace. The proposed legislation, and any broader remedial legislation, will have to address a number of questions, including but not limited to:

- Should a new preference category of "medium-sized" businesses be created, or should existing "small business" categories be expanded?
- Should acceptable size for these firms be a uniform standard -- say, 1500 or 2500 employees -- or should the size standards vary?
- Should affiliation rules apply, to disqualify firms that are affiliated with other firms and so form much larger joint enterprises?
- Should "size" protests be allowed, so that competitors and others may challenge firms that are apparently improperly benefiting?

- Will the "Rule of Two," which says that eligible procurements must be reserved for small business if it appears two or more small businesses will compete, apply?
- Should there be a limit on the number of contracts that can be awarded?
- Would benefiting firms have a priority in preference?
- Will these initiatives enhance competition? Create jobs?

The discussion below addresses these questions. As the discussion below reflects, because international trade obligations suggest that Congress should *not* create a new category for "medium-sized" businesses, but instead should expand the benefits available through existing small business categories and programs, many of the questions are resolved by resorting to the existing legal framework for small business preferences.

A. Because of International Trade Obligations, Legislation Should Expand the Definition of "Small" Business, or Encourage Mentor-Protégé Programs, Rather Than Creating New Category of "Medium-Sized" Enterprises

A threshold question is whether larger firms' access to procurement contracts -- the access of those firms that exceed the traditional size standards for "small businesses" -- should be resolved by expanding the definition of "small" businesses, or by creating a new category called "medium-sized" enterprise, as European governments have done. H.R. 1812 does not squarely present this issue -- the bill does not create a new "medium" category of firms, but instead creates a special pilot program for certain larger-than-small firms -- but this issue is likely to arise as policy discussions continue.

The answer to this question -- whether to treat the benefiting firms as relatively large "small" firms by expanding the size standards or as "medium-sized" firms -- may lie buried in a World Trade Organization (WTO) agreement, the plurilateral Government Procurement Agreement (GPA).[3]

The WTO members that join the GPA agree, with conditions, to open their procurement markets to vendors from other members of the GPA. Under the agreement, signatory nations agree (a) not to discriminate against other members' vendors, (b) to treat vendors from other member states as they would their own vendors, and (c) to follow certain procedural minima in conducting covered procurements. The United States is a member of the GPA, as are many of the United States' key trading partners, including the 27 member states of the European Union, Hong Kong/China, Iceland, Israel, Japan, Korea, Liechtenstein, Norway, Singapore, and Taiwan (Chinese Taipei). China is negotiating its accession to the GPA, and India is likely to follow behind China in joining the agreement. The GPA, which has been (in various forms) an important part of U.S. trade policy for many decades, is arguably the cornerstone to opening world procurement markets for U.S. exporters over the coming years. *See generally* Sue

[3] For background on the GPA, see the Office of the U.S. Trade Representative website, http://www.ustr.gov/trade-topics/government-procurement/wto-government-procurement-agreement.

Arrowsmith & Robert Anderson, *The WTO Regime on Government Procurement* (2011); Christopher R. Yukins & Steven L. Schooner, *Incrementalism: Eroding the Impediments to a Global Public Procurement Market*, 38 Geo. J. Int'l L. 529 (2007), *available at* http://ssrn.com/abstract=1002446.

Each nation that joins the GPA reserves certain elements of procurement from the agreement's free trade obligations. The United States, when it joined the GPA, made a number of reservations, including one vitally important to our discussion today: the United States reserved its right to give a preference to U.S. small businesses, even if that means discriminating against foreign vendors seeking to sell to federal agencies. The reservation, which is set forth in the United States' General Notes to the GPA, states (in relevant part) that **"this Agreement will not apply to set asides on behalf of small and minority businesses."** Other GPA member nations have not made similar reservations to protect their small businesses.

The United States thus has *not* reserved a right to discriminate against foreign vendors from GPA nations with regard to *medium*-sized businesses. A new, unreserved U.S. preference for procurement from medium-sized businesses also could undermine the United States' negotiating position with China and other developing nations, which are seeking broader protections for their own emerging industries before they agree to join the GPA. Moreover, were the United States to create a preference for medium-sized businesses, that preference could trigger a challenge by the European Union, or other GPA members, under the WTO disputes process. Finally, a new preference for medium-sized enterprises could prompt the European Union to demand that its member nations, too, be allowed to extend preferences to small and medium-sized enterprises (SMEs).

The European Union has long criticized the United States' procurement preferences for small businesses, arguing that the preferences in effect wall off European vendors from a major portion of the U.S. federal procurement market. In a 2009 report, for example, European policymakers wrote:

> The active promotion of small businesses is a common concern for the EU and the US. The EU is, however, concerned that the US "set-aside" measures and their exemption from the GPA favour US industry and have exclusionary effects to the detriment of foreign competitors.

European Union, *Market Access Database* (updated Mar. 1, 2009), http://madb.europa.eu/madb_barriers/barriers_details.htm?barrier_id=960300&version=5.

The European comments both reflected concern that small business preferences are excluding foreign vendors *and* hinted at where the European Union may go: the European Union may demand that it, too, be allowed to erect preferences to protect *European* SMEs from U.S. and other foreign exporters. *See* Max V. Kidalov, *Small Business Contracting in the United States and Europe: A Comparative Assessment*, 40 Pub. Cont. L.J. 443 (2011). European preferences "walling off" the market currently occupied by small- and medium-sized enterprises in European procurement could have a substantial impact on U.S. exporters, because a very large

share of that market -- an estimated 42% of all European prime contracting in 2005, for example -- goes to SMEs. *Id.* at 447 & n.12.[4] While the European Union has stopped short of creating SME procurement preferences to date (the European "Small Business Act"[5] issued last year instead sought merely to *facilitate* SMEs' participation in public procurement markets), a sweeping new U.S. preference for "medium-sized" enterprises could trigger a broader European political reaction.

Creating a new protected category of "medium-sized" enterprises may, therefore, raise serious issues under existing trade obligations. One way to avoid these issues would be to avoid creating a new category, and instead to work within the existing framework of small business preferences, perhaps as expanded by the pilot program contemplated by H.R. 1812.

B. One Option: Revising Size Standards

One policy option would be to revise the size standards for small businesses, to expand those standards to sweep up larger firms. *See* 13 C.F.R. § 121 (SBA size standards); FAR Part 19, 48 C.F.R. Part 19 (size standards in Federal Acquisition Regulation). This approach, which many advocates for medium-sized enterprises have urged, would not run afoul of the United States' trade obligations because the key trade agreement, the GPA, does not define "small business." While the European Union has generally lower guidelines for defining small business,[6] those guidelines are not binding on the European member states, and there is no binding international definition for "small business." The United States could, therefore, expand its definitions of protected "small" businesses, to sweep in larger firms.

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[4] Citing European Commission, *European Code of Best Practices Facilitating Access of SMEs to Public Procurement Contracts*, at 4, SEC (2008) working doc. (June 25, 2008), *available at* http://ec.europa.eu/internal_market/publicprocurement/docs/sme_code_of_best_practices_en.pdf.

[5] *Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - "Think Small First" - A "Small Business Act" for Europe*, SEC(2008) 2101, *available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0394:FIN:EN:HTML*

[6] The European Union has published the following guidelines for defining SMEs:

Enterprise category	Headcount	Turnover	or	Balance sheet total
medium-sized	< 250	≤ € 50 million		≤ € 43 million
small	< 50	≤ € 10 million		≤ € 10 million
micro	< 10	≤ € 2 million		≤ € 2 million

Available at: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm. These are generally much lower that U.S. standards. A "small" business under U.S. federal standards, for example, typically may have as many as 500 - 1000 employees, rather than the 50 employees contemplated by the European standards, above. *Cf.* U.S. Small Business Administration, *Table of Size Standards, available at* http://www.sbaonline.sba.gov/idc/groups/public/documents/sba_homepage/serv_sstd_tablepdf.pdf.

Although adjusting the size standards to sweep up "medium-size" firms would not necessarily trigger a trade dispute, the issue could be highly contentious because of the collateral impact on firms that do, or do not, qualify under current or prospective size standards. *See, e.g.,* Press Release: *Grassroots Movement Blasts SBA's Proposed New Size Standards: Proposed Size Standards Are No Help to Small Businesses in Key Sectors* (Mar. 12, 2011), *available at* http://www.prweb.com/releases/2011/03/prweb5176354.htm. Because the size standards ultimately rest largely on factual, not legal, questions of industry size and composition, this analysis will not address potential revised standards in detail.

C. Second Option: Proposed Pilot Program to Create Preference for Mentor-Protégé Participants

This brings us, then, to the option before the Committee today: H.R. 1812, the proposed legislation to create a procurement preference for vendors in the GSA mentor-protégé program. Because foreign firms could, in principle, participate as mentors in the GSA program,[7] this option raises far fewer concerns regarding possible trade frictions. This approach does, however, raise other practical concerns, which were alluded to above.

1. Should Affiliation Rules Apply?

The first question we will address is whether to disqualify mentor-protégé arrangements that involve affiliations to form much larger joint enterprises -- whether through joint ventures or other forms of common control -- that would normally be disqualified as "small" businesses under the SBA affiliation rules regarding business size.

As currently drafted, H.R. 1812 does not necessarily trigger concerns under the affiliation rules. Under the current bill, a business that did not qualify as "small" could still take the benefit of the preference, so long as that business had fewer than 1500 employees and was a participant in the GSA mentor-protégé program.

Affiliation concerns could, however, be triggered in two different ways. First, a participating firm could affiliate itself with a third party, in order (for example) to gain access to that third party's capital resources. The proposed legislation should clarify whether a potential

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[7] The GSA acquisition regulation, GSAM 519.7006, Mentor Firms, sets the following minimum criteria for mentors, none of which *explicitly* discriminates against foreign prime contractors:

(a) Mentors must be:

(1) A large business prime contractor that is currently performing under an approved subcontracting plan as required by FAR 19.7 - Small business mentors are exempted; or

(2) A small business prime contractor that can provide developmental assistance to enhance the capabilities of protégés to perform as contractors, subcontractors, and suppliers;

(b) Must be eligible (not listed in the "Excluded Parties List System") for U.S. Government contracts and not excluded from the Mentor-Protégé Program under section 519.7014(b);

(c) Must be able to provide developmental assistance that will enhance the ability of protégés to perform as contractors and subcontractors; and

(d) Must provide semi-annual reports detailing the assistance provided and the cost incurred in supporting protégés.

"affiliation" of this kind could disqualify a mentor firm, if the affiliated entities, combined, had more than 1500 employees (the proposed cap under H.R. 1812). If the goal of the legislation is to foster previously "small" firms that have grown out of the small business preference programs, and to encourage broader competition by mid-market companies in federal procurements, then applying "affiliation" rules to the mentor firm would seem to make sense, to ensure that the program did not create a masked preference for much larger firms. Before this question is concluded, however, policymakers should assess the costs -- including the costs of more complicated governance -- if the affiliation rules are applied to participating firms in this way.

A second possible line of affiliation would be between a mentor firm and the protégé firm. This line of affiliation would be less prone to abuse, and, by pulling the protégé firms into the procurements in which the mentor had a special advantage, would in fact help the small firms targeted for assistance by the mentor-protégé program.

The question for Congress, therefore, would be whether to extend current regulatory exemptions for affiliates to mentor-protégé ventures. As GAO's recent report to Congress on mentor-protégé programs noted, the SBA's mentor-protégé program permits a waiver of the affiliation rule between mentors and protégés that are small disadvantaged businesses participating in SBA's "Section 8(a)" program. Report GAO-11-548R, at 5. This means, in practice, that these mentor-protégé ventures may bid jointly on 8(a) contracts set aside for small businesses without the two firms being considered "affiliated." *See* 13 C.F.R. § 121.103. In addition, the report noted, the Small Business Jobs Act of 2010 granted SBA authority to establish new mentor-protégé programs for small businesses run by service-disabled veterans and women, and for HUBZone small businesses, modeled on SBA's current program for 8(a) participants. *See* Small Business Jobs Act of 1010, § 1347, *to be codified at* 15 U.S.C. § 637 note.

By their terms, the SBA size standards are used to determine "whether a business entity is small and, thus, eligible for Government programs and preferences reserved for 'small business' concerns." 13 C.F.R. § 121.101. At present those standards do not, therefore, normally apply to larger mentor firms. If the proposed legislation *did* impose a cap of 1500 employees on mentor firms in the pilot programs, then the size standards could be amended so that the SBA size rules (regarding, for example, affiliation to third parties) could be applied to mentor firms. This would, however, make the mentor firms subject to the complex and intrusive SBA rules on size, including the rules regarding affiliation, which in effect constrain firms' decisions regarding governance, staffing, revenue streams, and capital structures. Before taking this step -- before imposing these constraints on mid-size mentor firms -- policymakers should assess the potential costs and impacts of these new constraints.

2. Should Size Protests Be Allowed?

The next question is whether traditional "size" protests be allowed, so that competitors and others could challenge mid-size firms that apparently exceeded the cap -- 1500 employees, under the current bill -- for participation.

The SBA size protest system has proven an effective means of regulating the highly complex SBA size standards. While the protests can be expensive and disruptive, as with bid protests in general, they provide a means of third-party monitoring that balances the government's compliance needs with broader demands for efficient procurement.

Subjecting mentor firms to size protests would, however, trigger the systemic concerns outlined above, regarding the size standards in general. By subjecting the mentor firms to the SBA size standards, and then exposing them to size protests, the initiative would open the mid-size firms to scrutiny regarding affiliations and staffing, among other management decisions. This might create substantial costs, and discourage mid-sized firms from joining the GSA mentor-protégé program.

3. Should the "Rule of Two" Apply?

Under current law, procurements above the simplified acquisition threshold (generally $150,000) must be reserved for small business, subject to certain conditions, if the contracting officer reasonably concludes that two or more small businesses will compete for the work. *See* FAR 19.502-2.[8] The question is whether the same rule should apply under the proposed bill, which would otherwise apparently require GSA contracting officers to consider *all* full-and-open procurements, presumptively, for the pilot program. *See* H.R. 1812, sec. 2(d).

The current version of H.R. 1812 would apply a version of the "Rule of Two." Similarly, the amendment proposed by Congressman Rogers to H.R. 1540, discussed above, would apply the "Rule of Two" to a parallel initiative in Defense Department procurement. *See id.* sec. 845 (b)(1)(C) (contracting officer must consider whether "there is a reasonable expectation that at least 2 such program participants will submit offers with respect to the contract").

Should Congress decide to retain the "Rule of Two" constraints under H.R. 1812 and H.R. 1540, Congress may decide to reference the regulatory and caselaw authority that now surrounds the rule. The "Rule of Two" has been very controversial in application, and the lessons learned in applying that rule would, logically, help to ease administration of the proposed preference under the GSA mentor-protégé program.

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[8] The Federal Acquisition Regulation provides, in relevant part:

> FAR 19.502-2 Total small business set-asides.
>
> * * *
>
> (b) Before setting aside an acquisition under this paragraph, refer to 19.203(c). The contracting officer shall set aside any acquisition over $150,000 for small business participation when there is a reasonable expectation that:
>
> (1) Offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns (see paragraph (c) of this section); and
>
> (2) Award will be made at fair market prices. Total small business set-asides shall not be made unless such a reasonable expectation exists (see 19.502-3 as to partial set-asides). Although past acquisition history of an item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small businesses the best scientific and technological sources

4. Should There Be a Limit on Awards?

Because of the potential power of this preference -- it could, in principle, apply presumptively to all full-and-open procurements run by GSA -- some firms could, at least in theory, amass substantial contract awards under the program. Because of the relatively high cap on employees -- 1500 -- there is no guarantee that accumulated awards would "bump" a mid-size company from the program. This is, therefore, a question that should be looked at seriously.

An anomaly in the GSA mentor-protégé program may make it easier to set guidelines in this area. As it discussed below, the mentor firms in the GSA mentor-protégé program appear to be clustered exclusively in the professional services, janitorial, and construction services industries. Because there is a relatively high degree of concentration in services, it may be possible to set overarching limits on awards, without being unduly disruptive.

5. Would Benefiting Firms Have a Priority in Preference?

The issue of priorities in preferences has also been highly controversial. In addressing this issue, policymakers may want to look to the hierarchy of preferences established under existing programs, and set forth in FAR 19.203(c).[9]

6. Will This Initiative Enhance Competition? Create Jobs?

In assessing the proposed legislation, it is important to assess the broader potential economic impacts of the legislation. *See, e.g.,* Albert Sanchez Graells, *Public Procurement and EU Competition Rules* (2011) (arguing that, in assessing proposed procurement legal rules, we should assess not only the microeconomic impact on specific competitions, but more broadly the rules' impact on competition across a market). Under current conditions, the most important economic goal is jobs creation. The proposed legislation is not, however, necessarily well-suited to ensure rapid jobs growth. A simple example will illustrate why.

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[9] The regulation reads as follows:

> 19.203 Relationship among small business programs.
>
> (a) There is no order of precedence among the 8(a) Program (subpart 19.8), HUBZone Program (subpart 19.13), Service-Disabled Veteran-Owned Small Business (SDVOSB) Procurement Program (subpart 19.14), or the Women-Owned Small Business (WOSB) Program (subpart 19.15).
>
> (b) *At or below the simplified acquisition threshold.* The requirement to exclusively reserve acquisitions for small business concerns at 19.502-2(a) does not preclude the contracting officer from awarding a contract to a small business under the 8(a) Program, HUBZone Program, SDVOSB Program, or WOSB Program. If the contracting officer does not proceed with a small business set-aside and purchases on an unrestricted basis, the contracting officer shall include in the contract file the reason for this unrestricted purchase.
>
> (c) *Above the simplified acquisition threshold.* The contracting officer shall first consider an acquisition for the 8(a), HUBZone, SDVOSB, or WOSB programs before using a small business set-aside (see 19.502-2(b)). However, if a requirement has been accepted by the SBA under the 8(a) Program, it must remain in the 8(a) Program unless SBA agrees to its release in accordance with 13 CFR 124, 125 and 126.
>
> (d) Small business set-asides have priority over acquisitions using full and open competition. See requirements for establishing a small business set-aside at subpart 19.5.

A 2008 study published by the Small Business Administration, *High-Impact Firms: Gazelles Revisited,*[10] pointed out that firms the study called "*high-impact firms*" -- firms whose sales had doubled over a four-year period, and which had an employment growth quantifier (= firm's absolute change x percentage change in employment)[1] of two or more over the period -- *accounted for "almost all employment and revenue growth in the economy."* Conversely, with regard to firms with *lower* performance, the authors found that *nearly all the "job losses in the economy over [the periods] studied are attributable to low-impact firms with more than 500 employees."* The "high-impact" firms are not, the authors found, necessarily new and emerging companies. "The average age of a high-impact firm is around 25 years old," the report concluded. "These firms exist for a long time before they make a significant impact on the economy." *Id.* at 1-2.

This study affords one rough measure, then, of the proposed pilot program's potential success in generating jobs. If the program is likely to foster "high-impact" firms, per the SBA's sponsored study, the program is much more likely to generate jobs in the near term. Conversely, if the program will -- or *could* -- be used to foster large, "low-impact" firms, the program might even *worsen* job loss, if contracts were diverted from truly "high-impact" firms that simply did not qualify for the program.

The criteria for inclusion in the proposed program are spelled out above. To join the pilot program contemplated by H.R. 1812, a firm must: (1) be enrolled as a mentor or participating in the GSA's Mentor-Protege program; (2) if a mentor, have at least one protégé that is a small business; (3) have fewer than 1,500 employees; and (4) not be a small business. *None* of these criteria, of course, assures that only "high-impact" firms will participate; in fact, a large *low-impact* firm, which was shedding jobs, could also qualify. The criteria for program admission are not, therefore, highly aligned to assure that the proposed pilot program will generate substantial jobs in the coming years.

Nor is it clear that those firms that fit within the proposed program's eligibility are the ones most likely to warrant support, *i.e.*, firms which have matured out of the small business programs, or which will lend robust competition to the federal procurement market. The firms listed as participants in the GSA mentor-protégé program[11] are clustered in the professional services, janitorial, and construction services industries. There is nothing in the criteria for admission to the program to suggest -- or, more concretely, to confirm -- that firms in the program are struggling because they were previously protected by small business preferences, or that they are firms essential to maintain competition in their respective markets.

V. Conclusion

There is an abiding concern that mid-sized firms are disadvantaged in the federal marketplace, because of structural forces within that market and because the mid-sized firms may have grown up under the protection of small business preferences. There is also a

[10] Available at http://archive.sba.gov/advo/research/rs328tot.pdf.

[11] http://www.gsa.gov/portal/content/105301.

consensus that mid-sized firms typically provide healthy competition in the federal marketplace. Addressing these concerns by creating a special preference category for "medium-sized" firms could, however, trigger serious trade frictions, and could undermine ongoing efforts to open global procurement markets.

Another path, therefore, would be to establish a pilot program, as contemplated by H.R. 1812, to create a procurement preference for mentors in the GSA mentor-protégé program, so long as those firms remained under a certain size limit. Doing so, however, may mean in practice that these mid-sized firms are subject to intensely complex size and affiliation standards, which could have a real impact, in turn, on the those firms' business decisions, including decisions regarding revenue strategies, capital structure, business development, staffing levels, and governance. At the same time, given the criteria for admission to the program, there is no guarantee that the proposed pilot program will generate jobs rapidly (an economic imperative at this point), or that it will nurture recently graduated "small" businesses, or even that the pilot program will ensure robust competition in the federal market. These concerns suggest, therefore, that the program should be more aggressively focused, so that the public policy goals that undergird the legislation can be better met.

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Professor Christopher Yukins teaches on government contract formations and performance issues, anti-corruption measures, bid challenges, government contracts litigation, and comparative issues in public procurement at The George Washington University Law School. He is an active member of the Public Contract Law Section of the American Bar Association, serves on the steering committee to the International Procurement Committee of the ABA International Law Section, and is a member of the Procurement Roundtable, an organization of senior members of the U.S. procurement community. He is a faculty advisor to the *Public Contract Law Journal*, and has published on procurement reform in numerous journals, nationally and internationally. He regularly addresses audiences around the world on issues of procurement law and policy, anti-corruption, and international trade. Together with Professor Steven Schooner, he runs a colloquium series on procurement reform at The George Washington University Law School. He is an advisor to the U.S. delegation to the working group on reform of the UNCITRAL Model Procurement Law. In private practice, Professor Yukins has been an associate, partner and counsel at leading national law firms. He is currently of counsel to the firm of Arnold & Porter LLP. He has counseled small, medium-sized and large businesses in the federal marketplace, including firms that have qualified for mentor-protégé programs, and has served as an advocate for small businesses before the Small Business Administration and other agencies.

TESTIMONY
OF
MICHAEL D. FRISBEY

Government Suppliers & Associates
Knoxville, Tennessee

On behalf of the
NATIONAL SMALL BUSINESS ASSOCIATION

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

Before the U.S. House Committee on Small Business

September 14, 2011

Good morning Chairman Graves, Ranking Member Velázquez, and members of the committee; thank you for inviting me here today to discuss the *Small Business Growth Act.*

My name is Michael Frisbey and I am a member of the National Small Business Association (NSBA), America's oldest small-business advocacy organization, and small-business government contractor, with more than 40 years of experience. On behalf of NSBA, I would like to thank you for inviting me to testify today about an important issue: small businesses' access to federal contracts.

I started my firm, Government Suppliers & Associates, Inc. in 2002, after a long career in industry. I previously served as director of marketing for Champion Products, vice president of marketing for Russell Corporation, vice president of sales and marketing for Trench Manufacturing, and vice president of sales and marketing for Propper International. I also have a B.S. in Business Administration from the University of Tennessee, a Masters in Business Administration from the California State College System.

My small firm, Government Suppliers & Associates is registered in the state of Tennessee. Its Cage Code is 3A9R3. The company is registered in the Central Contractor Registry (CCR) and all of its Certifications and Representations are listed in ORCA.

In 2004, it competed on and was awarded three Prime Vendor Contracts with the Department of Defense, worth approximately $145 Million. Contract W91CRB-04-D-0027 supported approximately 50 individual uniform items. Contract W91CRB-04-D-0032 supported 12 different boot styles used by the U.S. Military and Contract W91CRB-04-D-0037 supported over 70 individual equipment items.

In 2009, these contracts were completed and new Prime Vendor contracts openly competed. Again Government Suppliers & Assoc. was awarded two Prime Vendor Contracts: W91CRB-09-D-0059 and W91CRB-09-D-0070, worth approximately $11 Million.

I am proud to say that, to date, Government Suppliers & Associates has not had a single lot rejected or returned to us for noncompliance with the U.S. Department of Defense Specification required. In the materials supplied you have a more detailed listing of the contracts Government Suppliers & Associates has been awarded. In addition to our contracts with the U.S. Department of Defense,

Government Suppliers & Associates also is a registered supplier to approximately 15 Allied Ministries of Defense.

In 2008, my wife and I purchased the assets of Columbia Sewing and started Government Sewing & Apparel LLC, which is a manufacturing company, registered in the State of Arkansas, that she runs; its Cage Code is: 4ZP48. It also is registered in the CCR and its Certs and Reps on file in ORCA.

Today, Government Sewing & Apparel LLC holds two contracts with the Defense Supply Center – Philadelphia (DSCP). Contract SPM100-06-D-0362 for the manufacture of the Marine MCCUU Combat Uniforms and Contract SPM1C1-11-D-1052 for the manufacture of the Coast Guard ODU Uniforms. The company directly employs approximately 80 people at the factory in Hope, Arkansas and supports approximately 200 more people at our two sub-contractors located in El Paso, Texas and Jamestown, Tennessee.

I think it is important to state that all of the contracts awarded to both Government Suppliers & Associates and Government Sewing & Apparel LLC were won in open competition and without any mentoring from a large business.

Small Business and Government Contracting

Federal procurement is of singular importance to many small businesses; and small-business participation is crucial to a healthy and competitive federal procurement process. In other words, expanding the access of America's small businesses to federal contracts is beneficial to all involved. The importance of expanding small-business access to federal contracts is certainly recognized by the membership of NSBA, which identified small-business contracting as one of NSBA's top-ten priority issues during our recent biennial Small Business Congress.

Small businesses provide high-quality goods and services to federal-contracting agencies and infuse the federal procurement system with much-needed competition. In turn, the federal government invests in the most-dynamic and innovative sector of the U.S. economy. America's small businesses annually have generated 60 to 80 percent of the country's net new jobs over the last decade. Small businesses also "produce 13 to 14 times more patents per employee than

their larger counterparts, and...these patents are more likely to be cited in other patenting applications," according to a recent SBA Office of Advocacy working paper.

Small Business Contracting Goal

America's small businesses—which comprise 99.7 percent of all employer firms in the U.S., employ half of all private sector employees, and are responsible for more than 50 percent of the country's private, non-farm gross domestic product—deserve their fair share of federal contracting dollars.

Despite employing more scientists and engineers than large businesses (32 percent vs. 27 percent) and generating five times more patents per research and development dollar than large companies, America's small businesses receive only 4.3 percent of federal research and development funds.

This unrivaled success has been achieved with less than adequate governmental support of oversight and over the strong objections of many large contracting firms, which, in my opinion, have worked to undermine and circumvent small business size standards.

Although the *Small Business Reauthorization Act of 1997* established a government-wide goal of 23 percent of prime, federal contracts to be awarded to small firms, this goal has not yet been met.

The U.S. government awarded 22.7 percent of federal contracting dollars to small businesses in Fiscal Year 2010 (Oct. 1, 2009 – Sept. 30, 2010), according to the U.S. Small Business Administration's (SBA) fifth annual small business procurement scorecard. While this represents the largest single year increase in more than five years and translates into a record $97.95 in contracts, the federal government once again failed to achieve its goal of 23 percent of federal contracts being awarded to small businesses.

The small-business members of NSBA believe it is high time that the federal government reach the goal Congress set for it. In fact, they think it is time to enhance the goal and support increasing the government's small-business procurement goal to 30 percent of all federal contacts.

Small Business Procurement Scorecard

The SBA's annual scorecard also rated 24 federal agencies according to their success in meeting their overall small-business contracting goals, as well as their success in the following socioeconomic subcategories: small, disadvantaged firms; small businesses in HUBZones; women-owned small business; and service-disabled, veteran-owned small businesses.

This year, the SBA awarded the agencies letter grades—from A+ through F. Agencies' overall grades were comprised of three quantitative measures: prime contracts (80 percent), subcontracts (10 percent) and plans for meeting goals (10 percent).

To achieve an "A+" grade, an agency must have met or exceeded 120 percent of its small-business contracting goals. Agencies that achieved between 100 percent and 119 percent of their goals could receive an A. Agencies that realized 90 to 99 percent of their goals could receive B grades, and C grades could go to agencies that met 80 to 89 percent of their goals. Any agency that was able to muster only 70 to 79 percent of its small-business contracting goal could receive a D, and anything less than that was worthy of an F grade.

In total, 13 agencies received an "A," five agencies received a "B," four agencies received a "C," and two agencies received a "D." Overall, the federal government received a "B."

Small Business Growth Act

NSBA historically has supported mechanisms—such as a three-year employment average—that would allow a small firm that *temporarily* outgrew its size standard because of its successful contracting performance to remain eligible for small-business contracting programs.

While appreciative of efforts to increase small-business contracting opportunities, NSBA does not support the *Small Business Growth Act.*

Since small contracting firms introduce critical competition to the federal procurement system but have historically been underutilized, Congress established the aforementioned small-business contracting programs and goals. The pilot program envisioned by the legislation would disfigure

this intent by creating a separate, competing program that would benefit firms far outside the scope of the traditional definitions of small-business.

By explicitly precluding the participation of small-business concerns, the pilot program would serve no benefit to small businesses at all. Until the federal government manages to meet the current small-business contracting goal, the small-business members of NSBA do not believe that a new, separate category of businesses need a separate procurement program.

The small-business members of NSBA are unconvinced that businesses that are, at least, three times the size of the traditional definition of a small-business concern need a separate procurement set aside. It is not clear that medium-sized firms need enhanced governmental assistance in well-functioning markets.

The legislation also leaves a number of issues unclear. Who will be responsible for administrating this program in the various agencies? The already overworked Offices of Small and Disadvantaged Business Utilization? Such an expansion responsibilities surely would be disadvantageous to the existing small-business constituencies of these offices.

Also, what would be the criteria for determining that, "if the contract were not awarded under the program, the contract would likely be awarded to an entity other than a small business concern?" Would such a determination be subject to protest? And, if so, by whom?

Also, instead of determining that a contract was unlikely to be awarded to a small-business concern, wouldn't small business be better served if the Administrator focused on ways to alter the contract so that small firms would be in a position to compete for it?

To give you an example from my personal experience of the obstacles confronted by small-business contractors, let me detail the Modular Lightweight Load Carrying Equipment (MOLLE) pre-solicitation notice, SPM1C1-10-R-1075. When this pre-solicitation finally becomes a formal solicitation and is awarded, in its current form, it will be worth approximately $98 million a year—or $294 million over the three-year life of the contract.

MOLLE consists of approximately 43 individual items, each of which is a stand alone item with its own NSN Number and construction specification. · The 43 various MOLLE items can be

configured into seven sets, including the Rifleman, Large and Medium Field Pack Sets, Pistolman, SAW Gunner, Grenadier and Medic Sets. Since each of the 43 MOLLE items has its own specification and NSN number, these 43 items easily could be made by a number of small businesses. A separate contract could be awarded to warehouse and kit the various items into any one of the seven specific sets. This would seem to be a perfect opportunity to infuse the federal procurement process with small-business competition.

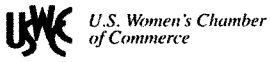
When pre-solicitation SPM1C1-10-R-1075 was originally published in August of 2010, however, it was Unrestricted—with no small business set aside. The reason given was the "interoperability" of the 43 various items. "Interoperability" translates into making sure an item like 9mm ammo or hand grenade pouch will attach to the Fighting Load Carrier Vest, with a 1" piece of purchased nylon.

After much back and forth with DSCP and with the support of some of our Congressional representatives, like Congressman Mike Ross of Arkansas, the small-business community was able to convince DSCP to set aside a small portion of this solicitation specifically for small business. This set aside is approximately $2.4 million—or just under 2 percent of the total annual contract value. The balance of the $95.6 million annually remains unrestricted.

Can one small business handle a $95 or $98 million dollar a year contract? No, but if that contract were split into four, five, or six small-business contracts I personally know a number of small businesses that easily could handle a contract with an annual volume of $16-19 million. Government Sewing & Apparel's two current DSCP contract are worth approximately $21 million over the next 12 months.

With the federal government having yet to meet the small-business contracting goal Congress set for it more than a decade ago, I think the small-business community would be better served if agencies concentrated on finding ways to expand contracting opportunities for small firms, rather than distracting their attention with a competing constituency, which may not need enhanced governmental assistance in the first place.

Thank you again for the opportunity to share with you my views on the *Small Business Growth Act.* I thank you for your time and welcome any questions.



Testimony of
Margot Dorfman, CEO
U.S. Women's Chamber of Commerce

Before the House Small Business Committee
for the Hearing
"Beyond the Size Standards: Sustainability of Small Business Graduates"
Wednesday, September 14, 2011 at 1:00 p.m.
Rayburn House Office Building, Room 2360

Chairman Graves, Ranking Member Velázquez and members of the Committee, I am here today on behalf of the U.S. Women's Chamber of Commerce representing our 500,000 members, three-quarters of whom are American small business owners and federal contractors.

The U.S. Women's Chamber of Commerce strongly opposes H.R. 1812, the Small Business Growth Act, and other similar legislation.

H.R. 1812 arbitrarily and unscientifically abandons the well established small business size standards methodology (which is managed by the Small Business Administration as directed by the Small Business Act -- Public Law 85-236, as amended) -- carving out a new contracting set-aside program for firms that are not small.

The SBA already has tools to assist small business growth.

SBA size standards methodology has scientific basis, ongoing oversight, and includes the specific objective to assure competition among industries.

The methodology employed by the SBA to provide small business size standards is scientifically sound, well documented and includes a mandate to foster competition. Through the size standards process, the SBA regularly examines the structural characteristics of industries as a way to assess industry differences and the overall degree of competitiveness of an industry and of firms within the industry. Industry structure is examined by analyzing five primary factors – average firm size, degree of competition within an industry, start up costs and entry barriers, distribution of firms by size, and small business share in Federal contracts.

SBA also considers other secondary factors as they are relevant to the industries and the interests of small businesses, including technological change, competition among industries, industry growth trends, and impacts on SBA programs.

At the core of the whole size standards philosophy and process is the intent of promoting industry competition -- which is why the SBA includes industry competitive analysis through the measurement of concentration or market power to determine the extent to which a particular industry is dominated by a few large firms.

This is also why the SBA recently increased (and continues to adjust) the employee and/or revenues size of a number of industry size standards -- appropriately fine-tuning industry size standards to reflect the current competitive landscape. In other words, the SBA is already making sure the definition of "small" for each industry encompasses the larger small firms so as to assure a strong competitive climate.

The federal government is not meeting its statutory obligations and goals for contracting with small businesses. These ongoing shortfalls should be the paramount concern of Congress.

Over the last five years alone, American small businesses have lost $22 Billion in revenues as the federal government has consistently failed to achieve the statutory requirement to place 23% of prime contracts with small businesses. This is a horrific loss of opportunity for small businesses, their employees, families and communities.

And, within the prime contracts that are placed with small businesses, the goals for emerging market businesses -- like women-owned small businesses -- are missed year after year. Over the last five years, American women-owned small businesses have lost over $29 Billion in revenues as the federal government has failed to achieve the goal of 5% prime contracting with women-owned firms.

What can be done to assure the growth of small firms that fall within industry size standards?

Congress can take action in a number of ways to support businesses that do qualify as small to assure maximum growth:

Take the caps off the contracting limits within the Women-Owned Small Business Set-Aside Program.

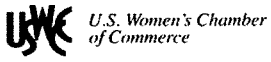
Increase the overall goals for contracting with American small businesses to a percentage that is more in alignment with our numbers.

Increase small business access to capital and compel banks to lend.

Continue to fight to eradicate bundling, big business sole source contracts and fraud.

Stop inappropriate in sourcing. This practice is destroying opportunities for thousands of American small businesses.

Remove the goaling exclusions that limit the "small business eligible" dollars and drive down our opportunities for growth.



Thank you for the opportunity to share our views. We strongly encourage Congress to not step outside of the well established small business size standards system. Instead we ask you to focus on assuring the businesses that are small secure access to larger contracts so that we might continue to grow and prosper.

Thank you.

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The following (goaling) exclusions apply to the Small Business Goaling Report driving down the dollars annually that are within the 23% statutory goal for prime contracting with small firms and limiting our growth:

- Javits-Wagner-O'Day Program (JWOD, Sheltered Workshop): Awards that have a contractor with a CCR based Sheltered Workshop designation Flag equal to "Y" are excluded.

- UNICOR: Exclude the UNICOR DUNS numbers specified in the APPENDIX A.

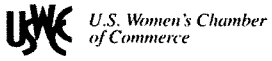
- American Institute in Taiwan: Awards with the American Institute in Taiwan designated as the contractor for the award and determined by a DUNS number of '161174503'.

- Contracts performed outside of the United States: Awards performed outside of the US are designated when the country in the place of performance is NOT the United States.

-Acquisitions by agencies on behalf of foreign governments or entities or international organizations: Awards with a "Foreign Funding" value of 'Foreign Funds FMS' and 'Foreign Funds non FMS' are excluded from the report.

- Contracts funded predominately with agency generated sources. Accordingly, the following Federal Government agencies are excluded:

- FDIC, 5100
- Postal Service, 1800
- Bureau Of Engraving And Printing, 2041
- United States Mint, 2044
- Office Of The Comptroller Of The Currency, 2046
- Office Of Thrift Supervision, 2047
- Transportation Security Administration, 6965; 7013, (data are included when the signed date is equal to or greater than July 1, 2008)
- Federal Aviation Administration, 6920
- Tennessee Valley Authority, 6400
- Administrative Office of the US Courts, 1027
- Architect of the Capitol, 0100
- Bankruptcy Courts, 1021
- Central Intelligence Agency, 5600
- Congressional Budget Office, 0800



- Court Services and Offender Supervision Agency, 9594
- Pretrial Services Agency, 959P
- Federal Judicial Center, 1028
- Overseas Private Investment Corporation, 7100
- Supreme Court of US, 1001
- US Courts of Appeals-Judicial Circuits, 1002
- US District and Territorial Courts, 1012

- Contracts awarded for the Defense Commissary Agency, (Awards with a Other Than Full and Open Competition value of "RES" for Resale).
- Product Service codes for Leases in the format X***.
- Product Service codes for Utilities S112 (Electric).
- Tricare DODAAC - H94002. (based on Contracting Office Code)
- Centers for Medicare & Medicaid Services (CMS) non-appropriated funded contracts - 00NAF (based on Contracting Office Code)

Rep. Bill Owens (NY-23)
Committee on Small Business
Questions for the Record
Michael D. Frisbey

1. Do you believe a preference category of "medium-sized" businesses should be created, or should existing "small business" categories be expanded? What are the benefits and drawbacks of either approach?

Rep. Bill Owens (NY-23)
Committee on Small Business
Questions for the Record
Michael D. Frisbey

1. **Do you believe a preference category of "medium-sized" businesses should be created, or should existing "small business" categories be expanded? What are the benefits and drawbacks of either approach?**

Response for Record:

Representative Owens, pursuant to the testimony before the Small Business Committee, Small Businesses produce:

1. 60-80% of all the new jobs in the USA
2. Employ half of all private sector employees
3. Are responsible for more than 50 percent of the country's private, non-farm gross domestic product.

Yet, Congress has only seen fit to set aside 23% of Federal Contracts for Small Businesses. Therefore I whole hearty endorse the Committee on Small Business's recommendation the Small Business Set Aside percentage be increased to 25%.

I fully understand both the size/budget differences and difficulties "medium sized" businesses face in competing against large businesses like BAE, Lockheed, Boeing, etc. and as such I would support the establishment of a new set aside category for "medium sized" businesses, as long as:

1. The new set aside category comes out of the Unrestricted portion of any future solicitations.
2. An enforcement mechanism is implemented that assures the Federal Government will at a minimum, meet the 23% Small Business Set Aside requirement on a regular basis.

With regard to your question. If we use the current SBA size standards, the competitive disadvantage a Small Business (under 500 people) has competing against a medium sized business (1,500 as proposed in your legislation) are as vast as the differences a medium sized business (say 1,500 people) has competing against a large business of say 5-10,000 people.

As such the Small Business Set Aside category must not be expanded to include what has been defined as "medium sized" business. To do so would totally destroy the Small Businesses community.

As stated at the hearing, "the 23% Small Business Set Aside goal established by Congress in 1997 has never been met." Why, because, in my opinion, there is no penalty for not meeting the goal. One enforcement mechanism could be to reduce the budget of any department who does not meet the 23% Small Business Set aside by 5% for each 1% it that department falls below the 23% requirement.

Therefore prior to the establishment of any new set aside category for "medium sized" businesses, the Committee on Small Business must:

1. Find a way to enforce the existing requirement that 23% of all Federal contracts be set aside for Small Business.
2. Ban the practice by Federal Agencies of "bundling" manufacturing and distribution activities into a single Statement of Work, thus precluding many Small Businesses manufacturers from bidding on contracts because they do not have the capability of meeting the website development, reporting and distribution requirements of these bundled solicitation. i.e.: The Department of Homeland Security bundles most of their uniform contracts.

Given, no enforcement mechanism presently exists to assure the Federal Government meets the current 23% Small Business Set Aside requirement, I feel any attempt at establishing a new set aside category for "medium size" businesses will simply pull the focus and resources away from Small Businesses, thus further reducing the percentage of contracts set aside for Small Businesses, as agencies scramble to find ways to direct contracts into the new hot button issue of "medium sized procurements."

Respectfully submitted

Michael D. Frisbey
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Wednesday, September 21, 2011

Dear Mr. Chairman and Ranking Member,

The Mid-Tier Advocacy is pleased to provide the following information as amplification of our testimony before the House Small Business Committee on September 14, 2011. We greatly appreciate the opportunity to voice our support for HR 1812: Small Business Growth Act.

As you continue your consideration of this very important legislation, we offer our understanding of the proposed legislation in rebuttal to some of the comments made during testimony that suggest that the proposed legislation will adversely impact opportunities for small business. As an organization of companies whose growth path was underpinned in large part by the safeguards provided small businesses in current statute, we fully recognize and support efforts to achieve current goals for small business participation in federal contracting. Our charge is to support the creation of an environment for mid-sized businesses that will ensure that today's small businesses have a path to continued success once they have exceed the size standards for their particular industry. We believe that passage of HR 1812 is critical to establishing that environment. To address what we believe are the specific areas where HR 1812 was misrepresented, please consider the following:

1. Infringement on the 23% set-aside for small businesses: The process outlined in HR 1812 ensures that safeguards for small businesses are protected. The decision to reserve an opportunity for mid-sized business to compete for an opportunity is taken only after a government official has determined that none of the small businesses who have expressed an interest is capable of satisfying the requirements or objectives outlined in the Statement of Work or Statement of Objectives. Of note, even in this case, the small business will be able to compete, just as small businesses are allowed to compete for unrestricted contracts today. Bottom line, the work this is targeted for mid-sized business will come from the 77% of the work that is theoretically allocated for large business and will not infringe on the 23% set-aside for small businesses.
2. Contribution to job growth: The current data addressing job growth among small businesses is collected based upon a general description that a small business is a business with less than 500 employees. Therefore, it is difficult to differentiate between small businesses and mid-sized businesses. However, we are able to extrapolate for recent Economic Census Data to gain some understanding of the relationship between company size, i.e., small or mid-size, and overall employment numbers. Census data from 2008 substantiates that businesses with less than 500 personnel employ 61% of the workforce. However, further analysis of the data indicates that 10% of those companies have annual revenue in excess of $7.3M which could potentially preclude them from competing in the small business category. The remaining 10% of businesses with less than 500 employees have annual revenues between $10M and $20M+ which are the group of companies MTA represents.

We believe that when taken in consideration, the information provided above will substantiate the importance of a pilot program similar to that proposed in HR 1812. Establishing a pilot program that could eventually be codified in a permanent program for mid-sized businesses will provide a path to success for current small businesses when they graduate from their small business status. Further, this will create an environment that supports the future viability of current and future mid-sized businesses.

Sincerely,

/s/

Tonya Speed
Executive Director