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**DOD's ACQUISITION REVOLUTION: IMPACT ON
MINORITY BUSINESS CONTRACTING**

BY

**COLONEL MARCIA R. MORGAN
United States Army**

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DOD's Acquisition Revolution: Impact on Minority Business Contracting

*by Colonel Marcia Morgan,
Senior Military Fellow*

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ABSTRACT

AUTHOR: Marcia R. Morgan, COL, USA

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Three recent events have prompted the Department of Defense to significantly revise its acquisition procedures in a process now being called the Acquisition Revolution. These changes have caused great concern in the small and disadvantaged business community because of their potential for significant negative impact on that particular group of businesses. The initial review shows there has been some impact in preferential and set-aside categories, but overall DoD had a slight increase in contracts awarded to small disadvantaged businesses.

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THE ADVERSE EFFECTS OF THE ACQUISITION REVOLUTION ON SMALL BUSINESS CONTRACTING

INTRODUCTION

Over the past twenty years, the Department of Defense (DOD) has been a significant source of commerce and revenue for small and disadvantaged businesses through various programs that set aside a certain percentage of defense contracts specifically for them. However, three recent events have prompted DOD to change its contracting procedures in ways that may alter its role as a source of contracts for these businesses: (1) disintegration of the Soviet Union, the single major military threat to our national security; (2) the National Performance Review (NPR), also known as "Reinventing Government"; and (3) Supreme Court decisions curtailing the use of race as a factor in awarding contracts. The massive changes resulting from these developments are now known collectively in DOD as the "Acquisition Revolution."

These events raise questions about the extent of continued DOD procurement from small and disadvantaged businesses. Declining defense budgets and new legal questions about set-aside programs make it more difficult to justify such programs. Naturally, the small and disadvantaged business community is concerned that these changes will reduce revenues substantially for companies that are already struggling. For DOD, on the other hand, small businesses have been especially valued as suppliers because they have been a source of innovation in modern military and other technology.

The findings in this paper are extracted from data maintained by DOD's Office of Small and Disadvantaged Business Utilization, reports from the Washington Headquarters Services Directorate for Information Operations and Reports, and from the Federal Procurement Data System. The data provide the basis for a longitudinal assessment of programs from 1985 through 1996. The preliminary findings show little impact in FY 96, but highlight concerns for the years ahead.

THE CASE FOR SMALL BUSINESS

Small businesses accounted for 23 percent of the FY 96 prime contracts awarded. Unlike large businesses, these firms are much more likely to depend heavily on government contracts for survival. This is particularly true for the disadvantaged businesses, which accounted for 6.3 percent of the prime contracts. As

a significant part of the industrial base that this country depends upon for its continued security and technological innovation, the fate of these businesses cannot be ignored.

The government is morally and legally obliged to insure that all sources have a fair opportunity to compete for contracting dollars in a nondiscriminatory manner. Therefore, this analysis must incorporate a discussion of the necessity or appropriateness of including race- and gender-based programs as part of the defense procurement philosophy.

After a review of key legislation relating to small and disadvantaged business procurement, this paper looks at recent acquisition reforms to determine how much impact they are likely to have, outlines defense department efforts to maintain supportive programs, and suggests ways that small and disadvantaged businesses can remain strong partners in national security.

While a review of FY 96 data shows slight increases over FY 95 in the percentage of small business awards (23.2 percent of total awards) and small disadvantaged business awards (6.3 percent of total awards), set-asides for small disadvantaged businesses dropped more than \$300M in total dollars. This was offset by a comparable increase in 8(a) awards (\$308M) and by a slight increase in direct awards (\$72M). The two categories of small disadvantaged business awards that reflect the immediate impact of the Supreme Court decisions on race-based programs are the 10 percent preferential awards and the set-asides. In FY 96, these two categories made up 15 percent of the small disadvantaged total. In FY 95, their share was 20 percent. Clearly, recent changes have slowed the growth of small disadvantaged businesses as partners in the defense industry and, without vigorous government intervention, this growth will continue to decline.

The Rise of Small Businesses in Government Contracting

Throughout its history, Congress has used government contracting as a component of its special socioeconomic programs. Some legislation affected government as a whole while others were directed specifically at defense agencies.

Following the stock market crash of 1929, the federal government began to look for solutions that fostered growth while avoiding excessive risk, thereby providing some security for various sectors of the economy. The result was the creation of laws and agencies that offered financial support and protection for both large and small businesses.

The entry of the United States into World War II gave rise to the creation of the Smaller War Plants Corporation (SWPC), established to mobilize small business for war and essential civilian production. A series of laws passed between 1947 and 1950 stipulated that small business must receive a fair share of government contracts. The Defense Production Act of 1950 specifically provided for participation by small enterprises in programs that were vital for the security and defense of the country.

On July 20, 1953, Congress created the Small Business Administration (SBA) as the single agency to assist, protect, and promote the interests of small businesses. As this agency continued to evolve, it began to take a closer look at minority business concerns, leading to the authorization of special programs for minority business during the Vietnam War era.

The Small Business Act of 1978 established the intent of Congress to support small business as a vital and integral part of the U.S. economy. It expanded the mission of the SBA to assist in business development through revised loan policies as well as through encouraging competition for government contracts. This act stipulated that small business should receive a "fair proportion" of federal contract dollars and that small businesses, including small disadvantaged businesses, should have the "maximum practical opportunity" to contract with federal agencies. It also redefined minority businesses as small disadvantaged businesses, took giant steps to advance the Section 8(a) program, and considerably strengthened defense subcontracting programs with major prime contractors.

In 1978, Congress amended the Small Business Act to further define the Government's preference procurement programs. This amendment established a special category of small-business-small-purchase set-asides, known as the "rule of two," as well as the subcontracting program for small and disadvantaged businesses. Under the rule of two, contracts could be set aside for small businesses if there were reason to believe that there were at least two small businesses that could compete for the contract at a fair market price. Specific government-wide participation goals of 20 percent for small business and 5 percent for small disadvantaged businesses were included in the Business Opportunity Development Reform of 1988 (Public Law No. 100-656.)

Small Disadvantaged Businesses

In addition to these government-wide laws, Congress passed legislation directed specifically at DOD to assist small and small disadvantaged businesses. The Defense Authorization Act for FY 1987 (Public Law 99-661) established a 5 percent

goal for award of procurement funds to small disadvantaged businesses, to historically black colleges and universities, or to minority institutes. These particular enterprises are described as "Section 1207" entities because of the segment of law involved. The intent of this provision was to increase the number of these entities in the defense industrial base. The significance of their inclusion will be discussed later as a readiness issue.

The Defense Authorization Act mandated certain benefits for small businesses. This act authorized awarding contracts to small disadvantaged businesses using less than full and open competition, provided that the award did not exceed the fair market price by more than 10 percent. Based on this authority, DOD developed a 10 percent price evaluation preference. Under the preference, if a small disadvantaged business's bid was within 10 percent of the lowest bid, the award would go to the small disadvantaged business. The same law, for the first time, authorized set-asides for small disadvantaged businesses.

The remarkable growth of minority business awards in subsequent years "set the stage for the recognition of the Department of Defense as the singularly most powerful instrument in the federal government on behalf of minority business."¹

In its 1993 report to Congress, the Acquisition Law Advisory Panel identified 114 socioeconomic statutes applicable to DOD. The panel's review of those statutes showed, "the defense acquisition system reflects a balance between the requirements of efficiency or streamlining and the dictates of larger national goals. In short, the requirements of the common defense have always been balanced by the necessity to promote the general welfare."² They further commented that, "Each defense dollar is expected to perform double duty: not only satisfying the primary purpose for which it was authorized but contributing as well to the objectives of full, fair, and equal employment opportunity, proper utilization of the defense industrial base, promotion of minority business, and protection of the environment."³

In 1994, Congress incorporated the panel's recommendations into the Federal Acquisition Streamlining Act (FASA), which extended to federal agencies in general the authority to conduct various race-conscious procurement activities. This authority had been singularly granted to the Defense Department prior to the passage of this act. It was this particular authority that was addressed by the Supreme Court the following year in *Adarand Constructors, Inc. v. Peña*. However, Congress has continued to recognize that "fostering contracting opportunities for minority-owned businesses at the Defense Department is crucial, because that agency alone typically

accounts for more than two-thirds of the federal government's procurement activities."⁴

WHAT CAUSED THE REVOLUTION

Declining Budget

Sizable budget cuts created a need for an improved acquisition system capable of doing more with less. The collapse of the Soviet Union in 1991 and the emergence of the Commonwealth of Independent States had profound implications for the American military. Now that the threat to national security had taken on a much different look, the defense establishment was also expected to take on a new, smaller look. Dollars once spent on the development of bigger and better weapons and for maintaining a large combatant force could now be spent on other national priorities.

Reinventing Government

During this same period, early in President Clinton's first term, Vice President Gore took on the assignment of reinventing government, otherwise known as the National Performance Review (NPR). One of the NPR goals was to increase the efficiency of the federal government through streamlining operations and adopting the best recognized business practices wherever possible.

When the current administration began its governmental reform, many agencies were struggling under the paperwork burdens caused by excessive bureaucracy. The directive from the White House to streamline procedures and become more customer-oriented had many far-reaching repercussions.

The Federal Acquisition Streamlining Act (FASA) of 1994 set the stage in the area of acquisition reform, with some key changes having great potential impact in the small disadvantaged business arena:

Creation of a New Micropurchase Threshold of \$2500. This category is no longer subject to the Buy American Act or to the small business set-aside restrictions that once existed. Additionally, below this threshold the International Merchant's Purchase Authorization Card (IMPAC) is the preferred method of procurement. Use of the IMPAC card reduced the paperwork required on a large number of low-dollar purchases and speeded up the payment process. Unfortunately for small business, this

opened to other commercial competition a category that had been almost exclusively for small businesses. Now, authorized government employees can use these micropurchase credit cards to procure low-dollar items quickly from whatever source they choose. Since under these new rules these purchases are no longer tracked, the true impact on small and disadvantaged businesses cannot be accurately measured. The speculation is that purchasers will take advantage of the prices offered by larger businesses such as major hardware chains or office supply stores rather than use smaller businesses as the government once did. The potential loss to small and disadvantaged businesses is reflected in the volume of purchases under this system: for FY 96 DOD used the credit card for \$1.4B while the federal government as a whole purchased \$2.9B in goods and services using this method.

Creation of a Simplified Acquisition Threshold (SAT). A threshold of \$100,000 was set for the use of simplified acquisition procedures. Normally, all requirements between the \$2,500 micropurchase threshold and the \$100,000 SAT are set-aside for small business. The exception to this is if the "rule of two" is not satisfied. The obvious advantage to small businesses is that the increased threshold broadens the range of contracts for which they can compete. In FY 96, 136,477 awards for \$6.3B fell into the \$25,000 to \$100,000 category. Moreover, the simplified process lowers overhead costs of doing business with the government by reducing the need for legal representation or contract specialists. This financial burden was more likely to be felt in smaller organizations than in the larger ones.

Creation of the Federal Acquisition Computer Network (FACNET). This is an Electronic Commerce/Electronic Data Interchange network (EC/EDI), to facilitate processing of solicitations, proposals, awards, and payments between the government and contractors. This is the preferred means of processing transactions that fall between the \$2,500 micropurchase threshold and the \$100,000 SAT. In essence, this mandates that in order to be competitive in conducting business with the government, small and disadvantaged businesses must possess some basic automation capabilities or contract for those abilities through a Value-Added Service (VAS). In either situation, a contractor would have to obtain the services of a Value-Added Network (VAN) for communication services for FACNET.

Establishment of a preference for acquisition of commercial items. Instead of automatically using the more complicated military specifications (MILSPECs), this allows the government to buy off-the-shelf commercial items. The transition gives larger name brands a competitive edge in providing products. They are better able to mass produce in quantities that allow them to sell at lower prices, plus they have the advantage of brand-name recognition by the consumer. When MILSPECs

were used, the specifications in many instances were narrow enough to require any manufacturer, large or small, to produce the item in smaller quantities that allowed the smaller entity to compete on a fairly even basis. Moreover, when the government uses commercial products, it loses its ability to require that company to subcontract with a certain percentage of small disadvantaged businesses. In the past, some commercial contractors refused to do business with the government because of the added cost of complying with unique government terms and conditions.⁵

The magnitude of readily available commercial items is reflected in the General Services Administration prediction that it will have more than 6,000 vendors on its 130 multiple award schedules on the GSA Advantage! World Wide Web home page by October of 1997.⁶ This catalogue service permits agencies to order from the GSA list without publicizing purchasing plans or disclosing their decisions. While minority set-asides once were the convenient way of purchasing an item quickly, the GSA schedules have changed that.

Increased emphasis on the use of past performance in the evaluation process. Each year, a large proportion of small and disadvantaged businesses start up. How do these emerging businesses establish past performance data? Under the new rules, they will have to find ways to carve out their own niche and establish their reputation. Participants in the 8(a) program are able to build their performance record while under the protective umbrella of the SBA; other fledgling companies do not have that luxury.

Thus, both DOD and the federal government through the NPR were concerned with streamlining the procurement process, simplifying it, and making it more "user friendly." All of these revisions, while ostensibly more beneficial to the government's efforts at improving procurement systems, are nonetheless disadvantageous to the smaller business community. The Department of Defense has had to look for new ways to operate efficiently and effectively while continuing to manifest its concern for small and disadvantaged business.

Supreme Court Rulings

While Congress continues to affirm the importance of minority business enterprises by encouraging their development, the Supreme Court has sent a less supportive message. In *Crosby v. the City of Richmond (1989)*, the Supreme Court found that Richmond had violated the Equal Protection Clause of the Fourteenth Amendment by setting aside 30 percent of public contracts for minority contractors. The Court subjected Richmond's actions to strict constitutional review and held that

Richmond had not shown a compelling reason to justify the use of racial classifications. While the *Croson* decision did not affect federal programs, it had a decidedly negative effect on state and local set-aside programs.

In a later decision, *Adarand Constructor, Inc v. Peña* (1995), the Supreme Court extended its ruling on strict scrutiny to include federal affirmative action programs that use race or ethnic criteria as a basis for decision-making. As the White House Conference on Small Business Commission stated, "In rendering a decision in *Adarand v. Peña*, the U.S. Supreme Court has potentially dealt the minority- and women-owned business communities a severe, and in some cases potentially fatal blow."⁷

As a result of this decision, DOD, in consultation with the Department of Justice, suspended the Small Disadvantaged Business set-aside program. However, DOD continues to use the 8(a), small disadvantaged business evaluation preference and small disadvantaged business subcontracting program in accordance with the Defense Federal Acquisition Regulation Supplement (DFARS). As opposed to set-asides, the preference programs allow DOD to grant contracts to the previously named categories if their bids are within 10 percent of the winning offer. "DOD will continue to emphasize the importance of the small disadvantaged business program to our buying commands and to our prime contractors. DOD believes that the small disadvantaged business program has paid dividends in that we have expanded our industrial base to include many new and innovative suppliers of goods and services."⁸

In April 1996, DOD announced amendments to DFARS that were designed to facilitate awards to small disadvantaged businesses while taking into account the Supreme Court decision. These changes included expanding the use of evaluation factors for small disadvantaged businesses; considering subcontracting to small-, small disadvantaged-, and women-owned small business as a factor in the evaluation of past performance; and relying more on the use of enforceable commitments to use minority businesses as well as tracking any substitutions of firms that do not fall into this category.⁹

WHAT THE DATA SHOW

As stated earlier, the end of the Cold War has led to a decreased emphasis on the procurement and development of major combat systems. Since those are the high-dollar items, their reduced numbers account for the phenomena of fairly constant small business dollars in contrast to the overall declining budget dollars. DOD

maintains detailed records on the contract dollars it spends. The information in the following tables and charts is taken from those records.

An overview of the basic categories tabulated since 1985 shows how the percentage going to the Small Business Program has increased over time compared to total DOD awards (Table 1). The data show that DOD has consistently improved both dollar and percentage awards to small disadvantaged business concerns since FY 85. Chart 1 graphs the same information, showing total awards to small business staying fairly constant over the years, while awards to small disadvantaged businesses and women-owned small businesses gradually increase.

Table 1. DOD Small Business Program Awards Compared to Total DOD Awards (Dollars in Millions)									
Fiscal Year	DOD Total Awards	LB Awards	LB % of Total	SDB Prime	SDB % of Total	SB Awards	SB % of Total	WOSB Awards	WOSB % of Total
1996	\$109,489	\$84,102	76.8	\$6,918	6.3	\$25,387	23.2	\$1,986	1.8
1995	110,033	84,758	77.0	6,862	6.2	25,274	23.0	1,994	1.8
1994	112,013	87,208	77.9	6,114	5.5	24,805	22.1	1,857	1.7
1993	116,007	91,135	78.6	6,183	5.3	24,872	21.4	1,683	1.5
1992	117,151	93,162	79.5	5,195	4.4	23,989	20.5	1,609	1.4
1991	125,878	99,942	79.4	4,423	3.5	25,936	20.6	1,513	1.2
1990	123,821	99,865	80.7	4,149	3.4	23,956	19.3	1,329	1.1
1989	120,003	97,231	81.0	3,998	3.3	22,772	19.0	1,292	1.1
1988	130,815	105,586	80.7	3,631	2.8	25,229	19.3	1,185	0.9
1987	135,340	108,716	80.3	3,317	2.5	26,624	19.7	1,115	0.8
1986	136,497	109,583	80.3	3,122	2.3	26,914	19.7	1,100	0.8
1985	139,587	113,538	81.3	2,899	2.1	26,049	18.7	898	0.6

Source: DOD

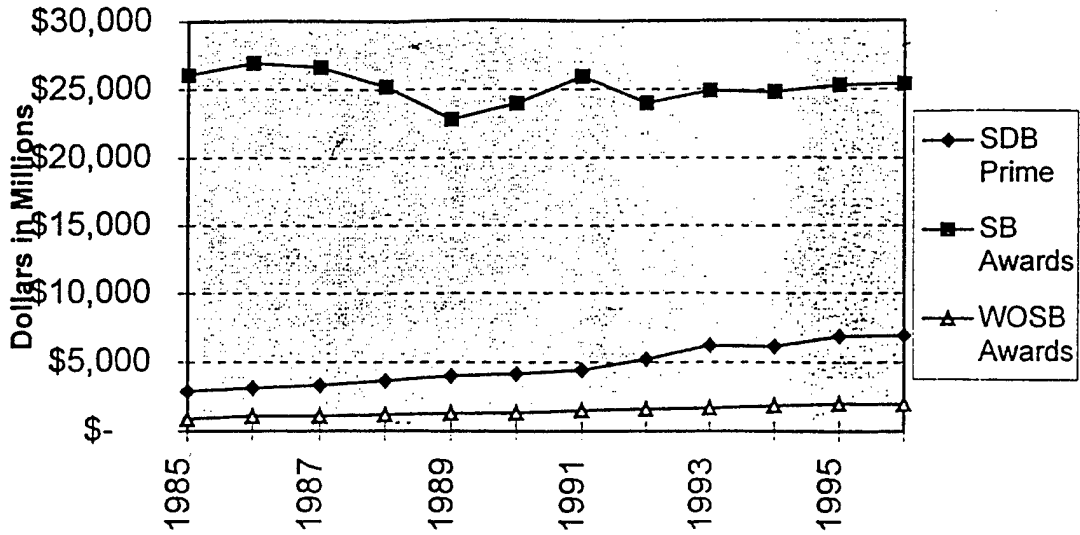
LB — Large Businesses

SB — Small Businesses

SDB — Small Disadvantaged Businesses

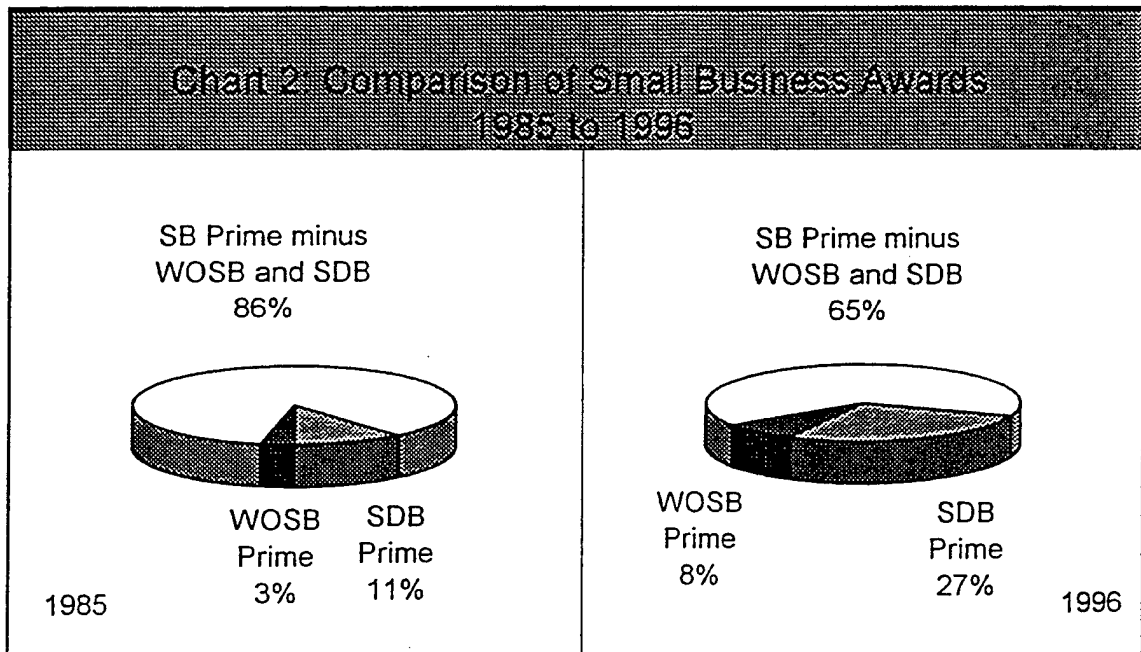
WOSB — Women-Owned Small Businesses

Chart 1. Small Business Awards



Source: DOD

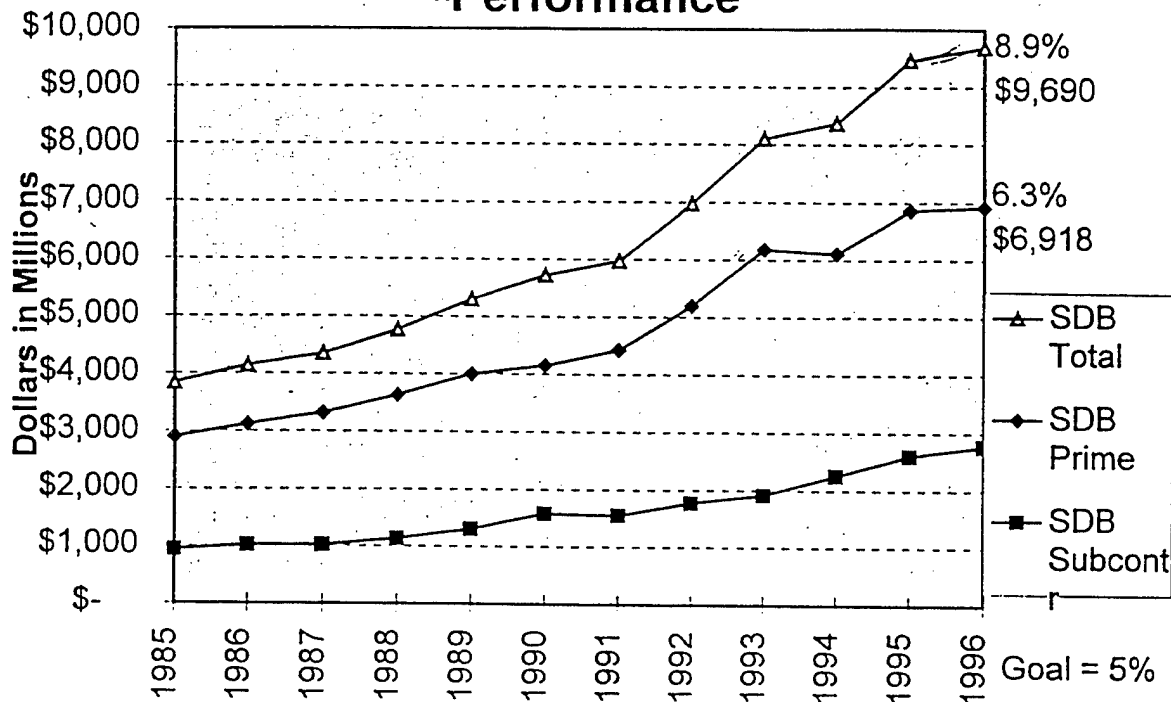
Looking at it another way, a comparison of the awards to small disadvantaged businesses and women-owned businesses to the small business segment of the budget shows that their growth is at the expense of small business as a whole (Chart 2).



Source: DOD

However, prime contract dollars reflect only a portion of the picture. DOD also encourages large business prime contractors to enhance the small disadvantaged business programs through subcontracting goals. In FY 96, 2,240 contractors subcontracted \$47.6B, with nearly 41.8 percent going to small businesses. When the figures for small disadvantaged businesses are added in, their total for FY 96 goes up \$2.8B for an additional 2.7 percent share of the total budget (Chart 3). This represents a sizable increase in business opportunities as large businesses are encouraged to form alliances with smaller entities.

Chart 3. Prime & Subcontract Combined Performance



Source: DOD

Thus, an analysis of total procurement dollars reveals that DOD is easily surpassing its legislated 5 percent goal for small disadvantaged businesses. Table 2 breaks out the data by specific program. Using this information, the impact of recent changes can be studied more closely. The two areas that we would expect to reflect the Supreme Court decision are in the small disadvantaged business set-asides and the 10 percent preference awards. Theoretically, the set-aside column should be approaching zero. Since this is the first year following *Adarand v. Peña*, one can

infer several explanations for the \$874M SDB Set-Asides that remain. Some contracts were already in place as multi-year awards when the decision to discontinue the SDB set-asides was made. There were also some contracts made at the very beginning of the year that could not be rescinded. In either case, this is a dwindling source of dollars for the small disadvantaged business community. Since 8(a) awards are granted to businesses that, by definition, are socially or economically disadvantaged, they were not subject to the Supreme Court ruling.

Table 2. Small Disadvantaged Business Awards						
Fiscal Year	Total Prime	SDB Prime	8(a) Awards	Direct Awards	10% Pref Awards	SDB Set-Asides
1996	\$ 109,489	\$6,918	\$3,615	\$2,231	\$198	\$ 874
1995	110,033	6,862	3,307	2,159	215	1,181
1994	112,013	6,114	2,754	1,915	356	1,089
1993	116,007	6,183	2,773	1,893	515	1,002
1992	117,151	5,195	2,566	1,569	264	796
1991	125,878	4,423	2,135	1,455	181	652
1990	123,821	4,149	2,081	1,357	304	408
1989	120,003	3,998	1,987	1,137	576	298
1988	130,815	3,631	2,163	1,189	134	145
1987	135,340	3,317	2,169	1,148		

Is there a need for concern since the totals are still well above the established goals? Yes, because the percentage of growth is now decreasing after a build-up of ten years. And even though these minimal goals are being met, are they high enough to ensure that minority businesses receive a fair proportion of DOD contract dollars? The Department of Justice reported that its evidence "indicates that racially discriminatory barriers hamper the ability of minority-owned businesses to compete with other firms on an equal footing in our nation's contracting markets. In short, there is today a compelling interest to take remedial action in the federal government."¹⁰

Not only does discrimination still exist, there is strong evidence that without the continued coercive influence of government programs, minority businesses will continue to fall behind. In a recent study by the Urban Institute,¹¹ researchers found

that minority-owned businesses receive on average only 59 cents for every dollar of state and local expenditures that those firms would be expected to receive, based on their availability and capacity in that particular community. The analysis also showed that minority firms were underutilized by state and local governments in all of the industry groups examined, with the largest disparity between availability and utilization occurring in the category of "other services." In this category, minority firms received 51 cents for every dollar they were expected to receive. The smallest disparity was in the category of construction subcontracting, where minority firms still receive only 87 cents for every dollar they would be expected to receive.¹² As the Justice Department pointed out, "The very same discriminatory barriers that block contracting opportunities for minority-owned businesses at the state and local levels also operate at the federal level."¹³

Solutions: The Uses of Benchmarks .

In its proposed methodology for addressing potential discrimination in a manner that would meet the Supreme Court's requirement for strict scrutiny, the Justice Department discussed establishing a system of benchmarks within each industry. In essence, the percentage of available small and disadvantaged minority businesses in a specific industry would be used as a benchmark to determine if goals or preferential programs were appropriate for that industry. As the percentage of awards converges with the percentage of available companies, special programs would be reviewed. Although this appears to do a good job of targeting problem areas, it would require constant auditing and revision at a time when federal staffs are being forced to cut back.

DOD STRATEGY FOR PROMOTING SMALL AND DISADVANTAGED BUSINESSES

In both published official policy and demonstrated practice, the federal government, primarily through the Defense Department, has shown its concern for the continuing development of small and disadvantaged business as an integral part of national security. As stated in the Federal Acquisition Regulation (FAR), "Maximum practicable utilization of small and small disadvantaged businesses concerns as subcontractors in Government contracts is a matter of national interest with both social and economic benefits."¹⁴ Repeatedly, small and minority enterprises have demonstrated their ability to respond quickly to military needs, particularly during Desert Shield/Desert Storm. This is not an issue of welfare programs for the

needy, but one of maintaining a healthy industrial base capable of responding to the country's needs.

Small Businesses' Contribution to Readiness and Sustainability

In his remarks at the 1996 DOD Health Care THRUST Conference in November, Robert L. Neal, Director DOD SADBU, talked about readiness and sustainability as the two driving concepts behind DOD's unequivocal support of small business.¹⁵ Both are fundamental to the long-range viability of the Department of Defense itself. Small businesses supply millions of different items to help ensure U.S. armed forces are properly sustained and that their equipment is at a high state of readiness to assure fulfillment of national security. As large firms move to more lucrative markets in the civilian sector, there is a growing need to cultivate small business as part of a national security strategy.

For example, when a production line for a major piece of equipment shuts down at the end of its contract, that piece of equipment will remain in the inventory for an extended period of time. Since it is no longer lucrative to continue production of parts for the end item, the large business responsible for the original manufacture of the item will move on to other products for other markets. Yet there will be an ongoing need for repair parts to maintain that equipment. In the past, the small business has stepped in and assumed the production of parts. This is only one example of how a small company becomes an integral part of a healthy industrial base.

Equity and Fairness As a Requirement

DOD has energetically pursued alternative ways to assure equity and fairness in its contracting programs, and to continue its support of small and disadvantaged business. It has conducted a series of conferences around the country under the THRUST program to educate small business entrepreneurs and keep them abreast of procurement changes and federal technical assistance programs available to them. These technical assistance programs include: (1) the Manufacturing Technology Program, which provides maximum dissemination of information on the latest technology for efficient and economical production of defense materials; (2) the Procurement Technical Assistance Centers, which are located across the country and provide advice and assistance regarding market opportunities and technical assistance; and (3) the Mentor-Protégé Program, which provides incentives for prime contractors to work with small disadvantaged businesses.

OTHER OBSTACLES TO MINORITY BUSINESS CONTRACTING

There are many facets to the problem of fair and equitable acquisition practices on the part of the federal government, or any entity. When a change occurs in a procurement process, very little attention is given to the adverse effects on small business contracting. Two areas that are of particular concern are contract bundling and access to capital.

Contract Bundling

One of the procurement practices that is increasing in popularity with contracting officers is the procedure known as contract bundling, which in general terms is the consolidation of two or more procurement actions into a single contract. The end result is a much larger contract that can easily grow out of the realm of consideration for small and disadvantaged businesses. If a contracting officer determines that bundling is in the best interest of the government, he or she prepares a statement explaining why it would be inappropriate to offer the smaller segments to small businesses and submits the document to the Small Business Administration. The Small Business Administration representative has the authority to review the acquisition and recommend alternative procurement methods that would increase small business contracting opportunities but cannot dictate who gets the award.

The dilemma is that "bundling could have a negative effect on small businesses that want to compete for government contracts and a positive effect on government procurement activities by reducing their workload."¹⁶ In other words, one of the acquisition practices that enhances the streamlining process exacerbates the exclusion of smaller businesses. Congress expressed its concern over this issue in 1990 by amending the Small Business Act to require the SBA to review proposed bundled acquisitions that included products or services currently provided by small business.

During an October 1995 hearing before the House Committee on Small Business, the Chairman recognized the significance of bundling:

When inappropriately applied, contract bundling can have devastating effects on small business and can ultimately reverse the benefits to the Government by eliminating competition....The Government's goal of cost efficiency is a laudable one, yet it cannot be accomplished solely at the expense of those small businesses that contribute so greatly to America's economic growth and to the employment of our citizens.¹⁷

In his statement during this same hearing, Jere Glover, Chief Counsel for Advocacy for the Small Business Administration, pointed out that, "By design, bundling reduces competition—and reduced competition leads to monopolies—and monopoly power, results in higher prices, fewer innovations and a stifled entrepreneurial environment over the long-term."¹⁸

In January of this year, Rep. Wynn (D-Md.) presented the Small Business Opportunity Preservation Act of 1997, which would amend the Small Business Act to strengthen existing protections for small business participation in federal contracting opportunities, and provide for assessments of the impact on small business of the steadily increasing use of contract bundling.

Access to Capital

As mentioned earlier, organizations that want to do business with the federal government must invest in the appropriate technology, whether it is to support the use of the IMPAC card or to participate in the electronic commerce system. There is an inherent expense tied to either of these business practices that escalates the problem minority businesses experience in terms of access to capital. In many cases, they just don't have access they need. "Inadequate access to capital continues to be one of the most significant barriers to minority business growth and stability."¹⁹ Numerous studies by Timothy Bates and others provide wide documentation for this position.²⁰ The small business owner typically has to rely more on the most basic sources for capital: immediate family and friends, credit cards, etc.²¹ By definition, they have fewer assets, and as the axiom goes, banks are primarily interested in loaning money to people who don't need it.

"The federal government should ensure that public policies (e.g., through the Treasury, bank regulatory agencies, Small Business Administration, and Small Business Investment Corporations, or SBICs) will ensure that more private capital be steered to minority businesses. Fair and equitable access to capital will allow rapid development of minority businesses and reduce the need for direct government intervention."²² Congressman William Jefferson also argues that access to credit is essential, but goes further to point out that the capital has to be extended on an enduring basis.²³ In other words, the loan has to be for a long enough period to make a difference. If an emerging small business has to use all of its capital in its formative years to repay the loan, it has nothing to invest in its own growth.

CONCLUSIONS

In summary, the acquisition revolution is changing the way government contracting is done, and in the process is adversely affecting small business contracting. Micropurchases and increased use of commercial items take dollars away, while the increased SAT adds a broader range within which to compete. The transition to electronic commerce, the wave of the future in all realms of business, is requiring an investment in technology and new skills. Many larger corporations already expect their trading partners to be able to perform transactions through this medium, so an additional business expense must be absorbed by small business. For ten years, small and disadvantaged businesses have increased their annual revenues through special programs. Now these programs are being challenged and changed to avoid further court challenges and legislation. The effect of these regulatory changes is showing up in the percentage of contracts going to small business.

Unfortunately, while there is some broadening of opportunities in the increased threshold, the new microcard system allows the government to give business to whomever they want for low dollar purchases. The removal of socioeconomic restrictions opens the door for cronyism and other old abuses to creep back into the federal contracting process. And, in larger contracts, as pointed out by a recent article by Peter Behr of *The Washington Post*, the advantage in FY 96 went to "large, well-connected firms" in Northern Virginia over smaller Maryland rivals, particularly in the area of information technology, which accounted for over \$1.8B of the Defense FY 96 budget. This also translated into less money for "smaller, minority-owned contractors."²⁴

As budget dollars continue to dwindle, the Department of Defense will continue to look for functions that can be outsourced to the civilian community. Small and disadvantaged businesses are in a strong position to pick up those functions, particularly those that fall into the service market. The additional advantage to this industry is that the service sector is more enduring than the product lines that are subject to the fluctuating demands for military hardware. In particular, small and disadvantaged businesses need to focus on selling their abilities to operate personnel and financial systems and provide infrastructure support to military bases.

In terms of national strategy, defense involvement in small business and socioeconomic programs needs to go beyond the narrow vision of cost per item. Not only does DOD need a wide range of capabilities in its industrial base to be able to respond to any challenge, as part of the greater society it also should be leading the way in ensuring equitable treatment among large and small businesses. The

government, through DOD, must continue other programs for small businesses such as set-asides as long as there is any evidence that the need exists. The society that fails in its fairness to all of its communities limits its ability to continue to grow and respond to external threats of any form.

NOTES

- ¹ Robert L. Neal, Jr., Director Small and Disadvantaged Business Utilization, Office of the Secretary of Defense, "Small Business in the Post Cold War Environment and the Twin Priorities of Readiness and Sustainability," Remarks at the Department of Defense Health Care THRUST Conference, San Antonio, Texas, 20 November 1996.
- ² Department of Defense, "Streamlining Defense Acquisition Laws," report to Congress prepared by Acquisition Law Advisory Panel, Washington, January 1993, 4-1.
- ³ Ibid.
- ⁴ Department of Justice, "The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey," <<http://www.usdoj.gov/jmd/pss/compl16.htm>>, 23 December 1996, 3.
- ⁵ Secretary of Defense William Perry, "The Problem -- Why Change is Necessary," plan provided to House Armed Services Committee and Governmental Affairs Committee, February 1994, <<http://www.acq.osd.mil/ar/doa/mand24.pdp>>, 1 April 1997, 1.
- ⁶ Anne Laurent, "Acquisition Reforms at A Glance," *Government Executive*, April 1997, <<http://www.govexec.com/features/0497s2s2.htm>>, 21 April 1997, 1.
- ⁷ The White House Conference on Small Business Commission, *Foundation for a New Century: A Report to the President and Congress*. Washington, September 1995, 36.
- ⁸ Department of Defense, "Report in Response to 10 U.S.C. §2323(I), Fiscal Year 1995," prepared by the Office of the Under Secretary of Defense (Acquisition and Technology) and the Office of Small and Disadvantaged Business Utilization, Washington, 6 August 1996, 7.
- ⁹ Director, Defense Procurement Eleanor Spector, "Small Disadvantaged Business Concerns," memorandum for Directors of Defense Agencies; Deputy for

Acquisition and Business Management, ASN (RD&A)/ABM; Deputy Assistant Secretary of the Air Force (Contracting), SAF/ACQ; Director, Procurement Policy, ASA(RD&A)/SARD-PP; Deputy Director (Acquisition, Defense Logistics Agency, Washington, 29 April 1996, 1-2.

¹⁰ Department of Justice, "Compelling Interest," 1.

¹¹ Maria E. Enchautegui, Michael Fix, Pamela Loprest, Sarah von der Lippe, and Douglas Wissoker, *Do Minority-Owned Businesses Get a Fair Share of Government Contracts?* Washington: The Urban Institute, October 1996.

¹² Ibid, 1.

¹³ Justice Department, "Compelling Interest," 12.

¹⁴ Federal Acquisition Regulation, *Part 19*, "Small Business and Small Disadvantaged Business Concerns," through FAC 90-45, .19.705-7.

¹⁵ Neal, "Small Business in the Post Cold War Environment."

¹⁶ General Accounting Office, "DOD Contracting: Extent and Impact of Contract Bundling Is Unknown," Washington, April 1994, 2.

¹⁷ Congress, House, Committee on Small Business, *Federal Contract Bundling: How Can Small Business Compete?* 104th Cong., 1st sess., 11 October 1995, 2.

¹⁸ Ibid, 122.

¹⁹ Weldon H. Latham, "Higher Ground," *Minority Business Entrepreneur*, November/December 1996, 16.

²⁰ Timothy Bates, *Major Studies of Minority Business: A Bibliographic Review*, Joint Center for Political and Economic Studies, Inc., 1993, 55-68.

²¹ White House Conference on Small Business Commission, 24.

²² Weldon H. Latham, 16.

^{23.} Congressman William Jefferson, remarks at Forum, Joint Center For Political and Economic Affairs, April 1997.

^{24.} Peter Behr, "The Debate Over Procurement Policy," 3 March 1997, <<http://www.washingtonpost.com/wp-srv/business/daily/mar/03/contract.htm>>, 21 April 1997.

GLOSSARY

Small Business. Independently owned and operated, not dominant in its field, and organized for profit; its principal place of business is located in the United States; is at least 51% owned, or in the case of a publicly owned business, at least 51% of its voting stock is owned by U.S. citizens or lawfully admitted permanent resident aliens. Usually considered to have no more than 500 employees.

Small Disadvantaged Business (SDB). A small business concern, including mass media, at least 51% owned and controlled by socially and economically disadvantaged individuals as defined by Section 8(a) of the Small Business Act.

Women-Owned Small Business (WOSB). A small business that is at least 51% owned by a woman or women who are U.S. citizens and who also control and operate the business.

Socioeconomic Programs. Federal programs designed to assist groups who are socially or economically disadvantaged.

Socially Disadvantaged Individuals. Individuals who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their qualities as individuals.

Economically Disadvantaged Individuals. Socially disadvantaged individuals whose ability to compete in the free enterprise system is impaired due to diminished opportunities to obtain capital and credit as compared to others in the same line of business who are not socially disadvantaged.

Preferential Programs. Federal programs to provide assistance to small, small disadvantaged, or women-owned businesses. These programs include outreach activities to advise businesses on contract opportunities, to assist in understanding the rules and procedures of the procurement offices, and to find ways to increase the number of contracts awarded to these businesses.

The 8(a) Program. Section 8(a) of the Small Business Act empowers the Small Business Administration to enter into prime contracts with other Federal agencies for goods and services. SBA then subcontracts the actual performance of the work to socially and economically disadvantaged small businesses that have been certified by SBA as eligible and competent to receive these contracts.

SDB Evaluation Preference. Under this evaluation preference, the contracting officer may add up to 10 % to the price of all non-SDB company offers when award is to be based on price or price-related factors.

8(a) Awards. Contracts set-aside for 8(a) companies.

Set-Asides. Awards that are set-aside for competition within a particular group.

Direct Awards. Contracts awarded in direct competition.