Testimony

***Small Business Participation***

***in the***

***Federal Procurement Marketplace***

U.S. House of Representatives

Committee on Small Business

**Congresswoman Nydia Velazquez, Chair**

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Rayburn House Office Building

Washington DC 20005

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**Sections VIII. And IX. Relating to size standards**

**VIII. SBA Size Standards Reform**

Since the inception of the SBA, one of the Agency's fundamental responsibilities has been to establish a numerical definition of small business, industry-by-industry, to establish eligibility for Federal small business programs. These numerical definitions are called “size standards.” SBA's Office of Size Standards has established size standards for all NAICS Codes in all industries.  Size standards are stated in either number of employees or annual receipts.

Size standards represent the largest size that a business may be, yet remain classified as a small business so as to be eligible to participate in Federal small business programs. Size standards apply to SBA’s financial assistance and procurement assistance programs, as well as, to Federal agency programs that benefit small business concerns (e.g., the SBIR Program).    
  
At the outset of the procurement process, contracting officers determine the size standard applicable to the procurement by selecting the NAICS Code that best describes the goods or services being procured. If the contracting officer decides that the requirement is to be a small business set-aside, all small businesses bidding on the requirement must meet the size standard established by SBA for the NAICs Code assigned to the requirement by the contracting officer. In bidding on a requirement, a small business self-certifies that it is a small business under the applicable NAICs Code in the solicitation.

When firms exceed these size standards, they are no longer eligible for small business set-aside contracts (or any other Federal small business programs) and are forced to compete against large businesses in their industries. There are widespread complaints in the small business community that many of the size standards established by SBA do not reflect the realities of their industries. The complaint most frequently heard is that certain size standards are too small. When the size standard is too small, the affected small businesses are forced into full and open competition with large businesses before there are competitively ready to do so.

Many SBA size standards are totally unrealistic and inadequate in the present contracting environment of large bundled contracts, especially in industries such as systems integration, environmental remediation, base management, etc. A size standard, for example, of $23 million in annual revenues for a small business in the IT systems integration business is totally inadequate in an industry wherein contracts are routinely in the hundreds of millions to billions of dollars, and wherein the large businesses competing for such requirements have billions of dollars in annual revenues and hundreds of thousands of employees.

When SBA pushes a small business with annual sales of $23 million out of SBA’s small business classification into the world of full and open competition to compete head-to-head against companies with billions in annual revenues, it is a dereliction of SBA’s duty to protect and nurture the development of small businesses so that they are competitive in the marketplace.

**Recommendation - Size Standards**

**LAMA recommends that Congress direct SBA to adjust size standards in a manner that is in keeping with the size of businesses (and the size of contracts) in their respective industries. We recommend that the small business size standard for all industries be established at 25% (or some reasonable percentage) of the size of the dominant companies in each industry. In this manner, when small businesses exceed their size standard, and are thrust out into full and open competition, they will be far better able to compete against large companies in their respective industries. In this manner, SBA will live up to its obligations as stated in the Small Business Act to establish size standards that: 1) account for differences among industries, and 2) assist small businesses as a means of strengthening their competitiveness in the economic system.**

**IX. SBA Size Standards Methodology**

LAMA believes that SBA's methodology for establishing size standards is fundamentally flawed. According to the SBA Office of Size Standards, in establishing size standards, the Small Business Act requires that SBA's size standards should "account for differences among industries." Our contention is that, in the IT industry in particular, SBA has not abided by that guiding principle. Instead, SBA has established a convoluted system for establishing size standards that is incomprehensible to ordinary business owners, and does not even come close to accounting for the extraordinary diversity in the IT industry. The following section is taken verbatim from SBA's Size Standards Methodology:

***As a starting point, SBA presumes:***

1. ***$7.0 million as an appropriate size standard for the services, retail trade, construction, and other industries with receipts based size standards***
2. ***500 employees [as an appropriate size standard] for the manufacturing, mining, and other industries with employee based size standards***
3. ***100 employees [as an appropriate size standard] for the wholesale trade industries.***

The three levels referred to above are called "anchor size standards... benchmarks or starting points." There is no discussion, however, of how these anchor benchmarks or starting points were determined. The "anchor size standards... benchmarks or starting points" appear to have be plucked out of thin air, arbitrary figments of someone's imagination in the Office of Size Standards. There is no rationale presented as to why these "anchor size standards" are appropriate. SBA simply "presumes" that they are an appropriate starting point.

Later in SBA Size Standards Methodology document, in the section on detailed analytical steps for establishing size standards, were are informed that (underscoring added):

Receipts based standards will have eight fixed size levels as follows:

1. $5.0 million
2. $7 million (anchor standard)
3. $10 million
4. $14 million
5. $19 million,
6. $25.5 million
7. $30 million
8. $35.5 million

Employee based standards for the manufacturing and mining industries will have four fixed size levels as follows:

1. 250 employees
2. 500 employees (anchor standard)
3. 750 employees
4. 1,000 employees

Employee based standards for the wholesale trade industries will have five fixed size levels as

follows:

1. 50 employees
2. 100 employees (anchor standard)
3. 150 employees
4. 200 employees
5. 250 employees

There is no discussion of how these fixed levels were determined, or why there were 8 levels in receipts-based size standards, 4 levels in employee-based manufacturing and mining size standards, or 5 levels in employee-based wholesale trade size standards. They appear to have be plucked out of thin air, arbitrary figments of someone's imagination in the Office of Size Standards. There is no rationale presented as to why these various fixed levels are appropriate. Again, it appears that SBA "presumes" that they are appropriate.   
  
In reality, no foundation is established for the "presumed anchor size standards." No foundation established for the various fixed levels of size standards. As if that weren't bad enough, SBA's Size Standards Methodology presents the reader with an incomprehensible blizzard of statistical procedures through which size standards are somehow established. SBA's Size Standards Methodology is ***totally incomprehensible*** to any normal business owner. See attached pages setting forth SBA's Detailed Analytical Steps for Establishing Size Standards.  
  
What is lacking is an understandable formula, a logical guideline, or a common sense construct that would enable an intelligent business owner understand for his/her size standard was established. For example, here are a couple common sense guidelines that would enable a business owner to understand, in principle, how SBA established its size standard:

1. As a general rule, SBA considers companies small if they are no larger than 25% of the size of the dominant firms in their respective fields;
2. In establishing size standards for small companies participating in the SBA Small Business Set Aside Contracting Program, SBA considers companies small if they are no larger than 25% of the size of the dominant prime contractors in their respective fields.

The percentage is not the important point. What is important is that SBA would be applying a common sense principle in establishing size standards that small business owners can understand. Such common sense principles are completely lacking in SBA's approach to size standards.   
  
SBA needs to be directed by Congress to develop a methodology for establishing size standards that contain principles that ordinary business owners can understand. That methodology should result in size standards that "account for differences among industries" as required by the Small Business Act. That methodology should result in size standards that "assist small businesses as a means of strengthening their competitiveness in the economic system," as required by the Small Business Act.

**Recommendation - SBA Size Standards Methodology**

**Congress needs to direct SBA to develop a methodology for establishing size standards that contain principles that can be understood by ordinary business owners. That methodology should result in size standards that: "account for differences among industries" as required by the Small Business Act. That methodology should result in size standards that: "assist small businesses as a means of strengthening their competitiveness in the economic system" as required by the Small Business Act.**

SBA's

Size Standards Methodology

Detailed Analytical Steps

for

Establishing Size Standards

For this document, please go to this link:

http://www.sba.gov/idc/groups/public/documents/sba\_homepage/size\_standards\_methodology.pdf