

Implementation of a Multi-Disciplinary Statement Of Work (SOW) Small Business Procurement Strategy

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Solutions Proposal

We in the small business federal contracting community cannot achieve competitive viability when our ability to build capacity and capability are negatively impacted because of the way that the Small Business Administration (SBA) currently defines size standards. Federal contractors are required to oblige by rules in bidding and pricing contracts that create a business environment substantially different from the environment of commercial and international sectors. Yet federal officials are using policies in the management of small business procurement programs that suggest doing business in the federal marketplace is the same as doing business in the commercial/international marketplace, which clearly is not the case.

Policy will have to be redesigned to more appropriately define and serve small businesses in the federal marketplace. We understand that many policymakers perceive a \$300 million firm to be a big business, which is inarguably true in the commercial/international marketplace, but simply does not apply to the federal sector because a \$300M federal contracting firm has to comply with the governments' strict rules for bidding and pricing contracts. In the federal marketplace, \$15 billion-\$30 billion firms therefore have an insurmountable advantage over any \$300 million firm. This is illustrated by the fact that even large firms with sales of \$1 billion-\$15 billion experience nearly no organic growth. It is baffling that policymakers are apparently not concerned about the fact that most firms are forced to sell, dramatically reduce operations or go out of business within 10 years after outgrowing their size standard.

The community has estimated that 80 percent of small federal contractors perform a wide range of technical support services, not just one, much like the large corporations. For the purpose of this proposal, we will refer to these firms as multidisciplinary companies – companies that are involved in a broad range of activities such as computer networks, telecommunications, computer hardware installation, research and development, training, and a whole host of other activities that defy stove-pipe NAICS (North American Industry Classification System) Code identification.

Such small firms are in direct competition with large businesses that are similarly multidisciplinary in nature, doing everything within a broad range of activities in the IT arena, telecommunications, manufacturing, engineering, high tech manufacturing and so forth. These large businesses are dominant in their industries. They are huge, some with annual sales over \$30 billion.

Having studied the history of small businesses developed through set-aside programs over the past four decades, the small business community has seen a great number of firms disappear

from the federal marketplace after benefitting from SBA set-aside programs and successfully providing services and products, because they were simply not able to succeed in strengthening their capacity and capabilities.

The Solutions Summit Series working group was organized to develop a solution that focuses on the establishment of a multidisciplinary small business procurement strategy. The working group acknowledges that any solution being implemented must include the ability to gather information regarding the amount of revenue accumulated in each NAICS code designation. Such information is used by the department of commerce to track the productivity of businesses by the work performed.

The working group recommends that the methodology to be used by the government to implement a Multi-Disciplinary SOW (Statement of Work) Small Business Procurement Strategy would require capturing information used by the Department of Commerce regarding the contracts which the contractor performs by NAICS designation.

As it relates to a competitive range procurement strategy, this solution provides the ability for companies to compete within their size range, according to the number of employees, or according to their annual revenue. The Multi-Disciplinary SOW Small Business Procurement Strategy is designed specifically for the federal marketplace. The small business community solutions summit working group has concluded that in order to modernize federal government size standard policies through a solution designed on the basis of clear intellectual integrity, it is critical and necessary for federal government policymakers to realize that small businesses performing work under any given NAICS code come in direct competition with the \$30 billion giants, which perform all types of work. The working group understands that SBA does not and should not create giants from the smallest of the small. Nonetheless, the small business community believes that policymakers have never presented any solutions to address how a small firm can consistently succeed in competing against the largest integrators. It is recommended that policymakers focus attention on modernizing size standards policy to become more relevant to modern day federal market realities.

The working group addressing size standards management recommends using a tiered approach, similar to the one successfully used in the Department of Commerce's COMMITS and the Department of Homeland Security's EAGLE programs. The working group recommends that this tiered approach should be expanded in order to assure that the smallest of the small firms, including start-ups and developing firms, are protected during their new business development period while providing them with the unrestricted ability to bid up to the highest tiers.

The working group concluded that a tier concept will also provide government managers the ability to increase their support to small business federal contractors, enabling them to procure 'niche' capabilities while maintaining support of the government's broad statements of work, often used to cover a wide range of needs not identified at the beginning of the contract period. In today's market place, most statements of work cover a wide range of work to be performed.

In order to establish the highest tier, SBA should identify the 10 largest multidisciplinary firms in the country and determine their average size (either in terms of revenues or numbers of employees). This could be done by identifying the top 10 federal prime contractors in the Federal Procurement Data System (FPDS) (Lockheed Martin, Northrop Grumman, etc.). Then, a

size standard for defining small multidisciplinary businesses could be established by SBA based on the size that small multidisciplinary firms need to reach in order to achieve competitive viability.

Some Summit participants propose that if the large multidisciplinary firms average \$30 billion per year in revenues and have an average of 130,000 employees, then small multidisciplinary firms up to 2% of the size of the dominant multidisciplinary firms should be considered small businesses.

In a multidisciplinary competitive procurement tier design, the smallest of the small and developing firms will compete within the respective ranges of their tier. Using the above formula, the highest size standard for small, multidisciplinary businesses would be about \$600 million in annual revenues.

In terms of employees that equates to about 2,600 employees. The highest size standard for small, multidisciplinary businesses would be 2,600 employees.

These small multidisciplinary firms would be eligible for small business set-asides in the multidisciplinary NAICS Code until such time as they exceeded \$600 million/2,600 employees. This would ensure that they have a good chance of achieving competitive viability in an industry dominated by \$30 billion per year behemoths.

Contracting officers would be permitted to set aside contracts for small multidisciplinary firms with annual revenues from \$1 to \$5 million (Tier 1), or \$5 million to \$25 million (Tier 2), or from \$25 million and above. Lower tier firms could bid up, i.e., they could bid on any requirement for which they could compete. Higher tiers could not bid down. Tier 2 and Tier 3 firms could not bid on requirements set aside for Tier 1 firms. Tier 3 firms could not bid on requirements set aside for Tier 1 or Tier 2 firms.

Background

Under the current system, the definition of small business in a majority of industries hinges on an entity's three-year average receipts. Most small businesses provide services in which the NAICS ceiling is set either at \$7 million or \$25 million (see Appendix, Table 1). The highest annual receipts-based size standard for small business in any service industry is \$35.5 million.

This system fails to effectively address economies of scale when small businesses are forced to compete against significantly larger businesses such as Northrop Grumman, Lockheed Martin, SAIC, EDS-Hewlett Packard, and General Dynamics. These mega-corporations average sales of \$30 billion per year and have 130,000 employees. Once the dollar threshold of the NAICS definition for small business is surpassed, every business, even one with only \$8 million per year in sales, is thrust into the unrestricted fully competitive market without the infrastructure and capital needed to compete successfully against significantly larger businesses, such as the top six federal government systems integrators named above. How can an \$8 million be expected to compete against a \$30 billion giant on a consistent basis?

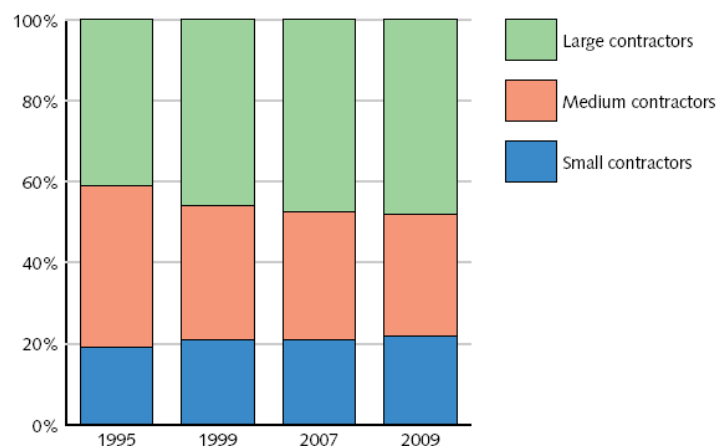
The purpose of small business set-asides is to provide a level playing field for competitors of similar size. However, the present size standards design cannot be interpreted as being reasonable in promoting competitive viability for developing firms or aiding their ability to gain competitive capacity. Due to the lack of any realistic modification to size standard thresholds

over the years, small businesses' ability to sustain themselves after exceeding their size standard thresholds is questionable. They are forced to travel a bumpy road just to survive. Consequently many have been sold or closed their doors.

For many years, second-tier companies in the federal services sector have been highly regarded as a source of innovation and productivity. They have the ability to perform and manage complex contracts with low risk. Because of their success in establishing themselves beyond the first-tier small business threshold, they have proven infrastructures and management processes, capabilities invaluable to the government and to our economy as a whole.

Changing the revenue size standards to employee head count more properly reflects the reality of today's marketplace. Having never been defined formally, there is much discussion about what constitutes the size of a mid-tier company. Regarding the professional services industrial base, the November 2010 report by the Gregory Sanders et al.'s report *Structure and Dynamics of the U.S. Federal Professional Services Industrial Base 1995-2009* clearly shows that second/mid-tier firms, by virtue of being neither small enough nor large enough to successfully compete, have seen their share of the market decline considerably, as demonstrated in the figure below.

Figure 3-14. Market Share of Small, Medium, and Large Contractors in the Federal Professional Services Industry, 1995, 1999, 2007, and 2009



Source: Federal Procurement Data System; analysis by CSIS Defense-Industrial Initiatives Group.

Below are reprinted some of the report's significant findings:

"The scale, range, and magnitude of critical mass has changed. In 1995, contract awards near a half billion dollars allowed an organization to be contractor number 20 in the top 20; in 2009 that ranking required annual awards of \$1.9 billion."

"[I]t is clear that those in the middle tier have suffered an erosion of their relative share. (...) Thus, the middle tier has been squeezed from above by consolidation and from below by the slight growth in small contractors' share of the market."

"Policymakers must determine whether a robust middle tier of services companies is important or desirable for the federal marketplace. If so, current incentives for companies to enter and remain in this mid-market level must be revisited."

Indeed, mature/second-tier small businesses lose all of the contracting incentives provided under the Small Business Programs. The impact this has on the marketplace, was illustrated by the

House Armed Services Committee report on acquisition reform in March 2010, which states:

“Mid-tier companies are either absorbed or decide to abandon defense acquisition for [the] more competitive commercial sphere (...). Winning or losing individual contracts becomes such a critical matter that the incentives to protest contract awards are overwhelming. (...) The end result of this process is the gradual erosion of competition and innovation in the defense industrial base.”

Many are beginning to realize that something needs to change for mature/second-tier small businesses to remain competitively viable. The numerous size standards based on three-year average annual revenue/receipts is no longer consistent with marketplace dynamics. All annual revenue dollars are the basis for calculation of the three-year average. Often, computer size standards, hardware and subcontracting are part of the contract award dollars. The success of a graduated small business is dependent on building an infrastructure to compete with companies that have billions of dollars in annual revenue.