

TESTIMONY OF
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PROFESSIONAL SERVICES COUNCIL
BEFORE THE
SUBCOMMITTEE ON CONTRACTING AND THE WORKFORCE
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES
“SIZING UP SMALL BUSINESS: SBA’S FAILURE TO IMPLEMENT
CONGRESSIONAL DIRECTION”
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Chairman Hanna, Ranking Member Takai, and members of the Subcommittee, thank you for the invitation to testify and the opportunity to discuss small business size standards.

My name is Roger Jordan and I am the vice president of government relations at the Professional Services Council. PSC is the national trade association of the government professional services and technology industry. PSC's nearly 400 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, cybersecurity, facilities management, operations and maintenance, consulting, international development, scientific, social, environmental services, and more. Roughly 20 percent of our members are small businesses and another approximately 30 percent would be considered small mid-tier firms. Together, the association's members employ hundreds of thousands of Americans in all 50 states.

The Importance of Size Standards

Small business size standards and the associated North American Industry Classification Systems (NAICS) play an often overlooked, yet significant role in the federal contracting marketplace. Whether a specific industry's size standard is employee-based or revenue-based, the methodology used by the Small Business Administration and the resultant size standard impacts competitiveness throughout the marketplace, including contracts that are set aside for small business competition and prime contractors' subcontractor utilization plans and implementation. For companies throughout the supply chain, size status carries significant weight not only because of the benefits offered by small business size status but also because of the potential penalties associated with misrepresentation of size status. Hence, there is broad interest whenever the SBA undertakes a review of, or revision to, an industry size standard.

Such interest and impact is amplified by the binary nature of the size standards: companies are either small business or "other-than-small." This binary approach means that once a company exceeds its industry size standard, even if only by one dollar or one employee, they are left on their own to compete in the full and open marketplace. Some will succeed, others will not. In short, since SBA's decisions can have transformational impacts on individual companies, the importance of accuracy and consistency in conducting size standard reviews cannot be overstated.

At PSC, we believe the philosophy of the overall small business program should be to facilitate long-term growth of companies with entrepreneurial spirit through awards to and performance of federal government contracts. We believe this philosophy is shared by the current SBA leadership. However, it is not always evident in policy or practice.

The statutory definition of a small business is designed to include firms that are not dominant in their primary field. But achieving an appropriate balance that allows companies with revenues or employees at the lower end of the size standard to break into the market while also protecting the

ability of companies that are larger, but by no means “dominant” in their field, to compete for set-aside opportunities is not a simple endeavor. At the time SBA initiated its review of the size standards, PSC’s position was, and remains, in support of size standards that lean toward the higher range. SBA must seek to balance size standards so that all small businesses have legitimate opportunities to compete, yet higher revenue generating small firms are not shut out from competing for small business set-asides. PSC’s position has been and continues to be that federal government policies should foster robust competition for federal contracts whether set-aside for small businesses or not. As such, we have not endorsed legislative proposals to create new set-aside programs, particularly for emerging or very small businesses.

Prior to 2009, it had been nearly 30 years since a comprehensive revision to industry size standards was conducted, and PSC was calling upon SBA to undertake a thorough analysis of the size standards, particularly for the “54” or “Professional, Scientific, or Technical Services” sector in which many PSC member companies operate. Examples of industries that fall under sector “54” include legal services, tax preparation services, architectural and engineering services, many computer related and information technology services, and a number of consulting services, including management consulting, logistics consulting, scientific and technical consulting.

Hence, PSC was pleased that SBA began a comprehensive review of the size standards in 2009. SBA began its process of revising the size standards by developing a methodology based on five significant factors: average firm size; startup costs and entry barriers; industry competition; distribution of firms by size; and impact on federal contracting and SBA loan programs. SBA also considered other factors such as technological changes and industry growth changes. In addition, SBA established their discretion to use “common size standards” for industries that share similar characteristics. According to SBA, these common size standards reflect cases where many of the same businesses operate in multiple industries, and might also make size standards among related industries more consistent than establishing separate size standards for each of those industries.

PSC Concerns with the SBA Approach

In December 2009, PSC submitted comments to SBA on their proposed methodology. SBA finalized this methodology in 2010 but did not accept any of our recommendations.¹

Subsequently, in March 2011, SBA issued a proposed rule to revise the size standards for 36 industries in the “54” category. In total, federal spending on contracts in this category represents over \$100 billion, or 20-25 percent, of the government’s annual spending on contracts.

¹ PSC comments on the SBA Size Standard Methodology are available at http://www.pscouncil.org/PolicyIssues/SmallBusiness/SizeStandardsSetAsides/Comments_on_Other_Se.aspx.

While PSC recognized the difficulty SBA faced in collecting and digesting significant amounts of data about the commercial and federal marketplaces, we raised a number of concerns with the SBA proposed rule.²

On February 10, 2012 SBA published a final rule regarding the “54 category” that increased size standards for 34 specific industries. For most industries, the increases to the size standards were fairly substantial. For example, most size standards that had been established at \$7 million in annual gross receipts were increased to either \$10 million or \$14 million. That increase provided much-needed flexibility for small firms to mature while still having access to restricted competitions. In our comments on this proposed rule, we raised concerns about proposals for computer-related services that we believed required greater scrutiny, and our views remain unchanged.

Our concern is that SBA is ignoring the fact that computer-related services has undergone, and continues to undergo, significant changes over the last 25 years. The federal government is purchasing more of these services than at any time in its history and companies across the industry are focusing on providing a comprehensive set of solutions and offerings to the federal government that include a combination of telecommunications, information technology and other solutions and services. Yet, in 2011, the SBA proposed raising size standards for those categories by only \$500,000, from \$25 million to \$25.5 million. The \$25.5 million size standard remained unchanged in SBA’s final rule.³

Common Size Standards

Additionally, SBA established a common size standard for the Computer Systems Design and Related Services industries (NAICS 541511, NAICS 541112, NAICS 541513, NAICS 541519 and NAICS 811212), even though the industry data supported a distinct size standard for each industry. The common size standard proposed by SBA for these categories was also \$25.5 million. However, SBA’s own analysis shows that for NAICS 541513—Computer Facilities Management Services—the calculated industry-specific size standard is \$35.5 million. Therefore, by establishing a common size standard that incorporates this NAICS category and other computer related categories at a common level of \$25.5 million, SBA has eliminated legitimate small businesses from being able to qualify. PSC’s comments to SBA focused heavily on this point. However, SBA declined to adopt our recommendations that “common size standards” be avoided and instead retained a size standard of \$25.5 million for all computer-related NAICS codes.

² PSC comments available at http://www.pscouncil.org/PolicyIssues/SmallBusiness/SizeStandardsSetAsides/Comments_on_SBA_Prop.aspx.

³ The size standard for computer-related NAICS codes is currently set at \$27.5 million because SBA has made inflationary changes over the past several years.

To this committee's credit, you recognized that the reliance on "common" size standards could have a negative effect on small businesses, and in May 2011 the Subcommittee on Economic Growth, Access to Capital, and Tax held a hearing on the issue at which PSC provided testimony. Soon after, legislation was introduced by Representatives Joe Walsh and Gerry Connolly to restrict SBA's practice of relying on common size standards. The legislative proposal was ultimately adopted in Section 1661 of the fiscal year 2013 National Defense Authorization Act (NDAA). Unfortunately, the NDAA language was enacted after the SBA final rule changing the size standards for the "54 category" was complete and SBA has yet to take any action to address the reliance on common size standards in this category.

Thus, legitimate small businesses have been denied the ability to compete for set-aside contracts since the final rule went into effect in March 2012. An additional effect, and one that is being felt by a broader number of companies, is that companies have been denied the ability to increase their revenues while maintaining their small business size status. In the Computer Facilities Management Services category, for example, firms that were close to exceeding the \$25 million small business size standard in 2012 would have been able to grow their business to \$35.5 million while still being afforded the benefits that come with being a small business federal contractor. The added growth that the higher size standard would have provided to these companies could have eased their transition into the full and open competitive federal market. Instead, the result has likely been that businesses have either refrained from growth in order to maintain their small business status or they have had a tougher transition from their small business status because they are entering the full and open market much sooner than they would have if SBA had designated the appropriate size standard that their own methodology established.

Currently, SBA is required to update the individual size standards at least every five years. Although PSC believes rapidly evolving industries such as information technology and complex professional service should be reviewed more frequently, we understand the broad scope of SBA's responsibility to review all the size standards. We expect SBA to initiate and potentially complete a fresh review of the "54 category" within the next two years, and while SBA should not be allowed to ignore the law in the interim, we certainly look forward to SBA complying with Section 1661 of the fiscal year 2013 NDAA at that time.

Other Considerations

As mentioned above, SBA evaluated five major factors to determine the proposed size standards: average firm size; startup costs and entry barriers; industry competition; distribution of firms by size; and impact on federal contracting and SBA loan programs. SBA determined that each factor would be given equal weight in its calculations. However, PSC continues to recommend that greater weight be given to the "impact on federal contracting" factor. In addition, SBA

should broaden its evaluation of the federal contracting market to examine if typical contract requirements under a specific category tend to gravitate toward larger contracts. If so, SBA might determine that a higher size standard is warranted. If typical requirements under a specific category seem better suited to small contract awards, then perhaps a lower size standard would be more appropriate.

PSC further encourages SBA to reconsider the merits of adopting separate size standards for federal contracting. The adverse impact on small businesses of a single size standard that covers federal procurement and all other SBA programs is documented in SBA's own methodology. SBA acknowledges that the disparity between small business federal market share and industry-wide share may be attributed to a variety of reasons, such as extensive administrative and compliance requirements associated with federal procurement, the different skillsets required by federal contracts compared with typical commercial contracting work, and the size of specific contracting requirements of federal customers. Such a structure would allow SBA to focus more on the market dynamics regarding federal contracting and in turn make the size standards more reflective of the realities of the marketplace they so significantly impact.

PSC also recommends regular review of the NAICS codes themselves to ensure that they are properly aligned with the ever-changing dynamics within specific industries. Within the information technology space, for example, the emergence of new and much needed capabilities such as cybersecurity and cloud computing are significant. Yet these capabilities or offerings are lumped together with other computer-related industries under a limited number of computer-related NAICS codes, which does not reflect how industry is organized or how federal agencies acquire these goods and services. This recommendation is not intended to suggest that each new capability is deserving of its own NAICS code. Instead, it is merely intended to require regular review of the NAICS codes to ensure that, as industries evolve at an increasing pace, the NAICS codes are still appropriately structured.

Lastly, it is important to recognize that Section 1661 of the fiscal year 2013 NDAA is one of many small business contracting statutory provisions enacted since 2010. This subcommittee has been vigilant about holding SBA and the FAR Council accountable for implementing those provisions and PSC shares the frustration expressed at the recent subcommittee hearing about the length of time it has taken to complete implementation. As such, PSC supports efforts to move toward concurrent and collaborative SBA and FAR rulemaking to speed the implementation process. The need to implement these laws quickly is underscored by the fact that this year's House-passed NDAA also contains a number of small business provisions. It is simply unacceptable that implementation of those provisions, if enacted, and other previously enacted reforms, will take three or more years before they will be used in the federal contracting marketplace.

Conclusion

PSC commends the Congressional action over the past several years to improve the size standard determination process. The enactment of Section 1661 is an important element of those reforms, and although it was enacted after work on the “54 category” of NAICS codes was last revised, we look forward to SBA complying with the law promptly and certainly no later than their next substantive review of the Professional, Scientific and Technology Services sector. PSC also reiterates its support for an SBA size standard methodology that gives more weight to federal marketplace dynamics and creating a completely separate set of size standards to be used for federal procurement purposes only.

Mr. Chairman, this concludes my testimony. Again, thank you for inviting PSC to testify today and for your attention to this important issue. I would be happy to answer any questions.