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United States House of Representatives  
Committee on Small Business  
Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base

Testimony for the Record

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On behalf of the  
National Defense Industrial Association

Mr. Chairman, Madam Ranking Member, and Ladies and Gentlemen:

On behalf of the 1,756 corporate members and over 96,000 individual members of the National Defense Industrial Association (NDIA), I would like to thank Chairman Sam Graves, Ranking Member Nydia Velazquez and all the members of the Committee for holding this important hearing on Sequestration: The Threat to Small Businesses, Jobs, and the Industrial Base.

We are all painfully aware that in the past 10 years the U.S. has experienced an economic downturn second only to the “Great Depression.” The most severe impact has been felt by small businesses, particularly in several critical industrial sectors.

Even in a good economy, small businesses have to navigate barriers and challenges. However, through this downturn they have experienced a significant decrease in customer orders; struggled with layoffs and the associated effects on the workforce; loss of access to capital (including the redlining of geographic regions); watching opportunities for business development slip away; feeling the pain of plant closures; and, all too often, suffering financial ruin-all at an unprecedented magnitude.

During any economic decline, small businesses can only reduce their staff so far and still be a government contractor. As business declines government contractors still need core staff to search for contracts, manage programs, inspect, and perform the necessary administration which requires a tremendous amount of overhead. Also, understand that as demand declines, costs increase due to

the inability to spread overhead costs over the needed volume of work, leading to a vicious cycle downward.

Erosion of critical industrial sectors has escalated the need to study and identify trades that are critical to reviving the U. S. economy and, more specifically, our homeland security and defense industrial base. The output of these eroded industries is still widely needed to produce product worldwide. These industries are critical to national security, needed for the health and revitalization of our national economy, and are recognized as an integral part of our National Innovation System.

*The vast majority of the companies classified in the critical industries are small businesses with 50 or fewer employees.* Please take a look at the chart<sup>1</sup> in your printout: 13 of 16 are considered “eroded”.

NAICS	Industry Description	Employment	Economic Activity	Establishments	Overall Status
3315	Foundries	●	●	●	Eroded
33211	Forging and Stamping	●	●	●	Eroded
33271	Machine Shops	●	●	●	Healthy
332811	Metal Heat Treating	●	●	●	Eroded
332997	Industrial Pattern Mfg	●	●	●	Eroded
333295	Semiconductor Machinery	●	●	●	Holding Steady
333314	Optical Instrument and Lens	●	●	●	Eroded
333511	Industrial Mold Manufacturing	●	●	●	Eroded
333512	Machine Tools (Metal Cutting)	●	●	●	Eroded
333513	Machine Tools (Metal Forming)	●	●	●	Eroded
333514	Special Die & Tool, Die Set, Jig	●	●	●	Eroded
334412	Bare Printed Circuit Boards	●	●	●	Eroded
334413	Semiconductor and Related Devices	●	●	●	Eroded
334418	Printed Circuit Assemblies	●	●	●	Eroded
3345	Nav, Meas, and Cntrl Instruments	●	●	●	Healthy
33591	Battery Manufacturing	●	●	●	Eroded

As a representative of small business manufacturing, I ask each of you to consider; how can we ever revitalize these critical industries (that have already sustained considerable economic injury); encourage innovation and invention; increase production and demand for new state-of-the-art products; and support and improve national security when small businesses are hit with yet another blow from the astounding budget cuts already taken by the Department of Defense, and then yet another blow from sequestration?

The challenges of the last ten years have made it difficult to identify individual businesses in these segments, to assess what capabilities and capacities exist, and consequently, to match the current needs with the proper resources. It can be easily demonstrated that these small businesses hold irreplaceable intellectual knowledge, which may not reside in the prime contractor community. Yet with the structure of the supply chain today, small business innovation and value-added work is often unrecognized, unrewarded, and under-represented in government awards. Ultimately, it means

<sup>1</sup> Alliance for American Manufacturing, *Manufacturing A Better Future For America*, 7: 274, 2009.

there is an increasing risk that we will continue to lose more and more of these “behind the scenes”, innovative- small business suppliers.

The sequestration mandated defense budget cuts will disproportionately impact small business unless we act in a proactive manner. The United States Government and its military strategic thinkers have always subscribed to the basic ancient military principle: “without industry a country cannot maintain an army.” I advocate that a certain outcome of blind implementation of sequestration will be further loss in our country’s small businesses and challenges in maintaining our military.

Examples of companies and communities that are facing the potential or have already been impacted include:

- Cuts to primes on contracts such as the MRAP, which totals over \$6 billion in contracting, will impact over \$1.5 billion of sub-contracts performed by small businesses.
- Many small businesses in the Michigan are reporting that they are holding back on hiring and investing in equipment, even though there is demand today, as they are worried that the cuts will lead to large losses in business down the road. Therefore, they are waiting to invest and grow until they know the outcome of potential defense cuts, which will negatively impact our economy.
- The Procurement Technical Assistance Center (PTAC) in Genesee County, Michigan, that works predominantly with small businesses, (as they have no large prime contractors located in their community), has already seen a 30% decrease since its peak in 2010 due to anticipation of defense budget cuts. They are concerned about the number of small businesses that may need to close their doors and the negative economic impacts for an already hard hit community.
- Miller-Holzwarth, a 2007 recipient of the SBA subcontractor of the year award, announced recently that they would be closing their doors. The business located in Salem, Ohio, employed 48 at the time of closing, and manufactured periscopes, vision blocks, ballistic windows, transparent armor and specialty components for the defense industry for more than 35 years. Among the issues affecting their decision to close, was the potential impact of significant business loss due to budget cuts and their concern over evolving trends in defense procurement practices.
- TACOM LCMC awards on the FHTV, M-ATV, FMTV, Stryker, and HMMWV include \$539.6 million directly to small businesses and an additional \$563.5 million in subcontract awards through March in FY12. This totals over \$1.1 billion in the first half of the year, demonstrating the importance of small business in this supply chain.

- Manufacturer of one of a kind High Tech “Hot Press” furnaces used in the manufacture of ceramic body armor plates – If the demand for sustainment of such furnaces is decreased or eliminated the manufacturer which is a small business comprised of 6 employees will simply shut his doors. There is no other application for these furnaces and this business is completely dependent on the DoD supply chain to remain in business. The ability for DoD to reconstitute this capability, if at all, in a minimum of 18 -24 months based on long lead items and unique equipment that is used in the design of the furnace supplied by 2d and 3d tier small businesses.
- Manufacturers of “high strength” carbon used in the manufacture of body armor. Small business suppliers of this item have already demonstrated what happens when the supply chain fails to keep them energized. In 2010 the DoD allowed this key component supplied by small business to be diverted to other worldwide demand for high strength carbon. When DoD again wanted to institute the manufacture of body armor that required this component to be available in the supply chain it simply was not available and the DoD suffered a 12 month lag in delivery times for body armor that was needed in theater. Suppliers of this component will again either divert to other industries or close their doors if the demand for this item evaporates due to DoD’s inability to sustain requirements for body armor. To support a DoD surge requirement for this component would again take 12 months or more to support expanded manufacturing requirements.
- Manufacture of carbon tooling, special foils and other production products unique to the manufacture of body armor components. All of these things are manufactured, supported and maintained by small businesses that will be heavily impacted by any reduction in current sustainment requirements. Many of these companies are 2-3 person operations and exist to only support the requirements of Ceradyne body armor manufacturing. If lost, it could take up to 24 months to replace such lost capabilities if needed to support surge requirements within DoD.

Many of these examples highlight negative impacts in anticipation of what is to come but there are perhaps others unknown. Further degradation of the small business base could result in the loss of sectors that are costly to rebuild, if not impossible; reduce competition, lead to the loss of innovation, increase unemployment, further erode skill sets, and a myriad of other unknown repercussions.

Utilizing goods and services produced by our allies is an important part of defense contracting, however this strategy must be more carefully considered. The Department of Defense has already felt

the impact of an ever-increasing number of counterfeit and defective parts in the defense market—a risk that is mitigated by using parts sourced from domestic small businesses. The number of counterfeit parts reported represents only those found; thousands more defective, damaged and substandard parts are likely installed throughout DoD weapons systems and within massive inventories of spare parts. We must consider the safety of our soldiers even as we consider pathways to cost savings.

It is a documented fact that small businesses are critical to the economy: according to the Small Business Administration, 99.7% of all employer firms are small businesses. They have created 60-80% of net new jobs since 1990, and account for half of the nation's private sector workforce and GDP. Small business produces 13 times more patents per employee than large firms. The SBA's first Advocacy report produced in 1979 by a task force stated:

*“Innovation is an essential ingredient for creating jobs, controlling inflation, and for economic and social growth. Small businesses make a disproportionately large contribution to innovations. There is something fundamental about this unusual ability of small firms to innovate that must be preserved for the sake of healthy economic growth”.*

That statement is still as true today as was in the 70s.

So what are the considerations that could create new opportunities to revitalize small business, grow the U. S. economy, and strengthen national and global security?

There are several ways we could strengthen the small businesses and increase the value to the Government:

- More direct sourcing to small business. The Executive Office of the President, Office of Management and Budget published a Memorandum dated February 11, 2011 regarding the need to increase small business participation in federal contracting and provided examples of tremendous savings due to small business awards in NNSA, EPA, NASA, DHS, and DoD totaling in excess of \$383 million dollars.
- Develop a program to reverse engineer "low hanging fruit" parts that are already in the DoD inventory (examples: vehicle cylinder head assemblies, axles, etc.). Again, to increase the opportunity for small businesses to provide part price reduction.
- Review the process of DCMA. If a quality assurance rep recommends "NO AWARD" on the Pre-Award Survey, the small business has one last chance with the SBA Certificate of Competency (CoC) program. The SBA is responsible for determining if the small business is capable and competent after the contracting officer has determined the company "non-responsible", but in most instances relies on the DCMA Pre-Award Survey and supports the

non-award. I have personal experience with the reams of paperwork and negative results. This process is not only costly to the small business but also to the Government.

- There are many great products and processes that have and continue to originate in small businesses. However, they struggle to connect and bring their product to market. We must work towards the support of more robust avenues for these products to reach the federal and Commercial market so that the \$180 billion invested in early stage innovation can actually be realized and multiply.
- Streamline and reduce the amount of paperwork and effort required to find, understand, and submit bids. It is a cumbersome and time consuming process that far too many small businesses are not willing to participate in as they cannot afford to hire the staff and the overhead needed to be successful.

We need to celebrate and support the strength that small business brings to the market, and better leverage these valuable resources. There are many ideas of how to reduce the costs for the Department of Defense but with every decision there are many unintended consequences. I am here today to advocate and ask each and every one of you to carefully consider how your decisions will impact small business. We must consider how decisions could support, uphold, and foster their innovation and growth. It is important to think about how we can make decisions to help revitalize critical industrial sectors, ultimately, creating jobs and improving our economy and national security. It is time to support the industrial sector and small businesses.

Mr. Chairman, thank you again for the opportunity to express my views and those of the National Defense Industrial Association. I welcome your questions and comments.