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Chairwoman Velazquez, ranking minority member Chabot, and honored members of the House Committee on Small Business, thank you for the opportunity to share my thoughts about the Small Business Administration's (SBA) contracting programs.

As a professor in the John Glenn School of Public Affairs at the Ohio State University I study government contracting and contract management. My research examines why governments decide to contract for some services and not for others, and perhaps more importantly, what investments governments make in the capacity to manage contracts once they have been let. In addition, I am a participant in the government contracting process, having been involved in the management of a cooperative agreement with the U.S. Agency for International Development on behalf of a large public university – Indiana University – since the mid 1990s.

This morning I am going to offer my professional opinions on some of the SBA's contract requirements. In particular, I am concerned that the increased push to further limit combining multiple tasks into a single contract vehicle – sometimes referred to as “contract consolidation” or “contract bundling” – will inhibit federal procurement personnel from maximizing public value, and will have unseen costs that outweigh the observable benefits.

The Challenge of Balancing “Public Value” with Small Business Goals in Public Procurement

I think everyone would agree that government agencies should target two primary goals when they turn to the market: first, the procurement of high quality goods and services, and, second, purchasing those goods and services at the lowest possible cost. The problem is that these two objectives may at times be in conflict with each other. Lower costs may undermine the quality of procured goods and services. Reflecting on the launch of his mission to orbit the earth, former Senator, U.S. astronaut, and patron of the school where I teach, John Glenn replied: “All I could think about was that the two million parts I was sitting in were built by the lowest bidder.” Senator Glenn's seemingly prosaic thoughts as he hurtled through space starkly illustrate the challenges faced by public sector procurement personnel: how to use purchasing to deliver high quality goods and services at the lowest possible cost? As a tax payer, this is exactly the question I want federal government procurement personnel focused on.

Fortunately federal procurement policy and practice has evolved since Senator Glenn's first days in space when procurement personnel were mandated to focus on cost, and cost

alone. Now, federal procurement personnel have been given more flexibility and discretion to balance cost and quality. For example, the Federal Acquisition Regulations now allow the use of vendor past performance as a decision criteria in contracting decisions. This is a significant and profound improvement in procurement regulations, modernizing what had for too long been an antiquated practice.

Over the years additional requirements have been layered on top of the basic cost-and-quality calculus. High on the list of those requirements are goals, preferences, and set-asides for targeted classes of organizations – minority-owned firms, veteran-owned firms, female-owned firms, and of central importance for this Committee, small businesses. From the perspective of this Committee, taking steps to ensure government agencies utilize small businesses in procurements – for example by raising the proportion of prime contracts agencies must award to small businesses from 23% to 30% as proposed in the Small Business Fairness in Contract Act [H.R. 1873] – is an admirable goal. The SBA data clearly show the important role small businesses play in the American economy – they are engines of employment and growth.¹ These facts are well known by the Committee.

However, the more goals, preferences, set asides, and associated requirements that are layered into the procurement process, the more difficult it becomes for federal procurement personnel to achieve the best balance between cost and quality. This is the case for several reasons. To begin, these preferences result in several important negative unintended consequences. For one, small businesses that rely on federal contracts as a source of revenues face a disincentive to grow larger as they will ultimately lose the preferential treatment they receive for being small.² We all lose if the strongest, most efficient and best run businesses are not rewarded and encouraged to grow. In addition, larger firms have an incentive to purchase or collude with smaller firms in order to take advantage of the benefits afforded to small businesses. In some cases small firms become fronts for big firms. As the members of this Committee know, a task of increasing importance for SBA personnel is to certify that the vendors that receive small business preferences are in fact “small” businesses.³

Increases in small business participation goals and increased effort to certify small vendors as small businesses adds another set of burdens to an already stretched federal contract management workforce, raises the costs of procurement, and ultimately inhibits the ability of contract managers to optimize public value for tax payers. The federal government devotes significant time and effort towards meeting small business contracting goals and ensuring that the contract recipients are certified. Much of the testimony from small business representatives before this Committee has been requests for adequate staffing resources for the SBA, particularly increasing the number of

¹ See the Small Business Administration’s Office of Advocacy document *Frequently Asked Questions* (<http://www.sba.gov/advo/stats/sbfaq.pdf>)

² See for example the testimony of Ms. Christina Schneiber Chief Financial Officer Purcell Contracting Corporation to the Subcommittee on Regulatory Reform and Oversight, House Small Business Committee, Thursday, March 30, 2006.

³ See for example 2003 GAO Report No. 03-704T. *Reporting of Small Business Contract Awards Does Not Reflect Current Business Size.*

Procurement Center Representatives (PCR).⁴ Such requests reflect the need to ensure that the goals are achieved and requirements are met. But these goals and requirements also impact the decision making of contract personnel in the agencies that let the contracts. Increased requirements, and the increased oversight and scrutiny that follow, will cause procurement personnel to focus more on the maze of rules and regulations at the expense of maximizing public value in contract decisions.

Contract Bundling and Contract Consolidation

This tension between maximizing public value and taking steps to ensure robust participation of small businesses in federal procurement is perhaps most apparent in the SBA requirements restricting the combining of previously independent task requirements into larger procurements, pejoratively called “contract bundling,” but more positively referred to as “contract consolidation” or “strategic sourcing.”⁵ As the Committee is well aware, “contract consolidation” increased considerably after Congress passed the Federal Acquisition Streamlining Act in the mid-1990s. There are good reasons for this increase. Combining task requirements into a single contract has much to recommend. It can lead to reduced costs as a result of price competition among larger firms or as a result of scale economies – why should agencies and the American tax payers that fund them pay retail for a good or service when they can purchase wholesale? “Contract consolidation” can also increase the government’s leverage over vendors. Private firms routinely use bulk purchasing to manage their supply chains. For example, the Swedish retail giant IKEA is renowned for using purchasing power to compel suppliers to use environmentally friendly production practices. In Ohio, public organizations also recognize this power. The Northeast Ohio Sourcing Office, a council of governments in the Cleveland area, with local governments, special districts and other public organizations to pool their purchasing to ensure they receive high quality services at the lowest possible cost. Some federal agencies, like the Department of Homeland Security, the Department of Defense, and the Department of Energy, are using “systems-of-systems” contracts for highly complex tasks in which responsibility for designing, building, and integrating processes and assets into a coherent system is contracted to a private sector “lead systems integrator.” The upside of the systems-of-systems contracting approach is access to highly technical capacity and expertise not available in-house, along with stimulated innovation through competitive bidding, and reduced procurement management costs.

Consolidation of tasks into a single contract can, however, have detrimental impacts on small businesses. A growing body of research shows that bulk purchasing is a primary

⁴ See e.g. testimony of Ms. Catherine Giordano, President of Knowledge Information Systems, Inc. and testimony of Ms. Christina Schneiber, Chief Financial Officer Purcell Contracting Corporation to the Subcommittee on Regulatory Reform and Oversight, House Small Business Committee, Thursday, March 30, 2006.

⁵ According to 15 USC 632(o)(2); FAR 2.101; 13 CFR 123.2 (d), contract bundling refers to “consolidation of two or more procurement requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation of offers for a single contract that is likely to be unsuitable for award to a small business.”

barrier to small business participation in government contracting as a prime contractor. On this point there is little debate. Individual small businesses are unlikely to win bids for many “bundled” contracts. The goal of helping small businesses compete for federal contracts was an important rationale for the of restrictions on bundling enacted in 2002, the passage this year in the House of the Small Business Fairness in Contract Act, and your increased oversight of the SBA’s implementation of the new rules.

Clearly, the question of contract bundling sits at the center of the tension between providing procurement personnel the flexibility to optimize cost and quality and the goal of trying to ensure the equitable participation of small businesses in federal procurements. I am concerned, though, that the trend is toward excessive “policing”, which comes at the expense of public value in federal procurement.

Finding a Balance between Public Value and Small Business Participation in Federal Procurements

As members of this Committee, you are chiefly concerned with the plight of small businesses. I propose that as you continue to make changes to the federal procurement process, you also assess the impact of your decisions on the ability of federal procurement personnel to deliver public value to American tax payers. My own experience and research suggest that a balance can be achieved between small business participation and providing federal procurement personnel with the tools and the discretion to optimize cost and quality. This does not have to be a zero-sum trade-off.

In moving forward – perhaps in conference committee should the Small Business Fairness in Contract Act pass the Senate or through the appropriations process for the SBA – I strongly encourage the House Small Business Committee to try to identify ways to achieve your goal of maximizing small business participation in the procurement process without unduly inhibiting the other goal of achieving best public value for the American tax payer. To that end I offer three specific recommendations that focus on increasing the capacity of the federal procurement system to address both goals.

Enhance SBA Capacity to Facilitate rather than Police

As I noted earlier, about a year and a half ago, the Subcommittee on Regulatory Reform and Oversight of this committee held a hearing on the SBA’s Procurement Assistance Programs. A consistent recommendation from those that testified from the small business community was to increase SBA staff capacity, particularly by increasing the number of PCRs at small business procurement centers.⁶ Let me add my voice to that chorus. The SBA needs more staff and capacity. However, rather than hiring new PCRs to just focus on enforcement (e.g. seeking out instances of contract bundling and referring those cases to the GAO for review) I would recommend that the focus in recruiting and training new

⁶ See also 2000 GAO Report No. 00-82 *Small Businesses: Limited Information Available on Contract Bundling’s Extent and Effects*.

staff be to work with small businesses to navigate the federal procurement system (e.g. widely disbursing information on upcoming bids to the small business community; assisting small businesses in developing bid proposals). A focus on assisting small businesses instead of on enforcing “contract bundling” or certification requirements will still contribute positively to your overall goal – increasing small business participation in federal procurement – without unduly inhibiting attempts by contract officers in federal agencies to optimize public value.

Encourage Collaboration and Learning within the Procurement System

This focus on facilitation and collaboration should also extend to encouraging positive relationships between SBA PCRs and procurement personnel in the federal agencies that let the contracts. In the near term there will be a significant influx of federal procurement personnel. The Partnership for Public Service projects the need for more than 8300 contracting experts throughout the federal government by 2009.⁷ The more incoming SBA procurement personnel are able to develop constructive working relationships with new procurement personnel in the agencies that let contracts, the more likely that both groups of procurement personnel are to learn how best to assist small businesses and improve procurement practices in the contracting agencies. Again I recommend the focus be on facilitation, rather than enforcement. As the procurement workforce turnover through attrition and new hires, the Committee should encourage SBA personnel to glean lessons in success from federal agencies with extensive procurement experience. The Department of Defense, for example, has perhaps the best developed set of policies and procedures for achieving balance between pursuing public value through contract consolidation and adhering to requirements prohibiting contract bundling.⁸

Gather More Information on the Impact of Contract Bundling/Consolidation on Small Businesses and Public Value

In reviewing various reports and research on contract consolidation, I was struck by how little is known about the impact of consolidation on both public value and small business participation in federal procurement. As noted earlier, research is fairly clear that consolidation or bundling harms small businesses in their drive to serve as prime contractors, but my judgment of the impact of consolidation on small business participation as subcontractors is that we do not know a lot. Part of this may stem from the fact federal agencies remain confused about what types of consolidation are prohibited and what types are permitted.⁹ Part of the uncertainty also stems from the lack of available data on subcontracting. I am hopeful recent Congressional action to improve the quality of information in the Federal Procurement Data System (FPDS) scheduled to

⁷ Partnership for Public Service. 2007. *Where the Jobs Are: Mission Critical Opportunities for America*.

⁸ Department of Defense. *Benefit Analysis Guidebook: A Reference to Assist Department of Defense Acquisition Strategy Teams in Performing a Benefit Analysis before Bundling Contract Requirements*.

⁹ 2004 GAO Report No. 04-454 *Impact of Strategy to Mitigate Effect of Contract Bundling on Small Business Is Uncertain*

go into effect in January of 2008 will improve the knowledge base. To that end, this Committee should ensure that the data base also includes information on the role of small businesses in subcontract arrangements. Should this information be adequately covered in the next generation of the FPDS, it will also provide opportunities for a more complete analysis.

In conclusion, I want to thank the members of the Committee again for the opportunity to share my thoughts on the SBA's contracting requirements.