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UNDER THE MICROSCOPE: REVIEWING THE SBA'S SMALL BUSINESS SIZE STANDARDS

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BEFORE THE

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HOUSE OF REPRESENTATIVES

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UNDER THE MICROSCOPE: REVIEWING THE SBA'S SMALL BUSINESS SIZE STANDARDS

TUESDAY, FEBRUARY 6, 2024

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:08 a.m., in Room 2360, Rayburn House Office Building, Hon. Roger Williams [chairman of the Committee] presiding.

Present: Representatives Williams, Stauber, Meuser, Molinaro, Alford, Crane, LaLota, Maloy, Velázquez, McGarvey, Gluesenkamp Perez, Scholten, Thanedar, Davids, and Pappas.

Chairman WILLIAMS. Before we get started, I want to recognize Congressman Stauber from the great state of Minnesota to lead us in the Pledge and a prayer.

Mr. STAUBER. Dear Lord, thank you for this wonderful day. And thank you for this Committee, the good work they do. And I want to thank you for my colleagues on both sides of the aisle that are doing your work and trying to make this nation an even better place. And let us share our love with one another, even when we disagree. It is your commandment, Lord. In your name we pray. Amen.

And join me in the Pledge. I pledge allegiance to the flag of the United States of America. And to the Republic for which it stands, one nation under God, indivisible, with liberty and justice for all.

Chairman WILLIAMS. Good morning, everyone, and I want to thank all of you for being here this morning. Appreciate it. And I now call the Committee on Small Business to order. Without objection, the Chair is authorized to declare a recess of the Committee at any time.

I now recognize myself for my opening statement.

Welcome to today's hearing, where we will be taking a close look at how the SBA defines small businesses and the impact it has in the federal contracting marketplace. To start off, I would like to thank our witnesses for attending today's hearing. We know that you have other work you could be focusing on, and we greatly appreciate your input.

Size standards were established over 70 years ago to protect small businesses by ensuring that only small business firms received SBA assistance in addition to determining eligibility for federal contracts. While size standards may seem like a topic that shouldn't garner too much attention, it is no secret to anyone here that determining what classifies as a small business is more complicated than it seems. And accurate size standards from the SBA

are critical because they impact the eligibility of small businesses for contracts across the entire government, not just one specific branch or agency.

At the beginning in 2010, it was decided the SBA would reassess their size standards, industry by industry, every 5 years. While there are many different opinions about whether the standards are too low or too high, one thing is abundantly clear, the SBA's size standards have a drastic impact on who can compete in the small business market.

A common issue this Committee has observed is the boxing out of small businesses from the federal procurement space. Since 2010, the number of small businesses winning federal contracts has decreased by 50 percent, which is unacceptable and an issue we cannot and we must correct.

Moreover, like anything in the federal government, the federal procurement space is home to fraud. Despite being faced with harsh penalties, fraudsters misrepresent themselves as small businesses to gain access to lucrative contracts.

The other larger concern is a real small business losing their small status. Many agencies is a receipt-based standard, and if it is too low, it may prevent the business from fully participating because they can lose their size status due to high revenue. Generating contracts in today's dollars is all what it is. This is nothing more than punishment for a business succeeding which is antithetical to the American dream.

Additionally, small businesses that lose their status are often left to compete with large firms that dominate the industry. We must ensure the SBA standards are not so rigid that they exclude thousands of small businesses.

Outside of size standards, the theme of today's hearing is ensuring the small businesses are not left behind. At the end of the day, the federal government is the largest customer in the world. Our small businesses deserve to compete fairly in this lucrative market. Federal procurement is incredibly complex and any small business can get lost in it. It is the job of this Committee to give main street a voice at the table. And exactly what we are here to do today is that.

I would like to once again thank our witnesses for being here with us. I look forward to today's discussion. It is my hope we can find some common ground so as we can best help our nation's small businesses during this time.

And with that, I will yield to our distinguished Ranking Member from New York, Ms. Velázquez.

Ms. VELAZQUEZ. Sorry, I was at the financial services hearing but I am here now. Thank you. Thank you, Mr. Chairman, and thank you to our witnesses for traveling here today.

The demands on a small business owner's time are already immense. I appreciate that you are using some of your time to help this committee address these important issues.

How the Small Business Administration defines "small" can have an enormous impact on the success of an individual small business, as well as the collective success of small businesses across the country. This hearing gives us an opportunity to better understand the standards, their application for government contractors, the en-

vironments that they create, and the challenges for small businesses who approach or exceed their industry's standard. Right sizing the size standard is critical to ensure fairness, promote competition, and encourage small businesses to enter and remain in the industrial base.

The federal government needs to both recruit and retain small businesses like those on our panel. Yet both tasks are becoming increasingly challenging. Fewer small businesses are signing up to work with the government, and many more are exiting the market sooner than expected. This is increasingly prominent in the small business market. The government has roughly 40 percent fewer small businesses in its ecosystem than it did a decade ago, and it has always been a challenge in the mid-tier.

A GAO report I requested in 2019 found that most small businesses do not successfully graduate. Only 2.5 percent of former small businesses receive contracts as mid-tier companies nine years later. This Committee has regularly reviewed the size standards and tried to ensure that companies that want to grow can.

We have at times provided additional runway to do it, to give small businesses additional time to build their capacity, portfolio, and workforce for long-term success. Yet changes to small size standards and policies can be a double-edged sword if not done correctly. We do not want to disincentivize or punish growth, but must also carefully ensure we do not prematurely push small businesses into a market where they cannot compete.

The stability of contracting with the federal government provides smaller businesses with the opportunity to plan, grow, and hire at a pace that is appropriate for them. It is important to ensure any changes to government policies account for the impact on all small businesses.

As we will hear today, the federal government imposes unique and complex requirements on government contractors. These rules impact small business structure, cash flow, and workforce, as well as strategic decisions about size growth and ultimately whether to continue to participate in the federal marketplace.

I look forward to hearing from the panel on past performance requirements, subcontracting processes, and bundling policies that will help improve the environment for small business government contractors. I again thank all of the witnesses for joining us today.

I yield back.

Chairman WILLIAMS. Yields back. And I now will introduce our witnesses.

Our first witness here with us today is Mr. Jay Lambke. Mr. Lambke is the president of Government Acquisitions, Incorporated, located in Cincinnati, Ohio. At Government Acquisitions, Mr. Lambke is responsible for leveraging his over 20 years of experience leading the organization specialized in the IT needs of governments to guide the company through its ongoing needs.

Prior to joining Acquisitions, Mr. Lampke was president of the Prism Pointe Technologies as well as GovConnection, where he was responsible for turning around the company following the loss of their federal GSA schedule and negative earnings. He has also held executive roles at Gateway, Ingram Micro, and Tech Data.

Mr. Lambke attended Central State University for 2 years, where he studied business management before dropping out to help his parents save their business. Despite being unsuccessful in that, he managed to grow quickly through the ranks of larger companies thanks to the entrepreneurial thinking and strict business discipline.

Thank you for joining us today. We look forward to the conversation ahead.

Our next witness here with us today is Mr. Brad Moore. Mr. Moore is the CEO of Sterling Computers, located in North Sioux City, South Dakota. I have been there. It is cold. Founded by Mr. Moore's cousin in 1996, Mr. Moore joined Sterling Companies in 2004, after over a decade at his previous job, where he served as vice president of sales.

From early on, Sterling Companies focused on contracting with the federal government because they knew the government would always pay when the work was done. Now, government entities from the three letter agencies down to local governments make up the majority of the company's business. Federal government contracts alone represent 75 percent of their business. Sterling Companies now has nearly 300 employees, with over half of them working locally in North Sioux City.

Mr. Moore attended Dana College where he earned his Bachelor of Arts in business marketing. Thank you for joining us today. We look forward to speaking with you.

Our next witness who is here with us today is Mr. Andrew Christ. Mr. Christ is COO of Compass Constructors located in Kansas City, Missouri. Prior to joining Compass Constructors in September of 2020, Mr. Christ worked for two large general contracting and roofing firms where he worked as a project manager and field superintendent.

Mr. Chris has extensive experience with the U.S. Army Corps of Engineers and National Guard, including as a Member of the leadership team which oversaw construction of over $350 million in new barracks buildings at Fort Riley. He also is the president of the American Subcontractor Association of Greater Kansas City and is also a Member of the Executive Committee of the National Organization of the American Subcontractors Association.

Mr. Christ attended Kansas State University, home of the Wildcats, where he earned his Bachelor of Science in construction science and management. Thank you for joining us today. We look forward to conversing with you.

And I now recognize the Ranking Member from New York, Ms. Velázquez, to briefly introduce our last witness appearing before us today.

Ms. VELÁZQUEZ. Thank you, Mr. Chairman.

It is my pleasure to introduce Ms. Erin Allen, the President of Contemporaries, a Maryland-based company providing human capital solutions for federal agencies focused on public health. Ms. Allen has grown her women-owned and family-run company since taking over for her parents, who started the company in 1991. Under her leadership, Contemporaries, Inc. has consistently served as the largest provider of staffing services to the National Institute of Health under their small business program and grown to become

one of the most successful staffing suppliers to the Department of Health and Human Services.

They are also ranked as one of the top 10 vendors in their respective GSA schedule and have been recognized as one of the top 100 small businesses of the year by the state of Maryland.

She co-chairs the Small Business Committee for the Montgomery Chamber of Commerce and volunteers with the Women President's Educational Organization.

Thank you for participating today, Ms. Allen. We look forward to your testimony.

Chairman WILLIAMS. Thank you, Ranking Member. And we appreciate again all of you being here today.

So before recognizing the witnesses, I want to remind them that their oral testimony is restricted to 5 minutes in length. That is a big number here, 5 minutes. Okay?

If you see the light turn red in front of you, it means your 5 minutes have concluded and you should wrap up your testimony. If you try to go over, you will hear me do this. That means shut it down. Okay?

And so with that being said, I now recognize Mr. Lambke for 5-minute opening remarks.

STATEMENTS OF JAY V. LAMBKE, PRESIDENT, GOVERNMENT ACQUISITIONS, INC.; BRAD MOORE, CHIEF EXECUTIVE OFFICER, STERLING COMPUTERS; ANDREW V. CHRIST, CHIEF OPERATING OFFICER, COMPASS CONSTRUCTORS; AND ERIN ALLEN, PRESIDENT, CONTEMPORARIES, INC.

STATEMENT OF JAY LAMBKE, PRESIDENT, GOVERNMENT ACQUISITIONS, INC.

Mr. LAMBKE. Thank you. Chairman Williams, Ranking Member Velázquez, and Members of the Committee, it is an honor to appear before you today on behalf of my firm, Government Acquisitions. Most people call us GAI.

My name is Jay Lambke. I am the president of GAI. We are a HUBZone-certified small business that has been providing the government with IT services and solutions for over 30 years. GAI is a Member of GovEvolve, an advocacy organization for small and midsized businesses that promote public policies encouraging innovation and competitiveness in the IT industry.

At GAI, we have built a special company. And I don't just say that as the president. I say that because I believe we embody everything that is great about American small businesses. Our success is the result of deliberately building a strong family culture full of people who are heavily involved in supporting their local communities.

We also all share a powerful commitment to serving the most important customer on planet Earth, and that is the U.S. federal government. We understand the unique needs of each of our federal customers, and we work to leverage best of breed technologies, such as AI, robotic process automation, and cybersecurity, to better enable them to deliver their mission. My personal aspiration is to build this company into the best the industry has ever seen.

Now, over the course of my years at GAI, I have seen how acquisition policies shape the environment for small businesses in both positive and negative ways. GAI has experienced great success as a federal IT value-added reseller, or VAR, but we have also faced continual challenges regarding size standards for the industry. So let me set the stage for the enormous shift that has happened in government purchasing of technology over the past two decades, which is when our current NAICS code was put in place.

Twenty years ago, an ITVAR sale to the federal government was basically buy a box, sell a box. It was not a very complicated business, required far fewer employees than it does today. And the business is so much—and today the business is so much more complex, requires far more people and cost. And I will try to demonstrate.

Nearly everything we do for our customers as a small business innovator involves providing complex solutions that require numerous hardware and software technologies that have to be integrated together. This requires large numbers of very specific engineering resources. Twenty years ago, we did not have teams of people who had to go onsite to deploy these systems. Today, we employ large teams of people who go onsite, install the solution, integrate it with customers' existing systems, and then remain onsite, often for many years to continue development inside of those systems.

Twenty years ago, the contracting environment was also very different. There were far fewer contracts to bid on and the bids were fairly straightforward. Today, our proposal efforts are often extremely large and very complex and require a significant proposal staff in order to be successful.

Also, the contract opportunities in the industry today are regularly for 5 or 10 years. So if you don't win a slot on one of those contracts, you are probably not doing business with that agency for many years. Because each contract these days are so long, they are that much more important for companies like ours, which has led to an incredible increase in protests. This causes delays in contracts for many years.

All of this to say, the stakes today are much higher. The contracting complexities I described create the need for more government contracting professionals on our staff, including lawyers, technical writers, and subject matter experts. Not only does this add significant expense to the business, but it also adds a number of employees, which is the significant challenge in a headcount-based NAICS code.

To protect against the ever present cyber threats and ensure secure supply chains, federal contractors are required to comply with a number of ongoing specific requirements. While we believe these are great moves from the government and it is doing the right thing to protect the defense industrial base, these requirements and certifications, like others, also add significant cost, complexity, and people to the business.

The method of calculating whether a small business is small you would think would be pretty straightforward in our industry, but it is not. For IT resellers there is only one NAICS code that easily fits all the products and services we provide. Often a contract for

IT-related acquisition involves both products and service. Checking my time.

For each contract, the contracting officer can only assign a single classification code for the component that accounts for the greatest percentage of the contract value. Recognizing traditional rules and regulations cannot properly be applied to ITVAR procurements; the federal agencies seek numerous workarounds. The rules have not adapted to the quickly changing technology related procurements, and ultimately this piecemeal approach is failing. It is time for the system to change.

If the federal government intends to continue to leverage innovative and cutting-edge technologies, which it must, the size standards and corresponding NAICS codes must be modernized to address small ITVARs.

I greatly appreciate you holding the hearing today, and its focus on critical component of determining success in selling to the federal government. Thank you again for having me. I am happy to answer any questions.

Chairman WILLIAMS. Let the record show you talked for 5 minutes.

Mr. LAMBKE. Exactly, right? Yes.

Chairman WILLIAMS. Let me inject one thing, too. You are going to see some of my colleagues on both sides of the aisle move in, move out. It is because we have other hearings we will go to and no reflection on this.

Now I recognize Mr. Moore for his 5-minute remarks.

STATEMENT OF BRAD MOORE, CEO, STERLING COMPUTERS

Mr. MOORE. Chairman Williams, Ranking Member Velázquez, and esteemed Members of the Committee, thank you for your opportunity to testify—my opportunity to testify before you today. My name is Brad Moore and I am the CEO of Sterling Computers Corporation, an information technology value-added reseller also known as an ITVAR.

As a family owned and operated company headquartered in North Sioux City, South Dakota, we serve an intermediary between our customers and the wide-ranging manufacturers of IT hardware, software, and services, the largest of whom are Dell, Cisco, and Microsoft. We serve as a reliable, nimble, and secure partner for our government customers in their quest for operational excellence through the use of modern technology.

My aim today is to present testimony regarding a select issue within the ITVAR industry, namely around the 541519 size standard, and to propose the adoption of a new NAICS code, one specific to ITVARs, allowing for a new size standard of 500 employees.

Twenty years ago, when the SBA first established the industry standard of 150 employees for ITVARs, the IT landscape was vastly different than it is today. Our industry has, of course, evolved, some might say exploded, in the years since. Alongside such an evolution has come an increase in the breadth and complexity of the compliance burdens placed upon ITVARs, including the enhanced focus on supply chain risk management, ISO certifications, and the cybersecurity maturity model certification.

To meet those requirements, ITVARs must now hire specialist employees who can effectively manage the growing slate of compliance obligations. For example, today Sterling employs 35 individuals who are dedicated solely to government program management and compliance, and another 130 other individuals who hold over 400-plus required certifications from the technology manufacturers we represent. It quickly becomes evident that the allocated 150 employees is an insufficient headcount when stacked against the complex demands of the federal government.

As such, there is currently a trend of consolidation in our industry. It is common for ITVARs, once they have exceeded 150 employees, to sell their business, typically to large companies or private equity firms, thus eroding the supplier base of highly qualified and experienced VARs who have so valuably serviced the government. Why? Because to go from successfully competing as a small business to suddenly going up against companies with tens of thousands of employees is an improbable endeavor.

The number of small businesses receiving government awards has steadily decreased from 121,000 companies in 2010 to less than half that number in 2022. This is an indication, in part, that the complexity of government contracting and compliance is making the barrier to entry much more difficult than it was 10 to 15 years ago.

Furthermore, 541519 is at its core of services code, which means ITVARs are lumped into the same designation as IT services companies, even though the two business types are vastly different, with dramatically varying solutions and employee headcount needs. It is a square peg for a round hole.

Compounding the issue is the fact that ITVARs often don't charge separately for their value-added services, meaning the build services generally do not account for 15 percent of the total contract price, a threshold outlined by code 541519. We estimate as few as 2 to 5 percent of ITVARs are able to achieve this benchmark.

While there are a number of possible solutions, I believe the most sensible to be the creation of a new NAICS code, one that accurately captures the core competency of ITVARs and includes the introduction of an appropriate SBA size standard of 500 employees, thus eliminating the exception under code 541519, at footnote 18, assigning a new, applicable and more appropriate code will solve the aforementioned issue. It will also increase small business participation, enhance supplier qualifications, and benefit federal government customers through more competitive pricing.

Once again, I appreciate the opportunity to speak to you today, and I am grateful for the Committee's thoughtful consideration. And I look forward to answering any questions today or in the future. Thank you.

Chairman WILLIAMS. Thank you, Mr. Moore.

And I now recognize Mr. Christ for his 5-minute opening remarks.

STATEMENT OF ANDREW CHRIST, COO, COMPASS CONSTRUCTORS

Mr. CHRIST. Chair Williams, Ranking Member Velázquez, Members of the Committee, thank you again for the opportunity to testify in front of you today. My topics are going to include federal government requirements for past performance and qualifications, the use of payment and performance bonds, the impact of continuing resolutions on small business, and the bundling of contracts into MATOCs and SATOCs, which are multiple award task order contracts and single award task order contracts.

My name is Andrew Christ. I, along with my business partner, Mr. Allan Arias, operate Compass Constructors. We are a small construction business located in Kansas City, Missouri, that delivers high-quality and efficient construction projects to the federal government. A lot of our current clients are the Corps of Engineers, the Air Force Civil Engineering Center, the Naval Facilities Engineering Systems Command, or NAVFAC, and GSA.

I am testifying not only as the COO of Compass Constructors, but also as an Executive Board Member for the American Subcontractors Association. We are an association of trade and suppliers that represent over 3,800 individuals since 1966.

Compass Constructors views the strict requirement for past performance and qualifications as the largest hurdle for small businesses to enter the federal market. We have witnessed unfair competition toward private contractors who are outside of the federal construction space that have similar past performance not receive a similarly favorable rating for federal government. This makes it extremely difficult for a new contractor to enter into the market.

Through this experience, we have learned the value of the myriad of SBA resources offered to small businesses to operate within the federal government's contracting system. federal contracts require often a detailed management plan. They offer specific project staffing and qualifications of key members of the execution team, and if the company does not have these individuals or qualifications, it forces them to enter into the market for additional employees with federal construction experience. This can be a significant and very cost-prohibitive barrier of entry into the federal market.

All federal projects, all federal projects, are mandated to have payment and performance bonds. These must be in place in order for a contract to be executed as required by the Federal Miller Act.

The surety, they are going to evaluate many factors when determining whether or not to issue a guarantee to the obligee. This often includes operating capital, income statements, cash flow, debts, work in progress. You'll see that there are many parallels to the considerations that a surety recognizes versus what the federal government is evaluating from a performance and financial standpoint.

We purport that the rigorous evaluation that the surety performs is far greater than what the government is going to evaluate in a small business' solicitation response. So we would recommend that less emphasis be placed on documented past government performance and more emphasis placed on whether or not the contractor can perform a bid, payment, or performance bond.

ASA supports House Bill 1740. It is bipartisan legislation authored by Representatives Bost and Pappas that would ensure these bonding protections are applied to water infrastructure projects where federal funds are being allocated to government contracts.

The instability caused by continuing resolutions also make it difficult for federal agencies to have certainty on funding for projects. There are many times that we put together solicitation responses, submit them, only to find out that the funds are no longer available. We put together these large proposals that can be tens of thousands of dollars. That is cash right out of our pocket. And then all of a sudden, due to a continuing resolution, the money is gone. The project no longer executes.

My final concern is bundling of contracts into MATOCs and SATOCs. This can be where a 5- to 10-year project that they are going to award to four to five contractors. Now, again, the emphasis on past performance is often scrutinized. And if those small businesses don't have that, they are not going to be allowed to be a part of those MATOCs and SATOCs, which can be 5 to 10 years.

I would like to conclude my testimony by recognizing Representatives Stauber and Scholten, both Members of this Committee, for their leadership as co-chairs of the Construction Procurement Caucus. Again, I thank everyone at this Committee.

Chair Williams, Ranking Member Velázquez, I will now take any questions. Thank you.

Chairman WILLIAMS. Thank you very much.

I now recognize Ms. Allen for her opening remarks.

STATEMENT OF ERIN ALLEN, PRESIDENT, CONTEMPORARIES, INC.

Ms. ALLEN. Thank you. Thank you, Chairman Williams and Ranking Member Velázquez and Members of the Committee. Thank you for the opportunity to testify today.

My name is Erin Allen. I am the president of Contemporaries. We are an SBA-certified woman-owned small business located in Silver Spring, Maryland. I also serve as the Chair of the Montgomery County Chamber of Commerce, where I am proud to represent the many businesses that make up our robust Maryland economy.

As a Member of the Women's Procurement Circle, which is a group that advocates for policies that strengthen women-owned businesses that do business with the federal government, I appreciate the Committee's focus on the topic of size standards and pathways to growth for small businesses. This issue is one that has become increasingly relevant to my company as we have grown significantly over the last several years.

So I am a second-generation business owner. My parents started a company back in '91 when they cashed in their retirement and took out a home equity line of credit and started the business. As a family, we have worked really hard to grow our business, bootstrapping every piece of it. And now we find ourselves teetering on the edge of our small business size standard, which puts our business in a very difficult position. I only see really two options. One is that we sell off part of our business or we find a small busi-

ness to team with, but teaming means giving away 49 percent of our business that we have worked so hard for.

By every measure, we are still a small business and only have 95 employees. Now, that might seem like a large for a local mom-and-pop, but in my industry, that is still teensy.

If we lose our small business status, I anticipate we will have to lay off about 30 percent of our employees. And while some might get picked up by another contracting firm, others may not.

Our size standard is revenue-based. And however, revenue is not really an indicator of present competitiveness, but really one of future competitiveness.

A challenge in the federal market is that size standards vary widely across the different NAICS codes. We primarily win contracts under a code with $12.5 million size standard, but there is other NAICS codes in my industry that have a $34 million size standard. So this wide disparity means that I can be a small business in one and large in another, doing exactly the same work.

So bigger small businesses that are about to graduate from the set-aside world need time to build their infrastructure to compete against the mammoth companies that are in there. A firm like mine simply cannot compete with large federal contractors overnight.

Government contractors experience a unique pattern in their growth, which is causing an industry-wide midsized business crisis. This pattern of sudden growth is increasingly common because the government's frequent use of large contract vehicles due to contract management.

The SBA program that I have been able to utilize is the WOSB program. It allows agencies to set aside contracts exclusively for small women-owned businesses. The government has the goal of awarding just 5 percent of all prime contracts to WOSBs, and yet since 2011, they have only met that goal twice.

Agencies are authorized to sole source contracts to WOSBs. However, these awards are few and far between. And as I teeter on the edge of sizing out of being small, increased effectiveness of this program would really, really help. It would enable me to secure contracts faster, thus allowing me to be in a better position to make the transition into the full and open marketplace.

So SBA is required to review all size standards every 5 years. I feel like the SBA should look at industries more holistically and seek engagement through live forums with businesses. This increased engagement would give the agency a more accurate picture of how federal buying is really impacting small businesses in the market, rather than just using a formula to determine the size. While there are many policies that contribute to small business success, there are also many, many areas where the federal government really could improve.

I don't pretend to have all the answers to this problem. All I know is that I cannot compete with large contractors like Booz Allen. I am way too young to retire and way, way too old to start over.

Adjusting the size standards isn't about maintaining my business. It is about helping my employees earn a sustainable living in the middle class.

I appreciate the Committee's continued efforts to support small businesses, and I am so grateful for the opportunity to share my experience today and thank you. And I look forward to answering any questions.

Chairman WILLIAMS. Thank you, Ms. Allen.

And now we recognize myself for 5 minutes.

Mr. Lambke, small businesses are disproportionately affected by the government's increased compliance burdens. We have talked about that. The staffing costs alone to navigate tens of thousands of pages of regulations, in addition to abiding by contract rules, can be extremely difficult and expensive. In some industries, compliance officers end up being a built-in cost to doing business.

So my question is, can you discuss how compliance requirements and navigating red tape can impose a burden on your business?

Mr. LAMBKE. Happy to. Thank you.

Compliance for us comes in many forms. One of the most recent ones is the CMMC, the cyber maturity model certification, which I referenced in my opening remarks, which we, the industry, believe is the right thing to do. The threat has never been higher at the defense industrial base. We are obviously being attacked daily. And so it is really important that we have the right infrastructure and protections in place from a cyber standpoint and for our cleared personnel and so forth.

The challenge is that—so I will give you an example on our side. My IT staff has gone from a few people 3 or 4 years ago to a small army today. And the cost and complexity and that headcount is going to increase as CMMC actually starts to take place. Right? So we are in a ramping phase. It hasn't been fully implemented. So great requirement, but adds people and complexity to the business. That is just one.

We have ISO certifications. We have all of those. And then there is the certifications that go with many of the bids will come out with requirements for, Brad mentioned Dell and Cisco, and those manufacturing partners that we have, many of the bids will come out and say you have to have this many certified engineers at this level to bid on this contract and so forth. And if you are in a certain size standard, there is just no way you can have those numbers of certified engineers on staff. Thank you.

Chairman WILLIAMS. This is a sunk cost that could be better spent elsewhere in their operations. I am concerned that for small businesses in the contracting space, the effect of additional compliance officer is even worse. So not only does it add a cost to business, but also takes away a spot in the business size standards metric that puts them on one more employee away from not being able to compete for small business set-aside contracts.

So I am going to just go down the line and ask each one of you this, starting with Mr. Lambke. Do you see initial reactions to an idea that is this, do you think we should exempt compliance officers from a business employee count when the SBA examines their size?

Mr. LAMBKE. That would be wonderful.

Chairman WILLIAMS. Okay. Mr. Moore?

Mr. MOORE. Yes, that would be great, but compliance is going to be a lot more than one person. It is going to be dozens of people.

Chairman WILLIAMS. Thank you. Mr. Christ?

Mr. CHRIST. Yes, I agree. I believe the definition of compliance officer will be something that could be scrutinized and would offer up that a clear definition is present.

Chairman WILLIAMS. Okay.

Ms. ALLEN. For my business it wouldn't really make a big impact because we are not really in the IT space. We don't have a lot of—other than, though, the normal reporting that we have to do, you know, or outsource to maybe an attorney or a CPA, and some of my staff will sort of share the roles and responsibilities for that.

But I would agree with Andrew that there might be some complications in what is the definition of a compliance officer? Because you could say, really, that all of my headquarters staff are in some way involved in headquarters—or in compliance. So then you get into, like, well, what percentage of the time are they doing compliance? And so that would be the challenge.

Chairman WILLIAMS. That is if we make it hard on you. We want to make it easy on you.

All right. Real quick, from time I have remaining. Mr. Moore, well, your firm is less than 500 employees. The SBA size decisions determined that you are not a small business. For any small business owner, you never want to cap your success. If business is booming, you want to capitalize on it as much as possible and not think about how growth could negatively affect your business. So getting big and growing is good?

Mr. MOORE. Yes.

Chairman WILLIAMS. So, can you discuss quickly the challenges that you face when your business outgrew the SBA small size standards? And do you feel that the SBA size standards accurately reflect your industry's needs?

Mr. MOORE. Thank you. So the size standard in our industry is 150 employees. So once you are at 151, you become large and you are competing against IBM and Dell and everyone else with 10,000 employees. You know, there are very few businesses in our industry between 151 and 500 employees. And you do the best you can to compete, but, in actuality, 60 percent to 70 percent of the opportunities that you were once working on are no longer available.

Chairman WILLIAMS. Thank you very much. My time is up.

I now recognize the Ranking Member for 5 minutes for questions.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Ms. Allen, you state that you have teetered on the edge of graduation a number of times, and it appears largely due to factors that are outside of your control. What would the appropriate size standard policy be that would bring you and other small businesses sufficient predictability and allow you to plan and grow if you choose?

Ms. ALLEN. That is a complex question. So it depends. I know in my industry, you know, as I mentioned in my testimony, that there are several different NAICS codes that we could use. One is teensy, $12.5 million, but another one is $34 million, which, you know, for the work that I am doing in support services, is maybe reasonable. But if I were doing, you know, some of the work that these guys are doing in the IT space, those salary ranges are crazy high.

And so it is sort of like—it is almost like if you look at a car dealer, like, are you large because you have sold, you know, $10 million worth of cars? Well, what if you are selling a Ford versus if you are selling Lamborghinis? Right. What is your profit margin in those, right? So it becomes a complex question in that and how do you work that out. Yeah.

Ms. VELAZQUEZ. Thank you. In your testimony, you highlight that a more effective WOSB program would have put you in a better position to make the transition from small to midsized. Do you think that contracting officers understand how to use the existing authorities to maximize awards through WOSB?

Ms. ALLEN. Not even kind of. When I am talking to a lot of my clients, I am having to educate them on the WOSB program. A lot of them don't understand it, haven't been educated on how to utilize it. And those that have been educated, you know, it is more cumbersome than some of the other programs, so it makes it harder for them to utilize.

Ms. VELÁZQUEZ. Do you think that if we require federal agencies to only count certified WOSB toward their small business goal, more contracting officers might be compelled to learn how to use the authorities?

Ms. ALLEN. For sure, yeah. Yeah.

Ms. VELAZQUEZ. Mr. Christ, you write that continuing resolutions can cause instability. How damaging are CRs or government shutdowns?

Mr. CHRIST. They are extremely damaging. Thank you for the question, first of all.

And the challenge is, you know, keeping projects in the pipeline, keeping consistent revenue. We live every day off of that revenue. That is how we pay our employees. And if we get into a scenario where the faucets all of a sudden shut down, and we have been providing a lot of front end work, whether it be design or whether it be budgetary estimates, we are out that money and we can't recoup it. And so that is really the damage, is that we need to have that consistency in the revenue and allowing the contracts to be executed.

Ms. VELÁZQUEZ. You cite a loss of $10,000 per proposal based on instability. Does the government reimburse you?

Mr. CHRIST. No, ma'am.

Ms. VELAZQUEZ. Does the agency have to tell you anything about why it canceled the solicitation if the work is moved or if there are similar opportunities for which you might be qualified?

Mr. CHRIST. No, ma'am.

Ms. VELAZQUEZ. Ms. Allen, the Rule of Two has been critical to leveling the playing field for small businesses. Will you elaborate on the changes you mentioned in your written testimony and how they will impact small businesses?

Ms. ALLEN. Yeah. So the Rule of Two currently only applies to a very small percentage of the acquisitions that are happening in the world in the federal space. If that Rule of Two was expanded to, you know, things well above the simplified acquisitions, of which small businesses are able to compete in and are qualified for, it would really open so many doors and really be a game-changer.

Ms. VELAZQUEZ. Thank you. I yield back.

Chairman WILLIAMS. Yields back.

I now recognize Representative Stauber from the great state of Minnesota for 5 minutes.

Mr. STAUBER. Thank you very much, Mr. Chair.

And Ms. Allen, between a Lamborghini and a Ford, I will take the Ford pickup all day long in northern Minnesota.

Minnesota's and this country's small businesses are powerhouses of innovation and resilience. They create jobs, fuel our local economy, and contribute to the unique character of our states and nation. Yet when it comes to federal contracting, their potential is often stifled by a complicated process that favors large corporations with the vast resources.

Mr. Christ, as you mentioned in your testimony, there are concerns with how small businesses are paid following change orders or modifications to the original contract. How do these changes affect your businesses differently than a large business?

Mr. CHRIST. Thank you for that question. You know, as far as change order work goes, oftentimes the change order is executed by the contracting official. Contractually, we have to then begin on that work. We don't necessarily sit there and have to say, oh, here is upfront costs to go ahead and cover all the work that you have done and completed to date. A lot of times those change orders and contract modifications, they can take many, many months to go through.

Mr. STAUBER. Do you hold the monies, then?

Mr. CHRIST. We do, yes, sir. Yes, sir.

Mr. STAUBER. What does that cost you?

Mr. CHRIST. We are working on one right now that we have got probably $250,000 that we are holding. We have expended the monies, but we have no contract vehicle to actually bill for the funding.

Mr. STAUBER. Well, we are working on that.

Mr. CHRIST. Thank you.

Mr. STAUBER. You know, the various issues that you have highlighted encapsulate why I introduced the Small Business Payment for Performance Act, and you are well aware of that. This legislation is not just about protecting individual businesses. It is about safeguarding the future of our infrastructure and our small businesses.

When small contractors go bankrupt, the impact is far-reaching. Projects stall, skilled workers leave the industry, and the very foundation of our nation suffers. Similarly, when small businesses outgrow their small status and are recategorized as a large business, they are forced to compete with big corporations, sometimes with a disproportionate gap in total employees.

Mr. Moore, having experienced the transition after outgrowing your small business status, could you elaborate on some of the difficulties and regulations you have seen since your transition?

Mr. MOORE. You know, the majority of the difficulties are you work at a lot lower margin than the large businesses. We are in a very low-margin business. And with the increased government regulations, that takes a bigger percentage of your net profit, which makes it harder to really scale and hire your employees. So you are

caught in this no man's land of you are not small, but yet you are not big, you are not able to compete.

So the size standards and the regulations are very impactful on U.S. midsized businesses.

Mr. STAUBER. You know, some businesses view their status changes as the government penalizes them for growth. Would there have been a benefit to your company to restrict growth and remain classified as a small business, Mr. Moore?

Mr. MOORE. Yes, for sure. It would have helped us stay more profitable. But we just felt like to our employees, we couldn't tell them to now forevermore be stagnant. So we broke through the barrier. But there is definitely—that line in the sand of that small business size standard is definitely motivation not to grow your business.

Mr. STAUBER. Right, right. In 2019, the House passed my bill clarifying the Small Business Runway Extension Act. The SBA utilizes a 3-year average of gross receipts to determine whether a company should be classified as small and considered for SBA benefits.

The Small Business Runway Extension Act extended the 3-year average to the 5 years. And thankfully, the SBA took it upon themselves to do the right thing, and they did not need further congressional action. However, as many of you mentioned is clear, we need to really foster an environment of growth, and, you know, I look forward to this Committee doing just that.

Mr. Christ, I have to say that you, as a business, you are holding a quarter of a million dollars because a change order that the federal government forced upon you, it is almost like you have got to do that. I don't know how many businesses across this nation that would have the capability to do that, and it is simply just wrong. And thank you for your testimony, all of you.

And I yield back, Mr. Chair.

Chairman WILLIAMS. The gentleman yields back.

I now recognize Representative McGarvey from the great state of Kentucky for 5 minutes.

Mr. MCGARVEY. Thank you, Mr. Chairman.

And I am fond of saying on this Committee, small businesses do big things, and the work you all do is so important. But what is a small business? Small businesses come in all different shapes and sizes. And so what we are trying to do on this Committee is give all these different entrepreneurs the support to start businesses and the tools that they need to help them grow. That is what we want to have with our small businesses. So I am glad to have the opportunity to discuss these size standards today with this panel.

I can tell you I have heard from people in my district on this very issue who just grow frustrated. They are trying to do a good job with their business. What happens when they are dealing with these standards from the SBA, and how can we make it better?

We know the current structure of small business contracting programs, while necessary to ensure entities can compete for appropriate federal contracts, can sometimes be discouraging, especially for the more advanced small businesses that are ready to grow to that medium size or maybe a little beyond. So these concerns stem

from the fact that surpassing their size standard will lead to a loss of eligibility for set-aside contracts, increase compliance obligations, and direct competition against billion-dollar companies.

So, given these realities, not enough companies successfully make that transition from small, again, whatever that means, to other than small business status. The Department of Defense has referred to this as the "Valley of Death" for small firms that want to grow.

According to a 2019 GAO report, over 93 percent of businesses that received only set-aside contracts in fiscal year 2008 and were still federal contractors by year 2017 remained small. Only about 2-1/2 percent of those businesses managed to graduate to midsize by fiscal year 2017.

So, Ms. Allen, I will start with you. You mentioned that your company teeters on this edge of small to medium-sized business standard. Are there adjustments to the size standard rules or methodology that would ease the transition for small businesses like yours that are ready to move away from that kind of smallish business standard?

Ms. ALLEN. Yeah, you know, the Runway Act was a really great start, so thank you for that. There are several things.

I think, making the size standard more consistent in the industry, in my industry in particular, because there are multiple NAICS codes that I could operate under, and it really varies wildly. But additionally, the number just needs to be higher across the board.

I think that, you know, as these gentlemen have pointed out, you can't go from 500, even 150 employees to 10,000 employees overnight. And that is what it takes to really be competitive.

And so the numbers, whether it be dollars or people, that number just needs to be increased.

Mr. MCGARVEY. Is it possible to incentivize growth given the current framework?

Ms. ALLEN. No, it is completely not incentivizing growth. It is doing completely the opposite of figuring out how do I, you know, operate in this really limiting environment.

Mr. MCGARVEY. Got it. Mr. Moore, I am going to come to you with the next question. Before I do that, though, I do just want to say to Mr. Christ, I married a Missouri girl and have a 12-year-old daughter, so there is some interest in the Super Bowl this upcoming weekend.

Mr. CHRIST. I may be wearing my Patrick Mahomes socks.

Mr. MCGARVEY. There we go. I figured that might be the case.

Mr. Moore, in your testimony, you spoke to the challenges your company faced when you began to outgrow the small size category under that definition. Do you feel that an off ramp program dedicated to making the transition out of small business, again, as it is defined, making that less burdensome and daunting could have helped your business?

Mr. MOORE. Definitely.

Mr. MCGARVEY. You know what? My grandpa said, don't sell past the close, so definitely is the answer.

Mr. Chairman, I yield back.

Chairman WILLIAMS. The gentleman yields back.

I now recognize Representative Alford from the great state of Missouri for 5 minutes.

Mr. ALFORD. Thank you, Mr. Chair. Good to have everyone here today, especially Mr. Christ from Kansas City.

I tell you what, it is an honor to be on this Committee working to really help the fabric of America. As a former small business owner in the Kansas City region, I understand some of the hurdles, nowhere near the size of your business or some of the issues you are dealing know.

You know, we are here to help champion Main Street America under the direction of our Chairman Williams, to lower the barriers to creating small businesses, and to support small businesses that already exist. However, we know that federal procurement is incredibly complex, leading to massive compliance costs, as you guys have spelled out here, can prevent small businesses from even trying to compete for bigger contracts. And beyond the burdensome compliance cost, out-of-date SBA size standards and agency decisions can also leave small businesses behind.

While small businesses are supposed to have unique contracting opportunities, agency decisions can prohibit qualified small businesses. I want to get right into the questions here. I want to start with you, Mr. Moore.

Since 2010, the number of small businesses winning federal contracts has dropped by 50 percent. That is a stark decline, and I think it can be attributed to several factors, including the sizing standards. The great thing about it, I hear from both sides of the aisle here, these standards are out of date. We need change on page 15 and 16.

By the way, your testimony is unbelievable. I encourage everyone to read it very thorough. On 15 and 16, you offer some solutions. Run through those real quick, just thumbnail solutions for us, please.

Mr. MOORE. I don't have that in front of me, but the solution has got to be either a ramp off or several things that we have talked about, getting credit for certain compliance people. But I think really an increased size standard, if we have gone from half—121,000 down to less than half that, small businesses, something is not working. You know, the businesses are going out of business, and the small businesses are not surviving long term. So there is got to be some sort of change in the NAICS codes, the size standards, or there is got to be an off ramp.

Mr. ALFORD. So I am trying to wrap my head around this. What would be the opposition to this? What do you think?

Mr. MOORE. If you go ask very small businesses, they are all against expanding the size standards, and I think they are the loudest. And there hasn't been detailed industry studies around some of these NAICS codes.

Mr. ALFORD. Thank you. Mr. Christ from Kansas City, congratulations on becoming the National Vice President for the American Subcontractors Association.

Mr. CHRIST. Thank you.

Mr. ALFORD. Great work in our region. In your testimony, you talked about how strict requirements for past performance and qualifications are the largest hurdle for small businesses to enter

the federal construction market. What are some of your recommendations? How do we fix this?

Mr. CHRIST. So, in our industry, small business is classified based off of a revenue basis. We are one of those very small businesses. And our concern with raising the small business threshold is that it creates a glass ceiling still. Right now that is one of the issues that we see, is that there is a glass ceiling and no transition period.

If there was a transition period outside of the small business designation, we feel that that would be successful. If you just raise the size standards, all you have done is raise that glass ceiling. People want to get right up to it, but they never want to make that jump, because the jump from small business to open competition is so drastic that you are going to get smothered. And that is why only 2-1/2 percent of businesses that graduate small business don't go on to get another contract. You know, it is insane. We are playing with the thousand-pound gorilla at that point, and we can't compete.

Mr. ALFORD. All right. Real quick.

Mr. CHRIST. Yes, sir.

Mr. ALFORD. We got about a minute left. I know you do private projects as well as federally funded. If you build a private project in the Kansas City region, it is X dollars. If you are building pretty much the same project on the federal level, what is the added cost for that, for compliance and other factors?

Mr. CHRIST. You know, on average, it is probably about 25 percent to 30 percent.

Mr. ALFORD. More?

Mr. CHRIST. Yes.

Mr. ALFORD. Plus 30 percent?

Mr. CHRIST. Yes, sir.

Mr. ALFORD. That is incredible.

Mr. CHRIST. Yes, sir.

Mr. ALFORD. Because the taxpayers are paying for that.

Mr. CHRIST. Yes, sir. However, on that, they do have a proven three-phase quality control program that, I can attest, does work. Right now, the Corps of Engineers and their quality control requirements and program, it does mandate quality on those projects.

Mr. ALFORD. All right. In your professional opinion, who will win the Super Bowl?

Mr. CHRIST. Kansas City Chiefs.

Mr. ALFORD. Go, Chiefs.

Mr. CHRIST. Yes, sir.

Mr. ALFORD. Thank you. I yield back.

Chairman WILLIAMS. The gentleman yields back.

I now recognize Ms. Scholten from the great state of Michigan for 5 minutes.

Ms. SCHOLTEN. Thank you so much, Mr. Chairman. And thank you to all of our witnesses for being here today.

As the Ranking Member on the Subcommittee on Contracting and Infrastructure, I see how small businesses get boxed out of the federal marketplace by agency size standard decisions. Everything you are talking about here today, spot on.

I am particularly concerned with the ability of women-owned small businesses, WOSBs, to compete and be prepared to succeed if they outgrow these size definitions. That jump is so extreme.

In my home state of Michigan, as our recently departed football coach Jim Harbaugh would say, business is booming. It is particularly booming for WOSBs, which represent over 40 percent of businesses in our state. Can you believe that? Isn't that incredible? I am thrilled that last week this Committee passed bills to support the WOSB program, but there is still so much more to be done.

My first question for you, Ms. Allen. As a certified WOSB, can you discuss your experience with the program and if there are any tools that Congress can facilitate to help businesses like yours with growth and the graduation.

Ms. ALLEN. Yeah. So, you know, recently I was thinking about this. We went after a solicitation, and I will be really brief as I can, that was a small business set-aside. But it had a scorecard that we had to self score, and it was things like ISO certification. Have you had a DCA audit? Do you have a security clearance? Also, the threshold insofar as the size of the contracts was huge, and yet it was still a small business set-aside.

And so I feel like it might be useful not only if the SBA were out helping to educate contracting officers, that would really go a long way to helping the program, but also, you know, if there was some sort of education insofar as—or training or something to help small businesses get those DCA audits, get our ISO certifications, get, you know, all those different pieces that would enable us to get a higher score because we are qualified to do the work. I don't need a DCAA audit to say that I am—you know, my CPA is auditing me all the time. I promise we are good. Right, whole other conversation.

So I think that that would really go a long way to help insofar as small businesses. And that would help teensy, tiny companies and, you know, larger smalls.

Ms. SCHOLTEN. Thank you. It is almost too practical, almost too commonsense. Thank you very much. Very, very helpful.

Another concerning barrier to entry that I see in the contracting space is the absolute muck of ambiguity that small businesses are forced to navigate in applying for project funding. While the federal government is operating under continuing resolutions in particular, so unclear, no guidance. If we make small businesses complete a lengthy and costly application process, we should be able to provide some certainty around the funding, regardless of the threat of a shutdown. We feel this is a keen and pressing need for a lot of our small businesses.

This question is for Mr. Christ. Can you please speak to your experience competing for contracts under a CR? And what recourse could the SBA implement for firms to weather the uncertainty of a shutdown?

Mr. CHRIST. We would love to be able to have some sort of compensation guaranteed, but we understand that that is probably very far-reaching.

We do understand that the costs involved with procurement is simply the cost of doing business. However, what has become ever-changing and increasing are the requirements for these solicita-

tions, you know, the vast information that has to be provided, and it takes having to hire a graphic artist. We build buildings, we don't do pretty proposals, right? And so now we have the added costs of this additional individual, and we don't even know if the projects are going to be funded. And that is a challenge. It really is.

But again, we understand it is a cost of doing business, but it has become a substantial cost at a risk of, potentially, projects not even being funded.

Ms. SCHOLTEN. Thank you. Very helpful and informative.

I yield back.

Chairman WILLIAMS. Yields back.

I now recognize Representative Crane from the great state of Arizona for 5 minutes.

Mr. CRANE. Thank you, Mr. Chairman. I appreciate the opportunity to participate in this important hearing.

Does anybody on the panel know what the national debt of the United States is? Mr. Moore, you look like you were hitting your button first.

Mr. MOORE. It is a lot, 37 trillion, maybe.

Mr. CRANE. Thirty-four trillion. You guys know that we spent about a trillion dollars in the last 90 days that we don't have? You guys know what the annual deficit is every single year up here? Two trillion dollars-plus, about 200 billion a month.

So when you hear, excuse me, one of my colleagues just talked about continuing resolution. Does anybody know what that means? What does it mean, Mr. Lambke?

Mr. LAMBKE. It means that the agencies get funded at a base level from the previous year——

Mr. CRANE. Yep.

Mr. LAMBKE.—with no incremental funding.

Mr. CRANE. So you guys—right. So basically, funding at the same level, right? So you guys are all business owners, right? You guys understand budgeting. If you had something similar to a $2 trillion deficit annually, what do you think you would be doing as a business owner?

Mr. LAMBKE. That is pretty easy. If you——

Mr. CRANE. Would you continue funding your business at the same level you were last year?

Mr. LAMBKE. Absolutely not.

Mr. CRANE. What about you, Mr. Moore?

Mr. MOORE. Definitely not.

Mr. CRANE. Mr. Christ?

Mr. CHRIST. No, sir.

Mr. CRANE. Ma'am?

Ms. ALLEN. No.

Mr. CRANE. Why do you think we do that up here? Because it is so easy to spend your money. Nobody wants to say no. Right?

A lot of you rely on government contracts, is that correct?

Mr. LAMBKE. We are 100 percent federal contractor.

Mr. CRANE. When this whole thing goes bust, how many government contracts do you think you are going to get?

Mr. LAMBKE. I am guessing zero.

Mr. CRANE. Yeah. What about you, Mr. Moore?

Mr. MOORE. None.

Mr. CRANE. Do you think that is possible or do you think we can just continue to print money that we don't have?

Mr. MOORE. I hope that we don't continue to print money that we don't have.

Mr. CRANE. Well, do you see that changing? Do you guys spend any amount of time up here on Capitol Hill?

Mr. MOORE. A Little bit, yeah.

Mr. CRANE. Do you see that changing, Mr. Lambke, with the conversations you have had?

Mr. LAMBKE. I haven't seen a change in the time I have been watching.

Mr. CRANE. I have meetings all the time. Nobody ever asked that we quit giving them money or give them less money.

Mr. LAMBKE. No, sir. The hole gets bigger.

Mr. CRANE. The only reason I bring that up is because there is obviously—you know, I honestly wish the best for you and your businesses and your employees. I really do. As a small business owner myself, and a very small business owner, probably about 20, 30 employees, I think 50 or 60 at most, I understand how tough it is to start a small business, maintain it, you know, make sure my employees are taken care of. But there is a bigger problem up here that very rarely gets talked about, and that is our spending problem up here.

And it concerns me because, you know, when I look at business owners like you that rely on the government and government contracts, because what we do up here is not sustainable. It is just not sustainable. And you even hear when people talk about, oh, these CRs, these continuing resolutions, with disdain, right? The problem is these CRs are spending at the same level. And you just had four business owners that have all been successful say that is not sustainable. We couldn't do that in our own business. Yet we arrogantly do that every single time up here.

Go ahead, sir.

Mr. LAMBKE. May I add something? CRs are one thing, shutdowns are another.

Mr. CRANE. Yeah.

Mr. LAMBKE. CRs are easier to deal wiyh, we have operated under CRs for so long, so many years. That is one thing. But it is the shutdowns that scare us to death. Right? Because then we are having to make really hard decisions about what we do with the families that rely on our companies, you know, to feed their families. Right?

Mr. CRANE. Right.

Mr. LAMBKE. And so those are testy times. And the longer they go, and there is been a few good ones, those are the ones, I think, that bother us the most. Scare us.

Mr. CRANE. Well, on this same train of thought, if you guys had one bit of advice that you could give us on how to make sure that we don't completely destroy our national economy and cause your businesses to go completely under because there is no more government contracts, do you guys have anything that you would like to say to the Members of Congress on this panel? Go ahead, Mr. Lambke.

Mr. LAMBKE. Oh, not in 5 seconds. No.

Mr. CRANE. Go ahead, Mr. Moore. Anything? Mr. Chairman might give us a few extra seconds.

Mr. MOORE. Create more jobs, more prosperity, bigger tax base would be my advice.

Mr. CRANE. Pro growth?

Mr. MOORE. Pro growth.

Mr. CRANE. Gotcha. Mr. Christ?

Mr. CHRIST. I would recommend taking a look at the small business standards and distributing some of that revenue throughout that organization reasonably, not to the gorillas in the room that are just underneath that glass ceiling that I mentioned——

Mr. CRANE. Yep.

Mr. CHRIST.—that can destroy these small businesses. You can imagine——

Mr. CRANE. Yep.

Mr. CHRIST.—us going up against $200 million a year company.

Mr. CRANE. Okay.

Mr. CHRIST. We are never going——

Mr. CRANE. I think we ran out of time. Sorry, ma'am. We would have given you time, but we ran out of time.

Thank you, Mr. Chairman, for letting me go over.

Chairman WILLIAMS. Thank you. Yields back.

I now recognize Mr. Meuser, Representative Meuser, from the great state of Pennsylvania for 5 minutes.

Mr. MEUSER. Thank you, Chairman. Thank you all very much for being here with us today.

So I spent about 25 years helping grow a small business into a larger business. And what was interesting as well, 90 percent of our customer base were all, you know, mom-and-pop size small businesses. So I have real good understanding of things, private sector contracting, primarily, but some federal government.

And as my colleague was bringing out, you know, it has actually been remarkable where you mentioned, Mr. Moore, the pro growth initiatives. Our revenues in the United States of America have increased almost 40 percent in the last 5 years, $5 trillion versus 3.5 trillion. But we are spending 6.5 trillion. So that is a little bit of a disparity, a little bit of a problem that would, you know, wipe any of your businesses out likely in a hurry. I don't think your bank would last too long there.

So it is certainly a combination of just good business management. Right? I mean, effective reductions, but pro growth. Pro growth. That is what brought the United States out of the debts that we had after World War II. And we can do it again.

So on this, your businesses are based upon federal contracting. The size of the federal government is not your fault. I mean, everything you see around here is contracted. I mean, the size of our federal government is wildly excessive, and supplies and computers and you name it, need to be provided to it. So that is just the way it is.

And it is great that the SBA works towards making small businesses receive their fair share so you don't have to compete against those that are hundreds of millions of dollars and such. So I am listening very closely to everything taking place here.

Clearly, the formula for small business contracting needs to be reviewed, right? A hundred and fifty if the revenues are worked into that as well, based upon the different NAICS codes, it could be what, computer sales could be different than desks or furniture and such. And you all expressed a fair amount of ideas.

I will just start, though, what should be done with the formula? Okay, you said just raise the standard from 150 up. Now that is fine, but then that could encroach upon small business startups.

Now, let's face it as well, some businesses like yours could go from, you know, as soon as you hit 140 employees, you say, my new marketing department is now going to be under a new LLC, and they're not going to have to necessarily count towards my revenues. I will serve as a customer to them and they will be a vendor.

You are shaking your head, so I am sure that is one of the oldest tricks in the book, so that is prohibited. But I wouldn't doubt that goes through people's minds as you are considering how to handle all this.

So, a couple of questions. One, how do you think the formula should be better set up, revenues, size? And as well are you asked? Did the SBA ask you? Do you do surveys?

And also consider this. When you are at a—you receive a contract, and as you stated again, that it takes time to grow, there should be in the formula maybe a 3-year or 4-ear, and these are things that I look forward to speaking with the Chairman of this Committee on, of assurity. Right? If you do grow to 200 employees, you don't lose the contract that year. There is at least a 3-, maybe even 4-year statute which permits you to continue serving in that way.

So, Mr. Lambke, I will start with you.

Mr. LAMBKE. Yeah. So I am fine with the headcount-based NAICS codes for our industry personally. I think that the number, though, has got to look at what has happened to the complexity of the business over the last 20 years, and so 500 to me is the right number.

If you look at what is happening in AI and large language models and robotic process automation, it is a team sport. It is a very complex business. It requires a lot of very smart people working together across multiple systems and platforms. And so it is really just if the government intends, and I know they do, to continue to compete with our adversaries, both offensively and defensively, then you have got to be able to have small business innovators that can get to a sufficient size that they can still innovate.

I would argue that many of the larger businesses are not as motivated by innovation. If we don't innovate, we are out of business. I think when you get to a certain size, you cannot innovate as much.

Mr. MEUSER. They look at it only every 18 months. I ran——

Mr. LAMBKE. Yes, sir

Mr. MEUSER.—our of time. My apologies for speaking too long. I wanted to hear from you, but perhaps we can continue this conversation.

I yield back, Mr. Chairman.

Chairman WILLIAMS. Yields back. I now recognize Representative Maloy from the great state of Utah for 5 minutes.

Ms. MALOY. Thank you all for being here. I want to start with Ms. Allen.

Rep. Scholten talked about a bill we are working on together to protect WOSBs. And the businesses already have to certify that they are women-owned, but they don't have to certify that they are small. And what I am hearing from you is that could be very confusing. A business may not even know if they qualify as small, depending on which contract they are going for.

And I have sat here listening, trying to decide what to ask all of you, because you have defined the problem very clearly, and we have asked a lot of follow-up questions. So I just want to give each of you a minute. Is there anything you were prepared to tell us as part of a solution that you haven't had a chance to talk about yet?

I will start with Mr. Lambke and work my way down.

Mr. LAMBKE. Look, I think it obviously takes time, energy, and resources on behalf of the government, but look at the industry. Spend some time with the companies that do what we do specific to IT and recognize that there needs to be something very specific. But you can spend some time with each of us, look at our receipts, look at our business, look at how we get things done and the results we deliver for the customer. I think you can quickly determine where the size standards should be.

Ms. MALOY. Thank you.

Mr. LAMBKE. Yes, ma'am.

Ms. MALOY. Mr. Moore?

Mr. MOORE. So our business is changing at lightspeed. And in our primary NAICS code 541519, we are basically providers of technology. There is a limitation on the subcontracting rule which says that we can only subcontract 50 percent or less of the value of the contract.

There is a nonmanufacturing rule which says that, OEM—if we are awarded a contract and it is small business set-aside, then you have to procure that product from a small business, which is a manufacturer that is small, which there are none.

Footnote 18 says that in our code there needs to be 15 to 50 percent of services, 15 to 50 percent of contract value, and that is never the case. Product is usually the greatest value.

So, in my opinion, I just think that the SBA has come together with industry. We are put in an impossible position. There is a lot of regulations that there is no way that we can meet. So I just think it takes more dialogue and understanding, truly, what it is that we do.

Ms. MALOY. Thank you. Mr. Christ?

Mr. CHRIST. Thank you. So what I would encourage, again, I had mentioned a transition period. I feel that the transition period promotes continuous growth for businesses. Do I have a definition on that transition period and what it looks like? No, that is for additional conversations and I would love to have those conversations with you.

But the goal is, to promote innovation, is for businesses to continue to grow, and without that transition period, there is no incentive for growth. They want to get right to that point, be the large gorilla in the room, and they don't want to get out of there.

So one other thing that that forces is small businesses to—very small businesses to look to team up with larger ventures and create a joint venture agreement. Right? These can be fantastic mentor-protégé agreements. we are living proof that they work, because we are in one right now.

However, there are some bad characters out there that will utilize those joint ventures and those mentor protege agreements to just have an avenue to continue to play in that small business. So, you know, being very diligent and scrutinizing that, we feel, is also another thing that could be extremely helpful. Thank you for your question.

Ms. MALOY. Thank you. Ms. Allen?

Ms. ALLEN. Thank you very much for this question. So, for us, these guys, I think that their NAICS codes are all based on the number of employees that they have, whereas mine is based on revenue, which to me, doesn't make any sense, because for me, my cost of goods sold is huge, right? I mean, my biggest cost is my labor. So, you know, I am paying this much money, but my margins are a little, teeny tiny.

And so when you are looking at my revenue as whether or not I am large or small, my revenue might be up here, but if, you know, my margin is this little, teeny tiny bit, it doesn't make a lot of sense to me personally in those labor categories.

I agree with Mr. Christ that I think that a transition period would be hugely helpful. As I mentioned, helping small—especially WOSB companies, close to my heart, to get their DCAA audits done, to be able to get security clearances, to be able to the ISO certifications, helping them with that process, I think would be huge insofar as helping them to make those transitions that is incredibly expensive and time-consuming for us.

Ms. MALOY. Speaker B: Thank you. My time has expired. I yield back.

Chairman WILLIAMS. The gentlelady yields back.

I now recognize Representative Gluesenkamp Perez from the great state of Washington for 5 minutes.

Ms. GLUESENKAMP PEREZ. Thank you, Mr. Chairman, and thank you all to the witnesses for being here today.

So we know that the SBA is tasked with ensuring that small businesses are given a fair shot at competing for federal contracting dollars. These federal contracts can be an incredible opportunity for small businesses and our entrepreneurs. And Congress has established goals to award a percentage of all prime and subcontracts to women-owned small businesses, small disadvantaged businesses, service-disabled veterans-owned small businesses, and HUBZone certified small businesses.

I want to make sure that we are holding agencies to these standards, which is why I cosponsored the Corrective Action Report Oversight and Accountability Act with Representative Meuser, which would hold agencies accountable for actually hitting these benchmarks. But today, I am really interested in how we make sure that the benefits of these important programs that give small businesses opportunity to compete for federal contracts are actually going to small businesses.

Mr. Christ, I am interested in one of the problems you mentioned in your testimony. You talk about acquisitions where small businesses are solicited by larger firms to join joint ventures in which the small business holds 51 percent and the big guys hold 49.

You mentioned that these joint ventures can be extremely beneficial for small businesses to tap into the larger firm's bonding program, employee pool, previous government network, but you also know the problems arise when these big guys simply utilize the small businesses as a vehicle to get federal work otherwise set aside for small businesses. This is concerning to me because it means large businesses are getting this advantage that Congress intentionally set aside for the small guys who can't otherwise compete.

So in your view, how should we improve the program to make sure that the small businesses receiving these benefits are actually small?

Mr. CHRIST. That is a very great question and it is difficult to answer because there is always going to be bad characters no matter what we do. And I feel that the program itself is established in a very good manner, but examining the ownership structure of the joint venture is extremely critical.

We know personally of several firms where the larger businesses have actually required them to give up ownership in some of the smaller business. So now they are not getting 49 percent. They may be getting 54 percent of the revenue, because from the joint venture entity standpoint, they may only be 49. But when you factor in the ownership in the small business, it is more than that.

So I feel that, you know, examining the ownership structure of both companies and making sure that there is no cross-pattern or cross-pollination in there, I feel that that is one way that you can help kind of clean that up.

Ms. GLUESENKAMP PEREZ. Thank you. Mrs. Allen, you also mentioned some of these issues in your testimony, including the problems that arise when certain companies fraudulently claiming to be women-owned to benefit from these set-asides. Can you expand on this process for self-certification, how that works and how you think it could be improved?

Ms. ALLEN. Yeah, self certification, I mean, you can just check a box and say, oh, yes, I am woman-owned. You really need to have, you know, as Mr. Christ is saying, as with small businesses, also women and small businesses, to look at the structure, who is doing what, who is actually day-to-day? You know, is—you know, Joe Jim Bob's wife, the one who is the figurehead, but she has nothing to do with the business. She is not involved. She is not running it. That really does a disservice to women like me who are out there, you know, doing the things every day and really, you know, slugging it out with companies that are not woman-owned and not always small.

Ms. GLUESENKAMP PEREZ. Yeah. Thank you.

Before coming to Congress, I ran an auto repair and machine shop. And COVID, obviously, we were largely impacted. And that year, I had a bunch of different projects running. We worked on air improvement quality projects. We worked on taking our intake process online, all these big projects. Some of our good friends who

own an auto body repair shop, that whole year her entire project was figuring out how to navigate a city's contract process, you know.

And when you see these big hurdles, you really grasp like when the bureaucracy becomes so extreme, it is the small business, it is actually the women-owned that create these issues.

So I sincerely thank you all for being here today. I thank the Committee for your attention to this.

Chairman WILLIAMS. Yields back.

I now recognize Mr. Molinaro, Representative Molinaro, from the great state of New York for 5 minutes.

Mr. MOLINARO. Thank you, Mr. Chairman, and thank you all for being here this morning still.

I think I am going to continue in sort of that line of questioning, only to acknowledge that in my previous life in local government, we certainly recognized that small businesses were so much more ably—or able to navigate the local procurement policies and, of course, state and federal becoming much more complex. We recognize that the bureaucracy is too overwhelming in many cases. Small businesses, by definition, have lesser resources and time to make the commitment to navigate that labyrinth of regulatory oversight and outdated standards that I think this Committee has been fairly earnest in attempting to address.

The problem hasn't been that small business is too small, it is that big government is too big, and navigating that field has become even more challenging. And yeah, big business has found ways to circumvent.

And I would also offer the certification of women- or minority-owned businesses are challenging for those who earnestly and appropriately qualify, and far too easy for those who wish to act in a nefarious way.

Obviously, so I want to get to NAICS codes in a moment. I do want to reference, however, the posted act, which this Committee unanimously adopted. It is a bill I sponsored, passed the House, meant to demand the SBA open up a more greater transparency for small businesses to know regulation and how to navigate that regulation. All of you have testified to this to some degree, but I would like to just narrow it into or at least like to focus in on the issue of transparency.

Given your experience, the work you have done, obviously interacting with the federal regulatory oversight and your own work with the federal government, what should we do to appropriately address the issue of lack of transparency? That is where it starts.

What would be a good first step for actual transparency to make it easier for you all small businesses across this country to navigate the SBA?

Not a single thought?

Mr. MOORE. I just think that the SBA has been wonderful and very helpful during our 8(a) certification. There is many programs, a lot of assistance, and, you know, a lot of learning sessions, educational sessions, and I think that is all great.

Once you move out of the small business category, there is very little, if no, support. And I would like to see more collaboration continuing between the small business administration and industry.

Mr. MOLINARO. So greater collaboration. Anyone else?

Mr. CHRIST. Utilization of the business opportunity specialists. It is amazing to me that these small businesses don't know that that resource is out there. And Our business opportunity specialist has been fundamental in helping us navigate through all of these programs and really helping us understand what is required and expected of us as a small business.

So, you know, getting that out there and getting small businesses to participate with their business opportunity specialist, and probably looking at extending that and making it a little larger, because I know just in our region, we have had issues with turnover on the business opportunity specialists and not having enough of them to take the need that is out there. Thank you.

Mr. MOLINARO. Thank you.

Ms. ALLEN. I would agree. And you can imagine we are here in Maryland and, you know, we are kind of a company town. So you can imagine how many government contractors there are that could really benefit from those small business specialists, and there just are not enough of them to really be able to make an impact. If Kansas City is struggling, the Maryland-D.C. area, those guys are overwhelmed.

But there is just not enough to be able to really make a dent in the amount of help that small businesses could use insofar as, you know, getting themselves off the ground and also making that transition, that they have a lot of knowledge and just, they are up to their eyeballs.

Mr. MOLINARO. Let's do this, Mr. Lambke. I am going to let you jump in, but it will be my last question. Hopefully, with 20 seconds, you will be able to get to it. But you speak and you all have dealing with the challenges that businesses not quite fitting neatly into the NAICS codes offered by the SBA.

You obviously referenced the continuing resolution. The SBA has found is to continue to add footnotes to types of businesses that are emerging. And as a result, we all recognize there are now over 41 pages of different NAICS codes, which indicates, obviously, the ongoing problem.

Based on your experience, do you feel the current rigidity of the system can shut out innovative companies, I think you do, and ultimately, limit competition for government contracting? And you may have to answer that in writing later.

Mr. LAMBKE. Indeed.

Mr. MOLINARO. Thank you.

Chairman WILLIAMS. Thank our witnesses for their testimony for appearing for us today. And I think you can see that at least there is one Committee, truly is bipartisan. We get it. We are going to fix it.

And without objection, Members have 5 legislative days to submit additional materials, written questions for the witnesses to the Chair, which will be forwarded to the witnesses. So I ask the witnesses to please respond promptly. If that happens.

If there is no further business. Without objection, the Committee is adjourned and thank you.

[Whereupon, at 11:35 a.m., the committee was adjourned.]

APPENDIX



Testimony of

Jay Lambke

President, Government Acquisitions, Inc. (GAI)

House Committee on Small Business

"Under the Microscope: Reviewing the SBA's Small Business Size Standards"

February 6, 2024

Chairman Williams, Ranking Member Velázquez, and Members of the Committee, it is an honor to appear before you on behalf of Government Acquisitions, Inc. (GAI). My name is Jay Lambke, and I am the President of GAI, a Historically Underutilized Business Zone (HUBZone) certified small business that has provided the government with information technology (IT) services for over 30 years. GAI is also a member of GovEvolve, an advocacy organization for small and midsize businesses that works to support the technology industry by promoting public policies that encourage innovation and competitiveness.

At GAI we have built a special company – and I don't just say that as the President. I say it because we embody everything that is great about American small businesses. Our success is the result of deliberately building a strong family culture full of people who are heavily involved in supporting our local communities and who all share a powerful commitment to serving the single most important customer on planet earth, the U.S. Federal Government. We have strong convictions that the world is a much better and safer place when the U.S. and our allies are in a leadership position. To that end, as our name reflects, the company was specifically built to serve the unique missions of this customer in its various forms. Our entire company is proud of the innovative work we do of solving our customers' most complex technological problems. We clearly understand that each of our civilian, Department of Defense (DoD) and intelligence community customers have unique missions. We work to leverage best of breed technology such as artificial intelligence (AI), robotic process automation and cybersecurity to enable them to better carry out those missions. Our aspiration is to build this company into one of the best companies in our industry. A company who is heavily relied upon by the customers we serve and the families of the people we employ.

Over the course of my 17 years at GAI, I have seen how acquisition policies shape the environment for small businesses doing business with the federal government in both positive and negative ways. GAI has experienced great success as a federal IT Value-Added Reseller (ITVAR), but we have also faced continual challenges regarding size standards as an ITVAR, given government trends toward purchasing from large, government-wide contract vehicles. I greatly appreciate the hearing today and its focus on a critical component of determining success in selling to the federal government.

Before I delve into issues relating to size standards, let me set the stage for the enormous shift in technology in the last two decades. When I started working in the technology field 20 years ago, an ITVAR sale to the federal government was pretty simple: "buy a box – sell a box." It was not a super complicated business and required far less employees than it does now. Today, nearly everything we do with our customers as a small business innovator is providing complex solutions that involve numerous technologies needing to be integrated together. These solutions include AI, robotic process automation, and cybersecurity, all requiring multiple hardware and software vendors. Complex solutions require multi-disciplinary engineering resources and frequent teaming arrangements between multiple companies.

Twenty years ago, we did not have teams who went on-site for customers to deploy and manage these solutions. Today, we employ deployment teams whose job it is to go onsite and install the solution, integrate it with existing customer systems, and stay onsite often for many years to develop the inside of those systems. Twenty years ago, there were also far fewer contracts to bid on and the bids were fairly straightforward, requiring a small proposal team or light outsourcing of the proposal. Today, proposal efforts are often extremely large, very complex and require a large staff to be successful. Additionally, opportunities in my industry are regularly solicited through large five- or ten-year contracts. So, if you lose a bid for a spot on the contract, you cannot do business with that federal customer for many years. The stakes today are much higher.

Given that bids are now longer and more complex, we have seen a massive spike in protests. Protests lead to delays for both businesses and the government customer. A CEO of a large defense contractor once said, "In today's world you can add at least a year to every major proposal effort." These complexities create the need for more government contracting professionals on staff, which includes lawyers, technical writers, and subject matter experts. Not only does this add significant expense for businesses, but it also adds to the number of employees – a concern that we watch closely given the current size standards.

I would be remiss if I did not mention compliance costs, especially those associated with International Organization for Standardization (ISO) certification and the DoD's Cybersecurity Maturity Model Certification (CMMC). In an effort to protect against the ever-present cyber threats and ensure secure supply chains, federal contractors are required to comply with ongoing and specific requirements. While we believe the government is doing the right thing to protect and secure the defense industrial base, these certifications add significant costs, complexity, and people to our business. My internal IT team has grown from a few people to a small army, and the expense has skyrocketed with no signs of letting up.

Given the complex nature of a technology sales in today's environment, size standards and the use of North American Industry Classification System (NAICS) codes play a significant role in determining our success. Not everyone may understand the significance of a small office at the Small Business Administration (SBA) that has a big mission – the Office of Size Standards. They, and they alone, decide what size a commercial company can be to be considered small, either in terms of revenue or employees. Size standards are industry specific and set through NAICS codes. The SBA calculates size standards by computing a weighted average of businesses in an industry using five factors: average firm size, average assets size, four-firm concentration ratio, Gini coefficient (measure of statistical dispersion intended to represent the income inequality, the wealth inequality, or the consumption inequality within a nation or a social group), and small business participation in federal contracting. On that note, the SBA has asked for comments to proposed changes to their formula for determining industry size standards, due on February 9, 2024.

The method of calculating whether a business is small seems like it should be pretty straight forward, but in our industry, it is not. For IT resellers, there is no one NAICS code that easily fits all the products and services we provide. The acquisition workforce is required to designate a single NAICS code to a procurement. A solicitation for IT-related acquisitions can often be for a mix of both products and services, which is inadequately captured by the current NAICS system. Recognizing the traditional rules and regulations cannot properly be applied to IT resellers, federal agencies have sought numerous workarounds. The rules have not adapted to quickly changing technology-related procurements and ultimately this piecemeal approach has failed. Therefore, the SBA came up with a solution: "Footnote 18" under NAICS code 541519 - Other Computer Related Services.

Misapplication of the ITVAR code is particularly problematic for small businesses. In this case, many businesses that otherwise meet the value-added requirements are often faced with a difficult choice. Bid, with the potential of not being able to provide services that align with the 15-50% requirement of 541519 or forgo the opportunity while competitors that are less worried about compliance are awarded the work.

The solution to this government and industry problem is the creation of a new NAICS code for the ITVAR community. Even though our industry has approached the General Services Administration (GSA), the Department of Commerce and Office of Management and Budget's Office of Federal Procurement Policy (OFPP) advocating for dedication of a new NAICS code to IT resellers, no one in any of these agencies has been able to point to the process necessary to secure a new code. The only option available to us is a directive from Congress, and we implore this Committee to assist us in our quest to fix this problem. By doing so, the small business ITVAR community will be better equipped to bid on federal contracts and meet agency missions. Given all the changes in federal acquisition policies, federal buying strategies and the IT sector, it is high time to move beyond being a footnote to a NAICS code specifically tailored toward the ITVAR industry.

In summary, small businesses who sell IT customizable solutions to the federal government have undergone significant changes in the last several decades as have the government's requirements. Being small in the federal space comes with benefits of restricted competition for contracts and can be a considerable leg up to get started and grow in winning federal work. Size standards and corresponding NAICS codes need to be modernized to accommodate the changes necessary for this industry to be successful.

This concludes my testimony. I will be happy to answer any questions.



Testimony of

Brad Moore

Chief Executive Officer

Sterling Computers Corporation

House Committee on Small Business Hearing

"Under the Microscope: Reviewing the SBA's Small Business Size Standards"

February 6, 2024

Chairman Williams, Ranking Member Velázquez, and Members of the Committee, thank you for the opportunity to testify before you today. My name is Brad Moore, and I am the CEO of Sterling Computers Corporation ("Sterling"), an Information Technology (IT) Value Added Reseller ("ITVAR") that offers hardware, software, and technology services to the federal government, state and local governments, and education and commercial customers. Sterling has been family-owned and operated company since its founding; My cousin and his wife started the company in Torrance, California in 1996. Sterling has been headquartered in the Midwest for more than 20 years, and in the State of South Dakota for more than 10 years. Currently, we are headquartered in North Sioux City, South Dakota. Our modern, beautiful headquarters evokes the best of Silicon Valley and celebrates our South Dakota heritage. True to our commitment of giving back and investing in the local community, Sterling completely renovated 83,000 square feet of the old Gateway Computers headquarters—infamous for its enormous cow-spotted buildings—and cemented our roots to the Siouxland area, resulting in a merging of the past and the present, tradition and the future.

We committed to employing individuals from the local community. Sterling's presence within the Siouxland community has resulted in a marked impact across the tri-state area. Economically, we support nearly 167 employees locally with payroll and competitive benefits, we host dozens of events throughout the year at local venues, and we leverage other community businesses as much as possible for our own internal needs.

Further, buoyed by our remarkable growth across all facets of our organization, Sterling has established Configuration, Integration, and Distribution (CID) centers in North Sioux City, South Dakota; Sacramento, California; and Dulles, Virginia. We also have offices established in Norfolk, Nebraska; Round Rock, Texas; Scottsdale, Arizona; and Cocoa Beach, Florida. All of whose aim is to meet the increasing demand for our unique brand of solutioning and procurement.

Sterling's rise within the industry featured several key junctures, from our humble beginnings as a hardware reseller who primarily sold simple client deployments to commercial enterprises … to a vast, nationwide organization specializing in hardware, software, cybersecurity, data center, and Cloud across all territories and verticals. We have provided products for missions to space, for technology used to advance medical science, and to provide for distributed citizen services. Sterling is continuing to grow and mature as a leading AI integrator today. We create digital humans and are working with the most prestigious academic institutions to advance 5G/6G technology – all from a rural community. We continue to leverage our Midwestern values, chase after lofty goals, and pursue excellence in all things, as we support our customers with character and tenacity.

At the core of Sterling's capabilities is "Transformation." This is not just about changing from one state to another; it's about uniquely combining our strengths, resources, and competencies to create a distinct outcome for our customers. Over the years, we have experienced unprecedented growth, causing us to primarily size out of the Small Business Administration's ("SBA") "small business" size determination. While we are grateful for our success, Sterling now faces unique challenges as a midsize business that must now compete against large corporations. In my testimony today I will outline some of the challenges we have

experienced in the federal market as a small business, as well those that continue in our transition to the full and open marketplace.

As an ITVAR, our role in the IT Channel is to offer our customers a reliable, nimble, secure and competent partner in their quest for excellence through modern technology, often acting as an intermediary between government agencies and the creators of this technology who are often referred to as OEMs or Original Equipment Manufacturers. Our company sized out of small business status under NAICS code 541519 in 2019 as we crossed over the 150 employee threshold. Our employee growth has been caused by two primary factors. First, our business success. We are a leading supplier on several government GWACS, such as SEWP, CIO-CS and 2GIT, and we are a valued supplier to many of the large government system integrators. We are also a valued partner to the largest OEMs in our industry, such as Dell, Cisco, HPE, Oracle, and Microsoft, and have high levels of partnership with our OEM partners. Second, the increased demand for capabilities by both our government customers and the large government system integrators, and our OEM Partners. With our business success and the increased demand for capabilities, has come an increase in the compliance burdens placed upon us. We have hired specialized employees in order to effectively manage our growing slate of compliance obligations. Today, Sterling employs 35 individuals who are dedicated solely to compliance and management of the complex demands of federal contract procurement and the regulatory landscape. Moreover, the 130 other individuals who comprise our technical and engineering teams—holding, collectively, over 460 advanced industry certifications, the possession of which is a requirement of conducting business with our OEM partners—and it quickly becomes evident why we crossed over the 150 employee threshold.

Sterling understands the Federal Government depends on small businesses to round out its supply chain and to facilitate achievement of important procurement goals. Each year, Congress sets Federal small business procurement goals in order to ensure "small businesses have the maximum practical opportunity to participate in providing goods and services to the Federal Government."[1] Currently, the Governmentwide goal for participation by small business concerns is "not less than 23 percent of the total value of all prime contract awards for each fiscal year."[2] In 2022, the Federal Government exceeded its 23% goal for the tenth consecutive year[3];

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[1] U.S. SMALL BUSINESS ADMINISTRATION, FY 2023 Goaling Guidelines, 2 (Dec 2022), *available at* https://www.sba.gov/sites/default/files/2023-01/FY23%20Small%20Business%20Goaling%20Guidelines_Final_221130%20%281%29.pdf ; *See* Small Business Act of 1958 § 2(a), 15 U.S.C. § 631.

[2] 15 U.S.C. § 644(g)(1)(A)(i). Once the annual Governmentwide goals are set, the Small Business Administration ("SBA") works with each agency to set an agency-specific goal for small business prime contracting and subcontracting. U.S. SMALL BUSINESS ADMINISTRATION, FY 2023 Goaling Guidelines, 3-6 (Dec 2022), *available at* https://www.sba.gov/sites/default/files/2023-01/FY23%20Small%20Business%20Goaling%20Guidelines_Final_221130%20%281%29.pdf The agency-specific small business goals for fiscal year 2024 range from 13.75 percent to 70 percent. U.S. SMALL BUSINESS ADMINISTRATION, FY 2024 Small Business Goals, 1 (Jan 2024), *available at* https://www.sba.gov/sites/default/files/2024-01/FY24_Final_Goals_508.pdf

[3] See U.S. Small Business Administration: Small business procurement scorecard overview (last visited Feb 1, 2024), available at https://www.sba.gov/document/support-small-business-procurement-scorecard-overview

awarding $162.9 billion in federal procurement opportunities (or 26.5% of total federal contract dollars) to small businesses, an $8.7 billion increase from the previous fiscal year.[4]

Twenty years ago—when the SBA first established the industry category and size standard of 150 employees for those ITVARs who fell under NAICS code 541519—the IT landscape was vastly different than it is today. Our industry has, of course, evolved—some might say exploded—in the years since. As the focus of government spending shifts more and more towards innovation and meeting agencies' burgeoning technology needs, small businesses are providing the Government with information technology more than ever before, including hardware, software, and cloud computing. In many cases, these small businesses are ITVARs that provide beneficial value-added services. These small business ITVARs can provide efficient and cost effective solutions for complex IT procurements, in addition to helping the Government meet its small business goals and creating more competition in the market. Thus, small business ITVARs are critically important to federal government procurement.

Yet, alongside the evolution of the IT landscape has come an increase in the breadth and complexity of the compliance burdens placed upon ITVARs. The current regulatory landscape includes a patchwork of rules and regulations for small businesses, including rules specific to the IT industry, that are unworkable in many cases. Issues and restrictions surrounding small business procurements have led to frequent misclassification of IT procurements and potential liability for contractors. This, coupled with contractor misunderstanding of the rules and a seeming unwillingness by agencies to correct issues or grant necessary waivers, has made it challenging – and in many cases impossible – for small business ITVARs to participate in federal procurements without potentially violating the law. In many instances, small business ITVARs are forced to choose between missing out on federal business opportunities and potentially opening themselves to considerable liability. To both mitigate this considerable liability and continue to compete for federal business opportunities, ITVARs look to hire employees to manage their growing slate of compliance obligations. However, this increased headcount presents a new dilemma for small business ITVARs, as they are forced to choose between increasing their headcount to effectively navigating the complex demands of federal contract procurement by increasing their headcount, and foregoing hiring those employees to stay below the 150 employee threshold and maintain its status as a small business. As the IT industry evolves and the government's demands for IT solutions increases, so too should the rules applicable to IT procurements, particularly where this will allow more opportunity for small businesses to compete.

I. Benefits of the Small Business IT Value-Added Reseller in Federal Contracting

Due to changes in how the Federal Government uses and procures IT, the type of small business providing IT to the Government has changed considerably, resulting in a new category of small business – the small business ITVAR. The small business ITVAR has been able to fill an important role where, generally, the Government (1) prefers to obtain IT equipment and supporting services from a single source; (2) regularly uses a single acquisition to obtain

[4] U.S. SMALL BUSINESS ADMINISTRATION, *Biden-Harris Administration Sets Record-Breaking $163 Billion in Federal Procurement Opportunities to Small Businesses, (July 18, 2023), available at* https://www.sba.gov/article/2023/07/18/biden-harris-administration-sets-record-breaking-163-billion-federal-procurement-opportunities-small.

numerous IT products that typically are not produced by any one original manufacturer; and (3) requires the contractor to customize computer hardware or software to meet an agency's specific needs.[5] ITVARs purchase IT products from the original manufacturer (or from another distributor) and resell the products to end users.[6]

But, rather than acting solely as an intermediary, many ITVARs provide valuable, customized IT solutions including configuration consulting, systems integration, and installation of multi-vendor computer equipment. Many of these services are provided pre-award, and thus are not directly reflected in eventual contract award amounts. Specifically, ITVARs provide access to engineers and architects with subject matter expertise that assist the Government in creating and implementing customized, scalable solutions. They serve to strategically connect Government with original equipment manufacturers (OEMs) in innovative ways. Further, many ITVARs provide pre-contract services to include access to demonstration centers, which allows the Government customer to conduct proof of concept testing to ensure the proposed solutions and equipment work as expected prior to making a final purchasing decision. To ensure the highest levels of competency, ITVAR employees may maintain multi-vendor certifications that indicate employees have the necessary skills to implement and operate key products. In addition, due to their industry position and structure, ITVARs can ensure that Government-required cybersecurity and supply chain risk management standards are in place to safeguard Government data and systems. These critical services are provided with minimal, if any, added cost to the government because they are included in overhead costs, covered by narrow margins on the IT products, and generally not separately charged. As such, ITVARs exist as a trusted and cost-effective conduit for original manufacturers to reach Government customers, and they pass these savings along to the Government.

Small business ITVARs are an integral part of the federal government pipeline. Nevertheless, a patchwork of rules and regulations specific to small businesses and the IT industry specifically have made it challenging, and in some cases impossible, for small business ITVARs to participate without potentially violating the law.

II. The Current Landscape of Small Business Procurement Requirements

A. North American Industry Classification System ("NAICS") Codes

The North American Industry Classification System ("NAICS") is the standard hierarchical classification system used by the Federal Government to classify business establishments into specific industries.[7] Although the NAICS Codes in many cases do not entirely mirror their specific requirements, agencies have adopted NAICS codes for – and these codes have a substantial impact on – federal procurements.

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[5] *See* Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, 81 Fed. Reg. 4436, 4443 (Jan. 26. 2016), *available at* https://www.govinfo.gov/content/pkg/FR-2016-01-26/pdf/2016-00922.pdf.

[6] Anne Pilon, *How to Become an IT Reseller*, SMALL BUSINESS TRENDS (Sept. 11, 2018), available at https://smallbiztrends.com/2018/09/it-reseller.html#:~:text=An%20IT%20reseller%20is%20a,intermediary%20in%20the%20distribution%20process.

[7] U.S. Census, North American Industry Classification System: Introduction to NAICS, *available at* https://www.census.gov/naics/ (last visited Feb 1, 2024).

In federal contracting, NAICS codes have two primary purposes: (1) to identify the purpose of the procurement, and (2) to identify the size standard an entity must meet to qualify as a small business for that procurement. When issuing solicitations, contracting officers are required to designate a single NAICS code that "best describes" the principal purpose of the product or service being acquired.[8] Often, a procurement for IT-related acquisitions may be a mixed procurement, involving both products and services. For these mixed procurements, the contracting officer still must assign a single NAICS code according to the "component which accounts for the greatest percentage of contract value."[9] This causes problems for ITVARs because in many cases these entities provide a combination of products and services not contemplated by traditional NAICS codes, and offer new technology, *i.e.*, software and/or cloud, that reasonably can be classified as a product or a service.

In addition to assigning codes to communicate the purpose of a procurement, the Government also uses NAICS codes "to establish size standards governing which entities qualify as small businesses for preferences or eligibility under government programs and procurements."[10] Generally, the size standards for supplies (under the "Supply Codes")[11] are defined in terms of number of employees, and the size standards for services (under the "Service Codes")[12] are defined in terms of average annual receipts. Although there are exceptions (some of which apply to ITVARs), "[m]ost manufacturing companies with 500 employees or fewer, and most non-manufacturing businesses with average annual receipts under $7.5 million, will qualify as a small business."[13] As such, these NAICS code designations largely depend on the nature of the items being acquired – for example, whether those items are supplies or services – and dictate the competitive pool of potential offerors.

The existing traditional NAICS codes used for federal contracting, and the corresponding SBA size standards, generally are not appropriate for small business ITVARs. Establishments that are "primarily engaged in" providing services can properly be classified under a Service Code.[14] Small business ITVARs provide hardware, software, and related products (supplies) that are manufactured by other companies along with services related to those products. Thus, the primary focus of the offerings available from ITVARs are not services and ITVARs generally cannot properly be classified under the Service Codes. Likewise, the Supply Codes used for federal procurements cover establishments that *manufacture* each specific product. Since the

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[8] 13 C.F.R. § 121.402(b).
[9] 13 C.F.R. § 121.402(b)(2).
[10] *Rotech Healthcare, Inc. v. United States*, 71 Fed. Cl. 393, 407 (2006).
[11] Service Codes begin with "5," for example, 518210 – Computing Infrastructure Providers, Data Processing, Web Hosting, and Related Services.
[12] Supply Codes begin with "3," for example, 334111 – Electronic Computer Manufacturing.
[13] U.S. SMALL BUSINESS ADMINISTRATION, *Basic Requirements: Meet Size Standards*, *available at* https://www.sba.gov/federal-contracting/contracting-guide/basic-requirements (last visited Feb 1, 2024).
[14] Each NAICS code description begins with "This industry comprises establishments primarily engaged in . . . ." *See, e.g.*, NAICS Association, NAICS Code Description for 334111 – Electronic Computer Manufacturing, *available at* https://www.naics.com/naics-code-description/?code=334111 (Last visited Feb 1, 2024).

products ITVARs provide often are manufactured by other companies, small business ITVARs do not fit neatly under the NAICS Supply Codes either.[15]

Relatedly, the existing SBA size standards associated with the NAICS product and service codes are not appropriate for small business ITVARs. The current employee-based size standards do not capture the fact that to be an ITVAR in the government sector is an employee-heavy burden. As mentioned previously, numerous employees are needed for compliance and ITVARs must obtain a wider breadth of knowledge with multiple OEMs than an IT service company would. Those numbers do not yet reflect the staff required to sell, purchase, track, invoice and collect during the course of business. Small businesses are not exempt from these requirements from the government nor the OEMs. To stay under the 150 employee small business size standard of 541519, small businesses must sacrifice hiring at the expense of obtaining and maintaining government mandated certifications and capabilities, or forgo obtaining advanced certifications with the OEMs, which hurts the portfolio of products they are able to offer and also negatively affects their pricing discounts and profitability.

There is a current trend of consolidation and acquisitions in our industry. It is common for VARs, once they exceed 150 employees, to sell their businesses. These VARs, who usually have years of experience in government contracting and mature capabilities, are purchased by larger industry competitors or private equity firms. There has been a mass exodus of firms from the industry once the size standard is exceeded. This hurts the federal government as they lose small businesses and qualified suppliers who are often replaced with less qualified and less capable suppliers. The unicorn in the ITVAR industry has become those companies with between 151 and 500 employees. To go from successfully competing as a small business to competing with companies like CDW (who has 15,000 employees) and IBM, once you reach 151 employees, is an improbable endeavor. The result is an erosion of the supplier base that has valuably serviced the government at the moment when they reach economies of scale. Not only does the government suffer under this scenario, but so do the employees and the communities where these businesses are located as the acquiring companies or private equity firms are headquartered in larger metropolitan areas. Increasing the employee size limit to 500 employees would insure there are ample small businesses that are qualified to meet the higher demands of today's government customers and would stay within the SBA PPP loan program guidelines used during the Covid Pandemic.

Moreover, the size standards based on revenue do not capture the fact that ITVARs typically operate on low margins. Consequently, their annual receipts can quickly surpass the size standard dollar thresholds. Thus, the typical size standards for Service Codes ($7.5 million in revenue) are too low for the ITVAR industry. This often results in excluding competent and

[15] Many small business ITVARs could be appropriately categorized under the Wholesale Trade NAICS codes (*e.g.*, 423430 – Computer and Computer Peripheral Equipment and Software Merchant Wholesalers). However, SBA regulations explicitly prohibit the government from classifying acquisitions for supplies under Wholesale Codes. *See NAICS Appeal of Global Precision Systems, LLC*, SBA No. NAICS-5681 (2015) (explaining 13 C.F.R. § 121.402(b)(2) requires that "[a]cquisitions for supplies must be classified under the appropriate manufacturing or supply NAICS code, not under a Wholesale Trade or Retail Trade NAICS code." Thus, even though the solicitation called for the contractor to distribute items manufactured by others, because the "heart of the procurement" is for supplies, it must be categorized under a manufacturing or supply code.); *see also* https://smallgovcon.com/naics-code-appeals/no-wholesaler-naics-codes-for-set-aside-contracts-sba-oha-confirms/

successful ITVARs that would otherwise qualify as small businesses (based on employee headcount).

In sum, traditional NAICS Supply Codes and Service Codes, and existing size standards, are not appropriate classifications for small business ITVARs, and, as discussed more fully below, present unique problems in the federal procurement context.

B. Unique Challenges for Small Businesses

Twenty years ago, when the SBA established the industry category and size standard of 150 employees for ITVARS using 541519, the landscape was vastly different than today. Our industry has evolved and exploded over even the last five years. The burden placed on ITVARS has increased drastically as well. With an increased focus on secure supply chain, certification requirements such as ISO certifications, CMMC, Supply Chain Risk Management, Environmental, ITAR, security clearances, Affirmative Action and others, ITVARS must now hire employees to manage compliance.

Today, Sterling employes 35 individuals who are dedicated to government program management and compliance. This includes contract program managers, deputy program managers, and a legal and compliance group that is responsible for the many certification requirements mentioned previously. Our OEM partners, who we team with to provide products to our government customers, also require us to hold increasingly advanced certifications to be authorized to sell their products. Currently, we have 130 unique individuals with 460 industry certifications. These certifications and OEM relationships are necessary to perform on our contracts, providing the necessary expertise required as the "value-add" in our industry. Government customers are also requesting these advanced OEM certifications as a requirement to bid on certain procurements. As an example, many requests for CISCO products now require the bidder to be a CISCO GOLD certified partner. Sterling has that certification; however, it was a timely and costly endeavor.

It is often difficult for small businesses to navigate these issues (and it has become apparent that many small businesses do not understand these issues), particularly where the Government has set-aside a procurement based on an inappropriate NAICS code. Currently, a $25 billion dollar industry is classified as an exception to a NAICS code that does not truly reflect what that industry does. ITVARS are lumped in the same code as IT service companies but are not the same. The types of services offered by each can be dramatically different as can the number of employees needed to support their businesses.

1. Limitation on Subcontracting Rule

For supplies and services, the limitation on subcontracting rule ("LOSR") requires that a small business not subcontract more than 50% of the prime contract amount to businesses that are not "similarly situated."[16] In contracts for mixed procurements (i.e., both supplies and services), "the limitations on subcontracting apply only to subcontracts that correspond to the

[16] 13 C.F.R. § 125.6; FAR 52.219-14. Under 13 C.F.R. § 125.1, a "similarly situated entity means a subcontractor that has the same small business program status as the prime contractor."

principal purpose of the prime contract."[17] The LOSR is problematic for small business ITVARs that resell IT products (*e.g.*, hardware, computers, etc.) and/or services (*e.g.*, cloud, hardware/software maintenance, etc.) to an end-user that originate from other companies. Often, the products and services the Government requires under the solicitation are provided only by large companies, and easily exceed 50% of the total contract amount. Thus, when applied, the LOSR has the effect of eliminating small business ITVAR participation in many federal acquisitions for IT products and services although they are set-aside for small businesses.

2. The Non-Manufacturer Rule

Specific to supply contracts, the non-manufacturer rule ("NMR") allows a small business to supply products it did not manufacture to the Government as long as certain requirements are met, including that the supplied products were manufactured by another small business.[18] A business generally may qualify as small under the NMR where it has 500 or fewer employees.[19] Small businesses may supply products manufactured by *any size* business if the SBA grants a waiver of the NMR.[20] There are two types of waivers: (1) an "individual" waiver, requested by the contracting officer and approved by the SBA, for a specific contract when there is no small business manufacturer that can meet the contract's requirements; and (2) a "class" waiver if there are no small business manufacturers available to supply a class of products.[21]

While class waivers exist for some hardware, currently, there are no class waivers for software products.[22] Thus, a small business ITVAR cannot participate in opportunities involving the purchase of commercial software manufactured by large businesses such as Microsoft, Oracle, Adobe, and Citrix, even where the Governmental agency specifically requires such software. Rather, small businesses can participate in such opportunities only when the contracting officer exercises his or her discretion and requests an individual waiver. Notably, it is not mandatory for the contracting officer to request an individual waiver, and it seems in most cases the contracting officer will choose not to seek a waiver, even if the acquisition is set up as a small business set-aside for product for which there is no small business manufacturer. This practice flies in the face of established rules and sets up unwary contractors to violate the NMR

[17] Small Business Government Contracting and National Defense Authorization Act of 2013 Amendments, 81 Fed. Reg. 34243, 34245 (effective June 30, 2016), *available at* https://www.govinfo.gov/app/details/FR-2016-05-31/2016-12494

[18] 13 C.F.R. § 121.406 (b).

[19] 13 C.F.R. § 121.406 (b)(1)(i). To qualify under the Information Technology Value Added Reseller exception to NAICS Code 541519 (Footnote 18), a business must not exceed 150 employees. *See* Section IV.A below.

[20] 13 C.F.R. § 121.406 (b)(5)-(7).

[21] *Id.*

[22] For example, the NMR Class Waiver list provides a very limited waiver for 334111 Mainframe Computers and Peripherals (note, peripherals are covered only when purchasing a mainframe computer), a wavier for 334111 commercially available off-the-shelf laptop and tablet computers, and a waiver for 334118 Printers, Computer, Manufacturing. *See* the NMR Class Waiver List at p. 12, *available at* https://www.sba.gov/sites/default/files/2022-10/NMR%20Class%20Waiver%20List%20-%20version%20June%202022.pdf.

(and, potentially, the False Claims Act) simply for following the requirements set forth by the Government.[23]

III. Various Attempts to Modify the Rules for Information Technology Procurements

Recognizing the traditional rules and regulations cannot properly be applied to ITVARs, the SBA and agencies have sought numerous workarounds. Indeed, various workarounds have been utilized by the SBA and government agencies because the rules have not adapted to quickly changing technology-related procurements. Ultimately, this piecemeal approach has failed. As a result, at least one government agency now is attempting to circumvent the onerous requirements by acquiring a blanket waiver.[24] This clearly demonstrates the need for a more complete solution, specifically tailored to meet the unique requirements of the Government and enable contractors to provide the best possible solutions with respect to IT procurements.

A. ITVAR Code 541519 (Footnote 18)

The SBA created a new sub-industry category for Information Technology Value Added Resellers ("ITVARs") under NAICS code 541519, with a corresponding size standard of 150 employees.[25] To accomplish this, it amended 13 C.F.R. § 121.201 by adding a footnote (Footnote 18), which provides a definition of ITVAR and describes the circumstances under which a procurement could properly be classified under the industry code 541519. The stated purpose of establishing this industry category was to "better apply small business eligibility requirements under Federal contracts that combine substantial services with the acquisition of computer hardware and software."[26] SBA believed establishing the ITVAR industry category was a "more effective approach to addressing the size eligibility requirements of nonmanufacturers providing substantial services along with IT products."[27]

Specifically, Footnote 18 requires an ITVAR classified under 541519 to "provid[e] multi-vendor hardware and software along with significant value added services. Significant value added services consist of, but are not limited to, configuration consulting and design, systems integration, installation of multi-vendor computer equipment, customization of hardware or

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[23] Small businesses also are subject to affiliation rules. For example, the ostensible subcontractor rule treats a prime contractor and its subcontractor "as joint ventures, and therefore affiliates, for size determination purposes" when the subcontractor "performs primary and vital requirements of a contract," or the prime contractor is "unusually reliant" upon the subcontractor. 13 C.F.R. § 121.103(h)(3). *See Size Appeal of Red River Computer Co., Inc.*, SBA No. SIZ-5512 (2013) (affirming that Red River was not a small business for a procurement involving Cisco's hardware and software maintenance where Cisco would perform most of the work because Red River was affiliated with Cisco under the ostensible subcontractor rule).

[24] The SBA approved a waiver to the NMR for the First Source III program and all delivery orders issued under FirstSourceIII. The NMR waiver was sought by DHS and approved by SBA on September 15, 2020 and applies to the NAICS codes under FirstSource III. *See* FirstSource III information at https://beta.sam.gov/opp/1d1105e4b3c440f5822ce86892fb5db1/view.

[25] Small Business Size Standards; Information Technology Value Added Reseller, 68 Fed. Reg. 74833 (Dec. 29, 2003), *available at* https://www.govinfo.gov/app/details/FR-2003-12-29/03-31795.

[26] *Id.*

[27] *Id.* At 74841.

software, training, product technical support, maintenance, and end user support."[28] As set forth in the regulation, the percent of value added services under Footnote 18 is measured as follows:

> For purposes of Government procurement, an information technology procurement classified under this exception and 150-employee size standard must consist of at least 15% and not more than 50% of value added services, as measured by the total contract price.

13 C.F.R. § 121.201 n. 18. (emphasis added). Thus, to qualify, a small business ITVAR must provide and charge the Government for value added services equivalent to between 15% and 50% of the total contract price. As discussed above, much of the value-added services provided by ITVARs occur prior to contract award and/or are built into existing pricing and not separately charged. Under the current Rule, measuring the percent of value added services as compared to the total contract price, the 15-50% requirement is unrealistic and will serve to unnecessarily increase the costs to the Government of meeting its small business goals.

Indeed, ITVARs add significant value to IT hardware and software products, in the form of features and services, prior to reselling those products to end-users. For example, ITVARs might provide configuration consulting, systems integration, and installation of multi-vendor computer equipment. These services are incredibly valuable to the government end-user, particularly where the Government often exhibits a preference to obtain IT equipment and supporting services from a single source. However, ITVARs generally do not charge separately for these value-added services. Rather, the service costs are incorporated into the company's overhead costs. As such, the services often do not account for 15% of the total contract price.

Under Footnote 18, an ITVAR contractor must comply with the NMR.[29] This is a change to the regulation made in 2016; prior to this, an ITVAR contractor was not subject to the NMR.[30] As discussed in more detail in Section III.B.2., above, applying the NMR to procurements of IT products presents several challenges for small business ITVARs and in many cases is inconsistent with what agencies specifically require in their solicitations. The ITVAR exception under NAICS code 541519 is insufficient to categorize the products and services required in recent complex agency IT procurements.

B. Software Code 513210 (Footnote 15)

Shortly after the current version of the ITVAR Footnote 18 was instituted in 2016, a separate SBA Rule went into effect amending certain SBA regulations related to software.[31] The new Rule relates to the current NAICS code 513210, Software Publishers, a services code with a

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[28] 13 C.F.R. § 121.201 n. 18.

[29] 13 C.F.R. § 121.201 n. 18 ("The offeror must comply with the manufacturing performance requirements, or comply with the non-manufacturer rule by supplying the products of small business concerns, unless SBA has issued a class or contract specific waiver of the non-manufacturer rule.").

[30] Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade, 81 Fed. Reg. 4436, 4441 (Jan. 26 2016), *available at* https://www.govinfo.gov/app/details/FR-2016-01-26/2016-00922.

[31] Small Business Government Contracting and National Defense Authorization Act of 2013 Amendments, 81 Fed. Reg. 34243 (May 31, 2016), *available at* https://www.govinfo.gov/app/details/FR-2016-05-31/2016-12494.

size standard of $47M. Relevant to ITVARs, the Rule classified unmodified, commercially available software supplied in procurements governed by NAICS code 513210 ("Software Publishers") as an item of supply rather than a service, thus subjecting these items to the nonmanufacturer rule.[32] To accomplish this, the SBA amended 13 C.F.R. § 121.201 by adding a footnote (Footnote 15), which explains that NAICS code 513210 is the proper NAICS code to use when the Government is purchasing commercially available off-the-shelf ("COTS") software, which is eligible for a waiver of the nonmanufacturer rule. Specifically, Footnote 15 reads:

> NAICS code 513210 – For purposes of Government procurement, the purchase of software subject to potential waiver of the nonmanufacturer rule pursuant to 121.1203(d) should be classified under this NAICS code.

13 C.F.R. § 121.201 n.15. Characterization of COTS software as a product subject to the nonmanufacturer rule presents the added complication of seemingly conflicting size standards applicable to these procurements. The NAICS code 513210, a services code, has a size standard of $47M, while a company may qualify as small under the nonmanufacturer rule based on a size standard of 500 employees.[33] Clarity has yet to be provided by the SBA on this issue.

As noted above, one intended consequence of changing the classification for COTS software to a supply was that the NMR then became applicable to procurements for this type of software, and waivers then could be sought. The Rule amended the SBA regulations to include a specific subsection regarding "waivers for the purchase of software."[34] Section 121.1203(g) says the "SBA may grant an individual waiver for the procurement of software," provided the software meets certain conditions.[35] Individual waivers may be requested by contracting officers and the public can request that SBA issue class waivers for software items.[36] However, in practice contracting officers have been reluctant to request a contract specific waiver prior to issuing the solicitation, and, to date, no class waivers for software have been granted.[37]

A class waiver here would be appropriate and a large step in the right direction for resolving many of the issues facing small business resellers. Specifically, four aspects of this new sub-industry strongly favor a class waiver specifically for the Footnote 15 portion of NAICS 513210: (1) the COTS software purchased under this NAICS Code is so overwhelmingly manufactured solely by large businesses that it obviates the purpose of the NMR; (2) the small business set-asides utilized under this code are almost universally in violation of the NMR;

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[32] The rule does not apply to *customized* software, which would remain classified as a service. *See id.* at 34255 ("Clearly, when the Government seeks to award a contract to a business concern to create, design, customize or modify custom software, that should be classified as a service requirement and the activity will remain classified in a service NAICS code to which the nonmanufacturer rule does not apply. For a service procurement set aside for small business, the prime (together with one or more similarly situated subcontractors) would have to perform the required percentage of work.").

[33] 13 C.F.R. § 121.201; § 121.406(b).

[34] *See* § 121.1203(g).

[35] *Id.*

[36] 13 CFR 121.1204.

[37] *See* the NMR Class Waiver List, *available at* https://www.sba.gov/sites/default/files/2022-10/NMR%20Class%20Waiver%20List%20-%20version%20June%202022.pdf.

(3) these violations are almost forced by the Government's dual need for both large business software and small business credit, leading to improper solicitations; and (4) this situation invites small businesses to expose themselves to the potentially existential risk of misrepresenting their size status.

C. Cloud Computing

The SBA issued a rule effective December 30, 2019 to lift restrictions for small businesses seeking to provide the Government with cloud computing solutions.[38] This rule acknowledges the reality that, in most instances, a small businesses is not able to commit to a procurement in which it (together with other small businesses, if needed) will provide more than 50% of the services under a contract involving cloud computing, where the cloud computing market is dominated by large companies. To allow more small business participation in opportunities involving cloud computing, the SBA reiterated its position that cloud computing is a *service*, and it may be excluded from the LOSR calculation where a small business will perform other services that are the primary purpose of the acquisition.[39] Here, the SBA created a specific, workable rule for cloud computing by recognizing and accounting for the unique aspects of the cloud computing market.

D. Blanket Waivers

A separate work-around involves obtaining waivers. As mentioned above, one way to allow small businesses to supply software manufactured by large corporations is to secure an individual waiver issued for a vehicle that covers a full array of IT orders of a government department. The Department of Homeland Security ("DHS") is currently working on a solicitation for a multiple-award contract known as FirstSource III and sought an individual waiver for all of the products and services to be procured under the contract, which was approved by the SBA on September 15, 2020.[40]

Under FirstSource III, any commercial IT product would be available, including products manufactured by large companies. Notably, FirstSource III will have two NAICS codes, 541519 (ITVAR) and 513210 (software publishing). To resolve the NMR issues, DHS is pursuing an individual contract level NMR waiver for FirstSource III. If the SBA approves the wavier, there would be no need for individual waivers for each order under FirstSource III.

DHS's attempt to secure a blanket waiver for the First Source III contract signals the Government's recognition of the need to change the rules to adapt to the evolving information technology landscape. A broader change is warranted for other types of IT procurements, particularly for those involving small business ITVARs.

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[38] 13 C.F.R. 125.6; 84 FR 65647 at 65664.

[39] Notably, in its proposed rule, the SBA considered recharacterizing cloud as a "product" (rather than a "service"), which would bring the NMR into play and allow SBA to issue broad waivers of the rule, 83 Fed. Reg. 62516. This proposed solution is the same as that adopted for commercial software (described above), Seemingly, the SBA realized the approach for software was not working and decided to go a different route to facilitate small business participation in procurements involving the cloud.

[40] *See* the FirstSource III information at https://beta.sam.gov/opp/1d1105e4b3c440f5822ce86892fb5db1/view.

IV. Potential Liability for Small Businesses Under the Current System

The Government regularly issues solicitations under inappropriate NAICS codes, thereby inviting small business contractors to violate the Small Business Act and exposing those small business contractors to risk of fines, debarment, or other penalties. Many times, small businesses do not fully understand the complicated rules, and there is little compliance oversight by the Government with respect to NAICS codes. Rather, the onus has shifted to small businesses to use already scarce time and resources to police government agencies via protests. Relying on protests to check this frequent misuse is unrealistic, costly, and unfair for small businesses.

For example, the Government regularly posts solicitations for acquisitions of COTS software manufactured by large businesses that are classified under NAICS 513210 and set-aside for small businesses and, overwhelmingly, the software the Government purchases under 513210 is manufactured by large businesses.[41] As discussed above in Section III.B.2, the NMR applies to these solicitations unless the contracting officer has obtained a waiver from the SBA.[42] If a waiver is granted, the solicitation can be set-aside for small businesses, and the small business awardee can provide an end-product made by any size manufacturer. In practice, waivers are rarely obtained.[43] If the solicitations do not include a waiver of the NMR, any small business awardee must provide an end-product made by a small business manufacturer. As discussed above in Section III.B.2, in many instances, this is not possible because the Government often specifically requests items manufactured exclusively by large businesses, or because certain products are not manufactured by small businesses. Without a waiver, any small business awardee that provides the required COTS software (manufactured by a large business) under a set-aside is violating the Small Business Act, opening itself to liability under the False Claims Act for making false statements and certifications to the Government, and subjecting itself to a host of other negative consequences – all at the behest of the Government agency.

Another issue facing small businesses in the IT space is agency misapplication of the ITVAR Code by assigning 541519 to solicitations when it is not appropriate; for example, when the contract necessarily includes services that account for less than 15% of the total contract price. In this situation, small businesses that otherwise meet the value-added requirements are stuck between a rock and a hard place. They can choose to bid, knowing they will not provide services that account for 15-50% of the total contract price as required by 541519, and thus potentially setting themselves up for an allegation that they have violated the law or made a false certification. Or, the small business can forgo the opportunity altogether, while less risk-averse competitors are awarded the work.

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[41] As of May 2019, a review of FedBizOps revealed more than 40 small business set-asides under 513210 (at that time, classified as NAICS code 511210) for COTS items. Nearly 70% of the solicitations specifically requested COTS items manufactured by large businesses and did not include a waiver of the NMR.

[42] Alternatively, the contractor (rather than the government) can seek a class waiver for classes of products where no small business manufacturers of those items exist. However, the SBA seems reluctant to issue such waivers. While certain hardware has been subject to a waiver, no class waivers for software currently exist. *See* the NMR Class Waiver List, *available at* https://www.sba.gov/sites/default/files/2022-10/NMR%20Class%20Waiver%20List%20-%20version%20June%202022.pdf.

[43] *See* Note 43, above.

This happens because IT service companies offer project management, architecture, maintenance of systems, operations, and monitoring that many times are on-site at the customer location for long periods of time. These services are almost always billed to the customer and have a small portion of gross profit tied to product sales.

The services offered by ITVARS more often revolve around configuration consulting, pre-purchase architecture, compatibility, functionality, delivery and integration of systems. Indeed, ITVARs add significant value to products, in the form of features and services, prior to reselling those products to end-users. These services are incredibly valuable to the government end-user, particularly where the Government often exhibits a preference to obtain IT equipment and supporting services from a single source. However, ITVARs generally do not charge separately for these value-added services. Rather, the service costs are incorporated into the company's overhead costs. As such, the services often do not account for 15% of the total contract price.

Our own estimates are that 1-5% of opportunities competed under NAICS code 541519 truly reach the 15-50% services threshold. To support this claim, publicly held VARS report between 7-10% of their total revenue coming from services in their annual 10k reports. Assigning a new, applicable and more appropriate manufacturing NAICS code instead of using this exception would increase small business participation, increase supplier qualifications and benefit the customer by more competitive pricing.

Ultimately, where a small business contractor is not compliant with the SBA regulations, it is susceptible to size protests, potential suspension or debarment, or False Claims Act liability. Relatedly, if a small business submits a bid or proposal for a small business set-aside contract based on a false statement about its size or status, this is likely to be viewed as a *willful and intentional* false certification.[44] Willfulness is an important element for finding liability under the False Claims Act, and can lead to treble damages.[45] Thus, simply by submitting a proposal where the business cannot comply with the NMR, or with the 15-50% service requirement under the ITVAR Code – even in situations where the contractor did not understand or know the rules – a small business contractor could potentially expose itself to False Claims Act liability (including treble damages), suspension or debarment, a size-based protest by a competitor, contract termination, and loss of business.

V. Proposed Solutions

As discussed above, the current system for classifying and executing procurements involving ITVARs has serious flaws that should be addressed. Any comprehensive solution must (1) recognize what ITVARs actually do (*i.e.*, the type and mix of services and products they provide); (2) capture and account for how services currently are billed to the government; (3) provide a realistic size standard that is not over- or under-inclusive; and (4) address head-on the NMR for COTS IT procurements.

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[44] *See* 13 C.F.R. § 121.108(b) (Submission of a bid or proposal for a contract that is set aside for award to small businesses "shall be deemed affirmative, willful and intentional certifications of small business size and status.")
[45] 31 U.S.C. § 3729(a)(1)(A).

While there are a number of possible solutions, the most viable and sensical solution is to create a new NAICS code that accurately captures the core competency of the ITVAR, accompanied by creation of an appropriate SBA size standard and elimination of the IT Value Added Reseller exception under SBA's size standard for NAICS code 541519, at Footnote 18. The new code should focus on the ITVAR's role as a consultant that provides pre-sales engineering and subject matter expertise on a variety of software and hardware products.

With respect to qualifying as a small business under the new NAICS code, the SBA should ensure the size standard is appropriate and acknowledge that the NMR is explicitly inapplicable. Recognizing that ITVARs typically operate on low margins even though their annual receipts may be high, the size standard should be based on employee count rather than annual revenue. A reasonable size standard for the new code is 500 employees.

Relatedly, because ITVARs by definition do not manufacture the products they resell, it is nonsensical to require ITVARs to comply with the NMR – particularly where solicitations overwhelmingly seek COTS items manufactured by large businesses. For example, requiring an acquisition of Dell computers from an ITVAR to comply with the NMR is impractical. The ITVAR code and the Software code (513210, Footnote 15) both require compliance with the NMR, but allow for waivers of the NMR. In short, rather than eliminating the NMR with respect to procurements using these codes, the SBA opted to put the onus on agencies to seek waivers. In practice, this is not a viable solution, as shown by how ineffective and underutilized it has been to date. As discussed in Section IV.B. above, contracting officers have been reluctant to request contract specific waivers prior to issuing solicitations and, to date, no class waivers for software have been granted.[46]

Importantly, the SBA size standard associated with the new NAICS code must not include a service requirement that is based on a percent of the total contract price, but should embrace a service requirement based on the distinct, robust value-added services provided by a typical ITVAR.[47] The current ITVAR 15-50% services requirement ignores the reality that (1) the fixed cost of the component *far* exceeds the cost of the services and implementation of equipment, and (2) the provided services generally are not separately billed. As detailed in Section II, ITVARs provide valuable services to the Government, but the costs of those services are included in overhead costs, covered by narrow margins on the IT products, and not separately charged. Therefore, the current requirement that services account for 15-50% of the total contract price is unattainable and should be eliminated under the new code and size standard.

Ideally, the Office of Management and Budget and Economic Classification Policy Committee will create a new, stand-alone NAICS code for IT value-added resellers. Once

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[46] *See* Section IV.B above for discussion regarding why a class waiver for software under NAICS code 513210Footnote 15 is appropriate. Further, even if a small business manufactures a certain COTS software, the Government is unlikely to be willing or able to purchase it due to, *e.g.*, compatibility issues with existing Government systems and/or stringent security requirements (e.g., FedRAMP or the Cybersecurity Maturity Model Certification ("CMMC"). This obviates the purpose of the NMR for these small business COTS software acquisitions.

[47] Alternatively, if the services continue to be measured in terms of total contract price, the required percent should be reduced and there must be a requirement that the contract include a CLIN to allow for services to be separately billed to the Government.

established, the SBA should then revise its current size standards accordingly and eliminate 541519 Footnote 18. The new NAICS code description (suggested as code 541520) should include the following language –

> **541520 – Information Technology Value-Added Reseller (ITVAR) Services**
>
> This U.S. industry comprises establishments primarily engaged in providing a total solution to information technology acquisitions by providing commercially available multi-vendor hardware and software items manufactured by original equipment manufacturers (OEMs), along with significant value-added services. The value-added services are the primary function of the ITVAR and are provided both before and after the item reaches the end-user. Significant value added services consist of, but are not limited to, configuration consulting and design, systems integration, installation of multi-vendor computer equipment, customization of hardware or software, training, product technical support, maintenance, and end user support.

As soon as practicable after this new NAICS code is implemented, SBA should revise its size standards to account for the new NAICS code and institute an appropriate employee-based size standard of 500 employees.[48]

VI. Conclusion

Small business ITVAR participation is critically important to the federal government's ability to acquire and implement COTS IT solutions. Yet, a patchwork of rules and regulations specific to small businesses and the IT industry have led to frequent misclassification of IT procurements and have made it challenging, and in some cases impossible, for small business ITVARs to participate without potentially violating the law. The current landscape clearly demonstrates the need for a more complete solution. Creating a new NAICS code and associated size standard, specifically tailored to meet the requirements of the Government and to account for the unique aspects of the ITVAR industry, would enable contractors to provide the best possible solutions with respect to IT procurements.

Thank you for considering my testimony on these important matters. I applaud the Committee's effort to address these issues and look forward to future opportunities to share my input on ways Congress can support small businesses as they continue to grow.

[48] As explained above, SBA should exempt this size standard from NMR compliance.

Written Testimony of Andrew Christ
House Small Business Committee
On behalf of the American Subcontractors Association (ASA)
February 6, 2024

Chair Williams (R-TX), Ranking Member Velázquez (D-NY), members of the committee, thank you for the opportunity to testify before you today as the committee reviews small business contracting reform within the federal government.

My name is Andrew Christ. I, along with my business partner, Allan Arias run Compass Constructors, a small construction business founded in 2012 and located in Kansas City, MO. My partner, Mr. Arias was born in Costa Rica and immigrated to the United States when he was 19 years old. Originally, Compass Constructors was focused on commercial roofing and architectural sheet metal, but we were awarded our first federal construction project with the National Parks Service in 2020, the same year Mr. Arias added me as a partner. Since that time, Compass Constructors has been awarded numerous federal government projects related to petroleum, oils, lubricants, and sensitive compartmented information facilities (SCIF) with the U.S. Army Corps of Engineers, Air Force Civil Engineering Center (AFCEC), Naval Facilities Engineering Systems Command (NAVFAC), and the General Services Administration (GSA). In 2023, Mr. Arias was awarded the Small Business Administration (SBA) Missouri Small Business Person of the Year.

Compass Constructors has a proven track record, and we do this by maintaining the industry's most talented and effective managers and superintendents to ensure that quality, schedule, cost controls, and safety are maintained through all aspects of a project's lifecycle. We value diversity and inclusion, which separates our company from our competitors, and we operate with an open and inclusive atmosphere where different viewpoints are welcomed and encouraged.

I am testifying before you today not only as a small business owner, but as a Board Member of the American Subcontractor Association (ASA), a trade association representing over 3,800 subcontractors and suppliers in the construction industry since 1966. ASA works with their membership on improving the business environment in the construction industry, representing subcontractors at all branches of local, state and federal government. For many years, ASA has had a long-standing working relationship with many of you and your staff on this Committee.

I am honored to offer comments on small business contracting reform within the federal government relating to the requirements for past performance and qualifications, the use of payment and performance bonds, the impact of continuing resolutions (CRs) on small businesses, and the bundling of contracts into Multiple Award Task Order Contracts (MATCOs) or Single Award Task Order Contracts (SATOCs).

Compass Constructors views the **strict requirements for past performance and qualifications** as the largest hurdle for small businesses to enter the federal construction market. We have witnessed unfair competition toward private contractors outside of the federal construction space - with similar past performance records, equivalent size and scopes of work demonstrating satisfactory Contractor Performance Assessment Reporting System (CPARS) or past performance questionnaires (PPQ) ratings - not receive a similarly favorable rating from the federal government. This makes it extremely difficult for a nascent contractor, with no prior experience working with the federal government, to be considered for a project award.

Having worked on federal government projects since 2020, we now have a better understanding of the importance of these past performance and qualification requirements, but we also recognize that many federal agencies and their contracting officers do not have the time to a mentor a successful contractor. In most situations, they are managing multiple projects at once. Through this experience, we have learned the value of the myriad Small Business Administration (SBA) resources offered to small businesses to operate within the federal government's contracting system. There does, however, seem to be reluctance by many successful private sector construction contractors to take advantage of their resources.

The Federal Acquisition Regulation (FAR) is the primary regulation used by the federal government for their acquisition of supplies and services and Compass Constructors has been diligent in working within the FAR process. However, when competing for federal contracts, most contracts require a detailed management plan on project staffing and the qualifications of key members of the field execution team. These qualifications often require a minimum number of years performing work for a federal agency in construction. If the company has not previously executed federal contracts, then this requires the contractor to enter the market for additional employees with federal construction experience. This is a significant investment for a small business and hiring new employees with federal experience does not guarantee that a contractor will be awarded a project. It creates financial stress on a company, which many companies do not want to consider or cannot sustain. *We view this as a significant and cost prohibitive barrier to entry for a small business attempting to enter the federal construction market.*

All federal projects are mandated to have a **payment and performance bond** to be in place before any contract can be executed as required by the Federal Miller Act. Through the underwriting process of providing a bond to a contractor, the contractor's surety assesses if the risk of bonding the contractor is tolerable before issuing the bond. This is beneficial to the obligee (the government) because it shows that the surety views the principal (the contractor) as an acceptable risk and is willing to back that view by issuing the bond. Essentially, the surety wants to ensure that the contractor can perform the project from a financial and historical perspective before they will agree to issue the government an "insurance policy" stating that if the contractor defaults, the surety will ensure that the government is provided the agreed to services. The surety is subsidizing the risk to the government to guarantee the project's execution.

From our experience, the financial and historical requirements for a surety to issue a bond have become increasingly more stringent. The underwriter does not simply make a determination based off of working capital within a company. They evaluate many factors when determining if they will issue the guarantee to the obligee such as income statements, cash flow, debts, work in progress schedules, and any other potential liabilities. This examination will include the principal company's credit rating (typically a Dun & Bradstreet rating), which is the institutional equivalent of a personal credit rating. They will evaluate the scope of work compared with past projects and they will evaluate the principal's reputation with past suppliers, projects owners, and subcontractors. As part of the bond application, it is not uncommon for the principal to be required to submit letters of reference from past clients, suppliers, or subcontractors. By requiring these references, the surety gains real-world knowledge of the contractor's payment history and whether the contractor poses a risk to their ability to make on-time payments to subcontractors and suppliers. If the contractor cannot produce favorable references, then it increases the likelihood of the surety not issuing a bond for the project. Finally, the surety will evaluate the ability of the principal requesting the bond to absorb potential project losses.

Compass Constructors, like most small businesses, entertain federal construction contracts to make a profit. These profits grow a small business into a successful and increasingly productive contractor for the federal government. However, unforeseen problems can sometimes lead to losses. Surety companies generally want contractors to take on jobs that are no more than twice the size of the largest projects they have completed with similar scopes in the past. In essence, credibility is key to the federal government and the surety. There are many parallels to the considerations that a surety recognizes versus what the federal government is evaluating from a performance and financial standpoint. We purport that the rigorous evaluation that the surety performs is much greater than the evaluation that the government proposal evaluation team can provide by simply evaluating a small business' response to a solicitation. With the above-mentioned in mind, *we would recommend to the committee that less emphasis be placed on documented past government performance and qualifications and more emphasis placed on whether the contactor can provide the bid, payment, and performance bond.*

I would be remiss if I did not mention ASA's long history in supporting payment and performance insurance bond protections. We currently support H.R. 1740, bipartisan legislation authored by Reps. Bost (R-IL) and Pappas (D-NH) that would ensure these bonding protections are applied to water infrastructure projects where federal funds are being allocated to government contracts. As previously stated, all federal projects are mandated to have a **payment and performance bond** to be in place before any contract can be executed as required by the Federal Miller Act. However, the advent, and increased use, of creative financing measures, such as public-private partnerships (P3s), has created an area of ambiguity, and in some instances, bonding requirements are not especially clear. This potential coverage gap leaves workers, subcontractors, suppliers, small businesses, and taxpayers exposed to unnecessary risks. Congress previously corrected this coverage gap for P3s utilizing the Transportation Infrastructure Finance and Innovation Act (TIFIA) program with broad bipartisan support in both the House and the Senate. H.R. 1740, which is modeled off the TIFIA policy, would close this coverage gap by ensuring proper financial protections are in place for P3 water infrastructure projects receiving Water Infrastructure Finance and Innovation Act (WIFIA) assistance.

The unpredictable and changing federal budget climate is always a challenge for small businesses. As of late, the **instability and ambiguity caused by CRs** make it difficult for federal agencies to have certainty on funding for projects. Traditionally, the process of putting in a solicitation response is very costly. The requirements for the solicitation responses continues to expand and the challenge for a small business is to stand out versus its competitors. Most small businesses that are new to the federal construction market are already at a disadvantage from a past performance qualification standpoint. They must be able to successfully highlight the execution, schedule, and pricing aspects of their proposal. To do this, it requires a small business to expend a significant amount of money to develop a detailed proposal submission. On average, our proposal responses cost approximately $10,000.00 worth of labor to draft, develop, review, and execute. This is a substantial expenditure for a small business.

With the ever-changing budget climate, there are many times that a solicitation response is submitted only to find that the funding is no longer available and the project must be terminated due to the lack of funding. Since the small business does not have any insight into the budget climate for the project, it can create a situation where the business spends a significant amount of money to develop a proposal response, only to find out that the project has become inactive.

My final concern is the **bundling of contracts into (MATOCs) or (SATOCs)**. These contracts can be extended if the federal contract administrator deems it acceptable. In a MATOC, there are typically four to eight contractor awards and once the award has been made, only those contractors will have the ability to bid on the work. These MATCO contracts traditionally will be extended for a total of five to ten years. Similarly, SATOCs are awarded to a single firm (typically with a unit price structure) and are held by that single contractor for a total of five years. If a small business is not awarded the initial solicitation for the MATOC or

SATOC, they are not allowed to bid on the work for the duration of the contracts – a period of five to potentially ten years. Once again, the emphasis on past performance and project team experience is highly scrutinized and evaluated when making these awards. This can make it extremely difficult for a small business to compete, as they are often deemed not qualified if they cannot provide evidence of past performance or a team meeting the specific resume experience required by the solicitation.

This lack of past performance and/or personnel qualifications for businesses new to federal contracting can create a scenario where small businesses are solicited by larger firms to form joint ventures. Large firms hold the past performance and/or personnel qualifications and will form a contractual joint venture entity in which the small business holds 51% ownership and the larger firm holds 49% ownership. These joint ventures can be extremely beneficial for small businesses. When joint ventures are executed for the proper reasons, it will allow for the small business to tap into the larger firm's robust bonding program, employee pool, and previous government work.

Problems arise when the larger firms simply utilize the small businesses as a vehicle to procure federal work otherwise set-aside for small businesses. The larger firms can do business under the joint venture, as 49% owners of the joint venture entity, but also hold ownership in the small business. The larger firm is receiving profits from both the joint venture entity and its minority ownership stake in the small business. This provides the most advantage to the large firms over traditional small businesses and undermines the goals of small business participation programs.

I would like to conclude my testimony by recognizing Reps. Stauber (R-MN) and Scholten (D-MI), both members of this committee, for their leadership as co-chairs of the Construction Procurement Caucus in the 118th Congress. This caucus serves as a bipartisan forum for the exchange of ideas and information on construction procurement in the U.S. House of Representatives. Additionally, Rep. Stauber and his staff have been stalwarts on change order reform in federal construction contracts for the past three Congresses.

More specifically, Rep. Stauber, along with Rep. Peters (D-CA), introduced H.R. 2726, the "Small Business Payment Performance Act, which was offered as an amendment to the House version of the FY24 NDAA and it would assist small business construction contractors receive timely payment for change orders. Construction firms of all sizes, but especially small businesses, have had to weather the effects of the pandemic and soaring construction materials costs. This commonsense and bipartisan legislation would help ensure that our nation's small business construction contractors do not go bankrupt waiting to be paid for work the federal government ordered them to perform. We will continue to make change order reform a priority in the 118th Congress.

Again, thank you Chair Williams (R-TX), Ranking Member Velázquez (D-NY), members of the committee, for the opportunity to testify before you today as the committee reviews small business contracting reform within the federal government. I am happy to answer any questions.



Testimony of

Erin Allen

President, Contemporaries, Inc.

House Committee on Small Business

"Under the Microscope: Reviewing the SBA's Small Business Size Standards"

February 6, 2024

Chairman Williams, Ranking Member Velázquez, and Members of the Committee, thank you for the opportunity to testify today. My name is Erin Allen and I am the President of Contemporaries, Inc., a Small Business Administration (SBA) certified women-owned small business (WOSB) located in Silver Spring, Maryland. I am also the Chair of the Montgomery County Chamber of Commerce (MCCC) where I am proud to represent the many businesses that make up our robust local economy in Maryland. An important part of the Chamber is its GovConNet Council, which is comprised of industry procurement experts. The Council meets monthly to tackle federal contracting issues that affect small and midsize firms. Additionally, I'm a member of the Women's Procurement Circle (WPC), a group that advocates for policies that strengthen women-owned companies that do business with the federal government. I appreciate the Committee's focus in this hearing on the important topic of size standards and pathways to growth for small business federal contractors. This issue is one that has become increasingly relevant to Contemporaries as we have grown significantly over the last several years.

I am a second generation business owner. My parents started our company in 1991 when they cashed in their retirement savings and took out a home equity loan. As a family, we have worked hard to grow our business, bootstrapping every part of it. Now we find ourselves teetering on the edge of our small business size standard, which puts our business in a very difficult position. While we have maintained our small business status a little longer than we expected due to some setbacks – but also thanks to this Committee's work on the *Small Business Runway Extension Act* – we only expect to remain small for another year or two.

My company is at a crossroads and we only see two options: sell off part of our business or find a small business to team with. Teaming means only retaining 49% of the contracts we have worked so hard to earn. By every measure we are still a small business, with only 95 employees. While this might seem like a large employee count for your local mom and pop shop, in my industry this is still very small. If we lose our small business status, I anticipate I will have to lay off 30% of our employees. While some may get picked up by another contracting firm, others may not. This is especially hard to consider as we figure out what to do next.

I don't have all the answers to this problem. All I know is I can't compete with the large contractors like the Booz Allen and the Lockheed Martin type companies of the world. I'm too young to retire, and too old to start over. Adjusting size standards isn't just about maintaining my business, it's about helping my employees earn a sustainable living in the middle class, some of whom have been with me for over 15 years.

As a result of that steady growth, we find ourselves at the top of our size standard, which is revenue based. Revenue is not an indicator of present competitiveness – it is an indicator of future competitiveness. A challenge in my industry is that the size standards vary across our set of NAICS codes. We primarily win contracts under NAICS 561110 - Office Administrative Services, which has a $12.5 million size standard. The other NAICS that contracts for my services can fall under,

such as 561320, have a size standard of $34 million. Wide disparity in my NAICS presents an issue for opportunities. The *Small Business Jobs Act of 2010*[1] requires SBA to review all small business size standards every five years and make adjustments to ensure they reflect current industry and market conditions. The SBA should look at industries more holistically and seek additional engagement with businesses through forums and roundtables. Relying solely on a mathematical formula and limited engagement with businesses isn't giving the agency an accurate picture of small business markets.

Bigger small businesses that are about to graduate from the set-aside world need time to recruit talented employees, develop their intellectual property and build infrastructure to compete at the next level. Small businesses face enormous infrastructure hurdles especially if they grow very quickly or win larger federal contracts with big task orders. Some refer to this as the Powerball effect, leaving businesses scrambling to stay ahead of the demands of their growth and simultaneously trying to compete in the open market. A firm like mine simply can't compete with the large federal contractors overnight. Government contractors experience a unique pattern in their growth that is causing a "midsize" business crisis. This pattern of sudden growth is increasingly common because of the government's more frequent use of large multiple award contract vehicles under which contractors can be awarded huge task orders.

The SBA program I have been able to take advantage of during my time as a small business is the Women-Owned Small Business Federal Contract (WOSB) program. The WOSB program, with a component of the program designated as the Economically Disadvantaged Women-Owned Small Business (EDWOSB) program, allows for agencies to set-aside contracts for women-owned companies to bid. The governmentwide goal of awarding 5% of all federal prime contracts to WOSBs (yes, just 5%) has only been met twice since the program was put into place in 2011. Agencies are authorized to sole source contracts to WOSBs; however, those awards are few and far between. According to The Pulse of GovCon, a women-owned federal market data intelligence company, in FY22, the federal government only awarded 135 WOSB sole source contracts, totaling $90.1 million. As for EDWOSB sole source contracts in FY22, there were 25 awards for a total of $13 million. As I teeter on the edge of sizing out of being a small business, increased effectiveness of this program would really help. It would enable me to secure more contracts faster, thus allowing me to be in a better position to make the transition into the full and open marketplace.

As part of WPC, we applaud the Committee for passage of the *WOSB Certification and Opportunity Expansion Act* on January 31. Moving away from self-certification will reduce fraudulent companies from claiming to be women-owned. Our hope is that federal agencies will be compelled to meet their WOSB goals, since they will only be able to count awards to companies that are SBA certified. WPC believes three additional policy changes would further increase awards to women-owned companies: maximize WOSB awards on governmentwide contracts,

[1] *Public Law 111-240, 124 Stat. 2504, September 27, 2010*

expand sole source contract opportunities for WOSBs and properly fund the WOSB Program Office at the SBA.

While there are many contracting policies that contribute to small business contractor success and growth, there are also numerous areas where the federal government needs to improve. It is important that taxpayer dollars are used to provide opportunities for the companies that are the engine of the U.S. economy. Amid a decline in awarding direct contracts to small businesses and contract consolidation, subcontracting is one of the best opportunities for small companies to enter and grow in the federal marketplace. However, working as a subcontractor comes with its own set of challenges. Too often, small businesses that help a prime contractor win a proposal receive little or no work once the contract is awarded. Since the government does not have a relationship with subcontractors, smalls have very little leverage to remedy this problem.

MCCC has worked with the Congress and industry over the past six years to find a solution. H.R. 7694, *Strengthening Subcontracting for Small Businesses Act of 2022*, which passed the House last Congress, improves the subcontracting ecosystem to help ensure that federal government contractors are utilizing small businesses in subcontracts. I encourage the Committee to introduce a similar bill that makes prime contractor performance on their subcontracting plans a more important evaluation factor in winning future work. Further, although reports by federal agencies show that dollars are being awarded to small companies at consistent levels in best in class (BIC) contracting vehicles, the number of small businesses being awarded prime contracts is shrinking drastically. Category management undoubtedly plays a role. Since many small businesses are not prime awardees of BIC vehicles, subcontracting is increasingly important for small contractors trying to grow their federal business.

Included in a recent memo[2] from the Office of Management and Budget (OMB) Office of Federal Procurement Policy (OFPP) was important clarification on the rule of two[3] as it applies to orders. The memo states that besides some limited exceptions, agencies should set-aside orders for small businesses when the rule of two criteria is met. This clarification is an important step in increasing awards to small businesses on large contract vehicles. However, an expansion of the rule of two to require analysis for all acquisitions above the micro-purchase threshold (MPT) would be a game changer for small businesses.

The industrial base has significantly decreased over the past ten years – around a 40% decline in the number of small businesses receiving prime contract awards. The strength of the industrial base is a concern to the entire federal contracting community, as well as civilian and defense agencies. The rule of two was created to support the ability for small businesses to compete for federal contracts. This rule has been confirmed by the courts in several cases, including

[2] https://www.whitehouse.gov/wp-content/uploads/2024/01/REV_Increasing-Opportunities-to-Small-Businesses-under-MACs-CATS-Final-Copy-1-25-24.pdf
[3] 15 USC 644(j)

Kingdomware Technologies and Tolliver.[4] In current law, the rule of two only applies to acquisitions above the MPT, but not greater than the Simplified Acquisition Threshold (SAT). In FY23, the federal government took over 5,700,000 actions that were over the SAT.[5] Given such a large number of contracts above this threshold, a change is critical to ensure that agencies are applying the rule more broadly. While the recent guidance will be impactful, removing the restriction that the rule of two only applies to contracts under $250,000 will be a turning point for small contractors. Agencies already know how to perform market research; therefore, this expansion would not cause an undue burden to the acquisition workforce. By amending the necessary legislation to conform with the court cases cited above, small businesses will have a better opportunity to win contracts and provide innovation and flexibility for federal buyers. H.R. 6320, *Increase Small Business Utilization Act of 2023,* introduced by Ranking Member Nydia Velázquez (D-NY) accomplishes this goal. It is time for Congress to amend the rule of two to increase contracting opportunities for small businesses.

An underappreciated tool for small businesses is Procurement Center Representatives (PCRs) and Commercial Market Representatives (CMRs). The Office of Government Contracting at the SBA employs a team of Area Directors, PCRs and CMRs that continually work with federal agencies to increase federal contracts awarded to small businesses. These specialists are in constant contact and collaboration with federal agency contracting personnel. PCRs increase the small business share of federal procurement awards by initiating small business set-asides, reserving procurements for competition among small business firms, providing small business sources to federal buying activities and counseling small firms. In addition, PCRs advocate for the breakout of items for full and open competition that could instead be competed amongst small businesses. There is a significant portion of small business eligible contract dollars that are not tapped for small businesses due to the lack of PCR/CMR coverage, as well as significant eligible small business spend and buying activities with limited or no PCR/CMR coverage. The recent OFPP memo requires federal agencies to take steps with respect to increasing small business participation on multiple-award contracts, and the value of engaging PCRs is mentioned. Additional funding for these positions would do wonders to increase awards to small businesses across government.

I appreciate the Committee's continual efforts to support small businesses and am grateful for the opportunity to share my experience with you today. While there are many improvements to be made to increase contract awards to women-owned, growing, and all small businesses, I applaud your dedication to these issues. Thank you and I look forward to answering any questions.

[4] TOLLIVER GROUP, INC. v. USA
[5] Pulse of GovCon analysis

AIRPORT MINORITY ADVISORY COUNCIL

February 6, 2024

The Honorable Roger Williams
Chairman
House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

RE: Airport Minority Advisory Council (AMAC) Comments for Full Committee Hearing titled "Under the Microscope: Reviewing the SBA's Small Business Size Standards."

Dear Chairman Williams and Ranking Member Velazquez:

The Airport Minority Advisory Council (AMAC) respectfully files comments to the US House Committee on Small Business Hearing titled *"Under the Microscope: Reviewing the SBA's Small Business Size Standards."*

AMAC is a national non-profit trade association dedicated to promoting and ensuring the full participation of ethnic minority-owned and women-owned disadvantaged business enterprises in contract and professional development opportunities throughout the aviation and airport industries. While AMAC is a national non-profit trade association, we have local presence with Chapters in Atlanta, Baltimore/Washington, Chicago, Denver, Detroit, Houston, Los Angeles and Portland. AMAC's membership is diverse. Members include firms certified (per U.S. DOT regulations) as "disadvantaged business enterprises" (DBEs) and/or "airport concessions disadvantaged business enterprises" (ACDBEs), as well as firms of all sizes involved in airport contracting but which are not certified, airport executives and managers and airports.

When establishing or reviewing size standards, SBA generally evaluates five primary factors for each industry, namely: average firm size, start-up costs and entry barriers, industry competition, distribution of firms by size, and the impact current or revised size standards might have on small business participation in Federal contracting. This is critical economic impact and business engagement for DBE (Disadvantaged Business Enterprises) and ACDBE (Airport Concessionaire Disadvantaged Business Enterprises) doing business at the nation's airports.

Since 1984, AMAC has been at the forefront of nearly every national policy initiative impacting the participation of disadvantaged businesses in airport contracting. In this regard, AMAC consistently engages and/or works with the U.S. Congress, federal executive branch departments and agencies, aviation and airport trade associations and with strategic partners as a resource for information, education, and guidance concerning diversity and inclusion in the airport industry. AMAC's comments are the product of extensive outreach to its members.



Business size standards are the mechanism by which the statutory requirement that Program participants be "small businesses" is implemented.

1. DBEs (Disadvantaged Business Enterprises)

   Under the current framework, firms are assigned a code(s) (a NAICS code) corresponding to the type(s) of work that it performs. DBE certification is limited to firms whose gross receipts are below the revenue amount for its NAICS code(s) based on a three-year rolling average. AMAC generally supports USDOT's Proposed Rulemaking Disadvantaged Business Enterprise (DBE) and Airport Concessions Disadvantaged Business Enterprise (ACDBE) Program Implementation Modifications - DOT-OST-2022-0051/RIN 2105-AE98 proposal to change the three-year average to a five-year rolling average.

2. ACDBEs (Airport Concessions Disadvantaged Business Enterprise)

   Size standard applicable to ACDBE firms is not based on individual NAICS codes. Instead, to obtain and/or maintain certification, the gross receipts of the firm cannot exceed $56.42 million measured over a three-year rolling average.

   AMAC supports USDOT's Proposed Rulemaking Disadvantaged Business Enterprise (DBE) and Airport Concessions Disadvantaged Business Enterprise (ACDBE) Program Implementation Modifications - DOT-OST-2022-0051/RIN 2105-AE98 proposal to change the current three-year average to five years as well as its intention to adjust the ACDBE size standard on a more predictable basis. AMAC also understands USDOT's proposal to clarify the allocation of gross receipts when a DBE or ACDBE is a party to a joint venture between two or more certified firms or between certified and non-certified firms. We concur with the guidance that parties in a joint venture must include in its gross receipts its respective proportionate share of the receipts generated by the venture.

   AMAC encourages USDOT to focus on business competitiveness as it relates to program size standards. We encourage USDOT to consult with other federal agencies for the framework of their contracting and/or investment programs. Finally, we encourage USDOT to closely study the important ways airport contracting has changed and evolved; especially the significant increases in the cost of entry and of doing business as an airport contractor or concessionaire.

   The SBA's Revised Size Standards Methodology is a significant update that small and disadvantaged businesses must pay attention to. At AMAC, we understand that adapting to these changes is crucial for maintaining competitiveness and eligibility for federal programs and contracts. We request that the committee provides leadership to reflect the needs of the entire business community so all business can navigate changes for positive economic benefit for tax revenue, workforce and community development.

AIRPORT MINORITY ADVISORY COUNCIL

AMAC appreciates the legal/constitutional issues with respect to a race conscious federal contracting program. However, the arguments/issues that we raised have merit and they are validated by the "real world" experiences reported by AMAC members.

Sincerely,

Eboni Wimbush

Eboni Wimbush
President & CEO

Global Small Business Sustainability Coalition

February 12, 2024

The Honorable Roger Williams
Chairman
Committee on Small Business
U.S. House of Representatives

The Honorable Nydia Velázquez
Ranking Member
Committee on Small Business
U.S. House of Representatives

RE: Statement for the Record – Under the Microscope: Reviewing the SBA's Small Business Size Standards

Dear Chairman Williams and Ranking Member Velázquez:

The Global Small Business Sustainability Coalition wishes to express its appreciation to the U.S. House Small Business Committee for convening a hearing on the important topic of small business size standards. We respectfully submit the following statement pertaining to issues facing the seasoned U.S. small business industrial base as it relates to U.S. Federal Government contracting activities.

1. Oppose Reducing Small Business Vendors by Lowering Size Standards

The U.S. Small Business Administration (SBA) is required by statute to review size standards on a five-year basis, and has the authority to adjust size standards to counter the effects of inflation. SBA has used both of these tools effectively to expand opportunities for more small businesses to support U.S. Federal Government customers. Despite these efforts, however, the U.S. Government Accountability Office (GAO) and others have cited a decline in the number of small businesses supporting the Federal marketplace. They also note a significant drop in businesses out of the Federal market once they cross the valley of death into large business status, where they are expected to compete against firms like Chemonics International, Inc., DAI Global, LLC, and Tetra Tech, Inc., who received $1.38B, $489M, and $287M, respectively in federal contract awards from the U.S. Agency for International Development (USAID) alone in FY2023. Lowering size standards will only further exacerbate this situation, which both harms small businesses and deprives agencies of increased competition and experienced workforce support. The Government should look to raise size standards to allow more small businesses to remain in the Federal marketplace longer, and certainly not lower these standards. Raising size standards would both expand the small business base for Federal agencies and improve the runway for these firms as they grow and have a chance to successfully graduate from their status as small businesses.



2. Secondary Impact on the Rule of Two

Failing to increase size standards, or reducing these standards, will continue the trend of decreasing small business participation in the Federal marketplace. FAR 19.502-2 requires that contracting officers shall set aside any acquisition over the Simplified Acquisition Threshold for small business participation when there is a reasonable expectation that offers will be obtained from at least two responsible small business concerns at fair market prices (the "Rule of Two"). Lowering size standards would decrease the pool of eligible offerors, and thus lead to fewer small business set-asides overall due to the reduced applicability of the Rule of Two.

3. Increase size standards

The U.S. small business industrial base needs more opportunities for small businesses to compete for awards, not fewer. This requires increasing size standards across the board to reflect the current economic realities and allow for the growth of small businesses to a point that they can effectively compete in full and open competition against large businesses upon graduation. An upward adjustment would enable a broader spectrum of small- and mid-sized businesses to compete for Federal contracts, ensuring a healthy, competitive marketplace that benefits the Government through access to a wider array of innovative solutions with greater competition.

4. Opposition to Geographically Differing Size Standards

The notion of geographically differing size standards, which has been proposed by SBA, is not reflective of the reality of the modern-day global economy, in which vendors and suppliers operate remotely and across multiple state and national boundaries. We urge the Government to maintain uniform industry size standards.

5. Request for Further Analysis

We request the Government provide a detailed analysis of how SBA's proposed changes, especially regarding adoption of the disparity ratio approach and the utilization of the Federal Procurement Data System (FPDS) and the System for Award Management (SAM) will affect small businesses across various industries. This analysis should include an assessment of potential impacts on small business participation in federal contracting.

In conclusion, while we recognize the importance of reviewing SBA's methodology for assessing size standards, it is crucial that any revisions are made with a clear focus on enhancing retention of the U.S. Federal contractor base.

Very respectfully,

The Global Small Business Sustainability Coalition

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