

Subcommittee on Contracting Oversight
Senate Homeland Security and Governmental Affairs Committee

**SMALL BUSINESS CONTRACTS: EXAMINING HOW OVERSIGHT
FAILURES AND REGULATORY LOOPHOLES ALLOW LARGE BUSINESSES TO
GET AND KEEP SMALL BUSINESS CONTRACTS**

July 26, 2011

Chairman Claire McCaskill
Opening Statement

This week Washington is focused on the debt ceiling and the looming possibility that our country will default on our obligations. This is a time for all of us here to take a hard look at the way the government is doing business.

Today's hearing is about restoring honesty, transparency, and accountability to one particular part of the government's books – the way that the government awards and tracks small business contracts.

Several decades ago, Congress passed legislation establishing annual goals for small business contracting. That goal is now set at 23%. Last year, the government announced that it had reached 22.7%.

This is a laudable achievement. Unfortunately, it is also an empty achievement. Many of the contracts that the government counts when it tallies the awards it says have gone to small businesses are in fact performed by large businesses. Today, we are going to examine how it is that a system that should be helping small businesses is in fact doing little more than helping the government play a numbers game.

This is not the Subcommittee's first hearing on problems with small business programs. Two years ago, the Subcommittee held a hearing on the multiple preferences for Alaska Native Corporations in the Small Business Administration's 8(a) program for small and disadvantaged businesses. At that hearing, we examined how special preferences in the 8(a) program allowed Alaska Native Corporations – many of which are very large businesses indeed, with revenues far in excess of \$100 million per year and multiple subsidiaries – to be considered "small" businesses by the federal government.

Today we are going to look at some of the other ways that the government's small business rules benefit large corporations. Since 2005, the SBA Inspector General has included in their list of the agency's top management challenges the fact that many contract awards recorded as going to small businesses are actually performed by large businesses.

In many cases this happens because the current regulations allow contracts to be counted this way. In preparation for this hearing, we looked closely at the ways that the size standards for small businesses allow the government and contractors to game the system to their advantage. The SBA sets size standards for businesses for each of the more than 1,200 industries defined under the North American Industrial Classification System (NAICS), a business classification system maintained and used by the U.S. Census Bureau for statistical purposes.

When the federal government awards a contract, the contracting officer determines the NAICS code to describe the product or service being bought. The size standard for that NAICS code defines the size of business that can be counted as small for the contract based on either a business' revenue or the number of employees it has.

Yet, even though the contracting officer should have the ability to choose a NAICS code that best fits the contract, SBA has created a special exception that swallows the whole rule. Even if you don't make anything and you're just buying products from a large business for resale to the government, with a markup, you get to be considered a manufacturer. This allows a bigger size standard to be used, which means that a business that might be too large to qualify as small can get the contract – and the government can count the dollars towards meeting their small business goals.

For example, one contractor, immixTechnology, resells commercially available information technology hardware and in 2009 had approximately \$400 million in revenue and 150 employees. In 2010 immixTechnology received more than \$18 million in new small business contracts for resale and wholesale contracts. SBA generally limits wholesale companies to a maximum size standard of 100 employees and retail companies to a maximum revenue of approximately \$7 million to \$30 million, depending on the industry both standards that immixTechnology far surpassed. But SBA has also created an exception which requires the government to use the classification for a manufacturing company for contracts like this one, which sets the size standard at 500 employees. All of a sudden, a big company like immixTechnology for all intents and purposes, is called “small” for the government's books.

In meetings in preparation for this hearing, the Subcommittee learned that the NAICS system was not designed for use as a government contracting tool. That disconnect may be at the root of some of the abuses that we now see in small business contracts. I'm going to be asking our witnesses today whether there is a more rational way of determining size.

I will also be asking questions today about all the complicated ways that the small businesses certify that they are small and what happens when they grow large or get bought and aren't small anymore by anyone's standards.

My biggest concern here is that the system simply doesn't make sense. Small businesses are one of the most important parts of the U.S. economy and government contracts can be an important economic opportunity for small businesses and an effective way that the government can use its spending power to help small businesses succeed. We need to make sure that the system provides them the opportunities that they need to be successful. We don't need to be spending taxpayer dollars to prop up a system that allows the government to take credit and large businesses to profit at the expense of the small businesses that the system is meant to help.

I thank the witnesses for being here today and I look forward to their testimony.