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Small Business and Defense Acquisitions

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Summary

For much of the past century, the federal government has consistently sought to boost small businesses. These efforts have included, in recent years, a federal government–wide statutory goal for 23 percent of prime contract dollars on goods and services to be spent with small businesses. Recent federal policies have also set spending goals with more narrow categories of women-owned businesses and small “disadvantaged” businesses1 as certified by the Small Business Administration (SBA). Because the Department of Defense (DoD) accounts for most federal purchases, its spending practices draw considerable attention from small business advocates. This report reviews the origin of these small business policies, evidence of their effects, and what lessons best commercial practices may offer for their improvement.

Efforts to support small business are long enduring and have been promoted by Congresses and presidential administrations of both parties. DoD has had mixed results in meeting some of its mandated small business goals, exceeding them in some industries while falling short in others. In Fiscal Year 2007, 20.4 percent of its prime contract dollars went to small businesses, although the nature of data available for analysis may mean that this figure is an underestimate of actual total purchases with small businesses.

Part of DoD’s challenge in meeting its small business goals may be in the nature of different industries and their conduciveness to small business. DoD exceeds the overall 23 percent goal for small business utilization in some categories of its expenditures. Some of the industries for which it does not meet this goal are those in which industry consolidation has concentrated business among larger firms. Because of customer needs for economies of scale as well as scope, flexibility, innovation, and agility, certain industries are better suited to businesses of particular sizes, and many of the goods and services that DoD procures are in industries dominated by large businesses. The challenges this broad economic pattern poses may be exacerbated by evolving DoD needs. Procurement needed to follow the long-range planning guidance of Joint Vision 2020 and its operational concepts, for example, will likely be in industries dominated by large businesses, making it very difficult for DoD to meet its small business goals in future years.

In some measure, the difficulties of meeting small business goals may also be attributable to the bewildering array of criteria for what constitutes a “small” business. The SBA sets separate criteria for nearly 1,200 industries. Criteria may be based either on number of employees,

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1 “Disadvantaged” businesses include, for example, those owned by African-Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and subcontinent Asian Americans with a net worth of less than $250,000 for initial applicants and $750,000 for continuing program participants, excluding home and business equity.
as is typical for manufacturing, or on total revenues, as is typical for services. Small business thresholds set by number of employees vary by industry from 100 to 1,500, and those set by annual revenues vary by industry from $750,000 to $35.5 million.

It may also be the case that many small businesses are simply not interested in government procurement. The few data that exist on the policy interests of small businesses indicate that government procurement is a low priority for many of them.

Unfortunately, there is little evidence of the effectiveness of small business policies. Small business utilization is generally judged on input, and policy effects have generally not been judged against alternative policies. Also, as noted, available data do not permit complete analysis of all purchases with small businesses.

DoD, which has been among the historic leaders in procuring from SBA-certified small “disadvantaged” businesses, often exceeds its goals for purchases from such businesses, but here, too, evaluation efforts are wanting. There is some evidence, for example, that minority employment increases among contractors subject to federal oversight, but this is true for both large and small contractors. Similarly, expanding employment opportunities for minorities outside small business entrepreneurship may mitigate the effects of small business preferences on minority employment, particularly given the greater opportunities that professionals of “disadvantaged” groups are increasingly finding in large firms and outside small business ownership.

Many leading private-sector firms typically have goals for procurement from minority firms (usually as certified by the National Minority Supplier Development Council, Inc.), but fewer have goals focusing on procurement from small firms. Those that do often do not have goals for small business utilization as high as those of the federal government and DoD. In large part, this may be because best commercial practices favor some contract and supply base consolidation that may preclude procurement from some small firms, while procurement goals with minority suppliers can serve other purposes (e.g., marketing). In seeking to find the greatest value in their supply chains, for example, leading commercial enterprises seek to develop more complex and ultimately rewarding relationships with a smaller number of firms. Small businesses can develop niche opportunities with leading commercial enterprises or find opportunities as “tier one” or lower suppliers to prime contractors of leading commercial enterprises. Yet the opportunities available to small businesses in best commercial practices are fundamentally changing in a way not always reflected by fixed prime contract quotas in federal policy.

Still, given the strong support small business policies have enjoyed by different Congresses and presidential administrations of both parties, supporting such policies is likely to remain a concern of DoD for many years to come. To continue to meet prime contracting goals, DoD policymakers may need to develop small businesses as prime contractors. Alternatively, Congress may wish to consider counting subcontracting dollars for small businesses toward small business utilization goals, as some private-sector firms do in their own small business utilization programs. DoD small business utilization, although sometimes falling short of non-statutory goals negotiated with the SBA, exceeds that for many leading large firms in the private sector, and many of its practices for increasing procurement for small and minority businesses match those of leading private firms. The F/A-18E/F Fleet Integrated Readiness Support Team of the Navy, the Flexible Acquisition and Sustainment Tool contract of the Air Force for
engineering and support services, and the Rapid Response to Critical Systems Requirements program of the Army have all emphasized involving small businesses in innovative acquisition policies. Small businesses may be able to play new roles in defense by supplying innovative ideas, responsive supply solutions, and services support as they do in the private sector, and receive federal contracts helping them grow as needs and best commercial practices evolve. Rather than considering how DoD can continue to meet very high small business utilization goals, policymakers may wish to consider what changing warfighter needs and business practices mean for DoD and the opportunities that small business itself may actually want.