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NATIONAL SECURITY RESEARCH DIVISION

Improving Federal and Department of Defense Use of Service-Disabled Veteran-Owned Businesses

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Prepared for the Office of the Secretary of Defense

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Summary

The federal government's goal of awarding 3 percent of all prime-contract dollars to service-disabled veteran-owned small businesses (SDVOSBs) (Bush, 2004; U.S. Congress, 2003, 1999) has not yet been achieved. The objective of this report is to identify barriers to federal contracting with such firms. It summarizes findings and presents recommendations from analyses of quantitative data on service-disabled veterans and of interviews with SDVOSBs and the federal contracting personnel who work with them.

Quantitative Analyses

Using person-level data on veterans, service-disabled veterans, and non-veterans, we consider individual-level barriers that might reduce the likelihood that they will own businesses.

We found that service-disabled veterans are less likely than both veterans and non-veterans to be self-employed. Service-disabled veterans' lower self-employment does not appear to be explained by a lack of education or experience in the labor market, because, on average, service-disabled veterans have more education than non-veterans and all veterans and are older than non-veterans. Even when differences in education, age, gender, race-ethnicity, and marital status are controlled for simultaneously, service-disabled veterans are still less likely than non-disabled veterans and less likely than non-veterans to be self-employed. Service-disabled veterans' odds of self-employment were 33 percent lower than for non-veterans and 48 percent lower than for non-disabled veterans—differences that are statistically significant.

Recent apparent increases in the number of service-disabled veterans appear unlikely to translate into increases in the number of SDVOSBs with whom the federal government might contract. This is because most recent veterans appear to have higher levels of disability and lower rates of self-employment than veterans from earlier cohorts.

Interviews

A central focus of this project is the identification of barriers experienced by SDVOSBs when trying to contract with the federal government. To assess these barriers, we conducted in-depth interviews with 13 SDVOSBs. We also interviewed DoD contracting staff who had worked with SDVOSBs to learn about their experiences and to obtain a more complete understanding of the barriers SDVOSBs face.

Methodology

We used five criteria to select firms for interviews. Specifically, we sought SDVOSBs in industries

1. with a sufficient number of SDVOSBs to provide for a sufficient number of responses
2. with sufficient federal spending to enable contracting with the federal government
3. where SDVOSBs have won some contracts
4. where SDVOSBs represent a significant portion of registrants in the Central Contractor Registration (CCR), that is, where federal contracting was not precluded by too few SDVOSBs
5. where SDVOSBs might have competition from businesses qualifying for other preference programs.

We used tabulations of 2011 Federal Procurement Data System contract-action data and CCR data to select the industries where we would focus our interviews. We used the North American Industry Classification System (NAICS) to define industries, and we ranked industries by the number and percentage of SDVOSBs registered in them, the amount of total federal spending in them, and the amount of federal spending awarded to SDVOSBs. We subsequently identified Engineering Services (NAICS number 541330), Commercial and Institutional Building Construction (NAICS number 236220), and Facilities Support Services (NAICS number 561210) as the three industries on which to focus our interviews.

We then sampled SDVOSBs in these industries to interview. We randomly selected firms within each of these three industries and within each of 12 groups defined by funding source, other preference-program membership, and Small Business Administration certification. We sampled 132 companies to solicit for participation in the study. We also randomly selected 20 contracting specialists in each of the three industries from all DoD contracts with SDVOSBs, for a total of 60 contracting specialists to solicit for participation. We developed interview protocols from the literature and policy presented in a background paper prepared by the Office of Small Business Programs (OSBP) at DoD.

We received responses from 13 companies and five contract staff. We rigorously analyzed the responses for themes and for insight into the barriers to federal contracting that SDVOSBs may face.

Results

The SDVOSBs interviewed were similar to those sampled with regard to their qualification for other preference programs, their size, and, to a lesser degree, their federal contracting experience. The interviewed firms also shared a broad range of other characteristics, including years in business, ownership of other businesses, proportion of commercial and federal contracts, and number and amount of federal contract bids and awards. The firms interviewed had worked with 21 federal agencies, the most common of which were the Department of Veterans Affairs (VA) and DoD.

The interviews identified three barriers unique to these firms because they were SDVOSBs: the prior definition of the SDVOSB contracting program as a less-urgent goal than other small business programs, a lack of understanding among many SDVOSBs interviewed about the program, and a barrier to receiving planned subcontracts.

The first barrier is that the SDVOSB contracting program's goal was first defined with less-rigorous language than the goals of other programs. The specific language in the Federal Acquisition Regulation (FAR) for SDVOSBs had, until a recent revision, used the term "may set aside acquisitions" for this group, whereas the language used for other preferred businesses, such as those in historically underutilized business zones, was "shall set aside acquisitions." This distinction of "may" versus "shall" was recently erased by the 2010 Small Business Jobs Act, which established parity among the different programs (U.S. Congress, 2010). When incorporating this change into the FAR, program administrators noted their intention to clarify "that there is no order of precedence among the small business socioeconomic contracting programs" (*Federal Register*, 2012). Nevertheless, the distinction has historically meant that contracting staff had greater discretion on whether to set aside or award a contract to an SDVOSB. Many SDVOSBs and some contract staff interviewed maintained that this discretion continues to result in a lower priority for SDVOSB contracting. Some contracting staff reported that the lower priority of SDVOSB contracting is exacerbated by the fact that goals for other small business procurement programs draw the efforts of contracting staff because the other goals are higher. The lack of knowledge and prior experience in federal contracting of many SDVOSBs interviewed, requiring that contracting staff and customers do more work and absorb more risk in working with such businesses, could further reduce the likelihood that an SDVOSB will receive a contract.

A second but related barrier described by these interviewees—and one that is unique to SDVOSBs—is that many did not understand that the SDVOSB procurement goals are not mandatory and are not guaranteed. We heard many misconceptions about the program in the SDVOSB interviews, despite the fact that the interviewees had attended federal information seminars about the program.

Finally, for prime contractors, including an SDVOSB on a bid demonstrates an effort to satisfy federal SDVOSB subcontracting goals, but a lack of federal oversight after awards are made reportedly fails to ensure that prime contractors include SDVOSBs in the actual work. Planning to use SDVOSBs for subcontracting to meet federal subcontracting goals improves a company's chances of winning a contract. Many SDVOSB respondents described experiences with prime contractors that included them as subcontractors on bids but then rarely included them in awarded work. These SDVOSBs were reluctant to complain about this problem to federal officials for fear of being labeled as whistle-blowers and being excluded from future subcontracts. The effect of making complaints could extend beyond the lost subcontracting business into future prime contracts as well.

The interviewees also described encountering many barriers faced by non-traditional suppliers and other small businesses as well. These included the inherent complexities of the FAR and of the federal bidding process, a lack of sufficient federal educational and networking opportunities, a lack of communication from key contracting personnel, the slow federal processes for award decisions and making final payments, insufficient knowledge among SDVOSBs about their chances of winning a bid, the risk of wasting resources on developing a bid that was likely to go to an incumbent or another established supplier or of investing in a bid that was subsequently cancelled, and the possibility of being in an emerging industry that does not fit existing NAICS categories.

The SDVOSBs also described some limited sources of support for managing these barriers. These included the federal training conferences, which provide very basic information, and more detailed information and assistance from state-level Procurement Technical Assis-

tance Centers (PTACs). A few SDVOSBs described partnering with other suppliers on bids as the most useful source of information. Firms that reported partnering with other suppliers or hiring staff with prior federal contracting knowledge improved their bidding further. Finally, SDVOSBs that had a strong customer-oriented approach to federal contracting described the greatest success.

For the SDVOSBs interviewed that were either unaware of or unable to invest in these sources of support, the barriers often created some level of disillusionment with the program and with the federal government's commitment to veterans. The widely publicized 3 percent goal raised the expectations of many of these SDVOSBs that they would receive federal business, and they invested in their companies and in bids accordingly. However, their experience was facing fewer bidding opportunities, greater competition, and fewer winning bids than they expected. Exceptions to this disillusionment were those few SDVOSBs interviewed that focused relentlessly on increasing their knowledge of the FAR and of the bidding process and that catered to the needs of both the contracting officer and the customer when they did win an award.

Our findings suggest multiple reasons for the low rate of federal SDVOSB contracting compared with the 3 percent federal goal. First, the level of priority placed on the program likely contributes to the federal government's inability to meet its goal. The policy has only very recently been worded as strongly as that for other small business procurement programs; competing goals from other programs limit set-asides for SDVOSBs, and limited oversight of subcontracting goals may discourage prime contractors from including SDVOSBs in awarded work. Second, SDVOSBs, especially new ones, may also confront the same barriers faced by small businesses and non-traditional suppliers. Third, although some sources of support for managing these barriers exist, they are limited. Finally, given these barriers, many SDVOSBs interviewed were disillusioned with the program, and, to the extent that such disillusionment is widespread, it may limit federal contracting rates further.

Recommendations

Given these barriers, whether the federal government can reach its 3 percent goal for SDVOSB contracting is not clear. Identifying the number of SDVOSBs in the industries in which federal agencies spend, particularly by federal agency, may be useful, as would analyses of service-disabled veterans' decisionmaking processes regarding self-employment and estimations of the actual dollar amounts and number of contracts that would be received by SDVOSBs. In addition, reducing barriers facing SDVOSBs may involve increasing the priority of the SDVOSB program, strengthening education and training opportunities, and continuing efforts to remove barriers to non-traditional suppliers and small businesses.

Increase the Priority of the SDVOSB Program

If the federal government wants to increase the priority of the SDVOSB program, federal agencies need to ensure that the recent changes to the policy made by the 2010 Small Business Jobs Act are transmitted explicitly to federal contracting staff. Agencies also need to inform staff of which industries have ample numbers of SDVOSBs, especially as compared with the numbers of firms in other preference programs. A final step toward raising the priority of the SDVOSB

program would be to provide contracting resources for reviewing prime contractors' execution of their bid and subcontracting plans, conduct those reviews, and publish the results.

Strengthen Education and Training Opportunities

Providing SDVOSBs also with the industry analyses described above could be a first step toward strengthening their education and training opportunities. Additional education could include more advanced information and training about the FAR and the federal bidding process and about the roles and responsibilities of contracting staff. Strengthening and enhancing PTAC support of these efforts could also strengthen education and training opportunities and may be most efficient. Networking opportunities in any of these forums could help SDVOSBs identify firms with which to partner or subcontract to learn more about the bidding process.

Finally, clarifying federal expectations of SDVOSBs might also help strengthen education and training opportunities. Some SDVOSBs interviewed saw dramatic improvements in their ability to win contracts when they invested effort in understanding the FAR and in the lengthy process of learning how to develop a successful bid. Similarly, the SDVOSBs interviewed that expected to have to learn and meet the needs of both the contracting officer and the customer reportedly received strong performance evaluations, which strengthened their ability to win future bids.

Continue Efforts to Remove Barriers to Non-Traditional Suppliers and Other Small Businesses

Barriers faced, at least by the SDVOSBs we interviewed, can also be reduced by more general efforts to remove barriers to non-traditional suppliers and other small businesses. These efforts include continuing to streamline the administrative requirements of and removing inefficiencies from the bidding process, further streamlining the award decision and closing payment procedures, improving communication between government and suppliers, and helping suppliers in emerging industries become known to both customers and contracting officers.