CHAPTER ONE

Introduction

Efforts to boost small businesses, both generally and of specific types, are an enduring theme of federal policy. One general policy to boost small businesses is a government-wide goal to spend at least 23 percent of its federal contract dollars for goods and services with small businesses.

In addition to this general goal, Section 8(a) of the Small Business Act seeks to "promote the business development of small business concerns owned and controlled by socially and economically disadvantaged individuals" (Public Law 85-536).[1] The federal government pursues this goal through a variety of business-development services as well as through the award of government contracts. Since 1988, the government-wide goal has been to spend 5 percent of all prime-contract dollars for goods and services with small and disadvantaged businesses (SDBs). (Such purchases count toward goals both for small businesses generally and for small and disadvantaged businesses specifically.)

Federal efforts to boost small and disadvantaged businesses originally focused on African American businesses but over time have encompassed those owned by other groups. Section 8(a) benefits are now available to small and disadvantaged businesses defined by (1) Small Business Administration (SBA) thresholds by industry and (2) at least 51 percent ownership and operation by individuals "who have been subjected to racial or ethnic prejudice or cultural bias within American society" and "whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others . . . who are not socially disadvantaged" (13 Code of Federal Regulations [CFR] §124, 8(a), annual).

In addition, small businesses owned at least 51 percent by organizations recognized as representing groups of individuals such as Alaska Native Corporations (ANCs), economically disadvantaged federally recognized Indian tribes, Native Hawaiian Organizations (NHOs),[2] as well as Community Development Corporations (CDCs) may qualify for the 8(a) program. These categories, like those for racial and ethnic groups other than African Americans, have been added over time as Congress became concerned with the economic development of other groups. The ANC qualifications, for example, were instituted in part to support ANCs' efforts to provide a wide variety of benefits to Alaska Natives, who received such benefits in part, as we will discuss, in settlement over land claims. (See Appendix C for selected dates in the evolution of policy for Native Groups.)

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[1] For further discussion of how congressional concern with small businesses merged with presidential concern with minority business development, see Luckey and Manuel (2009).

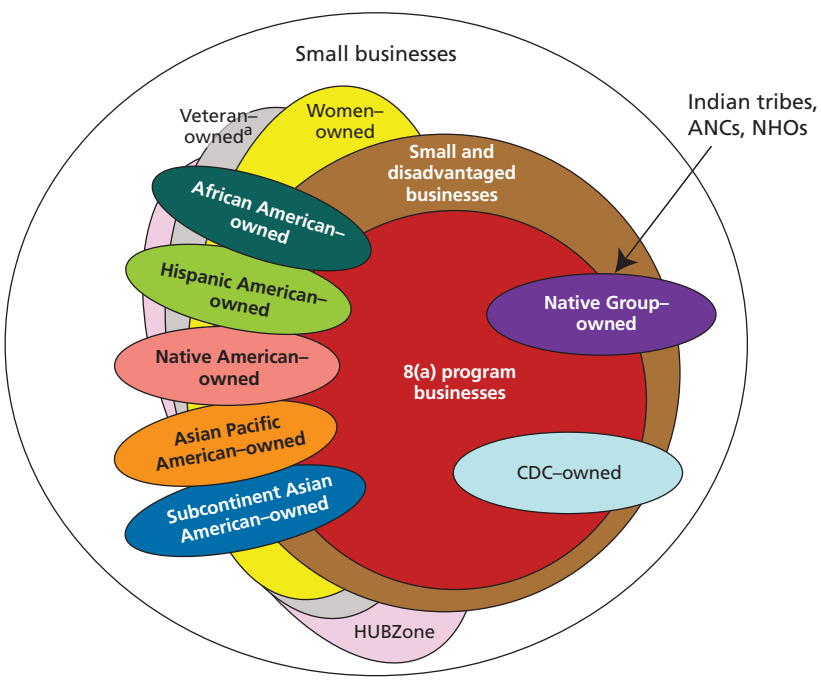
[2] Throughout this report, we use the term Native Group to refer to these organizations, which are recognized as representing Alaska Natives (e.g., Eskimos, Aleuts), American Indians or Native Americans, and Native Hawaiians. They represent a subset of all companies owned by Native Americans.

Figure 1.1 illustrates these categories and shows how they can overlap. Note that small businesses owned by Native American individuals, ANCs, NHOs, and economically disadvantaged Indian tribes fall into multiple categories.

Participants in the 8(a) program are eligible to receive government contracts set aside for them. Using such contracts for purchases of goods and services can also help agencies meet their contracting goals for both small businesses and small and disadvantaged businesses.

Before 1988, 8(a) contracts were not subject to competitive bidding, which meant that they could also offer a faster way to meet urgent customer requirements. This, critics charged, led to a few select firms receiving disproportionately large contracts ("Overhaul of Small Business Administration (SBA) Minority Program Cleared," 1988).[3] As a result, Congress required that contracts set aside for 8(a) participants that exceed specified thresholds be subject to competition. These caps, originally set in 1988 at $5 million for manufacturing industries and $3 million for nonmanufacturing industries, were raised in fiscal year (FY) 2011 to $6.5 million for manufacturing and $4 million for nonmanufacturing contracts (see Federal Acquisition Regulation [FAR] 19.805-1]. Congress also barred firms from selling or transferring 8(a) contracts to non-8(a) firms without a waiver and set a nine-year limit for participation in the program.

Figure 1.1
Overlaps in Definitions of "Small" Businesses Eligible for Federal Programs



[a]Includes a subset of service-disabled veteran-owned.

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[3] The most extreme example was that of Wedtech Corp. (Stengel, Boyce, and Constable, 1987).

There are some exceptions to 8(a) eligibility and contract rules. For example, although most 8(a) business owners can participate in the program only once in their lifetimes, ANCs, CDCs, and economically disadvantaged Indian tribes and NHOs can own more than one 8(a) firm as long as each is in a different primary industry. Contracts set aside for 8(a) businesses are now subject to competition if their dollar amounts exceed specified thresholds, but 8(a) contracts with firms owned by ANCs, CDCs, and economically disadvantaged Indian tribes and NHOs are not. Table 1.1 summarizes the key differences in requirements for 8(a) businesses by type. (See Appendix D for more details on the variance in 8(a) requirements by type of business.)

These rules have led to a sharp increase in contracting with firms owned by Native Groups. These firms have also benefited from a large increase in government contracting generally. Within the Department of Defense (DoD), for example, the nominal dollar value of purchased goods and services (excluding procurement of weapons) has nearly tripled since 1948 and is now approaching $250 billion annually (Office of the Under Secretary of Defense (Comptroller), March 2010). Native Group firms also benefited from provisions in the 2000 Defense Appropriations Act that allowed DoD organizations, when outsourcing to any Native American–owned firm, to perform direct conversions without the usual costs and time required

Table 1.1
Differences in Requirements for 8(a) Businesses, by Type

Requirement	Other 8(a) Businesses	8(a) Businesses Owned by ANCs, CDCs, or Economically Disadvantaged Indian Tribes and NHOs
Number of firms an 8(a) participant may own	Only one in a lifetime; no more than 20 percent of another 8(a) firm	No limit as long as each is in a different primary industry
Consideration of affiliates in determining size	Yes	If SBA determines affiliates provide unfair competitive advantage
Competition requirements for federal contracts	Procurements must be competed whenever possible, but firms can receive noncompetitive contracts for amounts up to $6.5 million for manufacturing industries and $4 million for nonmanufacturing industries, with $100 million total cap on noncompetitive contracts	No threshold above which competition is required for individual contracts for ANCs, economically disadvantaged Indian tribes, or, on DoD contracts, for NHOs, and no total cap for ANCs or Indian tribes; justification and approval now required for noncompetitive Native American contracts exceeding $20 million
Social and economic disadvantage	Persons owning 51 percent of a firm must prove disadvantage (with some deemed to have a social disadvantage)	Need not prove social disadvantage; Indian tribes and NHOs must prove economic disadvantage on first application
President or chief executive officer	Must be a socially and economically disadvantaged individual	Need not be a disadvantaged individual if SBA determines that such management is necessary to assist the business's development, etc.

SOURCES: Luckey and Manuel (2009); Jordan (2009).

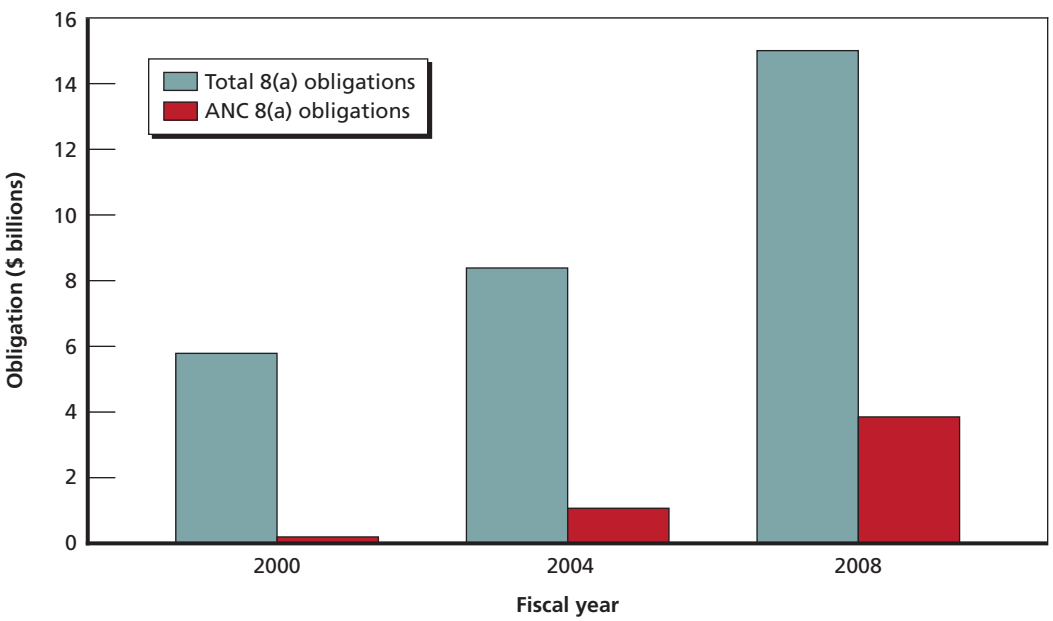
to complete a formal A-76 competition.[4] (See Lumpkin, 1999; Soteropoulos, 1999; Luckey and Manuel, 2009.)

The increase has been particularly sharp for firms owned by ANCs (Figure 1.2). From FY 2000 through FY 2008, federal 8(a) obligations to ANC-owned firms increased fourteen-fold, from $265 million to $3.9 billion (Government Accountability Office, 2006; U.S. Small Business Administration Office of Inspector General, 2009b). In FY 2008, ANC-owned firms accounted for 26 percent of total 8(a) dollars—an increase from 13 percent in FY 2004. Most of these awards were to the 11 largest ANCs, with most involving noncompetitive contracts. One ANC firm in FY 2008 received approximately $531 million in 8(a) contracts, of which $426 million, or four-fifths, were noncompetitive (U.S. Small Business Administration Office of Inspector General, 2009).

Proponents of these rules note the large number of shareholders that Native Groups must benefit, as well as the procedural efficiencies that noncompetitive contracts can offer. Critics note higher costs to taxpayers that could result from noncompetitive contracts, as well as the possible effect on other 8(a) firms.

Concern over the large size and increasing number of noncompetitive awards to Native Group–owned companies, particularly those owned by ANCs, led Congress to stipulate, in Section 811 of the National Defense Authorization Act for FY 2010 (Public Law 111-84),

Figure 1.2
Federal 8(a) Obligations for All Firms and for ANCs, FY 2000 to FY 2010



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[4] A-76 is the name of the Office of Management and Budget Circular that established federal policies for the competition (between public and private providers) of activities that have been designated as commercial (i.e., a recurring service that could be performed by the private sector). It can take from 90 to 135 days to complete a streamlined competition (65 or fewer full time equivalent (FTE) positions are being competed) to 12 to 18 months for a standard competition (more than 65 FTEs are being competed). See Office of Management and Budget, 2003; Andrews, 2004. However, large, complex competitions can take two years or more (Grasso, 2009, p. 4).

that noncompetitive 8(a) contracts exceeding $20 million may not be awarded unless there is a justification and approval (J&A) of the need for it. (See Appendix A for Section 811.) It is not known what effect, if any, this requirement will have on contracting processes and the competitiveness of Native Group–owned firms that can currently receive these large contracts noncompetitively without a J&A. Accordingly, Congress has also requested a report discussing how the J&A requirement may affect the contracting process generally and the selection of Native American companies for large contracts particularly, whether it places an excessive administrative burden on contracting personnel, and recommendations on mitigating any unintended negative results (House of Representatives, 2010). (See Appendix B for the specific language requesting this study.)

This report fulfills that request. As background, in the next chapter, we briefly review 8(a) policies, particularly those on contracting preferences and especially those affecting Native Group–owned firms. We provide an overview of Native Groups, their purposes, and the reasons policymakers deemed the small businesses they own to be eligible for noncompetitive 8(a) contracts of any amount. We also review some of the effects that similar rules have reportedly had on other 8(a) firms.

In the third chapter, we use data from the Federal Procurement Data System (FPDS) to explore concerns regarding the relatively large increase in sole-source contracts to Native Group–owned companies. We also explore the possible effects of the J&A requirement on the contracting process and possible administrative burdens resulting from the requirement. We do so by exploring all, small business, and 8(a) DoD contract dollars over time as well as contracts above and below the threshold of $20 million—the threshold for noncompetitive manufacturing contracts (raised to $6.5 million in FY 2011)—and the threshold for noncompetitive contracts in other industries (raised to $4 million in FY 2011).

In the fourth chapter, we summarize research and interviews with three key stakeholders in the contracting process—prospective competitors for the large contracts, Native Groups, and contracting officers who will be responsible for executing the change in policy—regarding prospective effects of the change.[5]

In the fifth and concluding chapter, we summarize our findings, review their implications, and offer recommendations for policymakers.

[5] The requirements for a J&A of sole-source 8(a) contracts over $20 million had not yet been implemented in the FAR when this study was written, thus we could identify only prospective effects.