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; by Henry Eschwege, Director, Community and Economic
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The Small Business Administration (SBA) uses its 8(a) procurement program to assist disadvantaged small businessmen by entering into procurement contracts with Federal agencies and subcontracting the work to these businessmen. Through sponsorship arrangements, SBA encourages nondisadvantaged businesses (sponsors) to provide management services, training, and capital to disadvantaged small businesses. SBA's success in helping disadvantaged firms to become self-sufficient and competitive had been minimal, and sponsorship arrangements did little to contribute to success. Contractors became sponsors to make profits and to protect their livelihoods in the Government contracting industry and had little incentive to develop 8(a) firms into viable businesses. SBA did not monitor the sponsors' control of firms, and did not establish procedures on management fees. SBA has recently revised procedures, but progress has not been evaluated. (HTW)

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Statement of
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and Economic Development Division
Before the
Subcommittee on Federal Spending Practices
and Open Government
Committee on Governmental Affairs
United States Senate
on
SBA's 8(a) Procurement Program

Mr. Chairman and Members of the Subcommittee:

We are here at your request to discuss the Small Business Administration's (SBA) 8(a) procurement program that deals with the use of sponsorship arrangements. We reviewed the effectiveness of this program in 1974 and the Comptroller General issued a report to the Congress on the results of that review in April 1975 (GGD-75-57). This work was part of a full-scale audit of SBA, which the General Accounting Office was mandated to conduct under Public Law 93-386, approved

August 23, 1974. The legislation was prompted in part by the House Banking and Currency Committee's investigations which indicated mismanagement and possible criminal activities at certain SBA field offices.

Briefly, Mr. Chairman, I would like to provide some background information on the concept and theory of the 8(a) program. SBA uses the section 8(a) program to assist socially or economically disadvantaged small businessmen to achieve a competitive position in the financial marketplace by entering into procurement contracts with Federal agencies and in turn subcontracting the work to these small businessmen.

In awarding an 8(a) subcontract, SBA hopes to provide a firm with enough work to operate at a profitable level while the firm is developing its non-8(a) commercial and Government sales. Each firm normally prepares a business plan, subject to SBA approval, which projects, on a multiyear basis, the amount of 8(a) subcontracting assistance needed to reach self-sufficiency. The firm also projects the growth in commercial sales which it believes it needs to become self-sufficient.

SBA obtains from Federal agencies prime contracts that ordinarily would be competitively awarded. The contracts are negotiated first between the Federal agency and SBA (prime contractor) and then between SBA and the 8(a) firm (subcontractor).

Our review of the 8(a) program was directed towards ascertaining (1) the degree of success the program had in assisting firms to become self-sufficient, (2) whether all firms admitted to the program--based on their social or economically disadvantaged status--actually needed the special assistance of the 8(a) program, and (3) whether sponsor organizations actually assisted disadvantaged firms and gradually relinquished control over these firms. Through the sponsorship arrangement, SBA encourages non-disadvantaged businesses (sponsors) to provide management services, training, and capital to disadvantaged small businesses.

We concluded, in our report, that SBA's success in helping disadvantaged firms to become self-sufficient and competitive had been minimal. From 1968 to August 1974, only 31 firms out of the over 2,800 participants successfully completed the program. SBA recently told us that as of May 1977, 97 out of 3,637 participants successfully completed the program.

We selected and evaluated the progress of 110 firms that had received at least one subcontract before December 31, 1970. Of the 110 firms, 73 had not reached self-sufficiency at the time of our review. Of these:

- 20 deteriorated financially,
- 27 went out of business, and
- 26 had either a slight financial improvement (but not enough to make the firm self-sufficient) or no change.

Of the remaining 37 firms, 18 became self-sufficient and 19 could not be classified because of insufficient information.

A major reason for this lack of success was SBA's inability to control the supply of contracts available from Federal agencies. Although applicants specify in business plans the amount of assistance they need each year to become self-sufficient, SBA cannot guarantee any level of assistance.

Specifically, we are here to talk about that part of our report that dealt with sponsorship arrangements. In performing this part of the audit, we reviewed files at the 10 SBA regional offices and identified eighty-nine 8(a) firms which had sponsors. We evaluated 25 of the 89 firms and the 7 sponsors of these firms. This subject was covered in chapter 3 and appendix IV of our report to the Congress. We also sent two letters and enclosures to the Administrator, SBA, on July 10, 1975, and November 5, 1975, respectively, describing the activities of two groups which, in our opinion, were involved in the most serious abuses of the sponsorship arrangement. SBA was provided these examples so that it could better evaluate the conclusions and recommendations contained in our report to the Congress and could consider providing the detailed information to its Internal and External Audit Groups and to its Security and Investigations Group.

The letters were also made available to the Chairmen of the House Small Business Committee and Senate Committee on Banking, Housing and Urban Affairs in July and November 1975.

I will now highlight some of our principal concerns about how sponsorship arrangements did little to develop viable 8(a) firms. I will not discuss this information in great detail since you have previously made the results of our review and the two letters part of the record.

Some experienced contractors became sponsors to make profits and to protect their livelihoods in the Government contracting industry. Their goal was accomplished by:

- forming new corporations using former employees as majority stockholders and officers, (For 16 of the 25 firms we evaluated, the disadvantaged owners had previous experience in janitorial and kitchen police work as managers for the sponsoring businesses, in the military, or elsewhere.)
- securing minority stock ownership for themselves,
- getting the new corporations approved for the 8(a) program,
- identifying and negotiating contracts for the new corporations, and
- subsequently providing them with services and items for a fee.

We believe that sponsors generally had little or no incentive to develop 8(a) firms into viable businesses. Instead, some sponsors benefited from the arrangement by maintaining their relationships with 8(a) firms for as long as possible to continue to profit from their investments.

It appeared that SBA relinquished to sponsors its responsibilities to insure that 8(a) firms were provided with capital, management services, and training to aid them in becoming self-sufficient. The sponsors often continued to control the firms; this did not meet SBA's objective of helping the 8(a) firms to become self-sufficient. SBA for its part did not (1) monitor the extent to which sponsors controlled 8(a) firms, or (2) determine whether firms were becoming self-sufficient. Instead, SBA considered majority ownership of 8(a) firms-- ownership of 51 percent or more--by disadvantaged individuals as the only evidence of their control. SBA also did not establish procedures on sponsors' management fees. For example, the sponsors included in our review charged their 8(a) firms fees ranging from about 6 percent to about 17 percent of the firm's gross receipts.

SBA agreed with our recommendation that a system be established to monitor a sponsor's compliance with the terms of the sponsorship arrangement as approved by SBA, especially management agreements establishing a sponsor's services and fees.

Recently the Director of the 8(a) program told us that SBA had revised its procedures to increase control and surveillance over sponsorships as follows.

- (1) Management agreements between sponsors and 8(a) firms are now required to be approved by SBA's Associate Administrator for Procurement Assistance.

- (2) The Business Plan, a form which 8(a) applicants are required to submit when applying for admittance to the program and which must be updated annually, has been expanded to collect information on sponsorship arrangements.
- (3) Revised procedures require field office personnel to monitor the compliance of sponsors with approved agreements. In March 1977, the field offices were instructed by SBA Headquarters to meet personally with sponsored 8(a) firms to review sponsorship arrangements.
- (4) A surveillance team of four members had been established to review SBA procurement programs, including the 8(a) program, through field investigation.

Mr. Chairman, we have not made a current evaluation of SBA's progress in controlling sponsorship arrangements. However, SBA internal auditors have recently completed an examination. They are in the process of completing their report on sponsor activities, and they believe that many 8(a) firms are still being controlled by sponsors. Further, they believe that the majority ownership criteria SBA uses in determining control over an 8(a) firm is ineffective. Their review indicated that the nondisadvantaged sponsors rather than the disadvantaged 8(a) owners were the prime recipients of the program's benefits.

This concludes our prepared statement, Mr. Chairman. We will be pleased to respond to any questions.