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Contact: Community and Economic Development Div.

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The Small Business Administration (SBA) uses the 8(a) procurement 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. Twenty-eight 8(a) applications in SBA's region IX in fiscal year 1977 were reviewed. Three basic conclusions on 8(a) program eligibility were reached: (1) the eligibility criteria were vague and not applied in a uniform and consistent manner; (2) region IX was not complying with program procedures because its files did not identify specific criteria used to approve eligibility, and it did not document the connection between an applicant's social or economic disadvantage and the inability to successfully compete in the economic mainstream; and (3) different offices can reach different decisions on eligibility in the same case. One example of the differing interpretations of eligibility criteria involved a particular architect/engineering firm. Although one district office approved the firm as being eligible for the 8(a) program, another office refused to recommend the company when the application was transferred to its district; the regional committee found the applicant ineligible, whereas the Regional Director, interpreting the criteria differently, admitted the firm to the program. (BRS)

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STATEMENT OF
JOHN LANDICHO, ASSOCIATE DIRECTOR,
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION
BEFORE THE SUBCOMMITTEE ON MINORITY ENTERPRISE
AND GENERAL OVERSIGHT COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVE
ON
SBA'S 8(a) PROCUREMENT PROGRAM

Mr. Chairman and Members of the Subcommittee:

We are pleased to appear at your request to discuss the results of our review of the eligibility criteria for the Small Business Administration's 8(a) procurement program.

Pursuant to your request, we made a review to determine whether SBA offices were uniformly applying the eligibility criteria for determining an applicant's economic or social disadvantage for participation in the 8(a) program. The Comptroller-General's report to you entitled "An Analysis Of How Eligibility Criteria Are Applied For Participation In The 8(a) Program" was issued on March 31, 1978, (CED-78-92).

Background

I would like to provide some background information on the concept and the theory of the 8(a) program before discussing our report findings.

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 subcontract 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. Each firm also projects the growth in commercial sales which it believes it needs to become self-sufficient.

To be eligible for the 8(a) program, a firm must be owned and controlled by a socially or economically disadvantaged person. Although the Congress has not precisely defined the term "disadvantaged," SBA has decided to base the eligibility criteria on a section of the Economic Opportunity Act of 1964, which indicated that SBA should attempt to assist small businesses in any way that furthers the purposes of the act. Although SBA recognizes that disadvantage may arise from cultural, social, or chronic economic circumstances or background or similar causes, its policies emphasize that eligibility determinations should avoid any implication that eligibility is based principally on the race, creed, or ethnic background of an individual.

Approval authority rests with the various regions. The approval process begins at the district, where the 8(a) application is initially screened by an SBA specialist and is then evaluated by a review board of district officials. If the district recommends acceptance, the application is forwarded to the region, where another board of SBA officials

reviews the case and makes appropriate recommendations to the Regional Director--final approval rests with the Regional Director. At any level an applicant may appeal a decision and receive further consideration of his application.

Results Of Review

Our review was primarily directed towards analyzing fiscal year 1977 8(a) applications in SBA's Region IX. There were 28 applications. We analyzed applications, supporting documentation, and held discussions with agency officials to examine how program criteria were applied and to determine whether they were uniformly or subjectively applied. We also summarized the economic data on each applicant contained in agency files and prepared a detailed study on one applicant of special interest to your office. This work was performed at the San Francisco regional office and the San Francisco, Los Angeles, San Diego, and Phoenix district offices of the Small Business Administration.

Based upon our review we reached three basic conclusions on 8(a) program eligibility. First, the eligibility criteria were vague and not applied in a uniform and consistent manner. Second, Region IX was not complying with program procedures because its files did not identify the specific criteria used to approve eligibility, nor did it document the connection between an applicants' social or economic disadvantage and their inability to successfully compete in the economic mainstream. Finally, different offices can reach different decisions on eligibility--as we noted in one case where the same applicant was recommended for acceptance by one

office while rejected by another.

At this point, Mr. Chairman, I would like to summarize the major problems identified in our review and included in our report to you.

Applicants Approved Based On Vague Information Subjectively Related To Eligibility Criteria

Our review of the 28 Region IX applicants found eligible in fiscal year 1977 for participation in the 8(a) program revealed that approval often was given on the basis of vague information about the applicant's social or economic position. The apparent level of disadvantage varied considerably. While the applicants experienced disadvantages during their youth, they later moved in two different socioeconomic directions. One undoubtedly disadvantaged group included applicants with a long history of low wages (possibly earned in the trades) that were attempting to succeed with such ventures as painting or janitorial services. The other group included applicants with college educations and moderate-to-high incomes, that typically were involved in more sophisticated ventures such as architect/engineering, consulting, or computer-oriented businesses.

In approving applicants, SBA did not identify the applicant's specific problems and relate them to the six principal criteria establishing eligibility. The six criteria are identified in the attachment to my statement. Approvals appeared to rely instead on vague statements professing disadvantage made either by the applicant or by an SBA official from information supplied by the applicant.

Approvals rarely stated the specific criteria used to approve eligibility, but referred instead to several different documents-- including the disadvantage statements. Thus, it is not possible to determine the specific basis for approval.

Let me focus on one of the six criteria--social background. Social background and its detrimental effect on the applicant appears to be the leading factor used in assessing applicant eligibility. The SBA criterion is:

"Because of his social background, the individual has been unable to obtain technical assistance, business assistance or financing of a quality or quantity similar to that available to the average entrepreneur in the economic mainstream (where possible, exclusions of this nature should be confirmed by specific examples)."

In the 28 cases we reviewed, there was some discussion, extensive at times, on the individual's earlier years in poverty. The discussions rarely compared the applicant's experience to the average entrepreneur. In some cases the information suggested that an applicant's disadvantage had even been overcome, while in other cases it was apparent that the individual was in a very low social or economic status.

In 20 of the 28 cases reviewed, the statements about the individuals' social background problems were generally vague. It was unclear about how the applicants' background had excluded

them from the economic mainstream. For example, one applicant with a salary of \$45,000 a year, company sales of over \$700,000, and an after-tax profit of \$66,000 argued that his social background had prevented him from obtaining traditional financing, especially from friends, relatives, and parents. The statement mentioned an unsuccessful attempt to obtain financing from a bank that had made loans to a competitor. Aside from the vague remark that his social background had made it difficult to obtain assistance, there was no discussion about how this precluded obtaining assistance or what efforts had been made to obtain help.

In the eight remaining cases, the files mentioned that individuals had been raised in poverty but had nevertheless made substantial progress in education and business or the files stressed the applicant's adolescent problems but gave little attention to how this related to eligibility criteria.

Based on our review, we concluded that SBA's eligibility criteria are not precisely defined, and that it is difficult to determine from applicants' files why an applicant is deemed eligible. SBA has not complied with its own procedures which require, when possible, that specific examples of how an applicant meets the eligibility criteria be cited. Nor has it complied with its procedures calling for documentation of the connection between applicants' social or economic disadvantage and their inability to complete successfully in the economic mainstream.

Prior GAO Review

As a result of an earlier review, we issued a report to the

Congress in April 1975, entitled "Questionable Effectiveness of the 8(a) Procurement Program" (GGD-75-57) wherein, among other matters, we addressed applicant eligibility. We reported at that time that SBA was admitting applicants into the program on the basis of social disadvantage without documenting the reason why the assistance was needed.

We recommended that SBA revise its standard operating procedures to require that field offices consider all of the suggested factors in determining the need for 8(a) assistance and document in writing the connection between an applicant's social or economic disadvantage and his inability to compete successfully in the business world. While SBA has established new procedures to require this, our more recent work in Region IX shows that these procedures have not been successfully complied with. Under the circumstances it is not possible for uniform decisions to be made.

Different Interpretations Of
Eligibility Requirements Expressed
By SBA Officials

SBA officials at all levels acknowledge that the eligibility criteria for 8(a) admission is very subjective. As a result, the same company may be considered eligible by one office but rejected by another office.

Various officials view the criteria for eligibility differently. The Director, Office of Business Development at SBA headquarters, and the San Francisco Regional Director consider the 8(a) program as designed to insure minority parity with firms owned by the majority

population. According to this view, almost all minorities presumptively qualify for the 8(a) program. The market share of the company, rather than the financial condition of the company's owners, is considered the basis for eligibility. Consequently, a company with some measure of success may still be eligible if it is trying to obtain a larger market share.

SBA officials at the Region IX district offices interpret the eligibility criteria differently. For example, some district offices emphasize an applicant's social disadvantage in determining his or her eligibility while others stress economic disadvantage. The Los Angeles district office accepts applicants into the program primarily based upon social disadvantage, whereas the San Francisco, San Diego, and Phoenix offices base their determination primarily on the economic needs of the applicant's company.

In summary, the 8(a) program is presently not uniformly administered because of the varying interpretations made in application of existing subjective eligibility criteria.

Architect/Engineering Firm

Our report also contains a case study of a particular A/E firm. The circumstances of this case present a good example of what happens when field offices rely on different interpretations of eligibility criteria. Although the one district office approved the firm as eligible for the 8(a) program, another office refused to recommend the company when the application was transferred to its district.

To further complicate matters, the regional committee found that the applicant was ineligible while the Regional Director, interpreting the criteria differently, admitted the firm to the program.

Let me highlight for you some of the aspects of this case. The record showed that the firm was established in July 1968, to perform architectural engineering and design. The firm's 8(a) program approval was gained in the following manner. On May 22, 1977, the company applied for entrance to the 8(a) program. At that time, the company showed prior fiscal year sales of \$1.7 million with a \$254,000 profit. Each owner's net worth exceeded \$300,000, and each drew salaries of \$50,000 a year from the firm. The firm's work backlog at this time was over \$300 million, ranging in projects worth \$1.4 million to \$110 million. Many projects appeared to be affiliated with either State or local governments.

Both owners submitted statements alleging past socioeconomic disadvantage. The two owners, who are black, cited several instances of alleged social discrimination; their backgrounds did indicate impoverished circumstances. One owner told SBA that he believed that every minority group member is socially and/or economically disadvantaged.

The firm's board chairman stated that the company has been deprived of the opportunity to develop and maintain a competitive architectural business practice because of:

- The owners' difficulty as minority architects in gaining positions with established firms during their formative professional years.
- The realization that their firm's practice would be limited to work in the minority community,

whereas larger community projects would be given to established firms.

--The continued tendency to consider the firm only as a joint venturer with established firms or only for projects requiring minority participation, although the company has independently completed major design and construction projects.

There was no further indication in the files of the company's social or economic disadvantage. The firm did not attempt to show that it met each criterion for eligibility. Where a criterion was addressed, it was supported with broad, undocumented statements.

In June 1977, the SBA district office stated that the company had qualified for 8(a) admission. The district apparently based eligibility on both social and economic disadvantage; officials referred to the applicants' ethnic and poverty backgrounds. They also pointed out that the firm was unable to break into the Federal procurement process due to its inability to secure the necessary bonding. District officials felt that 8(a) assistance would help gain a foothold in the Federal market with which it will be able to overcome the bonding and financial barriers.

Region IX, in reviewing the district recommendation, however, noted that the company's home office was in another city. Since an 8(a) application must be made in the district where a firm's home office is domiciled, the region recommended that the other district office decide whether to recommend the firm for approval.

The case was forwarded to the district office where the company's home was on July 14, 1977. After reviewing the case file, the district unanimously recommended disapproval of the firm for 8(a) admission. The firm was considered ineligible because the firm had not been "deprived of the opportunity to develop and maintain a competitive position in the economy because of social or economic disadvantage." The district felt that the owners had overcome whatever disadvantage they had initially experienced. Additionally, the committee stated that the firm's financial position (for example, financial condition, sales history, large dollar volume sales, etc.) indicated that it was viable and accordingly did not meet eligibility criteria.

The firm appealed the case to the regional office, questioning SBA grounds for disapproval and stressing the owners' past social and economic disadvantage. According to the company, minority architects were by definition unable to compete with the majority and therefore automatically entitled to 8(a) assistance.

Although the owners considered themselves technically qualified for an 8(a) project, they believed that their firm would not be competitive outside 8(a) unless they first acquired resources equivalent to the multimillion dollar firms they compete with.

The Region IX review committee met on August 17, 1977, to consider the refusal to recommend the firm as a potential 8(a) participant. A majority of this committee held that the applicants did not meet the eligibility criteria, and that the owners had overcome any past socioeconomic disadvantage. In support, the committee pointed to the owners' holdings that exceeded \$300,000 each and company sales that exceeded \$1.7 million for the preceding year.

According to the committee, the firm was in sound economic shape. The firm was compared with the 1976 Robert Morris and Associates studies for similar architect/engineering firms and found them substantially stronger financially than the general industry. The committee also noted that while the firm had never received a Federal contract, there was no evidence that the firm had ever attempted to obtain such work. Regional officials pointed to company projects completed in 1975 and 1976 worth over \$118 million and current projects worth \$304,750,000, with ranges between \$1 million and \$110 million, as evidence of the firm's viable condition.

Although the regional board upheld the decision on eligibility, this ruling was reversed. The Associate Administrator for Procurement Assistance at SBA headquarters determined that the firm was eligible for program admission, stating that the private commercial market has traditionally excluded minority-owned architect/engineering firms. The presence of

successful minority architect/engineering firms had not altered the fact that most were still disproportionately disadvantaged.

SBA headquarters commented that "the professional expertise possessed by [the firm] can bring a fresh new perspective to the diversity of our 8(a) portfolio." Headquarters still believed that the company was a long way from economic success and that 8(a) support could make such success a reality. Furthermore, it was argued, 8(a) support would help the company to become an established competitor for Federal design services and private commercial sector business.

On the basis of the above statements, the Associate Administrator recommended that the Administrator grant a waiver for the firm to enter the 8(a) program during the moratorium-- which as you know Mr. Chairman, was imposed by the Administrator in July 1977, and lifted 3 months later. SBA's Administrator concurred with his associate's view and on September 9, 1977, granted an exception to the moratorium. Region IX notified the firm of its acceptance on September 14, 1977.

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

CURRENT 8(a) PROGRAM ELIGIBILITY CRITERIA

PUBLISHED IN SBA'S STANDARD OPERATING

PROCEDURES ON FEBRUARY 2, 1976

- "(1) The administrative finding should disclose that the individual falls within the eligibility category of socially or economically disadvantaged. The facts behind this finding can include such matters as depicted in the following examples which, alone or together, might justified the finding; there are other situations which undoubtedly would also apply:
- "(a) Because of his social background, the individual has been unable to obtain technical assistance, business assistance or financing of a quality or quantity similar to that available to the average entrepreneur in the economic mainstream (where possible, exclusions of this nature should be confirmed by specific examples).
 - "(b) Because of past practice of discrimination, the individual has been impeded from normal entry into the economic mainstream (this example should be based upon specific facts applying to the individual involved and should not be based upon a generality applicable to a group, e.g., although many individual Blacks are 'disadvantaged' and therefore eligible, it is insufficient to state that all Blacks are eligible simply because they are Black).
 - "(c) Previous failures to compete effectively for government contracts could be traced, in significant part, to tendencies of regular financing and commercial agents to restrict their services to established businesses (specific instances of contract or financing "turn downs" would be helpful here).

- "(d) The individual is a long-term resident of urban areas with high concentration of unemployed or low income persons.
- "(e) The individual has been frequently unemployed or marginally employed due to his residency in depressed areas or due to past practices of discrimination.
- "(f) The individual has been in a low income status chronically.