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REPORT BY THE Comptroller General OF THE UNITED STATES

What Is A Small Business? The Small Business Administration Needs To Reexamine Its Answer

This report summarizes the results of GAO's survey of the Small Business Administration's definitions of small businesses, referred to as size standards, which control eligibility for Federal small business assistance programs.

Under Small Business Administration regulations, size standards should channel assistance to firms competively disadvantaged by being small. But standards have been developed without apparent consideration of the size of businesses most in need of Federal assistance. The standards include virtually all firms in some industries.

The standards have little effect on the distribution of Small Business Administration 7(a) loans but may have prevented smaller firms in the apparel industry from getting Federal contracts under the set-aside program designed to help small companies obtain contracts. The Small Business Administration needs to reexamine its size standards to provide Federal assistance for appropriate small business firms.

UNITED STATES GENERAL ACCOUNTING OFFICE

CED-78-149

AUGUST 9, 1978

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114835

The Honorable Gaylord Nelson
Chairman, Select Committee on
Small Business
United States Senate

Dear Mr. Chairman:

In accordance with your request of December 19, 1977, this report summarizes the results of our survey of size standards established by the Small Business Administration. As you are aware, these standards define which businesses are small and, therefore, eligible for Federal small business assistance programs.

Pursuant to authority granted by the Small Business Act, the agency has developed standards for many industries and for most of its programs. The standards define which businesses are small for either broad industry categories (e.g., wholesaling) or specific industries or activities (e.g., fluid milk production). In total 498 size standards for loan and procurement programs are listed in agency regulations.

We reviewed the development of the size standards governing eligibility for Small Business Administration loan and procurement programs and examined the justification for establishing 10 of these standards. We also evaluated how the size standards affected the distribution of loans in the agency's 7(a) loan program and small business set-aside contracts in the apparel industry. The 7(a) program is the Small Business Administration's principal business loan program; the set-aside contract program is a cooperative effort between the Small Business Administration and other Federal agencies by which selected Federal procurement contracts are reserved exclusively for small businesses. Details on the scope of our work are contained in appendix I.

The act declares that the policy of the Congress is that the Government should aid, counsel, assist, and protect the interests of small businesses in order to preserve free competitive enterprise. Small Business Administration regulations state that since smaller concerns often are forced to compete with middle-sized as compared with very large concerns, size standards should be established as low as reasonably possible and should be limited to that segment of each industry "struggling to become or remain competitive."

However, many size standards may not direct assistance to firms whose support is most important to maintaining competition. Specifically:

--The present loan and procurement size standards for most industries were established 15 or more years ago. The standards have not been periodically reviewed to determine their continuing validity.

--Small Business Administration records do not indicate how size standards established before 1971 (all but 64 of the 498 current loan and procurement standards) were arrived at. Officials of the Size Standards Division are uncertain about what, if any, analysis of industry conditions was done to establish these size standards.

The records do contain some explanation for how the 64 standards established since 1971 were developed. But the analyses supporting 10 of these standards do not demonstrate that the standards were set in conformance with agency regulations; i.e., standards should be set as low as reasonably possible and limited to businesses which are struggling to become or remain competitive. Nor did these analyses consider (1) whether businesses of certain sizes were failing or losing their market share because of competition from larger firms, (2) the impact of alternative size standards on the probable distribution of assistance, or (3) the size of businesses which have been unable to obtain Federal contracts because of competition from larger firms.

The last of these points seems essential to setting size standards for the set-aside program.

This program is designed to enable firms to win Federal contracts they otherwise could not get because of competition from larger businesses. But because the Small Business Administration has not collected data on the size of businesses that have bid successfully and unsuccessfully on set-aside and unrestricted (non-set-aside) contracts, it does not know the size of firms in many industries which need set-aside protection.

--The size standards often define as small a high percentage of an industry's businesses, including medium-sized firms with sales many times greater than those of smaller firms. For example, for purposes of the set-aside program, the size standard for wholesalers (500 or fewer employees) includes all but one-tenth of 1 percent of all wholesalers. The average wholesaler with between 100 and 500 employees had sales and receipts almost 27 times greater than those of the average wholesaler with fewer than 50 employees. In this and other industries, where there are almost no big businesses by Small Business Administration definition, setting aside contracts for "small businesses" may be meaningless.

The size standards established for many industries appear to have had little effect on the size of businesses which receive 7(a) loans but may have been detrimental to smaller firms competing in the set-aside program.

--The size standards for the 7(a) loan program are generally expressed as a maximum number of employees or dollar amount of annual receipts. The standards for manufacturing and air transportation are expressed in employees. About half the industries in these 2 groups have standards ranging from 500 to 1,500 employees; the other half are subject to a 250-employee standard. However, in both fiscal years 1974 and 1976 (the years we selected for analysis), 98 percent of the manufacturers and air transportation companies whose direct loans were approved and 96 percent of these businesses whose guaranteed loans were approved had fewer than 100 employees. The median size of borrowers subject to a dollar size standard was fewer than five employees in these 2 years.

--Smaller apparel manufacturers won only a small percentage of the set-aside contracts they had bid on at the Department of Defense's Defense Personnel Support Center because of competition from larger firms considered small under the size standards. These smaller firms may need Federal assistance most, since Census Bureau statistics indicate that the number of smaller apparel firms has declined significantly.

The feasibility of increasing the supply of contracts to smaller firms would depend, in part, on their ability to effectively perform additional contracts at a reasonable cost.

These matters are discussed in detail in appendix I. Appendix II outlines the current small business loan and procurement size standards by industry.

Although our survey was limited in scope, it has raised issues which the Small Business Administration should pursue. We recommend, therefore, that the Administrator reexamine the standards to ensure that agency assistance is directed where it will best preserve free competitive enterprise and protect the interests of small businesses. This review should include

--determining, in accordance with agency regulations, the size of businesses in each industry which are struggling to become or remain competitive and

--by collecting data on the size of bidders on set-aside and unrestricted contracts, determining the size of businesses which need set-aside protection because they otherwise cannot obtain Federal contracts.

If this review discloses that in certain industries small businesses which need procurement assistance to remain competitive cannot obtain set-aside contracts because of competition from larger businesses considered small under the present standards, consideration should be given to

--reducing the standards or

--establishing a two-tiered system of size standards for set-aside contracts, under which certain procurements would be available for bidding only to the smaller firms and others would be opened for bidding to all businesses considered small under the present standards.

As requested by your office, we did not ask for formal comments on this report from the Small Business Administration. However, we have discussed the report with agency officials and have included their comments where appropriate. As arranged also with your office, this report will be released 30 days after the issuance date unless you publicly release its contents before then.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

DPSC Defense Personnel Support Center

GAO General Accounting Office

GSA General Services Administration

SBA Small Business Administration

NEED TO REEXAMINE SMALL BUSINESS SIZE STANDARDS

On December 19, 1977, the Chairman of the Senate Select Committee on Small Business requested that we report to the Committee on the results of our survey of the small business size standards established by the Small Business Administration (SBA).

The survey was limited to the standards established for the SBA loan and small business set-aside contract programs. It consisted of interviewing officials and analyzing records relating to the size standards and the 7(a) loan program at SBA headquarters and reviewing set-aside contract records at Federal procurement installations in Pennsylvania and Texas. Our work on set-aside contracts focused on procurement of apparel by the Defense Personnel Support Center (DPSC), Philadelphia.

BACKGROUND

For a business to participate in most of the programs administered by SBA, it must be "small" as defined in the Small Business Act, as amended (15 U.S.C. 632), and SBA regulations.

The act gives only a general definition of small business but declares that the policy of the Congress is that the Government should assist small business concerns to "preserve free competitive enterprise." The act states that a small business concern is "one which is independently owned and operated and which is not dominant in its field of operation" and authorizes the SBA Administrator to expand on this definition by the use of other criteria, including number of employees and dollar volume of business. SBA has exercised this authority by establishing size standards for individual industries or for broad industry categories.

The current size standards are published in the Code of Federal Regulations, along with a statement of size standards policy and a list of factors which should be considered in formulating industry size standards. The regulations state that

--the purpose of SBA assistance is to preserve free competitive enterprise by strengthening the competitive position of small business concerns;

--in the absence of proof to the contrary, there are businesses in each industry which, because of their small size, are at a competitive disadvantage and that the standards should be limited to the segment of each industry "struggling to become or remain competitive";

--because smaller concerns often are forced to compete with middle-sized as compared with very large concerns, the standard for each industry should be established as low as reasonably possible; and

--small businesses should not rely on continuing assistance but should plan for the day when they will be able to compete without assistance.

SBA regulations list 498 size standards for SBA's loan and procurement programs. (App. II outlines these standards.) In addition, size standards have been established for the surety bond guarantee program, the small business investment company program, the lease guarantee program, the subcontracting program, Government property sales, leases of uranium prospecting or mining rights, and pollution control guarantee assistance.

The Size Standards Division, under SBA's Assistant Administrator for Planning, Research and Data Management, is responsible for developing size standards and advising program officials on their application. As of May 1, 1978, the Division was staffed by two professionals.

Loan approval specialists in SBA's district offices decide whether a loan applicant meets the size standard for its industry. A bidder on a set-aside contract certifies that it is a small business, and this certification is not examined unless a protest is made by another bidder or another interested party.

Disputes regarding the size eligibility of an applicant for small business programs are decided initially by the Regional Director of the SBA region in which the applicant's principal office is located. The Regional Director's decision may be appealed to SBA's Size Appeals Board, which consists of five high-ranking SBA headquarters officials or their delegates. The decision of the Board is the final administrative remedy offered by SBA.

Small business assistance programs

If a business is small under SBA's definition, it may be eligible for one or more small business programs, including the set-aside contract program and the 7(a) business loan program.

Under the set-aside program Federal agencies reserve selected contracts exclusively for small businesses. In fiscal year 1977 set-aside contracts totaling $4.3 billion were awarded. SBA's role in the program is to ensure that agencies set aside sufficient contracts. For this purpose SBA stations procurement center representatives at major Federal procurement installations to monitor contracting practices. When contracting officials disagree with an SBA determination that a particular procurement should be set aside, SBA may appeal to the head of the agency involved.

The 7(a) loan program, authorized by section 7(a) of the Small Business Act, is SBA's principal loan program. Loans may be made directly to businesses by SBA, jointly by SBA and a bank, or by banks which are guaranteed against loss by SBA for up to 90 percent of the outstanding loan balances. These loans are known respectively as direct, immediate participation, and guaranteed loans.

In fiscal year 1977 SBA made 3,766 direct loans totaling $182.3 million, 156 immediate participation loans totaling $11.6 million, and 23,383 guaranteed loans totaling $2.3 billion. By law, direct and immediate participation loans may be made for up to $350,000 and guaranteed loans for up to $500,000; however, SBA will not ordinarily make a direct or an immediate participation loan for more than $150,000 or guarantee a loan for more than $350,000.

SIZE STANDARDS ARE OFTEN HIGH AND OFTEN ARE NOT JUSTIFIED BY ECONOMIC RATIONALE

Many size standards may not direct assistance to the target group described in SBA regulations as businesses "struggling to become or remain competitive" because

--the loan and procurement size standards for most industries were established 15 or more years ago and have not been periodically reviewed,

--SBA records do not indicate how most standards were developed, and

--the standards often define as small a very high percentage of the firms in the industries to which they apply.

Many size standards are old and have not been reviewed

For loan and procurement purposes, SBA has established (1) size standards for major industry classes, such as manufacturing and services, and (2) standards for particular industries within these major classes, such as meat-packing plants within the manufacturing class and food services within the services class. The standards for major classes apply only to those industries within the classes for which no special standards have been established.

For loan purposes SBA has established standards for 7 major classes composed of 490 industries. Standards for 5 classes encompassing 420 industries were established in 1954; another, covering 34 industries, was set in 1962; and the standard for a seventh, including 36 industries, was fixed in 1977. Also, SBA has established more narrowly defined loan size standards for 344 industries.

For procurement purposes SBA has established general standards for seven major industry classes, which include 642 industries. Standards for 5 of these classes (526 industries) are set at the same level: 500 or fewer employees. The 500-employee standard was adopted by SBA in 1953 from a predecessor agency, the Small Defense Plants Administration. SBA has also established procurement size standards for 190 particular industries.

Except for a 1975 adjustment to standards expressed in dollars to account for inflation, most of the general procurement and loan standards are still at their original levels. Because of the large number involved, we did not attempt to trace the special industry standards back to the years they were established or last revised. However, from January 1, 1968, through April 25, 1978, SBA created or revised special standards 1/ for only 81 of the 534 industries covered by the special standards.

Officials of the Size Standards Division said that because of a lack of staff, size standards are not periodically reviewed to determine their continuing validity. Size standards for particular industries have usually been revised only when new small business programs are introduced or because of suggestions for change from SBA program officials or complaints from business people.

Inadequate justification for size standards

SBA records do not indicate how size standards established before 1971 were arrived at. Officials of the Size Standards Division are uncertain about what, if any, analysis

1/Again with the exception of the 1975 inflation adjustment.

of industry conditions was done to establish these standards (which represent all but 64 of the 498 present loan and procurement standards).

A study of size standards completed in 1975 by a former SBA Acting Assistant Administrator criticized these older standards as follows:

> "What is wrong with the present size standards? First of all, the economic basis upon which they were developed is hazy at best. Because the procedures used to establish them are unclear, their validity and accuracy in many cases is subject to question. A good example of such standards is a number of catch-all 500-employee procurement standards that seemingly have no logical relation to the industries that they serve.
>
> "* * * the original standards that serve as the basis for the current ones are in many cases questionable in terms of their appropriateness and justification."

Although the study made recommendations for major revisions of the standards, SBA never acted on them.

SBA records do contain some explanation of how the size standards established since 1971 were developed. We reviewed the following 10 of these new or changed standards.

Industry	Effective date of standard
Special trade (construction) contractors	December 3, 1975
Petroleum refiners	a/October 30, 1975
Custom livestock feedyards	May 14, 1975
Businesses engaged in dredging	September 27, 1974
Electric utilities	August 22, 1974
Services requiring use of helicopters and fixed-wing aircraft	March 12, 1974
Retail mobile home dealers	November 2, 1973
Certain agriculture-related businesses	April 9, 1973
Fluid milk producers	May 5, 1972
Air transportation	May 11, 1971

a/For financial assistance the standard was effective on the date indicated; for procurement assistance the amendment was effective for solicitations issued on or after November 29, 1975.

SBA's analyses supporting these standards do not demonstrate that the standards were set in conformance with SBA regulations; that is, as low as reasonably possible and limited to the segment of each industry struggling to become or remain competitive. (See pp. 1 and 2 of this app.) The following are examples of the methods and data used by SBA in establishing the 10 standards.

Helicopters and fixed-wing aircraft

On March 12, 1974, SBA changed the procurement size standard for services requiring use of helicopters or fixed-wing aircraft from 500 employees to average annual receipts for the 3 preceding fiscal years not to exceed $3 million. The $3 million standard was adopted after SBA proposals for $1 million and $1.5 million had been objected to by industry and Federal procurement agency representatives.

In 1971 SBA's Size Appeals Board ruled that under the then-existing regulations, the procurement size standard for services requiring use of helicopters and fixed-wing aircraft was 500 employees. The Board also noted that the 500-employee standard was probably too high and requested SBA's size standards staff to conduct an industry study to determine if another standard should be established for the industry.

SBA proposed a $1 million size standard in the Federal Register (May 20, 1971) based on its study. SBA found that the 500-employee standard included as small substantially all companies that provided helicopter and fixed-wing services, among which were companies that "hardly could be considered to be struggling to become or remain competitive within the meaning of SBA's Size Standard Policy." SBA felt that under such a broad definition of small business, the set-aside program was meaningless. According to SBA 97 percent of the firms engaged in forestry or forestry services (including services provided by helicopters and fixed-wing aircraft) had annual receipts of less than $1 million and accounted for 87 percent of total industry receipts. SBA records did not explain why a $1 million standard was appropriate or whether it would eliminate the companies considered small by the 500-employee standard that SBA said were not struggling to become or remain competitive.

SBA's proposal was opposed by some members of the industry and officials of Federal procuring agencies. Some helicopter and fixed-wing aircraft operators opposed the standard mainly because of the high capital investment needs of the industry. The Forest Service, Department of Agriculture, and the Bureau of Land Management, Department of the Interior, which procured aerial services, opposed the standard because they said many of the firms that would qualify as small might not have the equipment or expertise to meet their contract requirements. As a result of the opposition, SBA rescinded the proposal.

SBA officials, however, were convinced they were on the right track and in 1973 SBA published a $1.5 million size standard proposal in the Federal Register. SBA records indicate that the increased proposed standard was based on estimates of the annual receipts of helicopter firms and on information about Federal agency procurements. SBA records also indicated that there was no precise sales data for bidders on services requiring helicopters or fixed-wing aircraft but that persons familiar with the industry estimated that 95 percent of all helicopter concerns in the United States had average annual receipts not exceeding $1 million. The procuring agencies estimated that about 70 percent of bidders had receipts not exceeding $1 million.

The proposed $1.5-million standard was again objected to by some industry segments and procuring agency officials. Some companies said they depended primarily on Government contracts for survival. Procuring agencies claimed that unless the companies currently covered by the 500-employee standard retained their small business status, the set-aside program in this field would probably have to be cut back. The procuring agencies said that, due to the use of larger helicopters, many of their bidders would soon exceed $1 million in annual sales. These agencies recommended a $3 million size standard because it would encourage companies competing for Government contracts to purchase larger aircraft.

After reviewing these comments SBA concluded that the $1.5 million standard would not be adequate because many Government contracts required use of sophisticated and expensive aircraft. The comments indicated that helicopter and fixed-wing aircraft operators would need to generate more than $1.5 million in annual receipts to obtain a reasonable return on investment.

SBA officials finally acceded to the $3 million recommendation. The Assistant Administrator responsible for developing size standards believed the $3 million standard would eliminate only the significantly large companies in the field and still would provide adequate protection for the smaller companies, but there was no analysis in the files supporting this belief. Also, there was no information showing what, if any, portion of the industry considered small under the 500-employee standard would be excluded by the $3 million standard.

The $3 million standard became effective on March 12, 1974.

Special trade (construction) contractors

On December 3, 1975, SBA increased the procurement size standard for special trade (construction) contractors, an industry category which includes plumbing, painting, electrical work, masonry, carpentering, and other activities, from average annual receipts of $1 million or $2 million, depending on the trade, to average annual receipts of $5 million for all trades. This increase followed a February 1974 decrease in the procurement standard from $7.5 million to $1 million or $2 million (depending upon the trade).

The reduction was unpopular with SBA officials responsible for the set-aside program and caused the General Services Administration (GSA) to propose a change in its contracting practices. The GSA Administrator wrote to the SBA Administrator that many firms eligible under the $1 million to $2 million size standards were not capable of performing contracts in the $500,000 to $1,000,000 range which GSA's Public Buildings Service had automatically set aside under the $7.5 million standard. GSA said that it planned to continue systematically setting aside contracts under $500,000 for small business, but would consider setting aside larger contracts only on an individual contract basis. SBA procurement officials said that in "many areas" there was inadequate competition under the lower standards to support set-aside procurements.

The then Deputy Administrator of SBA directed the Assistant Administrator responsible for developing size standards to study how the special trades size standards should be increased, in view of the large special trades contracts ($500,000 to over $1,000,000) that were being set aside for small business.

After reviewing Census data on the special trades, the Assistant Administrator concluded that $1 million and $2 million standards clearly were reasonable and noted that "If the standards are increased, there is no question but that we are going to adversely affect the competitive position of concerns that currently qualify as small * * *." However, the Assistant Administrator said that

> "* * * it would seem desirable to propose appropriate increases in the definitions of small business [since] * * * it may be true that concerns in the $1 to $2 million range are not large enough to perform some of the larger set-aside

contracts and, since it seems settled that we are not going to discontinue setting-aside these large contracts."

The Assistant Administrator made two recommendations, one he described as "preferred," which would have increased the size standard to $5 million only with respect to procurements estimated to exceed $500,000, and an "alternative" recommendation to raise the standard to $2.5 million for all contracts. He noted that a $2.5 million standard would include about 98.5 percent of the companies in the industry accounting for about 68.7 percent of industry sales and said that a standard above $2.5 million "* * * would be unfair to the smaller special trade contractors whom we were trying to help when we lowered the standards from $7.5 million."

These recommendations were subsequently withdrawn by the Assistant Administrator, who then proposed adoption of a $7.5 million or a $5 million standard noting that "* * * we continue to receive a substantial volume of letters, both congressional and otherwise, insisting that we return to the $7.5 million standard formerly applicable to all construction work" and that "* * * our procurement personnel * * * seem to feel that we are impeding the administration of the set-aside program." He repeated his belief, however, that

> "If we continue to have only <u>one</u> standard for both large and small contracts, a standard higher than $2.5 million would be unfair to the smaller special trade contractors that we are trying to protect * * *."

The SBA Administrator approved a $5 million standard which he said included 99.6 percent of special trade firms accounting for 92 percent of industry sales. There was no evidence in the files to rebut the Assistant Administrator's claim that small firms would be hurt by the $5 million standard.

<u>Custom livestock feedyards</u>

In 1971 SBA raised the loan standard for custom livestock feedyards from $1 million to $2 million in annual receipts. In May 1975 SBA again raised the standard to $10 million in annual receipts.

SBA's 1971 change followed requests from a feedyard operator and a trade association that the standard be raised from $1 million to $2 million. SBA attempted unsuccessfully to get information on the annual receipts of firms engaged in the custom livestock feedyard industry. However, after reviewing various industry studies, SBA decided to propose a $2 million standard because:

1. Feedlots with a capacity of 5,000 or more head accounted for one quarter of cattle fed in 1964.

2. A 5,000-head-capacity feedlot might require an investment exceeding $200,000 and annual expenditures for feed and other variable costs of $1 million.

3. The number and sizes of feedlots were increasing. In 1962 there were, in 32 selected States, 315 feedlots with 4,000 or more head capacity, including 31 lots with 16,000 or more head capacity, whereas in 1964 there were, in the same States, 406 lots with 4,000 or more head capacity and 44 with 16,000 or more head capacity. Further, smaller lots accounted for a declining share of cattle marketed from feedyards.

4. If the standard were raised from $1 million to $2 million, "only" an estimated 70 percent of the lots in the predominant cattle-feeding areas of Texas would qualify as small.

SBA felt that the above data was not conclusive, and its records do not explain why the above factors suggested an increase in the standard. But SBA proposed a $2 million standard in the Federal Register to give the cattle-feeding associations in all States an opportunity to criticize or endorse the proposal. After considering the comments, SBA raised the standard to $2 million effective October 28, 1971.

In 1974 SBA was requested by industry and Members of Congress to raise the standard again. SBA reviewed Dun & Bradstreet data showing that a $10 million standard would include about 94 percent of all cattle feedlots and would account for about 44 percent of industry sales. SBA also found data showing that inflation had greatly increased the annual receipts of many feedlots over the past several years and reviewed Department of Agriculture figures indicating that due to economies of scale, the number of feedlots with more than 8,000 head capacity was increasing faster than the number of smaller feedlots.

SBA did not indicate why these factors warranted increasing the standard to $10 million but did note that such a standard would include a percentage of the feedlot industry comparable to percentages SBA was recommending in other industries. Nor did SBA records explain why a standard including 70 percent of the industry was appropriate in 1971 and one including 94 percent was appropriate 4 years later.

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The analyses supporting these 3 size standards are typical of the analyses of the 10 standards reviewed in that they contain little information on the size of industry firms struggling to become or remain competitive. The analyses do not consider

--whether businesses of certain sizes were failing or losing their market share because of competition from larger firms,

--the impact of alternative size standards on the probable distribution of SBA assistance, and

--the size of businesses which cannot obtain Federal contracts because of competition from larger businesses.

The last point seems essential to setting size standards for the set-aside contract program. This program is designed to enable small businesses to win Federal contracts they could not otherwise obtain because of competition from larger firms. But because SBA does not collect information on the size of businesses that have bid successfully and unsuccessfully on set-aside and unrestricted (non-set-aside) contracts, it does not know the size of firms in many industries which need set-aside protection.

SBA's decisions to revise the two procurement standards (those for helicopters and fixed-wing aircraft and special construction trades) seem to have been heavily influenced by (1) the preference of Federal procuring agencies for standards including larger industry firms and (2) the desire of some SBA officials to preserve a large set-aside program by making a large number of businesses eligible for it. SBA officials told us that as a general rule Federal procuring agencies want high procurement size standards because they prefer to contract with businesses of substantial size.

As we discuss in the following section, many size standards include a very high percentage of industry firms. In the absence of an analysis including the points listed above, SBA cannot be sure that the standards are low enough to direct assistance to the companies that most need it.

Large percentages of businesses in industries considered small

SBA regulations say that because smaller concerns often are forced to compete with middle-sized as compared with very large concerns, the size standard for each industry should be established as low as reasonably possible. However, Bureau of the Census data indicates that the standards often define as small a very high percentage of industry firms.

A study of the standards issued by SBA's Office of Advocacy in June 1977 calculated the percentage of the firms considered small in industries listed in the Office of Management and Budget's Standard Industrial Classification Manual and the percentage of industry sales accounted for by these firms. The calculations were based on 1967 Bureau of the Census data, the latest available at the time of the Advocate's study. The study indicated that for 147 (35.4 percent) of the 415 industries for which data was available, the procurement size standards included at least 90 percent of firms controlling at least 60 percent of their industry's sales. The study also showed that the loan standards included 90 percent of industry firms in 289 industries, or 61.4 percent of the 471 industries for which information was available. Generally the businesses considered small by the loan standards accounted for a smaller portion of industry sales than the businesses considered small under the procurement standards.

From Census statistics for 1972 (the most recent available as of May 1978), we identified 15 industries or industry groups in which the procurement standard includes virtually all industry firms. For example, according to the data, all but 7 of the 107,450 businesses in the painting, paperhanging, and decorating industry group are considered small by SBA for purposes of Federal procurement. Less than three-tenths of 1 percent of the more than 211,000 general building contractors are not small businesses according to SBA's size standard. In these and other industries, where there are almost no big businesses by SBA definition, setting aside contracts for small businesses may be meaningless.

The following chart lists 15 industries in which the SBA size standard includes virtually all industry firms. The percentage of firms considered small in these industries is not typical of all industries for which procurement standards have been developed. However, the question raised by the standards for the 15 industries is relevant to all procurement size standards covering a high percentage of industry firms: Do larger firms within the size standard obtain set-aside contracts at the expense of smaller firms which have a greater need for assistance?

Fifteen Industries in Which a High Percent of Firms Are Considered Small (note a)

Industry	Total firms in industry	Small firms	Percent of small firms	Percent of industry sales and receipts controlled by small firms
General building contractors	211,462	b/21[illegible],795	b/99.7	b/72.5
Painting, paperhanging, and decorating	107,450	107,443	99.9	N/A
Carpentering and flooring	154,715	154,690	99.9	96.6
All wholesale firms	328,535	328,301	99.9	90.8
Women's and misses' suits and coats	1,510	1,499	99.3	80.8
Millinery (note c)	215	215	d/100	100
Girls', children's, and infants' coats and suits (note c)	154	151	98.1	89.5
Setup paperboard boxes (note c)	368	346	94.0	81.6
Commercial printing, lithographic (note c)	8,159	7,984	97.9	68.5
Signs and advertising displays (note c)	3,222	3,188	98.9	87.4
Local trucking with storage (note c)	2,883	e/2,866	e/99.4	94.5
Household goods warehousing and storage (note c)	277	e/274	e/98.9	N/A
General warehousing and storage (note c)	1,674	e/1,613	e/96.4	e/77.4
Hats and caps, except millinery (note c)	252	243	96.4	71.0
Men's, youths', and boys' suits, coats, and overcoats coats	675	640	94.8	N/A

a/Based on 1972 Bureau of the Census data.

b/Figures are for firms with less than $10 million in annual sales and receipts. Census data is not available to show the number of firms with sales and receipts of $12 million or less, the procurement size standard for this industry.

c/Excludes firms without payroll, e.g., partnerships and sole proprietorships without salaried employees.

d/Although the procurement size standard for this industry is 500 employees, no firms had more than 250 employees.

e/Represents firms with less than $5 million in annual sales and receipts. Census figures do not show firms with sales and receipts of less than $7 million, the size standard for these industries.

In addition to covering a large portion of their industries, the size standards include medium-sized firms many times the size of their smaller competitors. For example, the procurement standard for the wholesale industry is 500 employees. 1/ Although less than 1 percent of the firms in this industry had between 100 and 500 employees, they accounted for 14.8 percent of industry sales. Firms with fewer than 50 employees represented 97.3 percent of the industry and had 65.2 percent of the industry's sales and receipts. The average wholesaler in the upper range of "small business" had sales and receipts almost 27 times greater than the average wholesaler in the smaller group. The following chart presents data on the sales and receipts of various classes of small businesses in 13 industries. (Comparable data was not available for the other two industries included in the previous chart.)

1/To be eligible for set-aside contracts, wholesalers must also furnish a product manufactured by a small business.

Sales and Receipts of Firms Considered Small by SBA (note a)

Industry	Sales or employment range	Percent of industry firms in each size range	Percent of industry sales and receipts accounted for by firms	Average sales and receipts per firm
General building contractors	$ 0 - $ 999,999	94.9	34.7	$ 115,927
	1,000,000 - 4,999,999	4.3	27.0	2,010,480
	5,000,000 - 9,999,999	0.5	10.8	6,879,716
Painting, paperhanging, and decorating	$ 0 - $ 499,999	99.3	b/59.6	b/17,696
	500,000 - 999,999	0.4	10.4	683,334
	1,000,000 - 4,999,999	0.2	13.8	1,779,741
Carpentering and flooring	$ 0 - $ 499,999	99.2	67.5	20,359
	500,000 - 999,999	0.5	12.5	777,480
	1,000,000 - 4,999,999	0.3	16.6	1,777,598
All wholesalers	0 - 49	97.3	65.2	857,739
	50 - 99	1.8	10.7	7,591,978
	100 - 249	0.7	9.0	16,982,892
	250 - 499	0.1	5.8	50,702,479
Girls', children's, and infants' coats and suits (note c)	0 - 249	92.9	69.7	487,413
	250 - 499	5.2	19.8	2,475,000
Setup paperboard boxes (note c)	0 - 249	91.8	71.8	694,846
	250 - 499	2.2	9.8	4,006,975
Commercial printing, lithographic (note c)	0 - 249	97.0	61.4	401,858
	250 - 499	0.8	7.1	5,330,454
Signs and advertising displays (note c)	0 - 249	98.4	77.7	309,722
	250 - 499	0.5	9.7	7,212,235
Local trucking with storage (note c)	$ 0 - $ 499,999	87.2	47.4	128,318
	500,000 - 999,999	8.5	23.6	652,646
	1,000,000 - 4,999,999	3.7	23.5	1,494,117
General warehousing and storage (note c)	$ 0 - $ 499,999	79.1	29.2	132,481
	500,000 - 999,999	9.7	17.4	645,196
	1,000,000 - 4,999,999	7.6	30.8	1,456,816
Hats and caps, except millinery (note c)	0 - 249	94.8	58.2	416,318
	250 - 499	1.6	12.8	5,475,000
Men's, youths', and boys' suits, coats, and overcoats	0 - 49	53.9	9.1	579,396
	50 - 99	16.4	N/A	N/A
	100 - 249	17.0	11.4	2,300,870
	250 - 499	7.4	10.7	4,972,000
Women's and misses' suits and coats (note c)	0 - 249	96.6	69.3	813,530
	250 - 499	1.4	8.1	6,450,000

a/Based on 1972 Bureau of the Census data.

b/Excludes firms with between $50,000 and $99,999 in annual sales and receipts. There were 6,092 such firms.

c/Excludes firms without payroll, e.g., partnerships and sole proprietorships without salaried employees.

EFFECT OF SIZE STANDARDS ON DISTRIBUTION OF SMALL BUSINESS LOANS AND CONTRACTS

SBA's establishment of high size standards for many industries appears to have had little effect on the size of businesses which receive 7(a) loans but may be detrimental to the interests of smaller firms competing in the set-aside contract program by exposing them to competition from much larger firms.

7(a) loan program

The size standards for this program are generally expressed as a maximum number of employees or dollar amount of annual receipts. The standards for manufacturing and air transportation are expressed in employees. About half the industries in these two groups have standards ranging from 500 to 1,500 employees; the other half are subject to a 250-employee standard. However, in both fiscal years 1974 and 1976 (the years we selected for analysis), 98 percent of the manufacturers and air transportation companies approved for direct loans and 96 percent approved for guaranteed loans had fewer than 100 employees.

The following chart shows the size of borrowers subject to an employment size standard whose loans were approved in fiscal years 1974 and 1976.

7(a) Loans Approved by Size of Borrower for Borrowers Subject to an Employment Size Standard

Number of borrower's employees	Direct loans 1974	Direct loans 1976	Guaranteed loans 1974	Guaranteed loans 1976
1 - 4	93	143	619	662
5 - 9	34	60	521	581
10 - 19	22	57	635	679
20 - 49	16	56	613	683
50 - 74	9	8	157	197
75 - 99	1	5	83	64
100 - 149	2	4	62	68
150 - 199	2	2	18	25
200 - 249	-	2	13	18
250 - 499	-	1	11	8
500 - 749	-	-	2	-
Not available	-	-	9	-
Total	179	338	2,743	2,985

The chart indicates for both years that the median size of direct borrowers was fewer than 10 employees and the median size of guaranteed borrowers was fewer than 20 employees.

It is apparent from these statistics that the size standards have little effect on the distribution of 7(a) loans. Officials of the Size Standards Division said that the statutory maximum loan amounts and requirement that bank credit be unavailable appeared to control the size of businesses which are interested in and eligible for the loans.

Since SBA did not keep computerized records of the annual receipts of borrowers subject to this kind of size standard, we could not determine the size of these borrowers in relation to their size standards. However, these businesses were also very small. Their median size for both direct and guaranteed loans in each year was less than five employees.

The set-aside contract program

Apparel manufacturers with fewer than 200 employees won only a small percentage of the set-aside contracts they bid on at the Defense Personnel Support Center, Philadelphia, because of competition from larger firms considered small under SBA's size standards. Bureau of the Census data indicates that the number of smaller firms in the industry has declined significantly. These firms may need Federal assistance most.

To determine whether high size standards prevented smaller firms from obtaining set-aside contracts, we reviewed 38 set-aside contracts for apparel items awarded in fiscal years 1975 and 1976 by DPSC, the major purchaser of apparel for the Department of Defense. The contracts were for items in the following industries: men's, youths', and boys' suits, coats, and overcoats; men's, youths', and boys' separate trousers; women's, misses', and juniors' blouses, waists, and shirts; and women's, misses', and juniors' suits, skirts, and coats. We selected contracts in these industries because the applicable size standards (500 or fewer employees) included at least 85 percent of each industry's firms and because records were available to show the size of bidders.

A total of 290 bids were submitted on the 38 contracts. We could determine the sizes of the bidders for 270 bids, including all successful bids. The table below summarizes the sizes of bidders and their success rates.

Number of bidder's employees	1-99	100-199	200-299	300-399	400-500
Successful bids	1	9	13	12	3
Unsuccessful bids	16	103	56	45	12
Chance of obtaining contract	5.9%	8.0%	18.8%	21.1%	20.0%

Although, as the table indicates, firms with fewer than 200 employees had a significantly smaller chance of winning a contract, these firms may be most in need of Federal assistance. Bureau of the Census statistics indicate that the number of small apparel firms decreased substantially between 1967 and 1972 (the most recent year for which figures have been published), as follows:

Industry	Number of firm's employees	Change
Men's and women's coats	0 - 99	-685
	100 - 249	-26
	250 - 499	-10
	500 +	No change
Men's trousers and women's shirts	a/0 - 249	-155
	250 - 499	No change
	500 +	+12

a/Figures for the 0- to 99-employee range not available.

These figures indicate that the apparel firms which most need assistance may not be getting it through the set-aside program and suggest a need to consider the feasibility of increasing the supply of contracts to these smaller firms. Whether an increase is possible would depend, in part, on the ability of smaller firms to effectively complete additional contracts at a reasonable cost.

CONCLUSIONS, SBA COMMENTS, AND RECOMMENDATIONS TO THE SBA ADMINISTRATOR

Conclusions

The policy of the Congress declared in the Small Business Act, which authorizes many SBA programs, is to aid small businesses in order "to preserve free competitive enterprise." SBA regulations state that small business should include only the segment of each industry "struggling to become or remain competitive." However, many of SBA's size standards have been established without apparent consideration of the size of businesses which most need Federal assistance and often define as small a large percentage of their industries, including firms many times larger than most industry firms. Where firms eligible under the size standards compete for small business benefits, as in the set-aside contract program, the question of which firms need competitive assistance because of their small size is especially important.

The standards seem to have had little influence on the distribution of 7(a) loans. Maximum loan amounts and the requirement that bank credit not be available to 7(a) loan applicants seem to have limited the size of borrowers to firms with fewer than 100 employees for the great majority of loans.

Whether the size standards have permitted larger firms within a size standard to dominate the competition for set-aside contracts needs to be investigated by SBA. SBA does not know whether its size standards are directing set-aside contracts to the appropriate businesses because (1) many of its procurement size standards are not based on a study of economic conditions in individual industries, (2) the size standards were established without data on the size of businesses which have bid on or won set-aside and unrestricted contracts, and (3) this data is still not being collected. Our review of set-aside contracts at DPSC indicates that smaller firms in the apparel industry have a much poorer chance of winning contracts than larger firms defined as small by SBA. These smaller firms may have a greater need for set-aside contracts, since Bureau of the Census figures indicate that the number of these firms has declined substantially.

SBA comments

The SBA Assistant Administrator, responsible for developing size standards, agreed that there was a need to reexamine the standards, including those discussed in this report. Officials of SBA's Office of Procurement Assistance and the Size Standards Division said that in the past insufficient resources had been applied to developing standards. They also said that our recommendations with regard to collecting data on the size of businesses bidding on Federal contracts and in possibly redesigning the set-aside program (see next section) merited serious consideration.

Recommendations to the SBA Administrator

Our survey of the small business size standards was limited in scope. We do not consider our findings to be a basis for reducing size standards in any particular industry. In some industries size standards may be too low. However, our survey raised issues that SBA should address. We recommend, therefore, that the Administrator reexamine the standards to ensure that SBA assistance is directed where it will best preserve free competitive enterprise and protect the interests of small business. This review should include

--determining, in accordance with SBA regulations, the size of businesses in each industry which are struggling to become or remain competitive and

--by collecting data on the size of bidders on set-aside and unrestricted contracts, determining the size of businesses which need set-aside protection because they cannot otherwise obtain Federal contracts.

If this review discloses that in certain industries small businesses which need procurement assistance to remain competitive cannot obtain set-aside contracts because of competition from larger businesses considered small under the present standards, consideration should be given to

--reducing the standards or

--establishing a two-tiered system of set-aside contracts, under which certain procurements would be available for bidding only to the smaller firms and others would be opened for bidding to all businesses considered small under the present standards.

APPENDIX II

SIZE STANDARDS BY INDUSTRY FOR

SBA LOAN AND PROCUREMENT PROGRAMS

APRIL 1978 (note a)

	Business loans	Government procurement
Manufacturing industries	Employment not exceeding 250-1,500 employees depending on industry in which applicant is primarily engaged (additional criteria for petroleum refinery and food canning and preserving).	Employment not exceeding 500-1,500 employees depending on industry in which product being purchased is classified (additional criteria for petroleum refinery, passenger automobiles, pneumatic tires, and rebuilding on a factory basis).
Construction:		
General construction industries	Annual receipts not exceeding $9.5 million.	Average annual receipts for preceding 3 fiscal years not exceeding $12 million.
Special trade construction industries	Annual receipts not exceeding $5 million.	Average annual receipts for preceding 3 fiscal years not exceeding $5 million.
Service industries:	Annual receipts not exceeding:	Average annual receipts for preceding 3 fiscal years not exceeding:
	(millions)	
Not elsewhere defined	$2	$2
Hotels and motels	3	2
Power laundries	3	4
Electric energy	4 million megawatt-hours/annum	2
Hospitals	150 beds	2

a/This table, based primarily on a schematic representation of size standards prepared by SBA, includes most industries for which standards have been established but excludes certain exceptions or qualifications for some industries.

APPENDIX II

SIZE STANDARDS BY INDUSTRY FOR

SBA LOAN AND PROCUREMENT PROGRAMS

APRIL 1978

Service industries:	Business loans Annual receipts not exceeding:	Government procurement Average annual receipts for preceding 3 fiscal years not exceeding:
	(millions)	
Motion picture products or services	$8	$8
Engineering	3.5	7.5
Refuse collection	2	3.5
Marine engineering	3.5	9
Helicopter or fixed-wing aircraft services	2	3.5
Janitorial and custodial services	2	4.5
Base maintenance	2	7.5
Cable TV	3	2
Marine cargo handling	2	7.5
Naval architectural services	2	9
Trailer courts and parks	1.5	2
Food services	2	5.5
Car and truck renting and leasing	2	7
Tire recapping	2	4
Convalescent homes	1.5	2
Data processing	2	4
Computer maintenance	2	7

APPENDIX II

SIZE STANDARDS BY INDUSTRY FOR SBA LOAN AND PROCUREMENT PROGRAMS

APRIL 1978

	Business loans	Government procurement
Wholesale industries	Annual receipts not exceeding $9.5 million to $22 million depending on industry in which applicant is primarily engaged.	500 employees provided that, if the procurement is reserved for or involves preferential treatment for small business, bidder must furnish product manufactured or produced by concern that meets definition of small business for industry in which product being purchased is classified.
Retail industries	Annual receipts not exceeding $2 million to $7.5 million depending on industry in which applicant is primarily engaged.	*
Transportation and warehousing industries:		
Not elsewhere defined	Annual receipts not exceeding $1.5 million.	500 employees.
Air transportation	1,000 employees	1,500 employees.
Trucking (local and long distance)	Annual receipts not exceeding $6.5 million.	Annual receipts not exceeding $7 million.
Warehousing except grain storage	*	*

APPENDIX II

SIZE STANDARDS BY INDUSTRY FOR SBA LOAN AND PROCUREMENT PROGRAMS

APRIL 1978

	Business loans	Government procurement
Transportation and warehousing industries:		
Packing and crating	Annual receipts not exceeding $6.5 million.	Annual receipts not exceeding $7 million.
Freight forwarding	"	"
Offshore marine services	Annual receipts not exceeding $10 million.	Annual receipts not exceeding $10 million.
Grain storage	Annual receipts not exceeding $1.5 million and storage capacity not exceeding 1 million bushels.	Annual receipts not exceeding $7 million.
Farming	Average annual receipts for preceding 3 fiscal years not exceeding $1 million.	500 employees
Custom livestock feeding	Annual receipts not exceeding $10 million.	"

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