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SMALL BUSINESS

Status of SBA's 8(a) Minority Business Development Program

Statement of Judy England-Joseph,
Director
Housing and Community Development Issues,
Resources, Community, and Economic Development Division

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Madame Chair and Members of the Committee:

We are pleased to be here today to discuss the Small Business Administration's (SBA) 8(a) business development program. This program provides federal contracts to small businesses that are owned and controlled by socially and economically disadvantaged individuals to help these firms develop their business skills and become viable businesses. Firms in the program are eligible to receive financial, technical, and management assistance from SBA to aid their development.

As you may recall, Madame Chair, our testimonies over the years have discussed the difficulties that SBA has had in implementing many of the changes mandated by the Congress in the Business Opportunity Development Reform Act of 1988 and subsequent amendments. Our testimony today is based on the work we did in 1992 and 1993, updated to reflect recent activities.[1] We will focus on SBA's progress in implementing key changes that are designed to make the 8(a) program an effective business development program. These are (1) requiring the competitive award of large-dollar-value contracts, (2) distributing contracts so that a larger number of firms receive them, (3) improving business planning by firms, and (4) requiring firms to achieve a certain mix of 8(a) and non-8(a) contract dollars as they progress toward the end of their program terms. As requested, we will also discuss the Department of Defense's (DOD's) small disadvantaged business program.[2] This

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[1]See Small Business: Problems in Restructuring SBA's Minority Business Development Program (GAO/RCED-92-68, Jan. 31, 1992); Small Business: Problems Continue With SBA's Minority Business Development Program (GAO/RCED-93-145, Sept. 17,1993); and Small Business: SBA Cannot Assess the Success of Its Minority Business Development Program (GAO/T-RCED-94-278, July 27, 1994).

[2]See Minority Contracting: DOD's Reporting Does Not Address Legislative Goals (GAO/NSIAD-93-167, July 27, 1993) and DOD Minority Contracting (GAO/NSIAD-94-117R, February 18, 1994).

program served as a model for a similar program established for other federal agencies in last year's procurement reform legislation.

In summary, Madame Chair, while SBA has made progress in improving certain aspects of the 8(a) program, it has not yet achieved key changes mandated by the Congress. Although the total dollar value of new contracts awarded competitively grew during fiscal year 1994, federal procuring agencies limit firms' opportunities for competition under the 8(a) program. The concentration of contract dollars in a few firms continued in 1994, limiting the developmental opportunities available to many firms. And, while SBA has approved business plans for most firms, it has not given the same attention to annually reviewing these plans to ensure that they accurately reflect the firms' development goals and contract needs. Moreover, many firms nearing the end of their program terms are still dependent on 8(a) contracts. These firms will thus leave the program without an adequate base of non-8(a) work, raising doubts about the firms' probability of success in the commercial marketplace.

BACKGROUND

The 8(a) program, administered by SBA's Office of Minority Enterprise Development, is one of the federal government's primary vehicles for developing small businesses that are owned by minorities and other socially and economically disadvantaged individuals. As of January 1995, 5,293 firms were in the 8(a) program. In fiscal year 1994, 6,012 new contracts and 19,790 contract modifications, together totaling about $4.37 billion, were awarded to 8(a) firms. Firms can participate in the 8(a) program for a maximum of 9 years.

The 1988 legislation marked the third major effort by the Congress to improve SBA's administration of the 8(a) program and to emphasize its business development aspects. Over the years, reports by GAO, SBA's Inspector General, and others have shown continuing problems with SBA's administration of the program and/or with the program's ability to develop firms that could compete in the commercial marketplace after leaving the program. A problem often cited in these reports was that a large percentage of the total number of contracts was being awarded to very few 8(a) firms. These reports made numerous recommendations for improving the 8(a) program.

COMPETITIVELY AWARDED 8(a) CONTRACTS HAVE INCREASED

To help develop firms and better prepare them to compete in the commercial marketplace after they leave the program, the act requires that 8(a) program contracts be awarded competitively when the total contract price, including the estimated value of contract options, exceeds $5 million for manufacturing contracts or $3 million for all other contracts.

New contracts that were awarded competitively during fiscal year 1994 totaled about $383 million. This amount represented about 18.5 percent of the $2.06 billion in new 8(a) contracts that were awarded during fiscal year 1994 and an 11 percent increase over the contract dollars that were awarded competitively in the prior fiscal year. While the total dollar value of new 8(a) contracts awarded in fiscal years 1991 through 1994 increased by about 29 percent, the total contract dollars that were awarded competitively increased about 81 percent. Most of this increase occurred in fiscal year 1992, with only a modest increase in competitive awards since then. Appendix I contains a table that shows the number and the total 8(a) contract dollars that have been awarded competitively since fiscal year 1991.

Despite the increase in total contract dollars that are awarded competitively under the 8(a) program, federal procuring agencies have limited firms' opportunities for competition under the 8(a) program. Our February 1994 report[3] on contracting practices at the Department of Energy (DOE) revealed several examples where a procuring agency kept price estimates for 8(a) program contracts artificially low and structured contracts so that their estimated prices were below the competition thresholds specified in the act.

-- In one case, a program office limited the length of an 8(a) support services contract and required the contractor to provide less-skilled personnel than originally planned, to ensure that the contract did not exceed the $3 million threshold for competition. At the conclusion of that contract, the office made another noncompetitive 8(a) award to the same contractor for approximately $2.9 million, to continue the support for another 12 months.

-- In another case, a program office prepared price estimates for both 3- and 5-year 8(a) support services contracts. The estimate for the 3-year contract was $2.95 million and for the 5-year contract was $5.42 million. The office, citing the immediate need for a contractor's services, made a noncompetitive 8(a) award for 3 years. At the conclusion of that contract, the office awarded another noncompetitive 3-year 8(a) contract to the same contractor for the same services, priced at less than $3 million.

Our work also showed that before the 8(a) competition thresholds took effect in October 1989, almost 40 percent of the support services procurements that the DOE offered to the 8(a) program carried price estimates above the $3 million competition threshold. However, after the thresholds took effect, none of the support service procurements that the Department offered to the

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[3]Energy Management: DOE Can Improve Distribution of Dollars Awarded Under SBA's 8(a) Program (GAO/RCED-94-28, Feb. 23, 1994).

8(a) program were estimated to exceed the $3 million competition threshold. In addition, over 60 percent of the procurements that the Department offered after the competition thresholds took effect had estimates between $2.5 million and $3 million, with half of those having estimated prices between $2.9 million and $3 million.

By avoiding the competition thresholds, agencies can direct sole-source contracts to firms with which they are familiar. SBA officials told us that agencies' procuring officials find the 8(a) program attractive because it allows them to develop a relationship with a firm and continue to make sole-source awards to that firm. It should be noted that the law generally requires SBA to award a sole-source contract to the 8(a) firm recommended by the procuring agency.

CONTRACTS DOLLARS ARE STILL CONCENTRATED IN A SMALL PERCENTAGE OF FIRMS

A long-standing concern has been the concentration of 8(a) contracts dollars among relatively few firms. In fiscal year 1994, 50 firms, or about 1 percent of the 5,155 firms in the program, received about 25 percent of the $4.37 billion in total 8(a) contract dollars awarded during the fiscal year. In addition, 22 firms that were among the top 50 firms in fiscal year 1993 were also among the top 50 firms in fiscal year 1994.

As 8(a) contract dollars continue to be concentrated in a few firms, many firms do not receive any 8(a) program contracts. According to SBA, of the 5,155 firms in the program at the end of fiscal year 1994, 2,885 firms, or about 56 percent, did not receive any program contracts during the fiscal year. In the prior 3 fiscal years, 53 percent of the firms did not receive any program contracts.

A key reason for the continuing concentration of contract dollars among relatively few firms is the conflicting objectives confronting procuring officials. The primary objective of agency procuring officials is accomplishing their agency's mission at a reasonable cost. The business development objectives of the 8(a) program are a secondary objective. Moreover, agency procurement goals for the 8(a) program are stated in terms of the dollar value of contracts awarded. The easiest way for agencies to meet this goal is to award a few large contracts to a few firms, preferably firms they have had experience with and know the capabilities of.

Nonetheless, some efforts have been made to increase the award of 8(a) contracts to firms that have never received contracts. SBA is requiring that during 1995 each of its district offices develop specific initiatives for marketing the program to federal procurement offices in their jurisdictions in order to increase contracting opportunities for more firms. In addition, DOD has agreed to give special emphasis to firms in the 8(a) portfolio that have never received contracts. Similarly, the Department of Veterans Affairs has agreed to a goal that each of its 172 medical facilities will award a contract to an 8(a) firm that has never received a contract.

BUSINESS PLANS ARE NOT ANNUALLY REVIEWED

Business plans help to develop firms by setting forth, among other things, the firm's business development goals and objectives, estimates of its future 8(a) and non-8(a) contract activity, and specific steps for ensuring profitable business operations after the firm completes its term in the program. The 1988 act requires SBA to annually review each business plan with the firm and modify the plan, as needed, to ensure that the firm's business development goals are realistic and to help the firm achieve them. During its annual business plan review, each firm is required to provide SBA with a forecast of the amount of 8(a) and non-8(a) contract dollars it will seek over its next 2 program years.

In July 1994, we testified that about 80 percent of the firms in the program had new or revised business plans approved by SBA. However, SBA could not tell us whether these plans were being annually reviewed or were being modified because it did not routinely collect these data from the field offices. However, SBA officials told us at that time that there is a need for this information and that SBA planned to direct its field offices to provide it.

Data provided by SBA field offices as of September 30, 1994, show that 4,393 firms, or about 85 percent of the firms in the program at the end of fiscal year 1994, had new or revised business plans approved by SBA. However, at the same time, the data also show that SBA field offices are not conducting annual reviews of these business plans. Of the 4,393 firms with approved business plans, 2,516 firms, or about 57 percent, had annual reviews conducted of their business plans during fiscal year 1994. To emphasize the importance of and need for annual reviews of business plans, SBA has made the annual review of each firm's business plan one of the three performance goals for its field offices in fiscal year 1995.

SUCCESS IN MEETING 8(a) AND NON-8(a) BUSINESS MIX LEVELS IS LIMITED

To increase the program's emphasis on business development and the viability of firms leaving the program, the act directed SBA to establish levels of contract dollars that firms in the last 5 years of their program terms must achieve from non-8(a) sources. The non-8(a) business mix levels that SBA has established increase during each of the 5 years, ranging from a minimum of 15 percent of a firm's total contract dollars during its fifth year to a minimum of 55 percent of the total contract dollars in the firm's ninth or final year. SBA field offices, as part of their annual reviews of firms, are responsible for determining whether firms achieve their non-8(a) business levels. In July 1994, we reported that SBA could not provide us with information on the extent to which 8(a) firms were meeting the non-8(a) business levels because SBA headquarters did not routinely collect this information from its field offices.

In February 1995, SBA provided us with data that show that of 1,038 firms in the fifth through the ninth year of their program term, 63 percent of the firms met or exceeded the minimum non-8(a) business levels while 37 percent did not meet the minimum non-8(a) contract levels. However, these data also show that firms who have been in the 8(a) program longer are doing a poorer job of meeting minimum levels of non-8(a) business activities than newer firms. While 72 percent of the firms in their fifth year met or exceeded the minimum non-8(a) business level established for that year, only 37 percent of the firms in their eighth program year, and 37 percent of those in their ninth or final program year met or exceeded the minimum levels established for each of those two years. Furthermore, for those firms in their final year that did not meet their non-8(a) business levels, their non-8(a) business, on average, comprised only 34 percent of their total contract dollars. SBA, recognizing how important it is that it initiate remedial actions when firms are not in compliance with their non-8(a) business targets, has made this one of its district offices performance goals for fiscal year 1995.

Appendix II contains a table showing the extent to which firms met their non-8(a) business levels for each program year.

DOD'S PROGRAM FOR SMALL DISADVANTAGED BUSINESSES

In addition to SBA's 8(a) program, DOD has a preference program for small disadvantaged businesses commonly referred to as the 1207 program.[4] This program (1) allows DOD to set aside contracts for competition among small disadvantaged businesses and (2) allows contracting officers, in evaluating other competitively offered prices, to provide price preferences to small disadvantaged businesses by increasing other offers by 10 percent.

DOD's 1207 program is of particular interest because last year's procurement legislation authorized a program for civilian agencies modeled after DOD's program. As in DOD's program, civilian agencies will be allowed to limit competition on some contracts to small disadvantaged businesses and to use price preferences in others.

Eligibility requirements for DOD's 1207 program are similar but not identical to those of the 8(a) program. As in the 8(a) program, participation is limited to concerns owned and controlled by socially and economically disadvantaged individuals. However, the 1207 program uses a less restrictive definition of economic disadvantage.[5] Moreover, while the 8(a) program requires SBA to certify firms' eligibility for the program, the DOD program relies on self-certification.

In fiscal year 1994, DOD awarded $6.1 billion in prime contracts to small disadvantaged businesses. About 18 percent of these contract dollars were awarded through the 1207 set-aside, and about 6 percent were awarded using price preferences (or as modifications to such contracts). Close to half of the contracts

[4]The program was created by section 1207 of Public Law 99-961, the Fiscal Year 1987 National Defense Authorization Act.

[5]Under the regulations applying to DOD's program, economically disadvantaged individuals are those individuals with a net worth of not more than $750,000 (excluding equity in the business and in a primary residence). Currently, the 8(a) program sets the net worth limits at $250,000 for individuals owning and controlling firms entering the program, which increases to $750,000 as the firm progresses through the program.

awarded to small disadvantaged businesses were awarded through the 8(a) program, while 31 percent were awarded outside the 1207 and 8(a) programs. According to DOD officials, the heavy reliance on the 8(a) program is the result of the priority given to 8(a) under DOD procurement regulations. These regulations provide that contracts should initially be considered for the 8(a) program, then for the 1207 set-aside program, next for the small business set-side, and finally to all businesses through full and open competition. DOD officials also indicated that contracting officials prefer the 8(a) program because it allows them to select a contractor they are familiar with. Appendix III shows the contract dollars awarded to small disadvantaged businesses under each program.

While concentration under the set-aside portion of the 1207 program is similar to that of the 8(a) program, contract dollars awarded through price preference are significantly more concentrated. Under the set-aside program, 1 percent of the firms, or 10 firms, received 15 percent of contract dollars in fiscal year 1993. For DOD awards under the 8(a) program, 1 percent of the firms, or 16 firms, accounted for 17 percent of the contract dollars. However, under the price preference, 1 percent of firms, or 13 firms, received 91 percent of the contract dollars. The high concentration is primarily the result of the award of large petroleum contracts. For all awards to small disadvantaged businesses, 1 percent of the firms, or 41 firms, received 24 percent of the total contract dollars.

CONCLUSION

While SBA continues to make progress in improving various aspects of the 8(a) program, key changes that the Congress mandated in 1988 to make the 8(a) program an effective business development program have yet to be achieved. Over the past 5 years, there has been virtually no improvement in the dispersion of program contracts among 8(a) firms, with the result that contract dollars remain concentrated in a small number of firms. While the 8(a) program is intended to facilitate the entry of firms into government procurement and aid their development, the concentration of contract dollars among a few firms denies or limits development opportunities for many other firms.

Over the past several years, SBA has paid considerable attention to ensuring that firms have new or revised business plans, but it has not given the same attention to annually reviewing these plans to ensure that they accurately reflect the firms' business development goals and 8(a) and non-8(a) contract needs. In addition, when such annual reviews have occurred, SBA has not focused sufficient attention on the actions needed to improve firms' development of their non-8(a) program.

Madame Chair, the limited success that firms are having in reducing their dependence on the 8(a) program as they near the end of their program term is perhaps the most significant issue facing SBA. The transition from the 8(a) program to the commercial market can be difficult even in those cases where the firm has developed a solid base of contracts outside the 8(a) program. However, for firms leaving the 8(a) program still heavily dependent on the program for its livelihood, as is the case with many firms nearing completion of their program term, survival outside the program will be even more challenging.

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This concludes my prepared statement. I would be glad to respond to any questions that you or Members of the Committee may have.

INCREASE IN COMPETITIVE 8(a) CONTRACTS AND DOLLARS SINCE 1991

Dollars in billions

8(a) contracts	Fiscal Year 1991	Fiscal Year 1992	Fiscal Year 1993	Fiscal year 1994
Number of new contacts	4,576	4,693	5,481	5,990
Number of new contracts awarded competitively	86	139	202	174
Percent of new contracts awarded competitively	1.88	2.96	3.69	2.89
New contract dollars awarded	$1.60	$1.70	$2.21	$2.06
New contract dollars awarded competitively	$0.21	$0.34	$0.34	$0.38
Percent of new contract dollars awarded competitively	13.13	20.00	15.38	18.45

Source: SBA

ANALYSIS OF 8(A) FIRMS' COMPLIANCE WITH THEIR NON-8 (A) BUSINESS LEVELS

Program Year	Non-8(a) business mix level (percent of total revenues)	Total number of firms	Number of firms that met or exceeded levels	Percent of firms that met or exceeded levels	Number of firms that did not meet levels	Percent of firms that did not meet levels
5	15-25	345	249	72	96	28
6	25-35	375	260	69	115	31
7	35-45	161	92	57	69	43
8	45-55	138	51	37	87	63
9	55-75	19	7	37	12	63
Total		1,038	659	63	379	37

Source: SBA.

DOD CONTRACTS AWARDED TO SMALL DISADVANTAGED BUSINESSES (SDB)

Dollars in millions

Program	FY 1992		FY 1993		FY 1994	
	(in millions)	(percent)	(in millions)	(percent)	(in millions)	(percent)
SDB set-aside	$ 796	15	$1,002	16	$1,089	18
SDB price preference	264	5	515	8	356	6
8 (a)[a]	2,566	49	2,773	45	2,754	45
Other awards to SDBs[b]	1,569	30	1,893	31	1,915	31
TOTAL	$5,195	100	$6,183	100	$6,114	100

[a]May include awards to 8(a) firms made outside the 8(a) program.

[b]Includes awards to SDBs made outside of the 8(a)/SDB program.

Source: DOD

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