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SMALL BUSINESS

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

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Madam Chair and Members of the Committee:

We are pleased to be here today to discuss the Small Business Administration's (SBA) 8(a) minority 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 into viable, competitive businesses. Firms in the program are eligible to receive financial, management, and technical assistance from SBA to aid their development.

Our reports and testimonies over the years have chronicled the difficulties that SBA has had in implementing many of the changes to the 8(a) program mandated by the Congress in the Business Opportunity Development Reform Act of 1988 and subsequent amendments.[1] Our testimony today focuses on SBA's progress in implementing several changes that are of special interest to the Committee and that are designed to make the 8(a) program an effective business development program. These are (1) requiring that 8(a) contracts with a large dollar value be awarded competitively, (2) distributing 8(a) contracts so that a larger number of firms receive them, (3) ensuring that firms rely less on 8(a) contracts—by increasing their business that does not come through the 8(a) program—as they move through the 9-year program period, and (4) "graduating" from the program firms that have demonstrated that they can survive without 8(a) contracts. As requested, we will also provide information on SBA's denials of firms seeking to enter the program, and discuss SBA's efforts to provide management and technical assistance to firms in the 8(a) program.

Our statement today is based primarily on information that we obtained from SBA through fiscal year 1995, the latest year for which complete data were available. Most of this data came directly from SBA's automated systems. We did not independently verify the accuracy of this data.

In summary: some progress has been made, but SBA has not yet achieved key changes mandated by the Congress. Specifically,

[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); Small Business: SBA Cannot Assess the Success of Its Minority Business Development Program (GAO/T-RCED-94-278, July 27, 1994); and Small Business: Status of SBA's 8(a) Minority Business Development Program (GAO/T-RCED-95-122, Mar. 6, 1995; GAO/T-RCED-95-149, Apr. 4, 1995).

- While the dollar amount of 8(a) contracts awarded competitively during fiscal year 1995 increased over fiscal year 1994, the percentage of contract dollars awarded competitively remained at about 19 percent.
- The concentration of 8(a) program contract dollars in a relatively few firms that occurred in prior years continued in fiscal year 1995, with less than 1 percent of the firms receiving about 25 percent of all contract dollars. This concentration limits the developmental opportunities available to other disadvantaged firms.
- During fiscal year 1995, a larger percentage of the firms in their final program year achieved the required level of non-8(a) business than we reported in April 1995—58 percent compared with 37 percent.
- During fiscal year 1995, 3 firms (among some 6,000 firms in the program) were graduated from the program because SBA determined that the firms had met their development goals and were able to compete in the marketplace without further 8(a) assistance.

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. Firms that enter the program are eligible to receive contracts that federal agencies designate as 8(a) contracts without competition from firms outside the program. During fiscal year 1995, 6,002 firms participated in the 8(a) program. SBA data show that during fiscal year 1995, 6,625 new contracts and 25,199 contract modifications, totaling about $5.82 billion were awarded to 8(a) firms.

To be eligible for the 8(a) program, a firm must be a small business that is at least 51-percent owned and controlled by one or more socially and economically disadvantaged persons. A business is small if it meets the SBA standard for size established for its particular industry. Members of certain ethnic groups, such as black and hispanic Americans, are presumed to be socially disadvantaged. To be economically disadvantaged as well, socially disadvantaged individuals cannot have personal net worth (excluding equity in a personal residence and ownership in the firms) exceeding $250,000. In addition, the firm must be an eligible business and possess a reasonable prospect for success in the private sector. Firms can participate in the 8(a) program for a maximum of 9 years.

The Business Opportunity Development Reform Act of 1988 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. The legislation affirmed that the measure of success for the 8(a) program would be the number of firms that leave the program without being unreasonably reliant on 8(a) contracts and that are able to compete on an equal basis in the mainstream of the American economy. Over the years, reports by GAO, SBA's Inspector General, and others have identified continuing problems with SBA's administration of the program and/or with the program's ability to develop firms that could successfully compete in the marketplace after leaving the program.

Percentage of Competitively Awarded 8(a) Contract Dollars Was About the Same

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 to 8(a) firms 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.

Of the approximately $3.13 billion in new 8(a) contracts awarded in fiscal year 1995, about $610 million, or 19.5 percent of the total dollar amount, was awarded competitively. In comparison, in fiscal year 1994, about $380 million, or 18.5 percent of the $2.06 billion in new 8(a) contracts, was awarded competitively. Between fiscal years 1991 and 1995, the total dollar value of new 8(a) contract awards increased by about 96 percent, while the value of contracts awarded competitively increased by about 190 percent. Appendix I shows the number and the dollar value of 8(a) contracts awarded competitively in fiscal years 1991 through 1995.

SBA's June 1995 revisions to the 8(a) program regulations closed a major loophole involving the competitive award of indefinite delivery, indefinite quantity (IDIQ) contracts. IDIQ contracts are used when an agency does not know the precise quantity of supplies or services to be provided under a contract. As the agency identifies a specific need for goods or services, it modifies the IDIQ contract to reflect the actual costs associated with providing that quantity of goods or services, up to the maximum amount specified in the contract.

Before the June 1995 revisions, SBA's 8(a) program regulations required that an agency, when determining whether an IDIQ contract should be offered on a competitive or noncompetitive (sole-source) basis, consider only the guaranteed minimum value of the contract rather than the estimated total contract amount. According to SBA, IDIQ contracts were often improperly used simply to avoid the need for competition, and wide differences often occurred between the guaranteed minimum values of IDIQ contracts and the amount eventually spent by agencies under the contracts. To avoid this problem, the June 1995 regulations require that for all 8(a) program contracts SBA accepts after August 7, 1995, including IDIQ contracts, the procuring agency must consider the total estimated value of the contract, including the value of contract options, when determining whether the contract should be awarded competitively.

Contract Dollars Continued to Be Concentrated in a Small Percentage of Firms

The concentration of 8(a) contract dollars among relatively few firms is a long-standing condition that continued in fiscal year 1995. SBA data show that in fiscal year 1995, 50 firms—less than 1 percent of the 6,002 total firms in the 8(a) program during the fiscal year—received about $1.46 billion, or about 25 percent of the $5.82 billion in total 8(a) contracts awarded. In fiscal year 1994, 50 firms—about 1 percent of the 5,155 firms then in the program—also received about 25 percent of the $4.37 billion in total 8(a) contract dollars awarded during the fiscal year. Twelve firms that were among the top 50 in fiscal year 1995 were also among the top 50 firms in the previous year. Furthermore, 22 firms that were among the top 50 in fiscal year 1994 were also among the top 50 firms in fiscal year 1993. Appendix II contains a table that shows the range of total contracts dollars awarded to the top 50 firms for fiscal years 1992 through 1995.

While 8(a) contract dollars continue to be concentrated in a relatively few firms, many economically disadvantaged firms do not receive any 8(a) program contracts. SBA data show that of the 6,002 firms in the program during fiscal year 1995, 3,267 firms, about 54 percent, did not receive any program contracts during the fiscal year. In comparison, in fiscal year 1994, 56 percent of the 8(a) firms did not receive any program contracts.

As we testified in April 1995[2], a key reason for the continuing concentration of contract dollars among a relatively few firms is the conflicting objectives confronting procuring officials, according to SBA officials. In SBA's view, the primary objective of procuring officials is to accomplish their agency's mission at a reasonable cost; for these officials, the 8(a) program's business development objectives are secondary. At the same time, the agency's procurement goals for the 8(a) program are stated in terms of the dollar value of contracts awarded. According to SBA, the easiest way for agencies to meet these goals is to award a few large

[2]Small Business: Status of SBA's 8(a) Minority Business Development Program (GAO/T-RCED-95-149, Apr. 4, 1995).

contracts to a few firms, preferably firms with which the agencies have had experience and whose capabilities are known.

In addition, according to SBA the concentration of firms receiving 8(a) contracts is no different than the concentration among firms that occurs in the normal course of federal procurement. However, while this may be true for federal procurement overall, the Congress in amending the 8(a) program in 1988 sought to increase the number of competitive small businesses owned and controlled by socially and economically disadvantaged individuals through the fair and equitable distribution of federal contracting opportunities.

In 1995, SBA made several efforts to increase the award of 8(a) contracts to firms that had never received contracts. SBA required its district offices to develop action plans to increase the number of 8(a) contract opportunities offered to a greater percentage of 8(a) firms. These action plans were to include specific initiatives for marketing the program to federal procurement offices in their jurisdictions. In addition, the Departments of Defense and Veterans Affairs agreed to give special emphasis to 8(a) firms that had never received contracts. Although SBA has not assessed the impact of these activities on increasing contract awards, SBA officials believe that these steps have helped in getting 8(a) contracts to firms that had never received them.

At the same time, in the view of SBA officials, the fact that some firms do not receive any 8(a) contracts may not be a problem because not all firms enter the program to receive 8(a) contracts. Rather, some firms, according to SBA officials, seek 8(a) certification in order to qualify as disadvantaged firms for other federal programs, such as the highway construction program funded by the Department of Transportation, or state and city programs that set aside contracts for disadvantaged firms.

Larger Percentage of Firms Met Target Levels of Non-8(a) Business

To increase the program's emphasis on business development and the viability of firms leaving the program, the act directed SBA to establish target levels of non-8(a) business for firms during their last 5 years in the program. The non-8(a) target levels increase during each of the 5 years, from a minimum of 15 percent of a firm's total contract dollars during its fifth year to a minimum of 55 percent in the firm's ninth or final program year. SBA field offices, as part of their annual reviews of firms, are responsible for determining whether firms achieve these target levels.

In April 1995, we testified that SBA data showed that while 72 percent of the firms in their fifth year that had 8(a) sales met or exceeded the minimum 15-percent non-8(a) target established for the fifth year, only 37 percent of the firms in their ninth or final program year that had 8(a) sales met or exceeded the minimum 55-percent target established for that year. The data also showed that of the 1,038 firms in the fifth through the ninth year of their program term that had 8(a) sales, 37 percent did not meet the minimum targets.

SBA data for fiscal year 1995 showed that of the 8(a) firms in their fifth year that had 8(a) sales during the fiscal year, about 85 percent met or exceeded the minimum non-8(a) business target of 15 percent established for that year. In comparison, of the 8(a) firms in their ninth or final program year that had 8(a) sales during the fiscal year, 58 percent met or exceeded the minimum non-8(a) business target of 55 percent established for that year. Appendix III shows the extent to which firms met their target levels for fiscal year 1995.

In a September 1995 report, SBA's Inspector General (IG) discussed SBA's problems in enforcing the business-mix requirements. According to the IG, over one-third of the 8(a) firms in the last 5 years of their program term did not meet the business-mix requirements, yet they accounted for about $1.4 billion (63 percent) of total 8(a) contract revenues of all firms subject to the requirements. The IG noted that SBA's regulations identify a range of remedial actions that the agency can take to improve firms' compliance with the requirements, including reducing or eliminating sole-source 8(a) contract awards, and that SBA personnel have the discretion of selecting which remedial actions to impose. The IG found, however, that SBA personnel often took minimal or no action when firms did not meet the requirements, and firms continued to obtain 8(a) contracts even though they were not complying with the regulations to develop non-8(a) business.

To address this problem, the IG recommended that SBA limit the dollar value of new 8(a) contracts awarded to firms that do not meet their non-8(a) business target levels. SBA concurred with this recommendation and in March 1996 stated that it was exploring two options—eliminating all new 8(a) contracts to firms that do not meet their non-8(a) business levels, or placing a limit on the dollar value of 8(a) contracts awarded to such firms. In September 1996, an SBA official told us that the agency could not propose regulations implementing such restrictions until the

Department of Justice finalizes its regulations regarding federal affirmative action programs.

The IG's September 1995 report also concluded that SBA could not measure the success of the 8(a) program as defined by the Congress, namely the number of firms that leave the program without being unreasonably reliant[3] on 8(a) contracts and that are able to compete on an equal basis in the mainstream of the American economy. The IG reported that SBA's procedures did not provide for compiling and reporting data on the (1) number of companies that met their business-mix requirements while in the program and (2) companies that remained in business after they no longer had 8(a) revenues. As a result, the IG concluded that neither SBA nor the Congress could determine whether the 8(a) program was accomplishing its intended purpose or whether any changes to the program were needed.

To address these problems, the IG recommended that SBA annually compile data on the numbers of firms that leave the 8(a) program that are unreasonably reliant on 8(a) contracts and those that are not. The IG also recommended that SBA (1) track former 8(a) firms after they have completed all 8(a) contracts to determine whether they are still in business and (2) annually determine how many of the firms that are still in business were unreasonably reliant on 8(a) contracts when they left the program. With regard to this recommendation, the IG noted that responses to a questionnaire it sent to former 8(a) firms that had been out of the program for approximately 1.5 to 5.5 years showed that many firms still had substantial revenues from carryover 8(a)contracts. For example, 23 percent of the respondents reported that more than 50 percent of their total revenues were from 8(a) contracts.

In March 1996, SBA stated that it would begin to annually compile data on the number of firms leaving the 8(a) program that met or did not meet the business-mix requirements and, as a result, were or were not unreasonably reliant on 8(a) program contracts. SBA also stated that it was currently tracking 8(a) graduates to determine their current status and levels of revenues. Finally, SBA announced that it was developing a more thorough survey to track graduates and was considering using external data sources, such as Dun and Bradstreet, for this information. As of September 1996, SBA had not developed this survey. According to an SBA

[3]SBA has interpreted the language "not unreasonably reliant" to mean 8(a) firms that have met the appropriate non-8(a) business target.

official, work on this project has been delayed by several factors, including the furloughs of SBA staff and the turnover of a top SBA official.

Few Firms Graduate From Program

SBA's regulations provide that any firm that (1) substantially achieves its business development goals and objectives before completing its program term and (2) has demonstrated the ability to compete in the marketplace without 8(a) program assistance may be graduated from the 8(a) program. According to the regulations, factors SBA is to consider in deciding whether to graduate a firm include the firm's sales, net worth, working capital, overall profitability, access to credit and capital, and management capacity and capability. SBA may also consider whether the firm's business and financial profile compares positively with the profiles of non-8(a) firms in the same area or a similar line of business. A determination of whether a firm should be graduated is a part of SBA's annual review of each firm. A firm has the option to appeal SBA's determination that it graduate from the 8(a) program. After graduating, a firm is no longer eligible to receive 8(a) contracts.

According to SBA data, during fiscal year 1995, SBA graduated three firms from the program—the first graduations in the program's history, according to SBA officials. The data also show that during fiscal year 1995, SBA terminated another 160 firms from the program for various reasons, including failure to comply with program requirements, and 250 more firms left the program because their program terms had expired during the fiscal year. According to SBA officials, SBA usually does not require that a firm graduate because of anticipated appeals and the difficulty in enforcing the graduation requirement, especially if the firm disagrees with SBA's decision.

SBA's IG has identified companies that should have been, but were not, graduated from the 8(a) program. For example, the IG reported in September 1994 that its examination of 50 of the larger 8(a) firms found that most of these firms were larger and more profitable than firms not in the program. Specifically, the IG's review showed that 32 of the 50 8(a) firms exceeded their respective industries' averages for the following five performance factors: business assets, revenues, gross profits, working capital, and net worth. The IG concluded that allowing such firms to continue in the program deprived other truly economically disadvantaged firms of 8(a) assistance and understated the 8(a) program's overall success because firms that had demonstrated success were not graduated.

In May 1995, as a result of the IG's review, SBA established requirements for its field staff to (1) compare annually five financial performance factors of 8(a) firms with the industry averages for companies in the same line of business and (2) consider graduation from the program for any 8(a) firm that meets or exceeds three of the averages. However, a February 1996 evaluation by SBA of annual reviews conducted by SBA field staff of 8(a) firms raises questions about the ability of the field staff to conduct such analysis. SBA noted that the staffs' financial analyses are very poor, staff members do not fully understand the concepts of economic disadvantage, financial condition of the firm, and access to capital, and the annual reviews contained few comparisons of the condition of 8(a) firms with similar businesses. To address this problem, SBA recommended that field staff receive training in financial analysis and guidance on the concept of continuing economic disadvantage. As of September 1996, SBA planned to provide this training during a national meeting planned for October or November 1996.

Applications Processed and Management and Technical Assistance Provided in Fiscal Year 1995

I would now like to provide some overall statistics regarding SBA's disposition of applications made to the 8(a) program during fiscal year 1995, and the amount of management and technical assistance provided during the year.

Applications Processed

SBA data show that during fiscal year 1995, SBA processed 1,306 8(a) program applications. SBA approved 696 of the applications and initially denied the remaining 610. Among the reasons cited for denying the 610 applications were the following:

- The firm lacked potential for success (367 applications).
- The socially and economically disadvantaged individual did not own or control the firm (364 applications).
- The individual who owned and controlled the firm was not socially or economically disadvantaged (263 applications).
- The firm was a type of business that is not eligible to participate in the program (78 applications).

Of the 610 applications that SBA initially denied, 323 were reconsidered and 189 were subsequently approved, bringing to 885 the total number of applications approved during fiscal year 1995. In comparison, SBA ultimately approved 1,107 of the 1,536 applications it processed in fiscal year 1994, and 540 of the 819 applications it processed in fiscal year 1993.

Management and Technical Assistance

As small businesses, 8(a) firms are eligible to receive management and technical assistance from various sources to aid their development. SBA's primary source of such assistance has been its 7(j) program. Authorized by section 7(j) of the Small Business Act, as amended, the 7(j) program provides seminars and individual assistance to 8(a) firms. The 8(a) firms are also eligible to receive assistance from SBA's Executive Education Program, which is designed to provide the owners/managers of 8(a) firms with executive development training at a university. SBA may also provide 7(j) assistance to socially and economically disadvantaged individuals whose firms are not in the 8(a) program, firms located in areas of high unemployment, and firms owned by low-income individuals.

In fiscal year 1995, SBA spent about $7.6 million for 7(j) assistance to 4,604 individuals. This figure included individuals from 1,785 8(a) firms that received an aggregate of 9,452 days of assistance, and 190 firms that received executive training under SBA's Executive Education Program.

In fiscal year 1996, SBA changed the focus of the 7(j) program to provide only executive-level training. The individual assistance and seminar training previously provided will be provided by SBA's Small Business Development Centers and Service Corps of Retired Executives.

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

8(a) Contracts and Dollars Awarded Competitively for Fiscal Years 1991 Through 1995

(Dollars in billions)

8(a) contracts—dollars and percent	Fiscal year 1991	Fiscal year 1992	Fiscal year 1993	Fiscal year 1994	Fiscal year 1995
Number of new contracts awarded	4,576	4,693	5,481	5,990	6,625
Number of new contracts awarded competitively	86	139	202	174	283
Percent of new contracts awarded competitively	1.88	2.96	3.69	2.89	4.27
Dollar amount of new contracts awarded	$1.60	$1.70	$2.21	$2.06	$3.13
Dollar amount of new contracts awarded competitively	$0.21	$0.34	$0.34	$0.38	$0.61
Percent of new contract dollars awarded competitively	13.13	20.00	15.38	18.45	19.49

Source: SBA.

Range of Total 8(a) Contract Dollars Awarded to Top 50 8(a) Firms for Fiscal Years 1992 Through 1995

(Dollars in millions)

(a) contracts—dollars and percent	Fiscal year 1992	Fiscal year 1993	Fiscal year 1994	Fiscal year 1995
Total 8(a) contract dollars awarded to top 8(a) firm	$91.6	$71.2	$57.2	$97.1
Total 8(a) contract dollars awarded to fiftieth 8(a) firm	$13.2	$14.2	$12.0	$16.9
Total 8(a) contract dollars awarded during fiscal year	$4,167.9	$4,333.4	$4,370.0	$5,820.7
Total 8(a) contract dollars awarded to top 50 firms	$1,227.7	$1,075.1	$1,083.0	$1,461.4
Percent of total 8(a) contract dollars awarded to top 50 firms	29.5	24.8	24.8	25.1

Source: SBA.

Analysis of 8(a) Firms' Compliance With Their Non-8 (A) Business Requirements for Fiscal Year 1995

Program year	Required level of non-8(a) business (percent of total revenues)	Total number of firms with 8(a) sales	Number of firms with 8(a) sales that met or exceeded levels	Percent of firms with 8(a) sales that met or exceeded levels	Number of firms with 8(a) sales that did not meet levels	Percent of firms with 8(a) sales that did not meet levels
5	15-25	266	227	85	39	15
6	25-35	319	239	75	80	25
7	35-45	189	140	74	49	26
8	45-55	148	87	59	61	41
9	55-75	198	114	58	84	42
Total		**1,120**	**807**	**72**	**313**	**28**

Source: SBA.

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