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August 2019

# FEDERAL CONTRACTING

## Awards to Mid-Sized Businesses and Options for Increasing Their Opportunities

Accessible Version

# GAO Highlights

Highlights of [GAO-19-523](#), a report to the Committee on Small Business, House of Representatives

## Why GAO Did This Study

Small businesses that receive federal contracts set aside for them may outgrow the size standards the Small Business Administration (SBA) uses to define small businesses. (Size standards vary by industry and generally are based on employees or revenue.) Questions have been raised about the extent to which mid-sized businesses can compete with large businesses for federal contracts.

GAO was asked to provide information on federal contracting opportunities for mid-sized businesses. This report analyzes, among other objectives, (1) the extent to which small businesses grew to mid-sized and continued to receive federal contracts and (2) options for increasing contracting opportunities for mid-sized businesses.

GAO analyzed federal contracting data for fiscal years 2008–2017 (most recent and complete). In the absence of legal definitions of “mid-sized” and “large,” GAO multiplied relevant size standards for small businesses to arrive at parameters for mid-sized and large businesses for its analysis. GAO reviewed literature to identify options for increasing contracting opportunities and interviewed SBA officials and a nongeneralizable selection of 11 stakeholders—trade association representatives, researchers, and small business directors at three agencies with large obligations for small business contracts in fiscal year 2017—to obtain views on the options. SBA provided comments, which we addressed as appropriate.

View [GAO-19-523](#). For more information, contact William B. Shear at (202) 512-8678 or [shearw@gao.gov](mailto:shearw@gao.gov).

August 2019

## FEDERAL CONTRACTING

# Awards to Mid-Sized Businesses and Options for Increasing Their Opportunities

## What GAO Found

From fiscal year 2008 through 2017, very few small businesses that were awarded limited competition (set-aside) contracts grew to be mid-sized and continued to receive contracts. (GAO defined mid-sized businesses as having revenue or employees up to five times above the small business size standard.)

- Of the 5,339 small businesses awarded set-aside contracts in fiscal year 2008 and awarded any sort of federal contract (including set-aside or competed) in 2013, 104 became mid-sized by fiscal year 2013.
- Of those 104 businesses, 23 remained mid-sized through 2017 and won 75 contracts. Another three businesses became large and won six contracts.

### Extent to Which 104 Businesses Awarded Set-Aside Contracts in Fiscal Year (FY) 2008 and That Grew to Mid-Sized by FY2013 Received Contracts in FY2014–2017, by Size

Business size in FY2014–2017	Number of businesses	Number of contracts (FY2014–2017)
Small	17	51
Mid-sized	23	75
Large	3	6
Size varied		
Mid-sized/large	5	34
Small/large	1	4
Small/mid-sized	28	204
Small/mid-sized/large	3	64
Did not receive any contracts	24	0
<b>Total</b>	<b>104</b>	<b>438</b>

Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Note: Size can vary because businesses can be awarded contracts in different industries and be considered small in one industry but not in another.

Options for increasing federal contracting opportunities for mid-sized businesses that GAO identified in its review include establishing a separate set-aside category, changing consideration of past contracting performance, and modifying size standards. Stakeholders told GAO some options would help mid-sized businesses more than others.

- While a set-aside category for mid-sized businesses would increase opportunities for mid-sized businesses, stakeholders generally believed it could decrease opportunities for small businesses and increase agency burden (time and costs to implement the set-aside).
- Requiring agencies to consider businesses’ past performance as subcontractors or as part of a team would help both mid-sized and growing small businesses by making them more competitive for contracts.
- Stakeholders said raising size standards based on revenue would allow a limited number of mid-sized businesses to be eligible for set-asides again, but not help the vast majority of mid-sized businesses.

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## Abbreviations

EAGLE II	Enterprise Acquisition Gateway for Leading-Edge Solutions II
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System-Next Generation
ID/IQ	indefinite delivery/indefinite quantity
NAICS	North American Industry Classification System
OSDBU	Office of Small and Disadvantaged Business Utilization
SBA	Small Business Administration

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August 20, 2019

The Honorable Nydia M. Velázquez  
Chairwoman  
The Honorable Steve Chabot  
Ranking Member  
Committee on Small Business  
House of Representatives

Federal contracts can be an important revenue source for small businesses, according to the Small Business Administration (SBA). Of the more than \$482 billion in contracts for goods and services the federal government awarded in fiscal year 2018, more than \$120 billion was awarded to small businesses.<sup>1</sup> To help ensure small businesses receive a share of federal procurement dollars, in 1997 Congress set an annual government-wide goal of awarding at least 23 percent of prime federal contracts to small businesses.<sup>2</sup> Contracting officers have the authority to set aside contracts for small businesses (that is, limit competition) to help expand their participation in federal procurement.

Some businesses have outgrown small business size standards (which vary by industry and are generally expressed as the number of employees or amount of revenue) and become mid-sized businesses. Although under federal procurement law businesses are either “small” or “other than small,” researchers and trade associations informally have defined mid-sized businesses as those that recently outgrew their applicable small size standards and are too large to benefit from small business set-asides, but may be too small to compete with the largest firms.

At a roundtable of the House Committee on Small Business in November 2017, business and industry leaders raised questions about the extent to which businesses that grew to be mid-sized experienced a decline in

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<sup>1</sup>Federal Procurement Data System-Next Generation, *FY 2018 Small Business Goaling Report*.

<sup>2</sup>Small Business Reauthorization Act of 1997, Pub. L. No. 105-135, § 603 (1997) (codified, as amended, in 15 U.S.C. § 644(g)(1)). A prime contract is awarded directly to a contractor by the federal government. Prime contractors award subcontracts to other businesses.

federal contracting opportunities.<sup>3</sup> At a House hearing in April 2018, it was noted that minimal data were available on what happens to firms after exceeding their small business size standards.<sup>4</sup> You asked us to provide information on contracting opportunities for mid-sized businesses and any options for increasing such opportunities.

This report analyzes (1) the extent to which small businesses grew to be mid-sized and continued to receive federal contracts; (2) instances in which mid-sized businesses can perform work on contracts set aside for small businesses; and (3) options for increasing federal contracting opportunities for mid-sized businesses and views on the strengths and limitations of the options.

For the first objective, we analyzed data from the Federal Procurement Data System-Next Generation (FPDS-NG) for fiscal years 2008 through 2017 (the most recent complete data available when we began our review).<sup>5</sup> Because there is no statutory or regulatory definition of a mid-sized or large business, we applied multipliers to SBA's size standards. We considered businesses with revenue or employees up to five times above the SBA small size standard as mid-sized and businesses with revenue or employees of more than five times the small size standard as large.<sup>6</sup> We used five times the small size standard to distinguish between mid-sized and large businesses based on the distribution of contracts and obligations among businesses in these two groups. We discussed this approach and methodology with SBA officials and officials at three federal agencies that had large obligations for small business contracts in fiscal year 2017. These officials did not raise any questions about our approach, and some reiterated that there was no legal definition of mid-sized businesses. To determine whether businesses that grew to be mid-

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<sup>3</sup>*Leaving the Nest: Challenges Facing Advanced Small Businesses*, roundtable before the House Committee on Small Business, 115th Cong. (November 2017).

<sup>4</sup>*No Man's Land: Middle-Market Challenges for Small Business Graduates*, House Committee on Small Business, Subcommittee on Contracting and Workforce, 115th Cong. (Apr. 26, 2018).

<sup>5</sup>FPDS-NG is the General Services Administration system used to collect and report data on federal procurements. FPDS-NG records whether contracts were awarded to small businesses.

<sup>6</sup>For example, in an industry with a revenue-based size standard of \$15 million, businesses with revenue of \$15 million or less would be small, those with revenue above \$15 million but below \$75 million would be mid-sized, and with revenue of \$75 million or more would be large.

sized continued to secure contracts, we used FPDS-NG data to determine the number of businesses awarded set-aside contracts in 2008 that became mid-sized by 2013 and the extent to which they were awarded any sort of contract (including competed contracts) in fiscal years 2014 through 2017.<sup>7</sup> We also determined the percentage of competed contracts awarded to small, mid-sized, and large businesses in fiscal year 2017. We assessed the reliability of the FPDS-NG data we used by performing electronic testing and reviewing information about the system. We determined that these data were sufficiently reliable for the purposes of determining the extent to which small businesses that grew to be mid-sized continued to secure contracts and the size of businesses awarded contracts during a specific time period.

For the second objective, we reviewed the Federal Acquisition Regulation (FAR)—the principal set of regulations governing the federal acquisition process—and small business laws and regulations to identify provisions that allow small businesses that grow into mid-sized businesses to continue providing services and goods on contracts set aside for small businesses. We also reviewed SBA documents related to its mentor-protégé programs, one way that mid-sized businesses can provide services and goods under set-aside contracts.<sup>8</sup> Using FPDS-NG and SBA data on mentor-protégé joint ventures, we determined the number of mid-

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<sup>7</sup>For purposes of this report, competed contracts are those competed using (1) full and open competition, (2) full and open competition after exclusion of sources, and (3) simplified acquisition procedures. Under certain circumstances, agencies may exclude a particular source from a contract action to establish or maintain an alternative source or sources for supplies or services being acquired. For instance, agencies may exclude a source if doing so would increase or maintain competition and likely result in reduced overall costs for the acquisition. Generally, agencies must use simplified acquisition procedures to the maximum extent practicable for all purchases of supplies or services not exceeding the simplified acquisition threshold (set in statute at \$250,000 as of December 2017). National Defense Authorization Act of Fiscal Year 2018, Pub. L. No. 115-91, § 805, 131 Stat. 1283, 1456 (2017) (codified at 41 U.S.C. § 134). The Federal Acquisition Regulation has not been updated to adopt the new amount, and as of June 2019 generally retained the prior \$150,000 standard. FAR § 2.101.

<sup>8</sup>SBA's mentor-protégé programs typically seek to pair new businesses with more experienced businesses and focus on enhancing the protégé's capacity to serve as a prime contractor or subcontractor in federal contracts.

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sized businesses that were awarded set-aside contracts by forming joint ventures with small business protégés.<sup>9</sup>

For the third objective, we reviewed literature such as trade association reports, congressional testimonies, and research reports. To gather feedback on strengths and limitations of proposed options to increase contracting opportunities for mid-sized businesses, we selected a nongeneralizable sample of 11 individuals or organizations representing three types of stakeholders (trade associations, researchers, and federal agencies). More specifically, we interviewed representatives from five trade associations for small and mid-sized businesses, three researchers who published on this topic, and directors of the Office of Small and Disadvantaged Business Utilization (OSDBU) at the same three agencies previously mentioned.<sup>10</sup> Because we selected a nongeneralizable sample of stakeholders to interview, their views are not generalizable to other stakeholders who have knowledge about options for increasing contracting opportunities for mid-sized businesses, but their views offered important perspectives. For more information on our scope and methodology, see appendix I. See appendix II for information on contracts awarded to small, mid-sized, and large businesses in fiscal year 2017.

We conducted this performance audit from April 2018 to August 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>9</sup>A protégé and mentor may form a joint venture as a small business for any federal prime contract or subcontract, provided the protégé qualifies as small for the procurement. 13 C.F.R. § 125.9. SBA defines a joint venture as “an association of individuals and/or concerns with interests in any degree or proportion consorting to engage in and carry out no more than three specific or limited-purpose business ventures for joint profit over a two year period, for which purpose they combine their efforts, property, money, skill, or knowledge, but not on a continuing or permanent basis for conducting business generally.” 13 C.F.R. § 121.103.

<sup>10</sup>In 1978, Congress amended the Small Business Act to require all federal agencies with procurement powers to establish an OSDBU to advocate for small businesses in federal procurement and contracting.



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## Background

SBA oversees a number of programs designed to provide small businesses with resources and tools, including access to capital, help with federal contracting opportunities, and entrepreneurial counseling and training.

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### SBA's Size Standards and Industry Classification Codes

Federal procurement regulations generally define a small business as one that is independently owned and operated and not dominant in its field and that meets the size and criteria or standards established by SBA.<sup>11</sup> The Small Business Act of 1953 authorized SBA to establish size standards for determining eligibility for all procurement programs in which small business status is required or advantageous. SBA uses the North American Industry Classification System (NAICS) as the basis for its size standards.<sup>12</sup> The standards vary by industry and are generally expressed as the average number of employees over a 12-month period or average annual receipts in the previous 3 years.<sup>13</sup> As of August 2019, employee-based size standards for federal procurement purposes ranged from 100 to 1,500, and revenue-based size standards ranged from \$1.0 million to \$41.5 million. The number of employees or average annual receipts

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<sup>11</sup>FAR § 2.101.

<sup>12</sup>The Economic Classification Policy Committee of the Office of Management and Budget, Statistics Canada, and Mexico's Instituto Nacional de Estadística y Geografía developed NAICS as a standard for collecting and analyzing data describing the economies of the three countries.

<sup>13</sup>In December 2018, the Small Business Runway Extension Act of 2018—an amendment to the Small Business Act—extended the time during which the size of service contractors must be determined on the basis of annual gross receipts to a period of not less than 5 years. Pub. L. No. 115-324, § 2, 132 Stat. 4444. SBA stated that the change would not take effect until SBA issued a regulation implementing it. *Small Business Size Standards: Revised Size Standard Methodology*, 84 Fed. Reg. 14587, 14588 (Apr. 11, 2019). In June 2019, SBA issued a proposed rule in response to the statutory amendment that would change the calculation of annual average receipts for all receipts-based SBA size standards and other agencies' proposed size standards for service-industry firms from a 3-year averaging period to a 5-year averaging period. *Small Business Size Standards: Calculation of Annual Average Receipts*, 84 Fed. Reg. 29399 (June 24, 2019). The proposed rule states that it applies the changes to all receipts-based size standards, and not just those applicable to the service industries with receipt-based standards as required by the law, to prevent confusion. 84 Fed. Reg. 29399, 29401.

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indicates the maximum size allowed for a business and its affiliates to be considered small.

The Small Business Jobs Act of 2010 required SBA to review at least one-third of all size standards during every 18-month period from the date of its enactment and all size standards at least once every 5 years thereafter. SBA completed the first 5-year review in 2016. According to SBA's size standard methodology, the agency assesses industry structure and the overall degree of competitiveness of an industry and of firms in the industry when establishing size standards. To assess industry structure, SBA analyzes four primary factors: average firm size, degree of competition in an industry, start-up costs and entry barriers, and distribution of firms by size. SBA also considers the ability of small businesses to compete for contracting opportunities under the current size standards. According to SBA officials, for industries with \$20 million or more in federal contracting annually, SBA also examines the small business share of federal contract dollars relative to the small business share of total industry receipts.

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## Small Business Goals and Set-Aside Contracts for Small Businesses

Each year, SBA negotiates small business prime contracting goals with federal agencies that have procurement authority so that, in the aggregate, the federal government meets its goal of awarding 23 percent of prime contract dollars to small businesses.<sup>14</sup> In September 2018, we reported that SBA considers prior-year achievement and other factors in setting annual agency goals.<sup>15</sup> SBA's procurement center representatives and OSDBUs assist agencies in meeting small business goals.<sup>16</sup>

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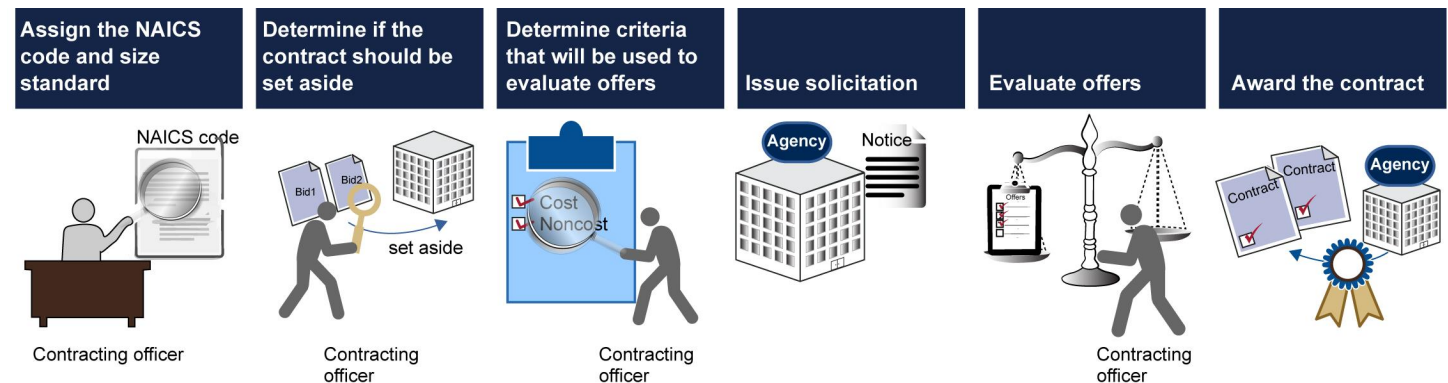
<sup>14</sup>SBA also negotiates subcontracting goals with agencies.

<sup>15</sup>GAO, *Small Business Administration: Actions Needed to Improve Confidence in Small Business Procurement Scorecard*, [GAO-18-672](#) (Washington, D.C.: Sept. 27, 2018).

<sup>16</sup>Procurement center representatives are among the primary staff who implement SBA's prime contracting and subcontracting assistance programs. See GAO, *Improvements Needed to Help Ensure Reliability of SBA's Performance Data on Procurement Center Representatives*, [GAO-11-549R](#) (Washington, D.C.: June 15, 2011); and *Small Business Contracting: Actions Needed to Demonstrate and Better Review Compliance with Select Requirements for Small Business Advocates*, [GAO-17-675](#) (Washington, D.C.: Aug. 25, 2017).

Agency contracting officers have the authority to enter into, administer, or terminate contracts and are responsible for helping agencies meet small businesses goals, including by setting aside contracts for small businesses.<sup>17</sup> One of the first steps in the federal acquisition process is assignment of the NAICS code that best describes the principal purpose of the acquisition and corresponding size standard (see fig. 1). Generally, the FAR states that if the contract is valued under the simplified acquisition threshold, the contracting officer must set it aside for small businesses. If valued above the simplified acquisition threshold, the contracting officer conducts market research to determine whether a contract should be set aside for small businesses.<sup>18</sup> For contracts not set aside for small businesses, contracting officers generally must include specific small business subcontracting goals for the prime contractor to meet.

**Figure 1: Overview of the Federal Acquisition Process for Small Business Set-Asides**



NAICS = North American Industry Classification System

Source: GAO. | GAO-19-523

<sup>17</sup>To be eligible for award of set-aside contracts, businesses must meet the small business size standard for the procurement and have the capacity to provide the goods and services.

<sup>18</sup>If the contract is valued above the simplified acquisition threshold, the contracting officer adheres to the "rule of two." For set-asides other than for construction or services, if the contracting officer's market research indicates there is a reasonable expectation that offers will be obtained from two or more responsible small businesses offering the products of different small businesses and the award will be made at a fair market price, the contract should be set aside. If the contracting officer does not have such a reasonable expectation, the contract can be offered for full and open competition.

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## Past Performance Requirements

The FAR requires agencies to evaluate price or cost to the government in every source selection and evaluate the quality of the product or service in the acquisition by considering one or more noncost factors, such as past performance.<sup>19</sup>

Contracting officers generally have discretion under the FAR to choose evaluation factors and their relative weights, rating systems, and the past performance they will consider. For example, a contracting officer could consider technical excellence, past performance (including relevance), and price.

To select a firm for contract award, agency officials evaluate offers against the criteria specified in the solicitation. According to the FAR, if an offeror has no record of relevant past performance, the offeror cannot be evaluated favorably or unfavorably on past performance.<sup>20</sup> Contracting officers use the Contractor Performance Assessment Reporting System to enter and review evaluations of past performance. The FAR generally requires agencies to document contractor performance on contracts or orders that exceed certain dollar thresholds. Once a project is complete, the assessing official rates the contractor on elements such as quality of the product or service, schedule, cost control, management, and small business utilization. This information then becomes available to other agencies for making source selection decisions.

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## Indefinite Delivery/Indefinite Quantity Contracts

Indefinite delivery/indefinite quantity (ID/IQ) contracts provide flexibility when an agency cannot specify the quantities or timing of a product or service. Contracting officers may issue ID/IQ contracts as single-award or multiple-award contracts. Single-award refers to a situation in which one contract is awarded under a solicitation.

The FAR establishes a preference for awarding multiple-award ID/IQ contracts—instances in which more than one prime contractor is awarded a task-order contract (for services) or delivery-order contract (for supplies)

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<sup>19</sup>FAR § 15.304(c)(1)-(3).

<sup>20</sup>FAR § 15.305(a)(2).

under a single solicitation.<sup>21</sup> Once agencies determine their specific needs, such contracts allow agencies to establish a pool of qualified contractors to compete for future orders under streamlined procedures. Contractors compete to be in the pool and generally compete again for task or delivery orders. Multiple-award ID/IQ contracts can be unrestricted (open competition for businesses of all sizes) or restricted to small businesses. They also can have one pool of contractors with separate “tracks” for small and nonsmall businesses to ensure contract opportunities for small businesses (that is, some orders are set aside for small businesses).<sup>22</sup>

After a multiple-award ID/IQ contract has been awarded, an agency places delivery or task orders, generally using the fair opportunities process.<sup>23</sup> An order, which is placed when a specific need arises, obligates funds and authorizes work. Orders must be within the scope, issued within the period of performance, and be within maximum value or quantities agreed to in the contract. For multiple-award ID/IQ contracts, the FAR requires that each awardee be given a fair opportunity to

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<sup>21</sup>FAR § 16.500; FAR § 16.504(c).

<sup>22</sup>For example, the Department of Homeland Security’s Enterprise Acquisition Gateway for Leading-Edge Solutions II (EAGLE II) is a suite of multiple-award ID/IQ contracts for small and large contractors. EAGLE II has three lines of services referred to as functional categories. Each functional category has tracks for small and nonsmall businesses. Small businesses can compete for task orders in small business tracks or compete against larger businesses in unrestricted tracks. In the original EAGLE, contractors in the small business track that outgrew the size standard in their category were moved to the unrestricted track. But EAGLE II has a mechanism (“off ramp”) that requires businesses that outgrew or otherwise lost small business status to leave the EAGLE II program after completing any ongoing task orders. See GAO, *DHS IT Contracting: Steps Taken to Enhance EAGLE II Small Business Opportunities, but Better Assessment Needed*, [GAO-15-551](#) (Washington, D.C.: June 24, 2015).

<sup>23</sup>FAR § 16.505(b). Generally, the fair opportunity process requires that the contracting officer provide each awardee a fair opportunity to be considered for each order in an ID/IQ multiple-award contract that exceeds \$3,500, with certain enumerated exceptions. FAR § 16.505(b)(1)(i). The contracting officer may take certain steps to provide fair opportunity, including developing a placement procedure that will provide each awardee a fair opportunity to be considered for each order and that reflects the requirement and other aspects of the contracting environment; not using any methods that would not result in fair consideration being given to all awardees before placing each order; tailoring the procedures to each acquisition; including the procedures in the solicitation and the contract; and considering price or cost under each order as one of the factors in the selection decisions. FAR § 16.505(b)(1)(ii). Additional procedures are required for orders exceeding the simplified acquisition threshold and orders exceeding \$5.5 million. Contracting officers also have requirements to consider when developing the procedures. FAR § 16.505(b)(1)(iii), (iv), (v).

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compete for subsequent orders. In April 2017, we found that in fiscal years 2011–2015, federal agencies obligated more than \$130 billion annually through ID/IQ contracts.<sup>24</sup> We also found that contracting officers said it was easier and faster to place an order under an existing ID/IQ contract than to award a separate contract when a specific need arose.

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## SBA's Mentor-Protégé Programs

A mentor-protégé program is an arrangement in which mentors—typically experienced prime contractors—provide technical, managerial, and other business development assistance to eligible small businesses, or protégés. SBA established the 8(a) Mentor-Protégé Program in 1998 for mentors to partner with 8(a) socially and economically disadvantaged businesses to improve the ability of 8(a) businesses to compete for prime contracts and subcontracts.<sup>25</sup> The Small Business Jobs Act of 2010 and National Defense Authorization Act for fiscal year 2013 authorized SBA to establish a government-wide mentor-protégé program for all small businesses, which SBA named the All Small Mentor-Protégé Program. Small businesses that have a mentor-protégé relationship through either program can form a joint venture with a mentor (which can be a mid-sized or large business) and compete for set-aside contracts as long as the protégé is a small business with at least a 51 percent interest in the joint venture.

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## Team Arrangements

Contractor team arrangements take two forms: two or more companies form a partnership or joint venture to act as a prime contractor or a prime contractor agrees with one or more companies to have them act as its subcontractors under a specified federal contract or acquisition program. Companies generally form a contractor team arrangement before submitting an offer.<sup>26</sup> Businesses of all sizes can form joint ventures to compete for contracts. Joint ventures generally have to consist only of small businesses to compete for small business set-aside contracts—the

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<sup>24</sup>GAO, *Federal Contracts: Agencies Widely Used Indefinite Contracts to Provide Flexibility to Meet Mission Needs*, [GAO-17-329](#) (Washington, D.C.: Apr. 13, 2017).

<sup>25</sup>The 8(a) Business Development Program offers assistance to businesses that are at least 51 percent owned and controlled by socially and economically disadvantaged individuals.

<sup>26</sup>FAR § 9.601; FAR § 9.602.

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exception being small and nonsmall businesses entered in a mentor-protégé agreement under one of SBA's programs.

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## A Very Small Percentage of Small Businesses Grew to Be Mid-Sized and Continued to Receive Federal Contracts during Fiscal Years 2008–2017

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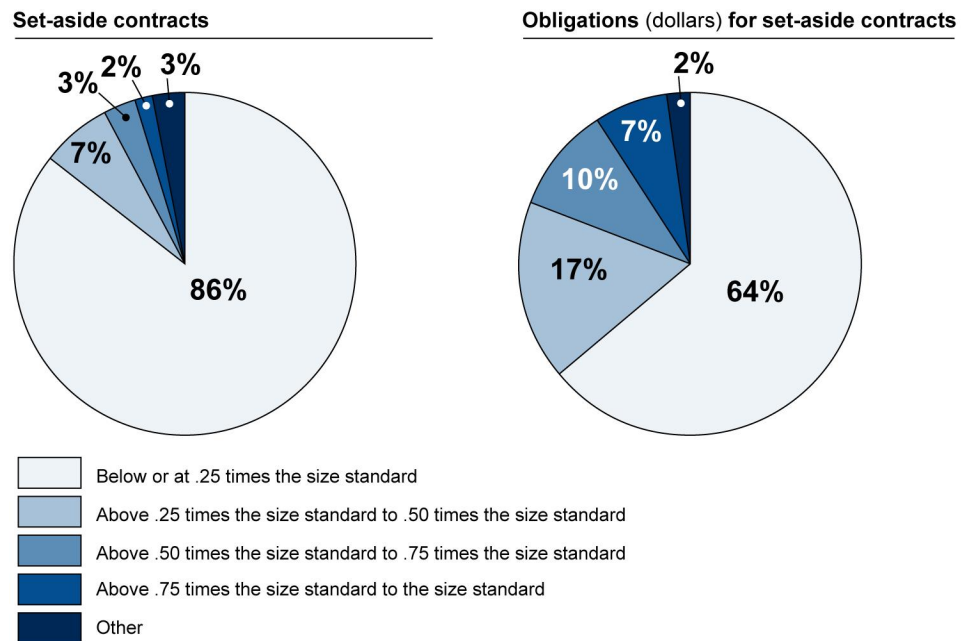
### Most Small Businesses Awarded Set-Aside Contracts in 2017 Were Well Below SBA Size Standards

Most small businesses awarded set-aside contracts in fiscal year 2017 did not appear poised to outgrow their size standard.<sup>27</sup> According to FPDS-NG data, about 86 percent of the 121,604 set-aside contracts awarded in that year were to small businesses with revenue or employees at or below 25 percent of the size standard for their industry (see fig. 2). These businesses received about 64 percent of the dollar obligations for set-aside contracts in fiscal year 2017. The small businesses closest to their SBA standards (above 75 percent of the size standard) were awarded about 2 percent of the set-aside contracts and about 7 percent of the contract dollar obligations in fiscal year 2017. We performed the same analysis for fiscal years 2013–2016, and the results across the four quartiles were generally the same throughout the time period.

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<sup>27</sup>In fiscal year 2017, FPDS-NG data showed that about 27 percent of the more than 450,000 contracts awarded were small business set-asides, and set-aside contracts made up about 41 percent of the almost 295,000 contracts awarded to small businesses.

**Figure 2: Percentage of Set-Aside Contracts and Contract Obligations Awarded to Small Businesses in Fiscal Year 2017, by Quartile of Size Standard**



Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Note: Other includes contracts awarded to small businesses for which we did not have size information or for which the size information was zero or inconsistently coded. Percentages may not sum to 100 due to rounding.

## A Very Small Percentage of Small Businesses Awarded Set-Aside Contracts in Fiscal Year 2008 Grew to Mid-Sized by 2013 and Continued to Obtain Contracts

Based on our review, a very small percentage of the small businesses that were awarded set-aside contracts in fiscal year 2008 grew to mid-sized in subsequent years and continued to receive any type of contract.<sup>28</sup> As shown in table 1, more than 93 percent of the businesses that were awarded only set-aside contracts in fiscal year 2008 and received any federal contract (including a set-aside or competed contract)

<sup>28</sup>In fiscal year 2008, more than 24,000 businesses were awarded only set-aside contracts.



in fiscal year 2017 remained small. About 2.5 percent of such businesses had become mid-sized by fiscal year 2017.<sup>29</sup>

**Table 1: Number and Percentage of Businesses Awarded Small Business Set-Aside Contracts in Fiscal Year 2008 and Any Type of Contract in Fiscal Year 2017, by Size in 2017**

Size category in fiscal year 2017	Number of businesses	Percentage
Small	3,465	93.4
Mid-sized	92	2.5
Large	41	1.1
Size varied	110	3.0

Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Note: Small businesses were those with revenue or employees at or below the Small Business Administration size standard for their industry. We considered businesses with revenue or employees that were up to five times above the size standard as mid-sized and more than five times the size standard as large. The size of some businesses varied based on the contract because businesses can submit solicitations under several North American Industry Classification System (NAICS) codes and a business may be considered small under one NAICS code but not under another.

In addition, we analyzed the extent to which small businesses that grew to be mid-sized in 2013 continued to receive any type of contract in fiscal years 2014–2017.<sup>30</sup> Of the 5,339 small businesses awarded only set-aside contracts in fiscal year 2008 and awarded any sort of federal contract in fiscal year 2013, 104 grew to mid-sized by fiscal year 2013.<sup>31</sup> Of those 104 mid-sized businesses, 23 remained mid-sized in subsequent years and were awarded 75 contracts, and three grew to

<sup>29</sup>We analyzed the 92 mid-sized businesses by industry sector in fiscal year 2017. The dominant industries were manufacturing and professional, scientific, and technical services. See appendix II for additional information on contracts awarded to small, mid-sized, and large businesses.

<sup>30</sup>For more research on mid-sized businesses, see Trevor L. Brown and Amanda M. Girth, “Examining the Effects of Set-Aside Policies on Competition and Growth for Small and Mid-Sized Suppliers,” paper included in the Proceedings of the Fourteenth Annual Acquisition Research Symposium (Monterey, California: Mar. 31, 2017). The study tracked the performance of more than 700 small businesses over a 10-year period (fiscal years 2005–2014) to determine whether there was a difference between firms that remained small throughout the 10-year period and those that became mid-sized.

<sup>31</sup>Because there is no statutory or regulatory definition of a mid-sized or large business, we applied a number of multipliers to determine size. Businesses with revenues or employees at or below the size standards were small. We considered businesses with revenue or employees up to five times above the size standard as mid-sized businesses. We considered businesses with revenue or employees more than five times the size standard as large businesses.

large and were awarded six contracts (see table 2). Seventeen of the 104 mid-sized businesses became small again. Thirty-seven of the 104 mid-sized businesses were awarded 306 contracts and were categorized as small, mid-sized, or large depending on the NAICS code listed in the contract. That is, businesses can be awarded contracts under several NAICS codes, each with a different size standard. Of the 24 mid-sized businesses not awarded any contracts in 2014–2017, nine were no longer registered in the System for Award Management, a central registration system for federal contractors.

**Table 2: Extent to Which the 104 Businesses Awarded Small Business Set-Aside Contracts in Fiscal Year 2008 and That Grew to Mid-Sized by Fiscal Year 2013 Later Received Any Contract in Fiscal Years 2014–2017, by Size**

<b>Business size in fiscal years 2014–2017</b>	<b>Number of businesses</b>	<b>Number of contracts (fiscal years 2014–2017)</b>	<b>Average number of contracts per business (fiscal years 2014–2017)</b>
Small	17	51	3
Mid-sized	23	75	3
Large	3	6	2
Size varied			
Mid-sized/large	5	34	7
Small/large	1	4	4
Small/mid-sized	28	204	7
Small/mid-sized/large	3	64	21
Did not receive any contracts	24	0	0
<b>Total</b>	<b>104</b>	<b>438</b>	<b>4</b>

Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Note: The 104 businesses in this table were awarded only small business set-aside contracts in fiscal year 2008 and any sort of federal contract in fiscal year 2013 and were determined to be mid-sized in fiscal year 2013. Small businesses were those with revenue or employees at or below the Small Business Administration size standard for their industry. We considered businesses with revenue or employees up to five times above the size standard as mid-sized and more than five times the size standard as large. The size of some businesses varied depending on the contract because businesses can submit solicitations under several North American Industry Classification System (NAICS) codes and a business may be considered small under one NAICS code but not under another.

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## Mid-Sized Businesses Can Provide Services and Goods on Contracts Set Aside for Small Businesses under Certain Circumstances

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### Businesses Can Keep Contracts If They Exceed Size Standards during the Life of a Set-Aside Contract

Federal regulations generally allow a small business with a contract to continue performing under its contract if it outgrows the size standard that it met in its initial offer. If a business qualified as small and was awarded a single-award contract under a small business set-aside, it generally would be considered small for contracting purposes for the life of that contract. The business can continue providing the service or product. Additionally, the agency can continue counting the contract towards its small business goals unless the business is required to recertify, whether through a regulatory or contractual requirement, and in doing so is deemed other than small.<sup>32</sup> Once the contract ends, the follow-on or renewal contract is a new contract; size is determined as of the date the business bids on the new contract.

The regulations are applied similarly to multiple-award contracts. Some multiple-award contracts are set aside for small businesses only. If a business qualified as small at the time of its initial offer, it is generally small for each order issued against the contract for the life of the contract even if it outgrows the size standard. Multiple-award contract orders awarded to businesses that have grown to be other than small during the course of the set-aside contract generally still may be counted toward agency small business goals. They would not be counted if the contractor

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<sup>32</sup>An agency official stated that when a contractor recertifies in the System for Award Management, the company's size standard changes to other than small business, and if an order is issued after the recertification in the system, the agency does not receive small business credit for the order issued.

were required to recertify, whether by a regulatory or contractual requirement, and in doing so was deemed other than small.<sup>33</sup>

There are a few instances in which a business must recertify its size status after its initial offer. In the case of an awarded multiple-award, set-aside contract, this would make the concern ineligible for the placement of orders or exercise of options. For example:

- SBA has stated that mergers and acquisitions create an exception to the general rule that a firm's size and status is determined at the time of the initial award. Generally, if a business becomes other than small pursuant to a merger or acquisition after its initial offer, the business must recertify its size.
- Certain requirements for recertification become effective just before the end of the fifth year on a multiple-award contract. A multiple-award contract that runs for more than 5 years, including options, requires each business to recertify size within 120 days before the end of the fifth year and 120 days before exercising options thereafter. The determination of small or other than small is based on the size standard at the time of the recertification. Size determinations are not permanent; a business can recertify later as small if it meets the size standard.
- A contracting officer may require a business to recertify its size status in response to a solicitation for an order. An SBA recertification determination is based on the size as of the date the business submits its response to the order.

The rules are different for agreements, including blanket purchase agreements.<sup>34</sup> A blanket purchase agreement is a simplified method of

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<sup>33</sup>In SBA's 2006 recertification final rule, the agency states in the preamble that contractors with a long-term or multiple-award contract that grow to other than small would not be ineligible to receive further orders. Rather, the procuring agency who knows of the growth could not count those orders toward the fulfillment of the small business goal. The final rule does not prohibit a contracting officer from exercising an option, even where a firm has outgrown the small business size standard on a small business set-aside contract, but it also does not require a contracting officer to do so. As such, if a procuring agency exercised an option with a contractor that has grown to be other than small, subsequent orders would not count toward the procuring agency's small business prime contracting goal. *Small Business Size Regulations; Size for Purposes of Government-Wide Acquisition Contracts, Multiple Award Schedule Contracts and Other Long-Term Contracts; 8(a) Business Development/Small Disadvantaged Business; Business Status Determinations*, 71 Fed. Reg. 66434 (Nov. 15, 2006).

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filling anticipated repetitive needs for supplies or services that functions as a “charge account” with qualified sources of supply. Where the agreement is a set-aside or a reserve award to any type of small business, a business must qualify as small both at the time of the offer and at the time of the order to be considered for the order. The agency may count the business toward its small business goal if the business is small at the time of the order.

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## Businesses That Form Joint Ventures under SBA Mentor-Protégé Programs Generally Can Access Set-Aside Contracts

Both SBA’s 8(a) and All Small Mentor-Protégé programs allow the mentor (including those that are mid-sized businesses) and the protégé to form a joint venture and bid on set-aside contracts based on the protégé’s status as a small business.<sup>35</sup> Once a protégé no longer qualifies as small, the mentor-protégé joint venture will no longer be eligible to bid for new small business set-asides. But, a change in protégé size generally does not affect contracts previously awarded to a joint venture between the protégé and the mentor.<sup>36</sup>

The mentor-protégé joint venture may seek any small business contract for which the protégé would qualify. Therefore, the size of the mentor generally does not affect whether a mentor-protégé joint venture can bid for a small business contract. According to SBA officials, the agency does not track the size of mentors. As of September 2018, there were 106 joint

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<sup>34</sup>Other types include basic agreements and basic ordering agreements. These agreements are not contracts. SBA’s regulations do not apply to blanket purchase agreements issued against a General Services Administration Schedule Contract.

<sup>35</sup>Small and large businesses also can be mentors, but our focus is on instances in which mid-sized businesses can perform work on contracts set aside for small businesses. Businesses can enter into joint ventures outside of SBA’s mentor-protégé programs, but such joint ventures only can bid on contracts set aside for small businesses if both businesses are small. Mentor-protégé joint ventures must be registered in the System for Award Management.

<sup>36</sup>Additionally, for 8(a) mentor-protégé joint ventures, once the protégé graduates from or otherwise leaves the 8(a) program, the joint venture is no longer eligible to bid for 8(a) set-asides. Furthermore, if an 8(a) protégé graduates from the program, the mentor-protégé relationship is transferred to a small business mentor-protégé relationship. 13 C.F.R. § 124.520(d)(1)(iii).

ventures formed under the All Small Mentor-Protégé program and 171 joint ventures under the 8(a) Mentor-Protégé program (see table 3).

**Table 3: Number of Agreements and Joint Ventures under SBA’s All Small and 8(a) Mentor-Protégé Programs**

Program	Number of agreements as of July 2018	Number of joint ventures as of September 2018
All Small Mentor-Protégé	549	106
8(a) Mentor-Protégé	471	171

Source: GAO analysis of Small Business Administration (SBA) data. | GAO-19-523

Note: A mentor-protégé agreement contains an assessment of the protégé’s needs and provides a detailed description and timeline for the delivery of the assistance the mentor commits to provide to address those needs. 13 C.F.R. § 124.520(e); 13 C.F.R. § 125.9(e).

We analyzed FPDS-NG and SBA data to determine the size of the mentors participating in joint ventures under SBA’s All Small Program that were awarded set-aside contracts in fiscal years 2016–2018. Of the 29 joint ventures awarded set-aside contracts during these years, 13 of the 26 mentors were mid-sized businesses.<sup>37</sup>

<sup>37</sup>The number of mentors does not match the number of joint ventures because two mentors were awarded contracts under multiple joint ventures. As noted previously, we considered businesses with revenue or employees up to five times above the SBA small size standard to be mid-sized businesses. We were not able to complete a similar analysis for joint ventures formed under SBA’s 8(a) mentor-protégé program because SBA does not maintain identifiers (Data Universal Numbering System numbers) for mentors in this program. The identifier number is required to determine the size of the mentor.

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## Options Proposed by Stakeholders for Assisting Mid-Sized Businesses Vary in Terms of Their Potential Benefits and Involve Tradeoffs

We reviewed options proposed in literature to enhance contracting opportunities for mid-sized businesses and asked stakeholders for their perspectives on potential benefits and drawbacks.<sup>38</sup>

Some options for increasing federal contracting opportunities for mid-sized businesses identified in our literature review would help mid-sized businesses more than others, according to stakeholders. They noted that establishing a set-aside for mid-sized businesses—the option designed to help mid-sized businesses most directly—also would pose challenges for small businesses and agencies. In contrast, some options primarily would help small businesses that were growing (revenue or employees approaching the size standards). This, in turn, could offset any of the advantages that mid-sized businesses would derive. For instance, benefiting small businesses could increase competition and result in fewer awards to mid-sized businesses.

As shown in table 4, we grouped the options into four categories: (1) establishing a set-aside for mid-sized businesses, (2) modifying the rules for multiple-award contracts, (3) changing how past performance is considered when evaluating bid proposals, and (4) modifying SBA's size standards.

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<sup>38</sup>We identified proposed options by reviewing literature on mid-sized businesses in federal contracting. (The definition of mid-sized businesses we developed for the analysis in the first two sections of this report does not apply in this section. In this section, we discuss mid-sized businesses in general.) The options we identified are not exhaustive; they are intended to be illustrative of potential types of approaches to enhancing contracting opportunities for mid-sized businesses. To obtain views on strengths and limitations of the options, we interviewed representatives from a nongeneralizable sample of 11 stakeholders in three categories: five trade associations for small and mid-sized businesses engaged in federal contracting, three researchers who published on mid-sized businesses in federal contracting, and OSDDBU directors at three federal agencies with large obligations for small business contracts in fiscal year 2017. To characterize the number of stakeholders offering the same opinion, we used “nearly all” for nine or 10 stakeholders, “most” for seven or eight stakeholders, “more than half” for six, “several” for four or five, and “some” for three. We also interviewed SBA officials to obtain their views. See appendix I for more information on our methodology.

**Table 4: Options Proposed in Literature to Increase Federal Contracting Opportunities for Mid-Sized Businesses**

Establish a separate set-aside	Modify rules for multiple-award contracts	Change how past performance is considered	Modify size standards
<ul style="list-style-type: none"> <li>Establish a set-aside for mid-sized businesses</li> </ul>	<ul style="list-style-type: none"> <li>Move small businesses that outgrow their size standard to the unrestricted version of the contract</li> </ul>	<ul style="list-style-type: none"> <li>Lower or eliminate quantitative requirements for past performance</li> <li>Consider past performance of individual businesses in team arrangements</li> <li>Require agencies to consider subcontracting past performance</li> </ul>	<ul style="list-style-type: none"> <li>Allow companies to use the lowest 3 of the last 5 years of revenue to determine small business status<sup>a</sup></li> <li>Allow companies to subtract research and development expenses from revenue to determine small business status</li> <li>Raise the current revenue-based size standards</li> </ul>

Source: GAO. | GAO-19-523

Note: We identified these proposed options by reviewing literature on mid-sized businesses in federal contracting. They do not constitute an exhaustive list, and are intended only to be illustrative of potential types of approaches to enhancing contracting opportunities for mid-sized businesses.

<sup>a</sup>In December 2018, the Small Business Runway Extension Act of 2018 (an amendment to the Small Business Act) extended the time during which the size of service contractors must be determined on the basis of annual gross receipts from a period of not less than 3 years to a period of not less than 5 years. SBA stated that the change would not take effect until SBA issued a regulation implementing it. *Small Business Size Standards: Revised Size Standard Methodology*, 84 Fed. Reg. 14587, 14588 (Apr. 11, 2019). In June 2019, SBA issued a proposed rule in response to the statutory amendment that would change the calculation of annual average receipts for all receipts-based SBA size standards and other agencies' proposed size standards for service-industry firms from a 3-year averaging period to a 5-year averaging period. *Small Business Size Standards: Calculation of Annual Average Receipts*, 84 Fed. Reg. 29399 (June 24, 2019). The proposed rule states that it applies the changes to all receipts-based size standards, and not just those applicable to the service industries with receipt-based standards as required by the law, to prevent confusion. 84 Fed. Reg. 29399, 29401.

## A Mid-Sized Set-Aside Could Increase Contracting Opportunities but Affect Other Businesses and Agencies

Several stakeholders told us that establishing a separate set-aside category for mid-sized businesses would increase contracting opportunities for mid-sized businesses, but others expressed concerns that the potential threat to small businesses and administrative burden on agencies might outweigh this benefit. Some literature suggests that when businesses outgrow their size standards they struggle to compete against much larger, established businesses for contracts.<sup>39</sup> Also, literature we

<sup>39</sup>Bloomberg Government, *The Mid-Tier Paradox: Too Small to Compete, Too Large to Survive?* (Washington, D.C.: 2016). Also see *No Man's Land: Middle-Market Challenges for Small Business Graduates* (Apr. 26, 2018); testimony of Stephen P. Ramaley on behalf of the Montgomery County Chamber of Commerce, and testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group.



reviewed suggested small business goals motivate agencies to set aside more and larger contracts for small businesses, resulting in a scarcity of smaller contract solicitations for mid-sized businesses.<sup>40</sup> Members of Congress have proposed establishing pilot programs that would help mid-sized businesses, either defined by business or contract size.<sup>41</sup>

Several stakeholders commented directly on separate set-asides and contracting opportunities for mid-sized businesses. An OSDDBU director noted former small businesses (those that outgrew their size standard) would benefit from an opportunity to compete with firms of similar size for prime contracts. However, some stakeholders believed the set-aside would not increase opportunities for mid-sized businesses. Specifically, one trade association executive noted that this option continues to shelter small businesses that become mid-sized businesses from competition with larger businesses. The stakeholder added that a set-aside would not address the ability of mid-sized businesses to compete against large businesses on an unrestricted basis. Another trade association executive said there still would be a need to help mid-sized firms develop expertise and encourage competition.

Some stakeholders believed the option would have a limited impact or was not necessary. Specifically, one trade association executive said that its members want a good path to growth for small businesses, not a set-aside. Another trade association executive similarly believed mid-sized businesses want to open up contract opportunities, not restrict them by creating more set-asides. One stakeholder also argued that the option could create incentives for large businesses to split their companies to fit new set-aside size standards.

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<sup>40</sup>See *The Mid-Tier Paradox: Too Small to Compete, Too Large To Survive?*; and *No Man's Land: Middle-Market Challenges for Small Business Graduates*, testimony of Eminence Griffin, Counsel and Director, Federal Procurement, Information Technology Alliance for Public Sector.

<sup>41</sup>For example, legislation proposed in 2011 would have created a pilot program in the General Services Administration in which contracting officers could have set aside unrestricted contracts for certain businesses with less than 1,500 employees, but it was not enacted. Small Business Growth Act, H.R. 1812, 112<sup>th</sup> Congress (2011). In 2012, a House bill included language that would have established a pilot program in the Department of Defense to assist "advanced small businesses." The provision was in the version of H.R. 4310 (2012) that became the National Defense Authorization Act for Fiscal Year 2013. The version that passed the Senate did not include the advanced small business pilot program. The Conference Committee report from December 18, 2012, states the two chambers agreed to the bill without the advanced small business pilot program. H.R. Rep. No 112-479, at 291 (2012).

Most stakeholders believed the set-aside for mid-sized businesses would take away opportunities from small businesses, with several noting that contracts that normally would be set aside for small businesses might be set aside for mid-sized businesses instead. SBA officials stated that a set-aside would have a negative effect on all small business programs and support the use of larger contracts, resulting in fewer contract awards to small businesses. However, one trade association representative said the set-aside could be structured so that small businesses still could compete for the mid-sized set-aside contracts. An OSDBU director told us contracting officers could limit the effect on small businesses by considering small businesses first, mid-sized businesses second, and large businesses last.<sup>42</sup> In this scenario, it would be large businesses that would be most affected by a set-aside for mid-sized businesses.

Stakeholders cited more limitations than benefits for agencies if this option were implemented. Most stakeholders told us a mid-sized business set-aside would increase agency burden, including additional time and cost to define and implement the new set-aside and additional tracking and reporting costs. SBA officials noted that it would create an additional burden for contracting officers and that further study would be needed before implementing a mid-sized set-aside. Some stakeholders also noted the potential burden on agencies of complying with additional contracting goals, with one OSDBU director saying that agencies do not have the resources to meet current small business contracting goals, let alone meet mid-sized contracting goals.<sup>43</sup> Another OSDBU director believed that mid-sized business set-asides likely would violate the World Trade Organization's Government Procurement Agreement because the United States negotiated exclusions for small businesses in the agreement, but not for mid-sized businesses. Some stakeholders believed it would be very difficult for agencies to define a mid-sized business. One OSDBU director told us that contracting officers would have to perform new market research for mid-sized set-asides and abide by a new layer of requirements. Several stakeholders questioned which agency actually would administer the new set-aside program.

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<sup>42</sup>The director further explained that the FAR gives small businesses priority over contracts competed under full and open competition when a contracting officer is deciding whether to set aside a contract. If contracting officers had to consider small businesses first, mid-sized businesses second, and large businesses or full and open last, the set-aside would not negatively affect small businesses.

<sup>43</sup>Several stakeholders assumed that annual goals for mid-sized business participation would be established if a set-aside were created for mid-sized businesses.

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Stakeholders identified a few benefits for agencies. Two stakeholders told us agencies could benefit from having a larger supplier base and more choices for services. One OSDBU director said agencies might benefit from retaining former small business contractors for a longer time, and a researcher said agencies might gain access to talent and value they might not get from large businesses.

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## Modifying Rules for Multiple-Award Contracts Could Help Mid-Sized Businesses

Stakeholders told us that allowing small businesses that grow beyond their size standards to move to the unrestricted version of multiple-award contracts could help mid-sized businesses. As discussed previously, multiple-award contracts can be unrestricted or restricted to small businesses or have separate tracks for small and nonsmall businesses (such as by using set-aside orders). This option proposes that small businesses on the restricted track of a multiple-award contract that outgrow the contract's small business size standard be moved to the unrestricted track.<sup>44</sup> This practice can be referred to as "on-ramping." According to the stakeholder proposing this option, if a small business contractor grew to mid-sized, but could not transition to the unrestricted track, all the effort the business put into winning the contract would be wasted simply because it grew.<sup>45</sup>

Some multiple-award contracts allow small businesses that outgrow the size standard to move to the unrestricted track of the multiple-award contract, but this is not always the case. Agencies have discretion when making this determination. If a business is allowed to move to the unrestricted track of such a contract, it would be able to place bids on additional orders resulting from the contract. In cases in which a business cannot move to the unrestricted track, it has to leave the contract after completing any ongoing orders. For example, the General Services Administration's One Acquisition Solution for Integrated Services allows

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<sup>44</sup>*No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group. Sanghani said that allowing small businesses that have outgrown their size standards to move to the unrestricted pool would encourage growth without penalty.

<sup>45</sup>*No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group.

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businesses that have outgrown their size standards to move to the unrestricted track, while EAGLE II does not.<sup>46</sup>

Most stakeholders we interviewed said this option could increase contracting opportunities for growing small or mid-sized businesses. An OSDBU director said the option would let businesses that grew to be mid-sized move to the unrestricted pool of the multiple-award contract so they could keep their existing contract. A researcher said the option gives more time for small and mid-sized businesses to prepare for full and open competition. But two stakeholders noted that mid-sized businesses already in the unrestricted pool may be negatively affected by increased competition from additional contractors placed in the pool for task orders.

Stakeholders offered differing opinions on how this option would affect agencies. Several stakeholders said that agencies would benefit from being able to retain contractors even if the contractors outgrew their size standard. For example, a trade association executive said it would be less disruptive for the agency if the business could continue its contract. Two stakeholders thought that moving a business to the unrestricted pool would reduce agency time and paperwork (compared to re-competing the contract and performing additional evaluations). However, several stakeholders told us that allowing small businesses that grew beyond the size standards to “on-ramp” might increase administrative burden on agencies. For example, it might take longer for an agency to evaluate proposals for unrestricted task order competitions if the pool of competitors grew. SBA officials expressed concern that if task order competitions grew too large, businesses in the unrestricted pool that objected to the increased competition from new contractors might pursue litigation.

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### Changing Past Performance Requirements Could Increase Contracting Opportunities for Mid-Sized and Small Businesses but May Increase Risk for Agencies

Stakeholders told us that changing past performance requirements could increase prime contracting opportunities for mid-sized and small businesses, but might increase risk for agencies. Some of the literature

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<sup>46</sup>One Acquisition Solution for Integrated Services is a multiple-award contract under which businesses, including small businesses, provide a variety of professional services, such as engineering and financial services.

we reviewed considered requirements based on the size or number of past contracts (“quantitative past performance requirements”) as a barrier to entry for mid-sized businesses.<sup>47</sup> Options have been proposed that would regulate what types of past performance contracting officers consider and how they establish solicitation requirements.

### Lower or Eliminate Quantitative Requirements for Past Performance

This option proposes lowering (for example, limiting their use or making their terms more flexible) or eliminating quantitative requirements for past performance.<sup>48</sup>

Nearly all the stakeholders we interviewed said that lowering quantitative requirements would increase contracting opportunities for mid-sized businesses, small businesses, or both. For example, one researcher said that mid-sized and small businesses would benefit because the barriers to entry on some large contracts would be lowered. Similarly, an OSDU director said that smaller mid-sized businesses and small businesses get shut out of contract competitions because they cannot meet the past performance requirements, and lower past performance requirements would give them a chance to compete. One trade association executive also pointed out that this option could help mid-sized and small businesses develop a performance record for future solicitations.

More than half of the stakeholders told us that eliminating quantitative past performance requirements entirely also would increase contracting opportunities for mid-sized businesses, small businesses, or both. Specifically, two stakeholders said eliminating these quantitative

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<sup>47</sup>*The Mid-Tier Paradox: Too Small to Compete, Too Large to Survive?* Also see *No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group. An example of a quantitative past performance requirement would be requiring offerors to submit five past prime contracts with a minimum combined annual obligated value of at least \$25 million.

<sup>48</sup>*The Mid-Tier Paradox: Too Small to Compete, Too Large to Survive?* The report says that current requirements hinder smaller mid-sized companies from bidding as prime vendors. Also see *No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group. Sanghani said that mid-sized firms struggle to compete against large firms based on size and number of past contracts but can compete on quality, value, and innovation. He said eliminating quantitative past performance requirements would allow small firms that grew to mid-sized to continue to compete for contracts.

requirements would enable mid-sized and small businesses without records of past performance to substantiate their qualifications in other non-quantitative ways.

Stakeholders noted trade-offs for agencies. Some stakeholders believed lowering past performance requirements would benefit agencies because more contractors would be eligible to bid. For example, one OSDDBU director said agencies might receive proposals from businesses that could not have met quantitative requirements but have enough expertise to submit a high-quality proposal. However, some stakeholders said lowering quantitative requirements may increase agency burden, citing a longer evaluation period due to a larger pool of bidders. More than half of the stakeholders said eliminating requirements entirely would increase the burden on agencies, for various reasons. One researcher said agencies might not have staff with the technical expertise to assess bids based on a strictly qualitative evaluation. Additionally, several stakeholders noted challenges for agencies in obtaining qualitative performance information using the Contractor Performance Assessment Rating System, citing rating subjectivity and verification difficulties.

Several stakeholders said lowering or eliminating quantitative requirements for past performance would increase the risk to the agency of awarding contracts to firms that cannot successfully complete the project. For example, one OSDDBU director pointed out that “conventional wisdom” for contracting officers is that a project’s success rate is higher when a company can meet higher past performance requirements. Another OSDDBU director said that qualitative forms of evaluation, such as testimony from another agency, are not sufficient and could put the agency’s project at risk for lack of an objective measure of a contractor’s capabilities. In contrast, the third OSDDBU director said that quantitative requirements do not lower the risk to the agency because completing a certain number of contracts is not a guarantee of satisfactory future performance.

#### Require Agencies to Consider Past Performance of Each Company in Team Arrangements

This option proposes that contracting agencies be required to consider the past performance of individual companies in team arrangements as opposed to evaluating only the aggregate past performance of

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contractors in team arrangements.<sup>49</sup> The literature suggested that requiring agencies to consider each team member's past performance would provide incentives to mid-sized businesses to work together to compete for contracts with past performance requirements that each would not be able to meet individually.<sup>50</sup> According to SBA officials, the Small Business Act already requires agencies to consider the past performance of each participant in a joint venture or team for bundled contracts and multiple-award contracts above a certain dollar threshold.<sup>51</sup> Also, agencies generally consider the relevant past performance information of individual members of a team arrangement in certain situations if they will perform major or critical aspects of the requirement. However, there are other situations—such as when the contract is not specifically for a small business but instead is bid on by a joint venture that includes a small business—in which agencies are not required to consider each team member's past performance.

Stakeholders identified some benefits to a more flexible consideration of past performance for mid-sized businesses. More than half of the stakeholders believed this option would increase contracting opportunities for mid-sized businesses. For example, a trade association executive said mid-sized businesses currently struggle to fulfill past performance requirements, and this would allow them to combine their past performance with another business to qualify for new and larger contract opportunities. However, some stakeholders noted that mid-sized companies probably have won prime contracts. Therefore, they already might have the requisite past performance to bid on a contract.

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<sup>49</sup>Currently, a solicitation could require teams to have past performance projects in the name of the existing joint venture, not the individual members. That is, if Company A, Company B, and Company C formed a joint venture called ABC Incorporated, only projects in the name of ABC Incorporated would be eligible past performance projects. Alternatively, a solicitation could allow the past performance projects of each joint venture partner to be submitted for the joint venture entity.

<sup>50</sup>*The Mid-Tier Paradox: Too Small to Compete, Too Large to Survive?* Also see *No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Eminence Griffin, Counsel and Director, Federal Procurement, Information Technology Alliance for Public Sector, and testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group.

<sup>51</sup>Contract bundling is consolidating two or more requirements for goods or services previously provided or performed under separate smaller contracts into a solicitation for a single contract that is likely to be unsuitable for award to a small business concern due to the diversity, size, or specialized nature of the elements of the performance specified; the aggregate dollar value of the anticipated award; the geographical dispersion of contract performance sites; or any combination of these factors. FAR § 2.101.

Nearly all the stakeholders we interviewed thought this option would increase contracting opportunities for growing small businesses because they would be able to team with a small or nonsmall business to bid on contracts for which they otherwise would not have the past performance to qualify. One researcher described a dilemma for small businesses: they cannot compete for contracts without past performance, but they cannot get past performance without winning contracts. SBA officials said that businesses prefer that the past performance of each member be considered instead of the past performance of the joint venture, which could be minimal, especially if it was a new joint venture.

Stakeholders identified trade-offs for agencies. More than half of stakeholders said considering past performance of both members in a team arrangement would benefit agencies because more contractors could meet requirements to bid. One OSD BU director said that this option also might allow agencies to benefit from the enhanced capacity and innovative solutions offered by mid-sized businesses. However, several stakeholders cautioned that this option could increase risk for an agency. For example, one trade association representative believed that because team arrangements are the companies' creation and the government has no involvement in administering them, there is more risk to the agency that the contracting team might not be able to complete the contract.

### Consider Subcontracting Past Performance in Contract Evaluation

This option proposes that agencies should consider subcontracting past performance when evaluating bid proposals. It has been suggested that this could be done in two ways. First, agencies could be required to consider a business's past performance as a subcontractor—a route for many small businesses to gain access to federal contracts—when competing for prime contracts. Second, agencies could be required to count the past experience of both the prime contractor and its significant subcontractors towards a solicitation's past performance requirements.<sup>52</sup>

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<sup>52</sup>*No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Mehul Sanghani, Chief Executive Officer, Octo Consulting Group. Sanghani said that considering only prime past performance places growing small and mid-sized businesses at a disadvantage when competing for contracts. A subcontractor is any supplier, distributor, vendor, or firm that furnishes supplies or services to or for a prime contractor or another subcontractor. FAR § 44.101.



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Stakeholders had differing opinions on whether this option would help mid-sized businesses. Several stakeholders believed that allowing mid-sized businesses to leverage their subcontracting experience to meet requirements would increase contracting opportunities for these firms. Furthermore, one researcher thought mid-sized businesses could secure more subcontracting opportunities because large firms might be more willing to team with them. However, some stakeholders believed this option would not increase contracting opportunities for mid-sized businesses, with two stating that this option is less important for them because they likely outgrew their size standard by winning set-aside prime contracts. An OSDDBU director thought it also might increase competition from smaller firms.

Nearly all of the stakeholders we interviewed said this option could increase prime contracting opportunities for growing small businesses. For example, one OSDDBU director said that considering subcontracting as past performance would help small businesses compete for prime contracts, grow, and move forward. A researcher noted this could help small businesses transition to mid-sized. SBA officials similarly stated that small businesses want agencies to consider their subcontracting past performance so they can access contracts for which they would not normally qualify. In May 2019, SBA officials said they were working on implementing legislation that requires SBA to create a pilot program to provide past performance ratings for small business subcontractors.<sup>53</sup>

Similar to previous options, stakeholders contrasted the benefits and drawbacks of increased competition for agencies. Several stakeholders thought this option would expand the pool of bidders, making contracts more competitive and bringing more value to agencies. However, four stakeholders noted that verifying prime and subcontracting experience could create more work for agencies. Specifically, two of the four noted that it could be difficult for agencies to determine subcontracting past

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<sup>53</sup>The National Defense Authorization Act for Fiscal Year 2017 included a provision that requires SBA to create a pilot program to establish past performance ratings for small business subcontractors. Pub. L. No. 114-328, § 1822, 130 Stat. 2000, 2654-2656 (2016) (codified at 15 U.S.C. § 637(d)(17)). The program will permit small businesses without a past performance rating as a prime contractor to request a rating for work done as a subcontractor if the small business is a first-tier subcontractor under certain contracts. The provision also stipulates the procedures under which the ratings are to be created. In April 2018, SBA stated that the pilot program will increase opportunity for small businesses to compete for federal contracts. See *Information Collection; Subcontractor Past Performance Pilot Program*, 83 Fed. Reg. 17583 (Apr. 20, 2018).

performance because the ratings in the Contractor Performance Assessment Rating System are tied to the prime contractors.

Some stakeholders also noted this option could increase the risk to agencies that projects would not be completed successfully. Specifically, because subcontracting agreements are between the subcontractor and prime contractor, and therefore are not enforceable by agencies, a prime contractor might not use a subcontractor whose past performance was considered during the evaluation process.<sup>54</sup> For example, a researcher pointed out that a prime contractor could use the subcontractor's experience to win a contract, but then not use the subcontractor for any of the work.

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## Modifying SBA's Size Standards Could Help Some Small Businesses Transition to Mid-Sized

Several stakeholders noted that modifying SBA's size standards would not help mid-sized businesses as such; rather, the modifications could allow a few mid-sized businesses to become eligible for small business set-aside contracts again and help growing small businesses prepare for the transition to mid-sized. It has been noted that agencies increasingly use large, multiple-award contracts that can cause small businesses to outgrow their size standard before they build the capacity (financial resources, business infrastructure, or past performance records) they need to successfully compete for contracts.<sup>55</sup> To address such issues, options have been proposed to modify SBA's size standards.

### Change the Calculation for Revenue-Based Size Standards

This option would change the number of years of revenue considered when applying revenue-based size standards. SBA would allow

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<sup>54</sup>In certain circumstances, SBA regulations require businesses to make a good-faith representation to the contracting officer to not use one company in the proposal and another in the actual work. Specifically, the business making the offer for the work must represent to the contracting officer that it will make a good-faith effort to obtain goods, services, materials, or the performance of construction work from the small business it used in preparing the bid or proposal. 13 C.F.R. § 125.3(c)(3).

<sup>55</sup>*No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Eminence Griffin, Counsel and Director, Federal Procurement, Information Technology Alliance for Public Sector, and testimony of Stephen P. Ramaley on behalf of the Montgomery County Chamber of Commerce.

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businesses to consider their past 5 years of revenue, pick the lowest 3 years in that period, and average them to determine if they met revenue-based size standards.<sup>56</sup> In a December 2018 amendment to the Small Business Act, Congress extended the number of years of revenue that service businesses use to calculate their size from 3 to 5 years but included no provision related to selecting lowest-revenue years.<sup>57</sup>

Stakeholders expressed reservations regarding this option for mid-sized businesses. Some stakeholders said that this option may not increase opportunities for mid-sized businesses because they already had outgrown their size standard. Several stakeholders also said the option offered only a temporary solution. One noted that this option would delay “graduation” from the size standard, but would not address the issue that mid-sized businesses need to continue to grow to secure additional federal contracts. An OSDBU director told us it is critical that small businesses develop and execute a marketing and business plan to transition from small to successful mid-size.

Nearly all the stakeholders we interviewed noted that allowing businesses to choose their lowest 3 years of revenue in a 5-year period could prevent an outlier revenue year from causing a small business to prematurely outgrow its size standard. For example, an OSDBU director said that a large, 1-year award is not indicative of a business’s revenue over the long term. Nearly all of stakeholders also said that enabling businesses to choose the lowest 3 years of revenue would help ease the transition to mid-sized. For instance, an OSDBU director said businesses could stay below the size standards for longer and establish a performance record to help secure future contracts.

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<sup>56</sup>*No Man’s Land: Middle-Market Challenges for Small Business Graduates*; testimony of Stephen P. Ramaley on behalf of the Montgomery County Chamber of Commerce. Ramaley said that using an average of the last 3 years of revenue did not account for a pattern of sudden growth that is increasingly common with the growing use of multiple-award contracts and that allowing businesses to choose their lowest 3 years of revenue in a 5-year period would give growing small businesses more time to adjust.

<sup>57</sup>Pub. L. No. 115-324 (2018). As described previously, in June 2019, SBA issued a proposed rule that would change the calculation of annual average receipts for all receipts-based SBA size standards and other agencies’ proposed size standards for service-industry firms from a 3-year averaging period to a 5-year averaging period. *Small Business Size Standards: Calculation of Annual Average Receipts*, 84 Fed. Reg. 29399 (June 24, 2019). A committee report accompanying the Small Business Runway Extension Act of 2018 stated that the purpose of the bill was to help advanced-small contractors successfully navigate the middle market as they reach the upper limits of their small size standard. H.R. Rep. No. 115-939 (2018).

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However, several stakeholders expressed concern that very small businesses might lose contracting opportunities due to increased competition (that is, more and larger-sized firms would remain under the size standards). Finally, SBA officials pointed out that this option could be perceived as unfair because it would not benefit businesses in industries with employee-based size standards.

### Subtract Research and Development Expenses

This option proposes that businesses be able to subtract research and development expenses from their total revenue when calculating their eligibility for small business status. The stakeholder proposing this option said that businesses close to the size standard have to focus their revenue on pursuing contracts that will support their company as they transition to full and open competition, and so cannot spare money to further invest in researching and developing new products or processes that might improve their business.<sup>58</sup> In addition to encouraging more investment in research and development, subtracting these expenses would lower revenue and allow some mid-sized businesses to be classified as small again.

One researcher told us this was a strong option for mid-sized businesses, particularly information technology businesses, because research and development investment is such a large part of their expenses. However, some stakeholders said this option would not increase contracting opportunities for mid-sized businesses. For example, one OSBDU director believed this option would not benefit mid-sized businesses because it did not help these businesses to compete with larger businesses.

More than half of the stakeholders we interviewed said that this option might encourage small businesses to invest in research and development. However, several stakeholders noted that this option only would help the small percentage of small businesses that perform research and development. SBA officials pointed out that this option could be perceived as unfair because not all businesses have research and development expenses. They also pointed out that modifying revenue calculations would not benefit manufacturing businesses, which invest

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<sup>58</sup>*No Man's Land: Middle-Market Challenges for Small Business Graduates*; testimony of Stephen P. Ramaley on behalf of the Montgomery County Chamber of Commerce.

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more in research and development than other sectors but primarily use employee-based size standards.

Stakeholders also noted potential trade-offs for agencies. Several stakeholders told us this option would benefit the government by encouraging investment in research and development with one stakeholder stating that it might result in higher-quality bids. However, several stakeholders and SBA officials also told us that allowing small businesses to subtract research and development expenses would increase the administrative burden on agencies or add too much complexity. For example, two OSDBU directors said it would be difficult for an agency to verify that research and development expenses were correctly claimed and subtracted from revenue. SBA officials noted that there were no industry-by-industry data on research and development expenses. Some stakeholders observed this option could lead to an increase in fraud or manipulation, with one trade association executive saying the option would not increase innovation, just claimed expenses.

### Raise Revenue-Based Size Standards

This option proposes increasing SBA's revenue-based size standards. The trade association representative who proposed the option believed that small business size standards should be raised so that high revenue-generating small businesses that still are not dominant in their field would not be shut out of set-asides.<sup>59</sup>

Increasing revenue-based size standards would benefit some mid-sized businesses by making them eligible again for small business set-asides. However, more than half of the stakeholders told us the option would have a limited impact—it would apply only to the mid-sized businesses small enough to fall under the newly raised standard—or no impact at all (for most other mid-sized businesses). To illustrate the limited impact, one OSDBU director used the example of management consulting services (NAICS 541611), which has a size standard of \$15 million (revenue). If the standard were increased to \$17 million, it might not affect many businesses. Rather, it would help only the \$16 million company to compete for set-asides again, the director said. Furthermore, one

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<sup>59</sup>*Professional Services: Proposed Changes to the Small Business Size Standards*, House Committee on Small Business, Subcommittee on Economic Growth, Capital Access, and Tax, 112<sup>th</sup> Cong. (May 5, 2011); testimony of Roger Jordan, Vice President of Government Relations, Professional Services Council.

researcher said that the increase would not address the systemic disadvantage that mid-sized businesses face in competing with large businesses.

Stakeholders identified tradeoffs for small businesses related to this option. Nearly all stakeholders said that raising revenue-based size standards could help growing small businesses better prepare to transition to mid-sized while remaining eligible for set-asides. One OSDBU director said small businesses could add to their performance record and have more time to become competitive with larger businesses. One researcher said that small businesses could get additional time to diversify contract portfolios and fund professional certifications. However, some stakeholders cautioned the option could harm very small businesses because as one stakeholder explained, there would be more competitors for small business set-asides. As noted previously, we found that most small businesses awarded set-aside contracts in 2017 were well below the size standards.

Stakeholders also identified trade-offs for federal agencies. Several stakeholders said agencies would benefit from the increased competition. For example, one OSDBU director said agencies might have more bidders, which could lower pricing. Some stakeholders said the option could help agencies reach small business goals more easily because more businesses would be considered small. However, a stakeholder advised that agencies also might need more time and resources to evaluate an increased number of bids.

SBA officials explained to us that they comprehensively review all the size standards every 5 years, looking at factors, such as industry trends and small business market share. They contended that if contracts became larger to the detriment of small businesses, small businesses then would have a decreased market share. If small businesses were losing market share, that would be captured by the SBA size standard methodology and the size standards would be adjusted accordingly. They also noted that revenue-based size standards were getting higher and higher as a result of adjustments during SBA's reviews and adjustments for inflation and that further increases might allow firms that were dominant in their industry to be small, which is contrary to statute. Finally, they stated that just raising size standards without taking into account industry structure and market conditions would enable more experienced businesses to qualify as small and hurt small businesses that need federal assistance the most, especially in competing for set-aside contracts.

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## Agency Comments and Our Evaluation

We provided a draft of this report to the Department of Homeland Security, Department of Defense, General Services Administration, and SBA for their review and comment. The Department of Homeland Security provided technical comments, which we incorporated where appropriate. In emails, the OSBDU director at the Department of Defense and an audit liaison at the General Services Administration stated that the agencies did not have any comments.

SBA provided technical comments in an email from the GAO Liaison, which we incorporated as appropriate. We considered a number of these comments to be more than technical in nature and therefore, summarize them here:

- SBA offered new views on three specific options for increasing federal contracting opportunities for mid-sized businesses presented in the report, which we incorporated where appropriate. SBA also made the larger point that they believe any option to help mid-sized businesses would hurt small businesses. In discussing the various options in the report, we present the views of various stakeholders and SBA on how the options would affect small businesses.
- SBA stated that we created our own methodology for determining a mid-sized business by multiplying the current size standards and that a formal study should be performed to establish a baseline definition of a mid-sized business. Our goal was not to establish a baseline definition of a mid-sized business. As we note in the report, there is no statutory or regulatory definition of a mid-sized or large business.<sup>60</sup> We applied multipliers to SBA's size standards only for the purposes of our analysis—specifically, to identify businesses that had outgrown small business size standards and continued to receive federal contracts.
- SBA stated that we multiplied size standards by a factor of five to define mid-sized businesses in all industries and cited analysis that it had done that indicated that more than 95 percent of businesses are at or below SBA's size standards. The agency concluded that this means that in some industries, almost all firms would be considered mid-sized under our definition of mid-sized. However, only those firms

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<sup>60</sup>Under federal procurement law, businesses are either "small" or "other than small."

with revenue or employees up to five times above the SBA small size standard would be considered mid-sized in our analysis. We counted any businesses with revenue or employees at or below the small size standard as small.

- SBA stated that considering a factor of two or three times the SBA size standards to identify mid-sized businesses would improve our results. We considered a number of different factors when developing our methodology. As noted in the report, we used five times the small size standard to distinguish between mid-sized and large businesses based on the distribution of contracts and obligations among businesses in these two groups.
- SBA stated that (1) the report should explain the basis and method for selecting the sample of 5,339 businesses awarded set-aside contracts in 2008 and (2) a sample of 104 out of 5,339 firms over that period of time was too small to be generalizeable. The 5,339 businesses awarded set-aside contracts in 2008 and awarded any sort of federal contract in 2013 were not a sample; rather, they were all the businesses that met these criteria. Therefore, we did not generalize to the population based on a sample. Our analysis showed that only 104 of these 5,339 businesses grew to mid-sized by 2013.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Secretary of Defense, the Acting Secretary of Homeland Security, the Administrator of the General Services Administration, and the Acting Administrator of SBA. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff members have any questions about this report, please contact William B. Shear at (202) 512-8678 or [shearw@gao.gov](mailto:shearw@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Major contributors to this report are listed in appendix III.



William B. Shear  
Director, Financial Markets and  
Community Investment



# Appendix I: Objectives, Scope, and Methodology

This report analyzes (1) the extent to which small businesses grew to be mid-sized and continued to receive federal contracts; (2) instances in which mid-sized businesses can perform work on contracts set aside for small businesses; and (3) options for increasing federal contracting opportunities for mid-sized businesses and views on the strengths and limitations of the options. We present information on contracts awarded to small, mid-sized, and large businesses in fiscal year 2017 in appendix II.

For the first objective, we analyzed data from the Federal Procurement Data System-Next Generation (FPDS-NG) for fiscal years 2008 through 2017 (the most recent complete data available when we began our review).<sup>1</sup> For a consistent set of data across the 10-year period, we selected all contracts awarded above the micro-purchase threshold.<sup>2</sup> To determine the relevant contract size standard, we matched the size standards data from the Small Business Administration (SBA) to the contract awards data from FPDS-NG based on the year of award and the contract's North American Industry Classification System (NAICS) code.<sup>3</sup> We then compared the businesses' annual revenue or number of employees to SBA size standards. We assessed the reliability of the FPDS-NG data we used by performing electronic testing of selected data elements and reviewing existing information about FPDS-NG and the data the system produces. We determined that these data were sufficiently reliable for the purposes of determining the extent to which small businesses that grew into mid-sized businesses continued to

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<sup>1</sup>FPDS-NG is the General Services Administration system used to collect and report data on federal procurements. FPDS-NG records whether contracts have been awarded to small businesses.

<sup>2</sup>The micro-purchase threshold generally ranged from \$2,500 in 2008 to \$3,500 in 2017. From this population, we excluded contracts coded under any of the generic Data Universal Numbering System numbers because they do not refer to a unique business.

<sup>3</sup>SBA's size standards vary by industry and are generally expressed as the number of employees or amount of revenue. We excluded any contracts awarded under NAICS codes without size standards or under NAICS codes with size standards other than revenue or number of employees.

receive federal contracts and the size of businesses awarded contracts during a specific time period.

To determine the extent to which contracts were set aside for small businesses, we calculated the percentage of new contracts awarded in fiscal year 2017 that were small business set-asides. To determine the size of the small businesses awarded these set-aside contracts, we divided SBA's size standards into four segments for each NAICS code—below or at one-fourth of the size standard, above one-fourth to one-half of the size standard, above one-half to three-fourths of the size standard, and above three-fourths of the size standard—and determined the number and obligations of set-aside contracts awarded to small businesses in each quartile for fiscal year 2017.<sup>4</sup> We completed this same analysis for fiscal years 2013 through 2016 to see if the results were similar.

To determine the extent to which small businesses grew to be mid-sized and continued to receive federal contracts, we used FPDS-NG data from fiscal years 2008 through 2017. Because there is no statutory or regulatory definition of a mid-sized or large business, we applied a number of multipliers to determine size. Businesses with revenues or employees at or below the SBA small size standards were small. We considered businesses with revenue or employees up to five times above the SBA size standard as mid-sized businesses. We considered businesses with revenue or employees more than five times the size standard as large businesses.<sup>5</sup> We used five times the small size standard to distinguish between mid-sized and large businesses based on the distribution of contracts and obligations among businesses in these two groups. We discussed this approach and methodology with SBA officials and officials at three federal agencies that had large obligations for small business contracts in fiscal year 2017. These officials

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<sup>4</sup>For example, for a NAICS code with a revenue-based size standard of \$27.5 million, one-fourth of the standard is \$6.9 million, one-half is \$13.8 million, and three-fourths is \$20.6 million. The small businesses with revenue of more than three-fourths of the size standard would be the closest to the size standard, while the smallest would be those with revenue below one-fourth of the size standard.

<sup>5</sup>For example, in an industry with a revenue-based size standard of \$15 million, those businesses with revenue below or at \$15 million would be small, those with revenue more than \$15 million but less than \$75 million would be mid-sized, and those with revenue of \$75 million or more would be large.

did not raise any questions about our approach, and some reiterated that there was no legal definition of mid-sized businesses.

Using these definitions, we selected businesses awarded only small business set-aside contracts in fiscal year 2008 and determined whether these businesses also were awarded any type of federal contract in fiscal year 2017 and if they were in the same or different size category in fiscal year 2017. We then determined the number of businesses awarded set-aside contracts in fiscal year 2008 and awarded any sort of federal contract in 2013 that had become mid-sized in fiscal year 2013 and the extent to which those businesses were awarded any contracts in subsequent years.

We also determined the percentage of competed contracts awarded to small, mid-sized, and large businesses in fiscal year 2017. For purposes of this report, competed contracts are those competed using (1) full and open competition, (2) full and open competition after exclusion of sources, and (3) simplified acquisition procedures.<sup>6</sup> To determine the industry sectors with the largest number of set-aside and competed contracts in fiscal year 2017, we collected and analyzed FPDS data for each of the two-digit NAICS industry sectors.<sup>7</sup> See appendix II for more information.

For our second objective, we reviewed the Federal Acquisition Regulation and small business laws and regulations to identify provisions that allow small businesses that grow into mid-sized businesses to continue providing services and goods on contracts set aside for small businesses. We reviewed SBA documentation related to its 8(a) and All Small Mentor-Protégé programs because forming joint ventures with small businesses

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<sup>6</sup>Under certain circumstances, agencies may exclude a particular source from a contract action to establish or maintain an alternative source or sources for supplies or services being acquired. For instance, agencies may exclude a source if doing so would increase or maintain competition and likely result in reduced overall costs for the acquisition. Generally, agencies must use simplified acquisition procedures to the maximum extent practicable for all purchases of supplies or services not exceeding the simplified acquisition threshold. The simplified acquisition threshold is set in statute at \$250,000 as of December 2017. National Defense Authorization Act of Fiscal Year 2018, Pub. L. No. 115-91, § 805, 131 Stat. 1283, 1456 (2017) (codified at 41 U.S.C. § 134). However, the Federal Acquisition Regulation (FAR) has not been updated to adopt the new amount, and as of June 2019 generally retains the prior \$150,000 standard. FAR § 2.101.

<sup>7</sup>Small business set-aside contracts include contracts competed among small businesses and sole source contracts. Sole source acquisition means a contract for the purchase of supplies or services that is entered into or proposed to be entered into by an agency after soliciting and negotiating with only one source. FAR § 2.101.

under these programs is one way that mid-sized businesses can provide services and goods under set-aside contracts. We analyzed lists from SBA of the businesses that entered into mentor-protégé agreements as of July 2018 and the mentor-protégé agreements that had formed joint ventures as of September 2018.

Using FPDS-NG data, we determined the number of joint ventures formed under the All Small Mentor-Protégé program that had been awarded set-aside contracts from fiscal years 2016 through 2018. We began with 2016 to allow time after the program was created in 2013 for businesses to enter into agreements and form joint ventures. We ended with 2018 because it was the most recent complete year of data available when we conducted this analysis. Using the same multiplier methodology designed for our first objective, we determined the number of mentors awarded set-aside contracts as part of a joint venture that were mid-sized businesses. We assessed the reliability of the SBA and FPDS-NG data we used by interviewing SBA officials about their data and performing electronic testing. We determined that these data were sufficiently reliable for determining the number of mentors awarded set-aside contracts as part of a joint venture that also were mid-sized businesses. We were not able to perform a similar analysis for joint ventures formed under SBA's 8(a) Mentor-Protégé program because SBA does not maintain a Data Universal Numbering System number for mentors participating in that program. This number is needed to determine the size of the mentor.

To identify stakeholder views on options for increasing federal contracting opportunities for mid-sized businesses, we identified a number of proposed options by reviewing literature, including sources identified during our background research and initial interviews. We also conducted a literature search. We used ProQuest to search 13 databases—including Business Premium Collection, EconLit, Global Newsstream, Policy File Index, and ProQuest Dissertations and Theses Global Research Library. We also conducted searches using Lexis Advanced, EBSCO Business Source Corporate Plus, Dialog, DTIC, Scopus, and HeinOnline. The search was limited to 11 years (2008–2018) and to scholarly, trade, think-tank, and government publications.

For the searches, we used keywords such as “advanced small businesses,” “federal contracting,” “mid-tier/mid-sized small businesses,”

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“middle market,” “IDIQ,” “challenges,” and “opportunities.”<sup>8</sup> Our searches yielded 199 sources. To select relevant sources, an analyst reviewed the titles and abstracts and selected 21 as likely to propose options for increasing federal contracting opportunities for mid-sized businesses. A second analyst reviewed the first analyst’s selection for concurrence. The 21 sources we selected included trade association reports, congressional testimonies, and research reports.

One analyst read the 21 sources and identified any specific options discussed. We eliminated suggestions or recommendations that were unclear, duplicative, or unconnected to mid-sized businesses. A second analyst read the same sources and verified that the first analyst had correctly identified all the options pertaining to increased contracting opportunities for mid-sized businesses. From this analysis, we compiled a final list of 14 options for which we would obtain stakeholder views. The options selected were grouped into four categories. The list of options included in the report is not exhaustive; the options are intended only to be illustrative of potential approaches to enhancing contracting opportunities for mid-sized businesses.

To obtain stakeholders’ views regarding the strengths and limitations of these options, we selected three categories—trade associations, researchers, and federal agencies—from which to develop a nongeneralizable sample of individuals to interview. To identify trade associations, we compiled a list of 20 trade associations that represented small and mid-sized businesses from the literature search and previous GAO work on small business contracting. We searched each organization’s website for any publications the organization may have published on small and mid-sized businesses and federal contracting. We used search terms such as “federal contracting,” “mid-size,” and “size standards.” We identified six trade associations using this process. Because one did not respond to our request, our sample included representatives of the remaining five associations.

We also selected three researchers who published on mid-sized businesses and federal contracting. In addition, we selected the directors of the Offices of Small and Disadvantaged Business Utilization (OSDBU) at three federal agencies—Department of Defense, Department of

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<sup>8</sup>ID/IQ stands for indefinite delivery/indefinite quality. Such contracts are awarded to one or more businesses for the same or similar products or services and are used when the exact times and quantities of future deliveries are not known at the time of award.

Homeland Security, and General Services Administration—that were among the top five agencies in terms of total dollar obligations for small business contracts in fiscal year 2017.<sup>9</sup>

We then interviewed the 11 stakeholders. For each interview, we asked them to provide their views on the strengths and limitations of each option in relation to small, mid-sized, and large businesses and for federal agencies.

We performed a content analysis to analyze the responses. First, we created preliminary codes that represented key themes across the interviews of the strengths and limitations of the 14 options, such as “would increase administrative burden on agencies” or “would increase contracting opportunities for mid-sized businesses.” A methodologist reviewed the coding system to ensure it was logical. We pre-tested the coding of responses from three interviews to ensure the appropriateness of the codes. One analyst coded each response to a particular strength or limitation of an option and a second analyst reviewed the coding. If a response did not align with a strength and limitation, the response was coded as “unclassified.” The team discussed the results of the initial coding analysis and made some adjustments to the codes. Once the coding scheme was finalized and the responses from the remaining eight interviews were coded by an analyst, a second analyst reviewed the coding. If the second analyst disagreed with the coding of a particular response, the two analysts spoke and achieved concurrence. After response coding was completed, we tabulated the responses based on the codes. A second person verified the calculation of the stakeholders’ response totals.

Because we selected a nongeneralizable sample of stakeholders to interview, their views are not generalizable to other stakeholders who have knowledge about options for increasing contracting opportunities for mid-sized businesses, but their views offered important perspectives. To characterize the number of stakeholders who offered the same opinion, we used “nearly all” for nine or 10 stakeholders, “most” for seven or eight stakeholders, “more than half” for six stakeholders, “several” for four or five stakeholders, and “some” for three stakeholders. We also interviewed SBA officials to obtain their views on how the options might affect small

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<sup>9</sup>In 1978, Congress amended the Small Business Act to require all federal agencies with procurement powers to establish an OSDBU to advocate for small businesses in federal procurement and contracting.

businesses, as well as to gather information related to our other two objectives.

We conducted this performance audit from April 2018 to August 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Appendix II: Information on Contracts Awarded to Small, Mid-Sized, and Large Businesses in Fiscal Year 2017

In this appendix, we provide information on contracts awarded to small, mid-sized, and large businesses in fiscal year 2017. Because there is no statutory or regulatory definition of a mid-sized or large business, we applied multipliers to the Small Business Administration's (SBA) size standards. Small businesses were those with revenue or employees at or below the size standard for their industry. We considered mid-sized businesses as those with employees or revenue up to five times above the size standard and large businesses as those with employees or revenue more than five times the size standard.

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### Percentage of Competed Contracts Awarded in Fiscal Year 2017 by Size

Our analysis of Federal Procurement Data System-Next Generation (FPDS-NG) data showed that mid-sized businesses received the smallest share—9 percent—of competed contracts (compared with small and large businesses) in fiscal year 2017 (see fig. 3).<sup>1</sup> For purposes of this report, competed contracts are those competed using (1) full and open

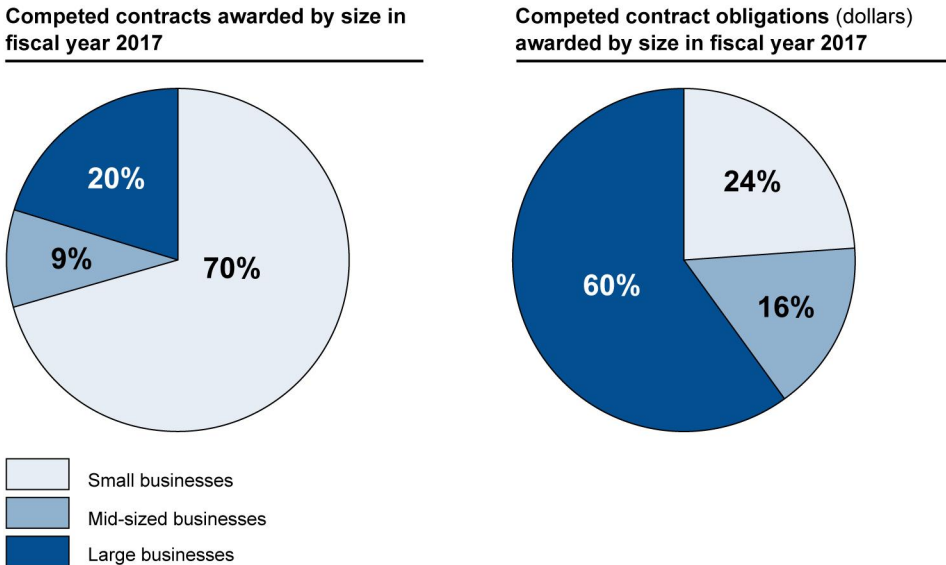
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<sup>1</sup>FPDS-NG is the General Services Administration system used to collect and report data on federal procurements. FPDS-NG records whether contracts were awarded to small businesses.



competition, (2) full and open competition after exclusion of sources, and (3) simplified acquisition procedures.<sup>2</sup>

**Figure 3: Percentage of Competed Contracts and Contract Obligations Awarded in Fiscal Year 2017, by Business Size**



Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Note: Small businesses were those with revenue or employees at or below the Small Business Administration size standard for their industry. We considered businesses with revenue or employees that were up to five times above the size standard as mid-sized and those with revenue or employees more than five times the size standard as large. Competed contracts exclude contracts set aside for small businesses. Percentages may not sum to 100 due to rounding.

<sup>2</sup>Under certain circumstances, agencies may exclude a particular source from a contract action to establish or maintain an alternative source or sources for supplies or services being acquired. For instance, agencies may exclude a source if doing so would increase or maintain competition and likely result in reduced overall costs for the acquisition. Generally, agencies must use simplified acquisition procedures to the maximum extent practicable for all purchases of supplies or services not exceeding the simplified acquisition threshold (set in statute at \$250,000 as of December 2017). National Defense Authorization Act of Fiscal Year 2018, Pub. L. No. 115-91, § 805, 131 Stat. 1283, 1456 (2017) (codified at 41 U.S.C. § 134). The Federal Acquisition Regulation has not been updated to adopt the new amount, and as of June 2019 generally retained the prior \$150,000 standard. FAR § 2.101.

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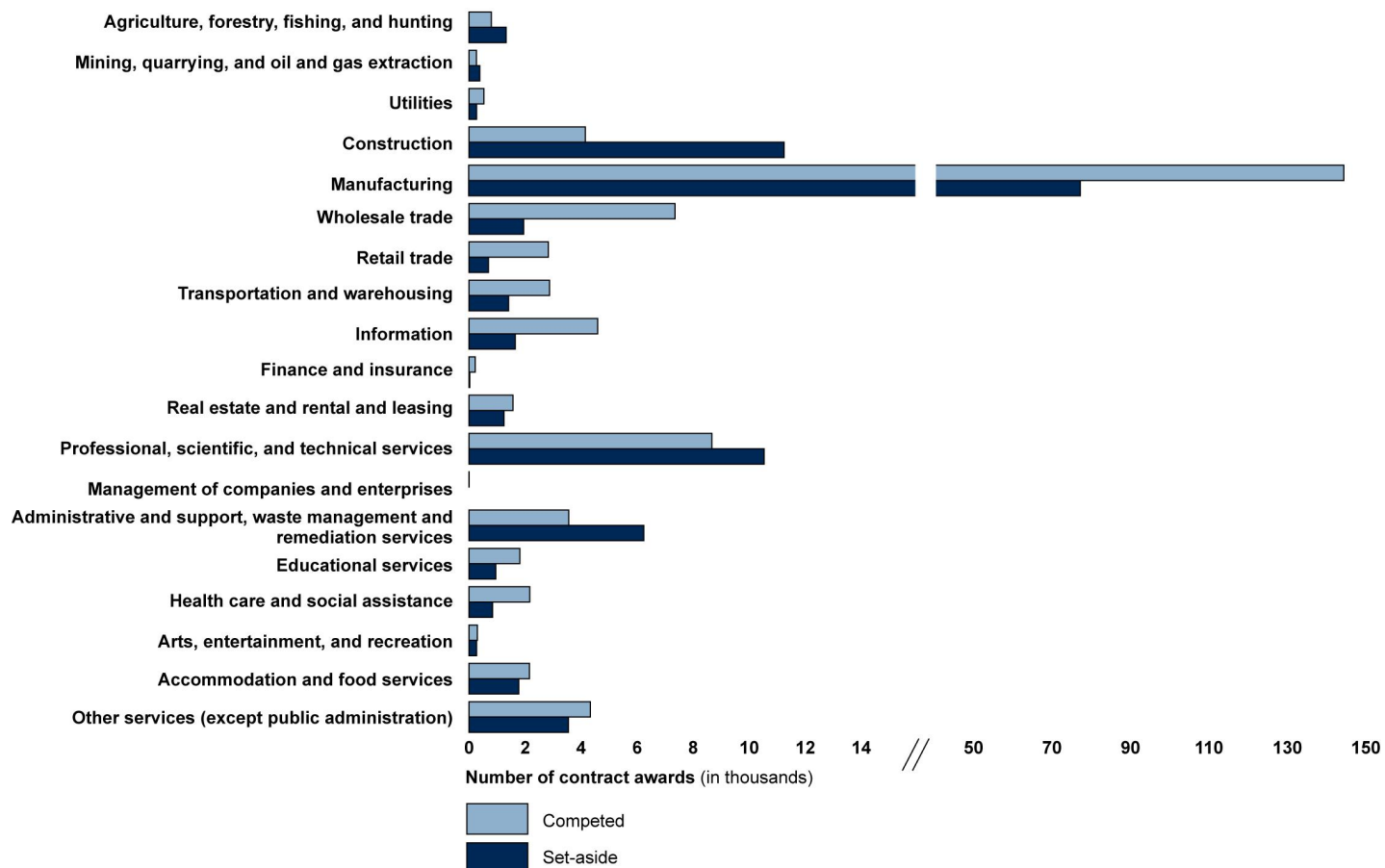
## Dominant Industry Sectors in Federal Contracting

We analyzed FPDS-NG data to determine the number of set-aside and competed contracts awarded in fiscal year 2017 by industry sector.<sup>3</sup> In fiscal year 2017, the largest number of set-aside contracts were awarded in the following sectors: manufacturing; professional, scientific, and technical services; and construction (see fig. 4). In that same year, the largest number of competed contracts were awarded in the following sectors: manufacturing; professional, scientific, and technical services; and wholesale trade.

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<sup>3</sup>Small business set-aside contracts include contracts competed among small businesses and sole source contracts. Sole source acquisition means a contract for the purchase of supplies or services that is entered into or proposed to be entered into by an agency after soliciting and negotiating with only one source. FAR § 2.101.

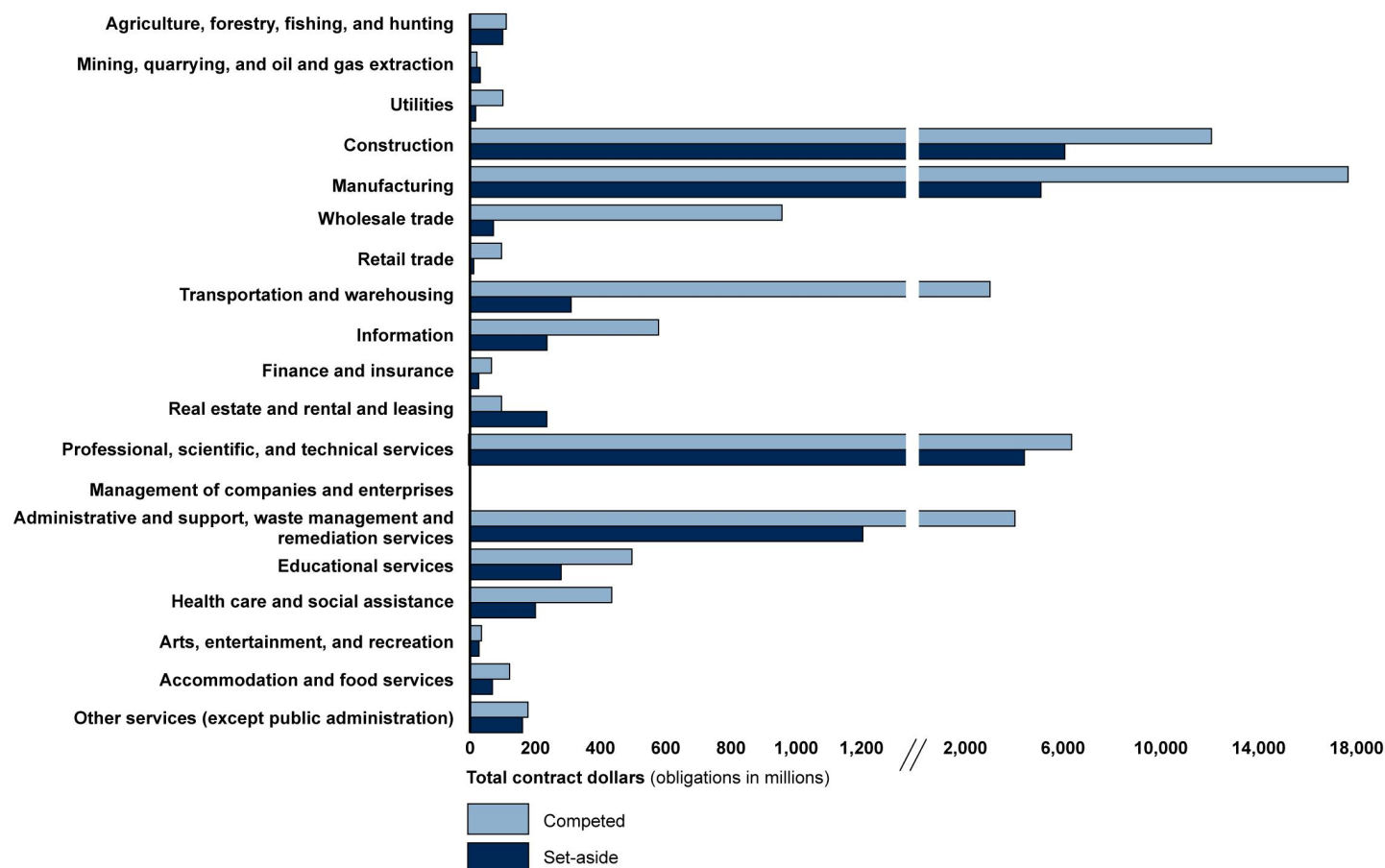
**Figure 4: Number of Set-Aside and Competed Contracts Awarded in Fiscal Year 2017, by Industry Sector**



Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Similarly, in fiscal year 2017 the largest contract obligations (set-aside and competed) were awarded in the sectors of construction; manufacturing; and professional, scientific, and technical services (see fig. 5).

Figure 5: Obligations of Set Aside and Competed Contracts Awarded in Fiscal Year 2017, by Industry Sector



Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

For competed contracts, we analyzed FPDS-NG data to determine if the size of businesses awarded contracts varied by industry sector. In fiscal year 2017, small and large businesses were generally awarded more competed contracts than mid-sized businesses, regardless of sector (see table 5). The industry sectors in which small and large businesses were awarded the most competed contracts in fiscal year 2017 were manufacturing; professional, scientific, and technical services; and wholesale trade. Similarly, in fiscal year 2017, mid-sized businesses were awarded the most competed contracts in the manufacturing and professional, scientific, and technical services sectors. The third dominant sector for mid-sized businesses was information.

**Appendix II: Information on Contracts Awarded  
to Small, Mid-Sized, and Large Businesses in  
Fiscal Year 2017**

**Table 5: Number of Competed Contracts Awarded in Fiscal Year 2017, by Size and Industry Sector**

Number of competed contracts.

Industry sector	Small	Mid-sized	Large	Total
Sector 11—Agriculture, forestry, fishing, and hunting	397	101	300	<b>798</b>
Sector 21—Mining, quarrying, and oil and gas extraction	183	37	45	<b>265</b>
Sector 22—Utilities	396	48	88	<b>532</b>
Sector 23—Construction	2,916	507	730	<b>4,153</b>
Sector 31-33—Manufacturing	107,243	11,289	25,833	<b>144,365</b>
Sector 42—Wholesale trade	4,492	408	2,452	<b>7,352</b>
Sector 44-45—Retail trade	2,065	238	530	<b>2,833</b>
Sector 48-49—Transportation and warehousing	1,975	341	559	<b>2,875</b>
Sector 51—Information	2,186	681	1,724	<b>4,591</b>
Sector 52—Finance and insurance	109	31	84	<b>224</b>
Sector 53—Real estate and rental and leasing	891	161	520	<b>1,572</b>
Sector 54—Professional, scientific, and technical services	5,047	1,031	2,592	<b>8,670</b>
Sector 55—Management of companies and enterprises	0	1	1	<b>2</b>
Sector 56—Administrative and support, waste management and remediation services	2,399	439	723	<b>3,561</b>
Sector 61—Educational services	997	269	549	<b>1,815</b>
Sector 62—Health care and social assistance	1,216	396	556	<b>2,168</b>
Sector 71—Arts, entertainment, and recreation	220	41	35	<b>296</b>
Sector 72—Accommodation and food services	1,539	270	349	<b>2,158</b>
Sector 81—Other services (except public administration)	2,062	634	1,633	<b>4,329</b>
<b>Total</b>	<b>136,333</b>	<b>16,923</b>	<b>39,303</b>	<b>192,559</b>

Source: GAO analysis of Federal Procurement Data System-Next Generation data. | GAO-19-523

Note: Small businesses were those with revenue or employees at or below the Small Business Administration size standard for their industry. We considered businesses with revenue or employees that were up to five times above the size standard as mid-sized and those with revenue or employees more than five times the size standard as large. For the wholesale and retail trade sectors (Sectors 42 and 44-45), we used the 500 employee non-manufacturer size standard to determine the size of businesses.

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

William B. Shear, (202) 512-8678 or [shearw@gao.gov](mailto:shearw@gao.gov)

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## Staff Acknowledgments

In addition to the contact name above, Paige Smith (Assistant Director), Nancy Eibeck (Analyst in Charge), Edward Chiu, Sarah Garcia, Julia Kennon, Jill Lacey, Barbara Roesmann, Jessica Sandler, and Jena Sinkfield made significant contributions to this report.

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