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Small Business

Caught in the Middle: The Plight of the Midsize Contractor



BY DEVON HEWITT

One of the priorities of this administration has been to support small businesses, including small business government contractors. The government's spotlight on small businesses appears to be justified. According to SBA, they accounted for almost 60 percent of the net job losses during the height of the recession in 2010. Because the recession resulted in tighter private lender restrictions to small business, they have not been able to rebound as quickly from these losses. Despite various legislative efforts, the largest customer in the world, the U.S. government, also has not favored small businesses. The federal government has missed the governmentwide 5 percent small business contracting goal five years running (2005 – 2010).

Not surprisingly, therefore, in this election year, Congress too is focusing on the plight of small businesses and small business government contractors in particular. In March alone, the House Small Business Committee reported out more than ten separate pieces of legislation addressing the needs of small government contractors, all with bipartisan support.

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On March 19, 2012, the House Committee on Armed Services issued findings by a panel it created to investigate Business Challenges in the Defense Industry. The panel found that small government contractors face the greatest challenges in getting DOD business, and their lack of access to DOD contracts threatens the defense industrial base. Many of the recommendations made by the panel reflect the concerns addressed by the various small business bills reported by the House Small Business Committee.

In fact, following publication of the panel report, the House Small Business Committee urged the House Armed Services Committee to consider integrating many of the small business bills the Small Business Committee reported into the FY 2013 Defense Authorization bill. This week, the House Armed Services committee held hearings on the authorization bill, including the need to include provisions addressing greater small business access to DOD contracts.

Inconvenient Facts. The renewed focus on and activity surrounding small business federal contracting, however, also has revealed some inconvenient facts. Specifically, the House Small Business Committee panel found what many of us in the government contracting community have known for some time, that the contractors most underrepresented in DOD acquisitions are not “small” contractors after all, but rather “midsize” companies.

Under SBA regulations, contractors qualify as “small” if they fall under “size standards” established by SBA. Size standards are expressed in terms of em-

ployees or annual revenues and correlate to industrial codes published by the Department of Commerce. SBA has been working towards updating and streamlining its size standards by reducing their number and aggregating sub-industries under major industry categories. As a result, many businesses that were considered “small” before SBA’s revisions to the size standards are now “other than small” or “midsize.” Contractors that “graduate” from the size standards applicable to their industry or sub-industry have long complained that they are left to fend for themselves in an unforgiving federal acquisition environment.

In 2010, a number of these contractors formed the Mid-Tier Advocacy group, whose charter is to lobby Congress to recognize the challenges faced by these “other than small” contractors. In the group’s words, these contractors are “too big to be small and too small to be big.” The “mid-tier” movement caught a bit of traction in late 2010 and early 2011 with articles featuring their concerns published in Washington Technology and the Wall Street Journal. Not much has been done since then.

The panel’s report has brought this issue to the forefront once again. The report confirms that these “mid-size” contractors face unique difficulties within DOD because they are not “small” enough to take advantage of SBA’s preferential small business contracting programs and are not large enough to compete successfully with the Boeings, Lockheed Martins, and Northrop Grumman of the world.

In this regard, the report cites a study by the Center for Strategic and International Studies, which found that during the ten-year period between 1999 and 2009, the share of DOD contracts awarded very large defense contractors (over \$3 billion in annual revenue) increased steadily, from 47 percent to approximately 54 percent. The share of DOD contract awards to “small” businesses during this period increased far less, from 17 percent to 17.4 percent. The share of DOD contract awards to “midsize” businesses, however, *decreased* by

from 36 percent to about 29 percent, the same margin by which the share of DOD contract awards to large businesses *increased*.

The Center for Strategic and International Studies concluded that “midsize” businesses are increasingly being “squeezed out” of the DOD marketplace by both small and large government contractors. The panel found the decrease in DOD contract awards to midsize businesses particularly troubling because midsize contractors are the most suitable option for diversifying DOD’s defense industrial base. The panel explained that “midsize businesses” are far more likely to have the capacity to perform large and complex DOD contracts than “small” contractors because they have greater experience and greater access to bonding than small businesses.

Looking Ahead. A few bills have been introduced over the last year addressing concerns of “midsize” contractors, including the Small Business Protection Act of 2012 (H.R. 3987), one of the many bills reported out of the House Small Business Committee in March.

Whether the voice of “midsize” contractors will be heard is another issue. While the panel report legitimizes their concerns, other sources suggest midsize contractors are positioned better in the federal marketplace now than any other contracting group. An article published in the Washington Post on April 1 notes that, in this new era of fiscal austerity, midsize contractors are better able to compete for federal contracting dollars. The article reports that midsize contractors are more experienced and have greater access to capital than small businesses, and are more nimble and have lower overhead than the larger defense contractors. With reduced budgets, contracting agencies also are more willing to bypass the large contractors for small contractors with new ideas and lower prices. In this election-year flurry of small business advocacy, therefore, the pleas of “midsize” contractors might fall on deaf ears.