

THE DEMISE OF THE FEDERAL GOVERNMENT SMALL BUSINESS PROGRAM

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This article examines the legislation leading up to the Small Business Act of 1953 and the resulting implementation of congressionally mandated small business goals; industry's support of small business initiatives; government oversight of small business plans; and the sometimes improper interpretation of rules and regulations affecting the Small Business Program (SBP). The combination of mandated goals, improper interpretation of regulations, and the resulting negative effect on large businesses may, as supported by the author's research, be significant factors in the program's demise. Also included are suggestions on how the federal SBP can become a viable program that benefits small businesses so they truly receive an equitable share of government dollars without infringing on supply chain initiatives of large business contractors.

Keywords: *Small Business Act of 1953, Small Business Goals, Small Business Plans, Mandated Goals, Small Business Program*

The background of the top half of the image is the Seal of the United States Small Business Administration. It features an eagle with wings spread, perched on a shield. The eagle is surrounded by a circular border containing the text "E PLURIBUS UNUM".

SMALL BUSINESS ACT OF 1953



small vs. big business

In the winter 2007 issue of the Air Force Small Business newsletter *Beyond Goals*, Scott Denniston, then director of the Office of Small and Disadvantaged Business Utilization, Department of Veterans Affairs, was asked to assess the state of the Service-Disabled Veteran-Owned Small Business Program. Denniston stated that government-wide, the 3 percent goal for awards to Service-Disabled Veteran-Owned Small Businesses had not been met. He went on to say that in past years, contracting officers had been encouraged to set aside procurements to 8(a) certified small businesses, disadvantaged small businesses, and women-owned small businesses. He could also have included HUBZone small businesses and Native American-owned businesses. Denniston (Cenkci, 2007) expressed the hope that government contracting officers would focus on veteran-owned small businesses. It is this myopic view of the federal Small Business Program, in my assessment, that will be its demise.

But how did the government arrive, or at what point in time did a government agency or its representative assume the untenable position of promoting one type of small business set-aside, while another government entity might be simultaneously promoting a different set-aside? What effect does this flavor-of-the-month attitude have on large business supply chains? Is this current interpretation of the federal Small Business Program the original intent of Congress? Does today's interpretation result in fair and reasonable prices? This article explores these issues and makes recommendations to help the federal Small Business Program survive during these uncertain times.

Background

Helping businesses in dealing with federal government contracts began in 1929 when Herbert Hoover created the Reconstruction Finance Corporation (RFC) following the Great Depression (Overview & History of the SBA, n.d.). The RFC was created to loan money to all businesses, large and small, stymied by the depression. During World War II, the prevailing view was that many small businesses could not compete with large businesses in making products and providing services in support of war efforts. As a result, in 1942 Congress created the Smaller War Plants Corporation (SWPC) (Overview & History of the SBA, n.d.). This agency provided loans to small businesses and encouraged federal agencies and large businesses to buy from such businesses. Congress also passed the Small Business Mobilization Act of 1942. This act acknowledged that a price differential might be necessary to keep small plants mobilized, but only for war efforts (Small Business Mobilization Act, 1942).

At the end of World War II, SWPC was abolished and the RFC took over its lending and contract powers. The Department of Commerce also assumed some of SWPC's responsibilities. The Department of Defense (DoD) was

pulled into the discussion of small business participation in federal contracts by the creation of the Armed Services Procurement Act of 1947. This act mandated that a fair proportion of total federal contracts should be placed with small business (Armed Services Procurement Act, 1947). The intent of this act was to continue in peacetime the policy that had prompted the enactment of the Small Business Mobilization Act of 1942.

As the Korean War began, Congress created another wartime organization to handle small business concerns—the Small Defense Plants Administration (SDPA). Its functions were similar to those of the SWPC. The SDPA certified small businesses to the RFC when it determined a business had the capability to perform the work of government contracts. At this same time, an Office of Small Business (OSB) in the Department of Commerce assumed some educational responsibilities. Believing that a lack of information and expertise was the main cause of small business failure, the OSB produced brochures and conducted management counseling for individual entrepreneurs. Congress also passed the Defense Production Act of 1950. This act again emphasized that the preservation of small business mobilization capability was necessary, even if awards were made at a higher rather than lower price (Defense Production Act, 1950).

By 1952, the RFC was no longer considered necessary, but to continue the important functions of the earlier agencies, President Dwight Eisenhower proposed creation of a new small business agency—the Small Business Administration.

In the Small Business Act of 1953, Congress created the Small Business Administration (SBA), whose function was to “aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns.” The charter also stipulated that the SBA would ensure small businesses receive a “fair proportion” of government contracts.

The act stipulated that the definition of what constitutes a small business should vary from industry to industry to reflect industry differences (Small Business Act, 1953). It charged the SBA with establishing small business size standards on an industry-by-industry basis. Another stipulation of the act was that to be considered a small business concern, the concern must be independently owned and operated and not dominant in its field of operation.

Helping small businesses get a “fair proportion” of government contracts as mandated by the World War II SWPC charter and the Armed Services Procurement Act of 1947 did not lead small businesses to the government as envisioned. The Comptroller General issued a report in 1977 verifying this conclusion saying these early attempts to bring small business into the federal business environment had not been successful. A House Small Business Committee reported that small businesses, particularly those owned by the disadvantaged, had not been considered fairly as subcontractors and suppliers to prime contractors performing work for the government (Clark, Moutray, & Saade, 2006).

As a result, Public Law (Pub. L.) 95-507, a bill to amend the Small Business Act and the Small Business Investment Act of 1958, was enacted in 1978. This law (Amendment to Small Business Act and the Small Business Investment Act of 1958, 1978) created several significant changes to the federal government Small Business Program. Specifically, it—

- Made participation by large businesses in some type of Small Business Program mandatory instead of voluntary
- Changed “best efforts” to “Maximum Practicable Opportunities”
- Required a small business plan for procurements over \$500,000 (now \$550,000)
- Eliminated the small business “minority-owned” category
- Determined disadvantaged business concerns as being both socially *and* economically disadvantaged¹
- Reserved solicitations under \$25,000 for small business (now >\$3,000 but not over \$100,000)
- Required federal agencies to establish small business goals and explain to Congress when goals were not met
- Established the Office of Small and Disadvantaged Business Utilization (SADBU) (now Office of Small Business Programs in the Department of Defense).

The Small Business Act was significant because the Small Business Program now had teeth, and large business participation could be evaluated more definitively if still somewhat subjectively regarding outreach efforts. Congress also continued to refine the program by establishing separate setaside requirements and goals for additional categories of small businesses.

In Pub. L. 99-661, The Department of Defense 5% Minority Contracting Goal (1987), a 5 percent Small and Disadvantaged Business goal, and SDB setasides were implemented.² In Pub. L. 100-656, Business Opportunities Development Reform Act (1988), the 8(a) Program was established; a liquidated Damages Clause was added to the Federal Acquisition Regulation (FAR) to help ensure that goals were met; and 20 percent was identified as the federal agency small business prime contract goal.

In Pub. L. 103-355, the Federal Acquisition Streamlining Act (1994) was enacted. It added a Women-Owned Small Business goal of 5 percent. In 1997, the HUBZone Act, Pub. L. 105-135, was passed (Beale & Deas, 2008). It provided preferences to small business concerns located in HUBZones or areas of high unemployment. Such firms must be owned and controlled by one or more U.S. citizens, and at least 35 percent of its employees must reside in a HUBZone.

That same year the federal agency small business goal was increased from 20 percent to 23 percent.

Finally, Pub. L. 106-50, the Veterans Entrepreneurship and Small Business Development Act (1999), established goals for awards to Veteran-Owned Small Businesses and Service-Disabled Veteran-Owned Small Businesses. Those goals are now 3 percent for both Veteran-Owned and Disabled Veteran-Owned Small Businesses.

The original purpose of programs designed to help contractors do business with the federal government was to loan money to all businesses following the great depression of the late 1920s. By 1999, it had changed to a program that required federal contracting officers to reserve for small businesses all solicitations expected to exceed \$3,000 but not exceeding \$100,000—unless the contracting officer determined there was no reasonable expectation of obtaining offers from two or more responsible small business concerns that are competitive in terms of market prices, quality, and delivery. The FAR, in subpart 19.102, Size Standards (FAR 2005a), also required the contracting officer to set aside any acquisition expected to exceed \$100,000 for small business participation only when there is a reasonable expectation that offers will be obtained from at least two responsible small businesses offering the products of different small businesses with award at fair market prices. This apparent emphasis on award at fair market prices contradicts, to some extent, the original intent of the Small Business Mobilization Act of 1942 and the Defense Production Act of 1950.

Discussion

Small businesses suddenly had many avenues to pursue in competing for government contracts, and large businesses could no longer look to small businesses solely for Bill of Materials, or BoM buildup. They now had to divide their vendor base into several more categories such as Disadvantaged Small Business, Women-Owned Small Business, HUBZone Small Business, and Veteran and Disabled Veteran-Owned Small Business. Moreover, contracting officers expected to see goals and goal achievement at the levels identified by Congress, such as 5 percent to Women-Owned Small Businesses, even if Make-or-Buy analyses for a particular solicitation did not support such goals.

These changed expectations and mandates regarding the use of small businesses appear to be overreaching when compared to the goal set forth in Pub. L. 95-507 of giving small businesses the “...maximum practical opportunity...” to compete for federal prime contract dollars and subcontract awards. However, the federal Small Business Program, if interpreted consistently using practical sound business judgment, may still be workable.

Regrettably, interpretation is often not grounded in common sense and does not follow the congressionally mandated requirements identified

in the FAR at subpart 6.1, Competition Requirements (FAR, 2005b), which states, "...with certain limited exceptions...Contracting Officers shall promote and provide for full and open competition in soliciting offers and awarding government contracts."³ While it can be argued that providing "maximum practicable opportunities" to small business trumps the achievement of fair and reasonable prices, it is my view that contracting officers should always strive to efficiently fulfill the requirements of the warfighter at fair and reasonable prices. This is especially true today when services-type contracts are increasing in use. Unless the contracting officer is reasonably sure that a resulting contract, if set aside for small business, will be awarded at fair and reasonable prices, the solicitation should be issued as open competition, large and small.

This was echoed by John J. Young, former Under Secretary of Defense (Acquisition, Technology, & Logistics). In testimony before the Senate Committee on Armed Services on June 3, 2008, he commented on a Government Accountability Office report on weapon program outcomes (GAO, 2008a).

He identified four strategic thrust areas to make federal acquisition better. One of these thrust areas is to "Responsibly Spend Every Single Tax Dollar." Identifying complex acquisitions for small business setsides may not always ensure responsible spending of tax dollars because the best solutions to a problem may not be captured within the small business community and may prevent a business with the best technical and cost solution—a large business—from competing.

In fiscal year 2006, the DoD spent over \$294 billion to procure goods and services, with more than one-third of this total to subcontractors (GAO, 2008b). Many of these subcontracted dollars were awarded to small businesses, as large businesses awarded subcontracts to small businesses as part of their small business outreach efforts; and small businesses awarded subcontracts to other small businesses in order to perform parts of awarded contracts.

With over \$100 billion of federal acquisition dollars potentially going to small businesses in fiscal year 2006, a case could be made that the policies implemented to give small business a fair opportunity in the government marketplace are finally paying off. These results, while not at the congressionally mandated goals for Veteran and Disabled Veteran-Owned Small Businesses, are in line with congressional mandates to provide a maximum practical opportunity for small businesses to participate in the federal market.

However, the pressure to achieve the minimum goals in all small business categories and achieve improved year-over-year small business statistics have a sometimes negative effect on large business as the various changes to the Small Business Act and individual contracting agency interpretations of the federal Small Business Program requirements unfold.

What are some of these issues? While not all-inclusive, they can be broken down into several categories.

- Mandating specific goal achievement
- Requiring goals based on contract value, not subcontracting opportunity
- Not recognizing the negative impact of small business goals on large business supply chain decisions
- Myths
- Reorganization within the Defense Contract Management Agency
- Training shortfalls of government small business specialists and large business SBLOs (Small Business Liaison Officers).

MANDATING SPECIFIC GOAL ACHIEVEMENT

Some government solicitations now mandate the small business goals that must be achieved. The mandating of goals may violate the FAR 19.704(a)(2), Subcontracting Plan Requirements (FAR, 2005c), which only require a prospective offeror to identify total dollars planned to be subcontracted. Dollars planned to be subcontracted might differ greatly from company to company depending on in-house capability. A large hazardous waste disposal company might have fully trained employees, capable of performing all activities involved in the pickup, segregation, packaging, and transportation of hazardous waste; while another company might have to subcontract various aspects of such services. The small business plans for these two companies will be very different because the companies are very different. It is not fair to the company with in-house resources to be penalized because its small business plan is less “robust” than the company with limited resources that may have to subcontract many aspects of the services or cannot justify the agency-dictated small business goals.

The U.S. Army Corps of Engineers, New York District, issued solicitation W912DS-07-B-0011 in May 2007. This Invitation for Bid (IFB) identified various small business goals it expected bidders to meet. The IFB stated, “If plan includes goals less than indicated, explain extenuating circumstances why Corps of Engineering goals can’t be met....”

The mandated small business goals in this particular solicitation ignore the likely differences in potential bidders, but more importantly, may violate the FAR in an IFB environment. FAR 14.301(a), Responsiveness of Bids (FAR, 2005d), states, “...to be considered for award a bid must comply in all material respects with the IFB. Such compliance enables bidders to stand on equal footing while maintaining integrity of the sealed bidding system.” Discussions are not usually part of an IFB. The winning contractor is determined by lowest price among the responsive, responsible bidders.

Asking a bidder to explain why its small business plan does not meet the pre-determined goals of the agency contradicts the rules for advertised bids. FAR 19.702(a)(2), Statutory Requirements (FAR, 2005e), says that in sealed bidding acquisitions, the bidder selected for award must (if dollar parameters for a small business plan are met in the bid price) submit a subcontracting plan. No other requirements are identified, and no specific goal achievements are required other than best effort. If this solicitation was a request for proposal (RFP), discussion of small business plans would be more appropriate as such discussions would not broach contractor responsiveness issues to the extent they would in an IFB environment.

REQUIRING GOALS BASED ON CONTRACT VALUE, NOT SUBCONTRACTING OPPORTUNITY

Some contracting officers are requiring small business goals based on “contract value.” Other agencies are requiring that all statutory goals be met before a subcontracting plan will be accepted. Both of these approaches violate the Small Business Act, Section 8(d), Subcontracting Program, which ties goals to subcontracting opportunities, not to contract value or to statutory goal minimums. Actual subcontracting opportunities, while subjective to a degree, simply may not support the meeting of statutory goals because the skill sets required in the various small business categories may not be available or the contractor may not require outside vendor/subcontractor assistance.

NOT RECOGNIZING THE NEGATIVE IMPACT OF SMALL BUSINESS GOALS ON LARGE BUSINESS SUPPLY CHAIN DECISIONS

Another reality of business today involves the efforts contractors are making to decrease the number of dollars they are spending on outsourced materials and services. Many large businesses are improving their supplier selection process by eliminating poor performers and consolidating purchases. Every time the vendor database is reduced, small businesses may suffer in the process. However, the typical large business materials department is a profit center for its company and is expected to meet certain goals associated with buying more for less. Large businesses are increasing global sourcing initiatives and maximizing economies of scale by buying more quantity from fewer suppliers. These initiatives do not usually improve the small business vendor spend statistics. However, it is not the role of the federal government to tell businesses how their supply chains should operate.

MYTHS

Myths about the Small Business Program also generate their own problems. For example, some argue that the bundling of requirements into large contracts prevents small businesses from performing on them. The SBA supports this claim and criticizes agencies that combine similar requirements to maximize economies of scale. The SBA claims 34,221 new bundled contracts were awarded between 1992 and 2001, transferring \$840 billion of contract revenue from small businesses, causing a 56 percent decline in the number of small businesses contracting with the government. Yet, only 25 bid protests were filed by contractors between 1992-2004 over contract bundling—sharply contradicting the SBA's estimates of bundling frequency or negative impact to small businesses (Nerenz, 2007).

Another myth involves the idea that innovation is exclusively a small business phenomenon. Andy Grove, Co-Founder of INTEL, stated in *Portfolio Magazine* (Grove, 2007) that, "Some sectors are hobbled with intractable, industry-wide problems that only a large company can solve." He cited Apple Computer's entry into the music business and Wal-Mart's introduction of in-store health clinics as examples of solutions only possible through large business involvement.

REORGANIZATION WITHIN THE DEFENSE CONTRACT MANAGEMENT AGENCY

The Defense Contract Management Agency (DCMA) reorganized itself to align its limited resources to the more specific types of products or services it manages instead of the geographic orientation by physical location to the large businesses it monitors. This reorganization has resulted in limited face-to-face contact between DCMA small business specialists and the large business SBLOs. Elimination of the geographic proximity between DCMA and the contractors it monitors has reduced the knowledge of the government small business specialist about a specific company, and increased focus on year-over-year increases in goal accomplishment when such increases may not be possible.

TRAINING SHORTFALLS OF GOVERNMENT SMALL BUSINESS SPECIALISTS AND LARGE BUSINESS SBLOs

Training of government small business specialists and contractor Small Business Liaison Officers (SBLOs) is also lacking. Some contractor and government personnel cannot differentiate between the various types of small business plans—Comprehensive, Master, Commercial, or Individual. They are not familiar with how goals data should be calculated or how reports on goal achievement should be prepared and submitted.

Some SBLOs do not understand how to report small business dollars if a vendor fits more than one small business size category. Some agencies do not allow the use of Commercial Plans where some services—for example, dredging services—clearly meet the definition of a commercial item. This lack of knowledge is the result of the government reducing funding for its Regional Councils for Small Business Education and Advocacy and indifference of large businesses toward the Small Business Program. Many large businesses doing significant business with the federal government simply do not attend small business meetings chaired by the DoD, nor do they participate in local SBLO groups.

So what can be done to make the federal Small Business Program work better?

Recommendations

Federal agencies should re-focus the program to its original intent. If changes are not made to the program, continued compliance by large businesses may wane, and the very existence of the Small Business Program as we know it today may be in jeopardy. In the Small Business Act of 1953, Congress voiced its conviction that the federal government should, “aid, counsel, assist, and protect...the interests of small business concerns...to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the government... be placed with small business enterprises.” The federal Small Business Program can more effectively meet the intent of the Small Business Act of 1953 by making changes to the program so it truly benefits small business manufacturers and service providers, does not negatively affect the supply chain of large businesses, and helps ensure that the federal buyer gets quality products at fair and reasonable prices.

The following four recommendations, if implemented, can be the recipe for continued success necessary to energize the federal government Small Business Program.

1. Reduce employee count or revenue ceilings in North American Industry Classification System (NAICS) size standards.
2. Allow large businesses to create small business plans based on subcontracting opportunities after they conduct a comprehensive Make-or-Buy analysis for a particular solicitation.
3. Assign DCMA small business specialists the monitoring of large businesses by geographic proximity.
4. Take advantage of the expertise within Procurement Technical Assistance Centers (PTACs).

Recommendation 1. The SBA, in conjunction with the Office of Management and Budget (OMB), should re-examine how employee count or annual revenue ceilings are determined for the various NAICS codes. The goal should be to create small business size ceilings that are reflective of the size of most small businesses—500 to 1,000 employees is simply too large for the small business ceiling of most NAICS codes. The Department of Health and Human Services Web site states that 90 percent of all small businesses in the United States employ fewer than 20 employees. When a 20-person small business competes with a 1,000-person small business, it may not be a true competition between two small businesses.

Recommendation 2. First, allow large businesses to submit small business plans based on their internal capabilities and documented determination regarding outsourcing. When preparing the RFP, do not include small business plan goals in the Section M, Evaluation Factors for Award criteria. Subcontracting opportunities may be very different from one large business to another. Because a large business identifies higher small business goals does not make that plan better than another large business that identifies smaller goals. Plans may be very different from large business to large business, but still represent maximum practicable opportunity for small businesses to participate in contract performance consistent with the management plan of the large business. By including small business plan goals as a criterion, one increases—needlessly, in my view—the complexity of the evaluation and the possibility of botching the source selection. Grading one small business plan “better” than another without taking into consideration the makeup and business model of the large business could also lead to protests after award (GAO, 2007) and jeopardize timely support of the warfighter.

Second, do not dictate small business goals in solicitations. Dictating goals does not acknowledge that goal identification is the responsibility of each large business based on its subcontracting opportunities.

Third, if goals do not meet the Congressional goal mandates for various categories of small business, so be it. Large businesses should not be forced to meet congressionally mandated goals if the subcontracting opportunities do not warrant such goals.

Large business SBLOs have a multi-faceted job description, differing in some ways from company to company. However, if the large business SBLOs are doing their job effectively, they should be making sure company employees—especially purchasing department buyers—fully understand the government Small Business Program and the associated buyer responsibilities to provide maximum practicable opportunity for small businesses to compete for subcontracting requirements. SBLOs should also keep abreast of changing Small Business Program requirements, whether they involve a change in mandated goals or a change in reporting, such as a transition from paper reports to electronic reports.

In years past, the large business SBLOs kept abreast of changing requirements by attending quarterly or semiannual meetings with other large businesses in their immediate geographic area as part of a large business SBLO group. Such groups usually included participation by a small business specialist from the DCMA. It was this interface between large business SBLOs and DCMA small business specialists that kept all parties informed about the Small Business Program. The DCMA reorganized its small business specialists in 2005. This reorganization eliminated geographic proximity of the DCMA small business specialists and the large businesses they monitored, resulting in less communication and less face-to-face interface.

Recommendation 3. Re-orient DCMA small business specialists so they are in geographic proximity to the large businesses they monitor. This re-orientation will result in better oversight of large business compliance with the intent of the Small Business Program.

Many agencies and associations—some funded by the federal government, some funded by state governments—promote small businesses selling to the federal government. A myriad of companies is also focused on some part of the small business market. These organizations include the National Association of Minority Contractors (NAMC), National Association of Women Business Owners (NAWBO), the Office of Women's Business Ownership (OWBO), The Center for Veterans Enterprise (VetBiz), the National Veteran-Owned Business Association (NaVOBA), Minority Business Development Agency (MBDA), and the Latin Business Association (LBA) to name a few. The problem with all of these organizations is their inherent focus on their own particular category of small business.

Yet, one organization, Procurement Technical Assistance Centers (PTACs), stands out from the rest because PTACs look at the bigger picture instead of the flavor-of-the-month mindset that places emphasis with women-owned firms today, but with veteran-owned firms tomorrow. PTACs, to the contrary, work effectively with all small businesses, regardless of the small business type, in helping them make contact with large businesses or federal buying agencies.

Authorized in 1985 by Congress, the Procurement Technical Assistance Program (PTAP) strives to increase the number of proficient businesses engaging in the government marketplace. PTACs often reflect the communities and areas in which they serve, so they vary in size and shape. A small percentage of PTACs are administered by state governments, while others work in partnership with community colleges, universities, local economic development corporations, or other institutions in the local area.

Recommendation 4. Emphasize to large businesses, small businesses, and federal buyers that PTACs should be the focal point for small business

vendor outreach. Emphasize to small businesses that PTACs are the best resource for information on doing business with the federal government. De-emphasize any focus on “one trick pony” associations and agencies so the federal Small Business Program is more in line with the original intent of the Small Business Act of 1953—to help small businesses.

Conclusions

If the federal Small Business Program is enforced from the perspective of its original intent, goal achievement for the sake of goal achievement will be de-emphasized, and the recommendations identified in this treatise will be seriously considered. If these steps are taken, small businesses should continue to prosper in the federal marketplace and receive a fair proportion of government contracts. Additionally, the American taxpayer will see better use of taxpayer dollars. These actions, if enforced, will mark a return to the original objectives of the Small Business Act of 1953.

Author Biography



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ENDNOTES

1. Prior to Pub. L. 95-507, minority businesses were defined as socially *or* economically disadvantaged small businesses. According to a Congressional Report at the time, the change from “or” to “and” was to prevent the increasing number of “front” companies—companies posing as minority businesses but controlled by non-minorities.
2. This setaside was rescinded in 1996.
3. FAR 6.202, Establishing or Maintaining Alternative Sources, establishes or maintains an alternative source if agency head determines doing this will also result in reduced overall costs; or is in the interest of national defense; or ensures continuous availability of a reliable source; or fulfills a statutory requirement related to small business concerns; or only one source will satisfy agency requirements.