



Issues and Recommendations for Federal Government Set-Aside Policies

*Enhancing Mission Support.
Ensuring Opportunity for All*

Introduction – Coalition for Competition

- Tax exempt non-profit organization committed to achieving a competitive government contracting environment that supports the government's goals of cost efficiency, quality results, and a robust industrial base
- Goals
 - To promote an environment in which service providers of all sizes can engage in Federal government contracting competition to ensure cost efficiency, high quality solutions, innovation, and best value to the taxpayer
 - To support a healthy and sustainable provider base for government services
 - To help identify effective pathways for transition of small businesses as they grow beyond the limits for set-aside contracts

The "Mid-Tier" Market Squeeze

<\$400M Contracts



\$25 - \$400M Contracts

Increasing number & value of
Small Business Set-Asides

SQUEEZE

Sequestration & shrinking Defense budgets drove **Very Large Businesses** to compete for smaller contracts

As Agencies scramble to achieve their **Small Business Goals**, individual award values are increasing

Middle East Troop Withdrawal

Sequestration

Senior Executives Bonus tied to
Small Business Goals

Time

Unintended Consequences Dominate Set-Aside Issues

- » Pressure to meet exceed the prime contract goals has resulted in unintended consequences to industry and the customer
 - Extreme concentration in the services sector
 - Bundling of requirements to set-aside largest possible small business contracts or task orders
 - Disenfranchisement of Engineering Services (NAICS Code 541330) and IT (NAICS Codes 541511-19) small businesses
- » Sweeping up large contracts and task orders into small business set-asides has left a dearth of opportunities for mid-tier and graduating small businesses firms
 - Graduates face a daunting market, unable to re-compete for most of their backlog
- » Proliferation of small business services prime contracts has increased cyber threat to programs
 - Mandatory compliance with NIST instructions will help, but at larger cost and less effectiveness

Data Summary

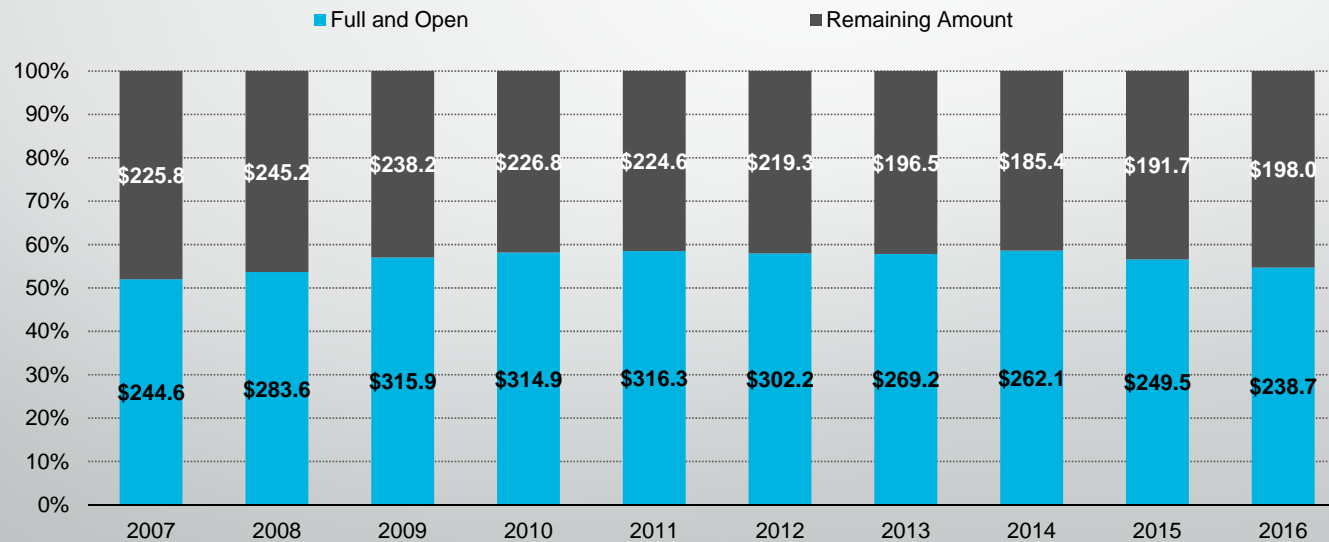
- » Addressable, competitive services market has declined steadily since fiscal year 2012
 - Opportunities have declined for mid-tier and recent graduate firms
- » Small business set-aside spending and shares are at an all-time high
- » Set-aside spending is concentrated at DoD although shares are higher in other agencies
- » OCONUS small business set-aside spending up
- » Competitively awarded ANC contracts are growing
- » Small business set aside task orders on Multiple Award Contracts are major driver of increase in set aside spending
- » Still no reliable data on small business subcontracts

Share of Obligations Competed Full and Open is Decreasing

Full and Open vs. Uncompetitive Spending by Fiscal Year

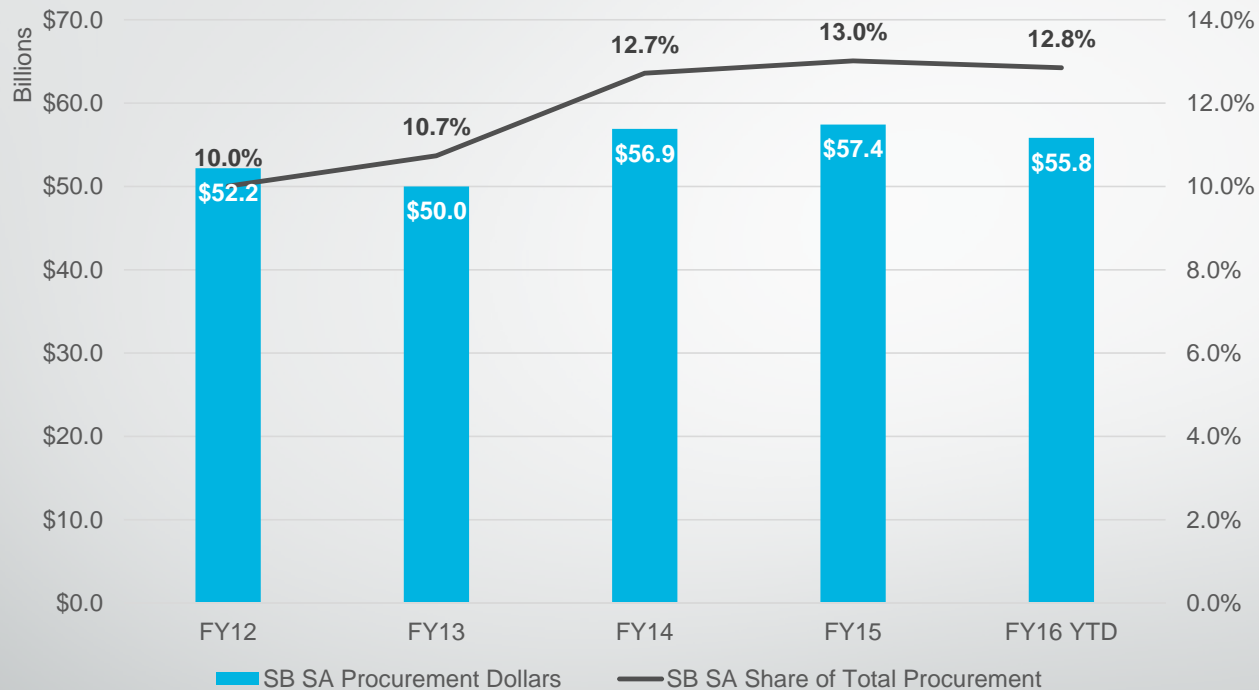
- » Since its peak in 2011, obligated dollars that are competed full and open have been decreasing both as share of overall spending and dollar size.
- » In fiscal 2011, full and open spending was about \$316 billion, and fell to about \$250 billion in fiscal 2015.

Dollars obligated, in billions



Source: Bloomberg Government

Small Business Set-aside Spending and Share Rise to all-time High in FY 2015

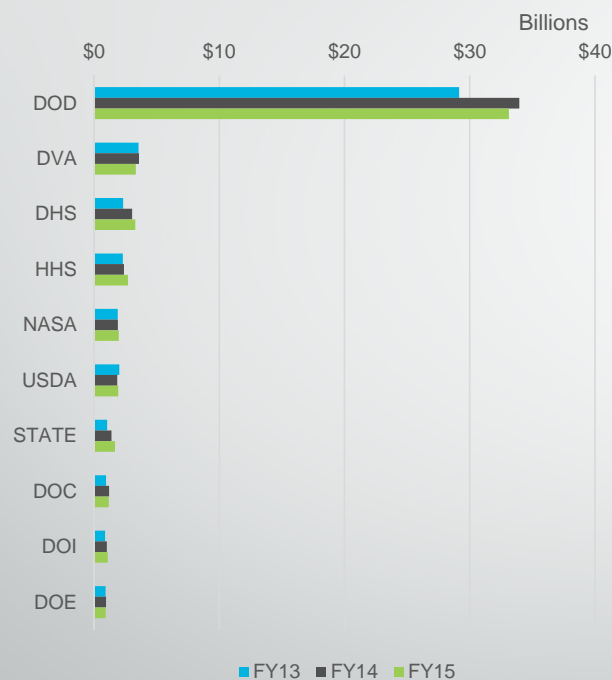


Note: All years are fiscal years. Dollars aggregate contracts coded as both set-aside and as small business. Share calculation measures small business set-asides as a percentage of total procurement. This excludes a small share of set-asides listed as awarded to large/other firms. Data as of December 8, 2016. DoD FY 2016 data will not be completely reported until the first week of January, 2017, so FY 2016 total and share calculations are subject to change.

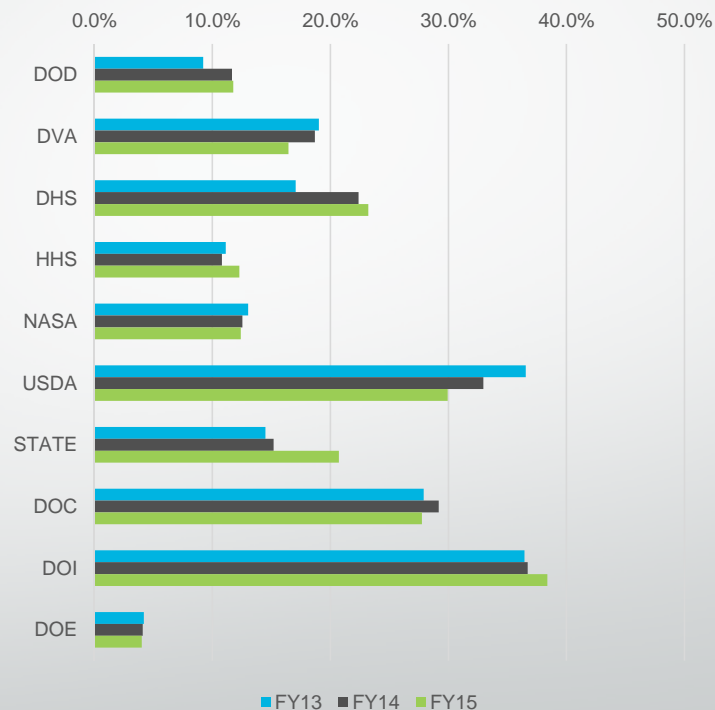
Source: Bloomberg Government proprietary contracts database. Data current as of December 8, 2016.

SB Set aside spending concentrated at DoD where set-aside spending share is rising

Security, Vet Agencies Biggest SB Set Aside Spenders



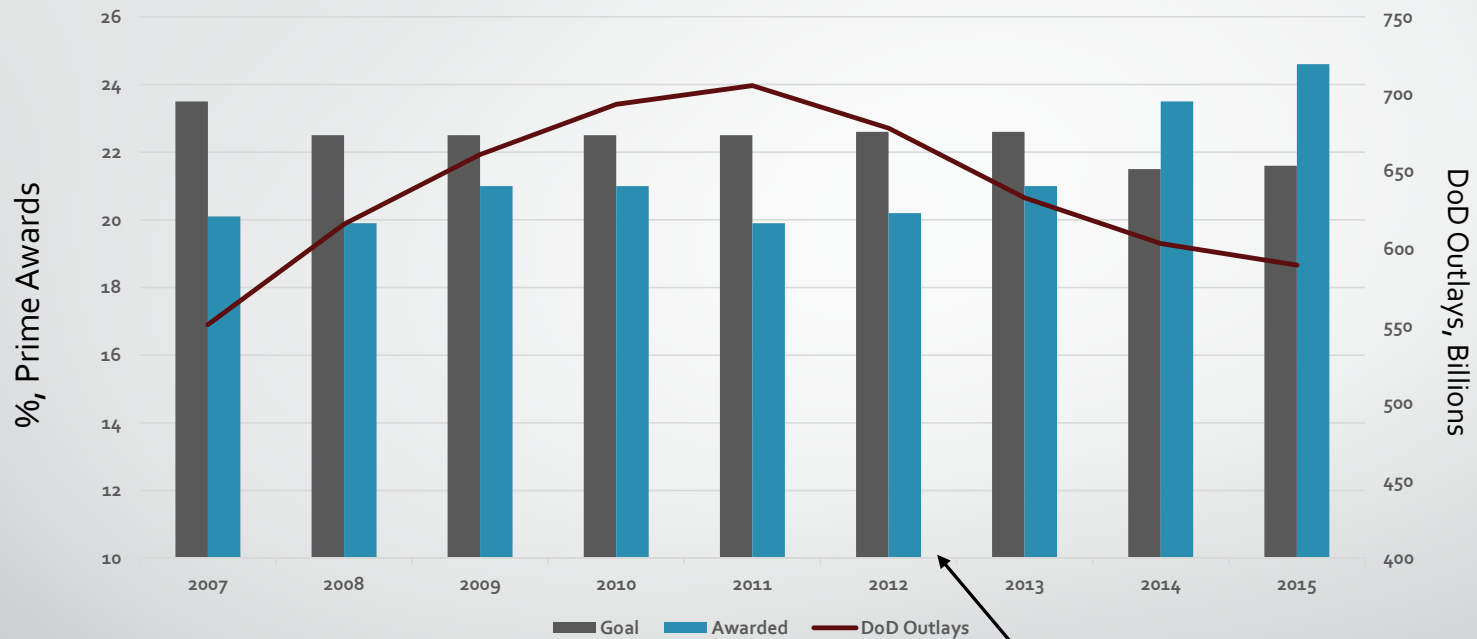
DOI, USDA, DOC Show Highest Shares While DoD Is Rising



Notes: DOD – Department of Defense, DVA – Department of Veterans Affairs, DHS – Department of Homeland Security, HHS - Department of Health and Human Services, NASA – National Aeronautics and Space Administration, USDA – US Department of Agriculture, State – State Department, DOC – Department of Commerce, DOI – Department of the Interior, DOE – Department of Energy

Source: Bloomberg Government proprietary contracts database. Data current as of December 8, 2016.

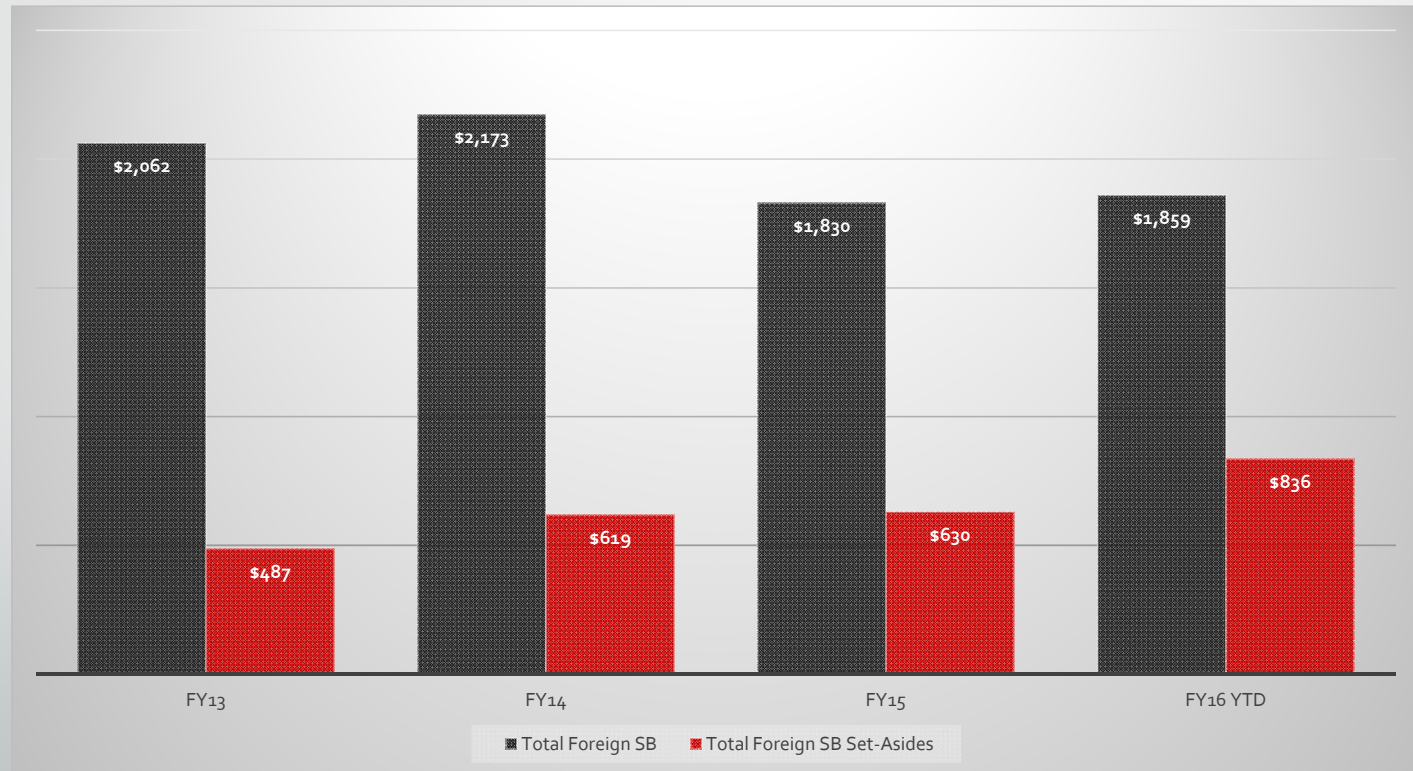
DoD Goals vs. Actual Awarded Small Business "Prime" Dollars



"Therefore, to improve DoD's small business contracting performance, Senior Executives will be rigorously evaluated and held accountable for meeting DoD small business contracting goals." DepSecDef memo, Feb 10, 2012

Source: Preliminary Data, UMD Small Business Study; DoD "Green Book"

OCONUS Set-Aside Spending is up 71% While Overall OCONUS Small Business Spending has Declined

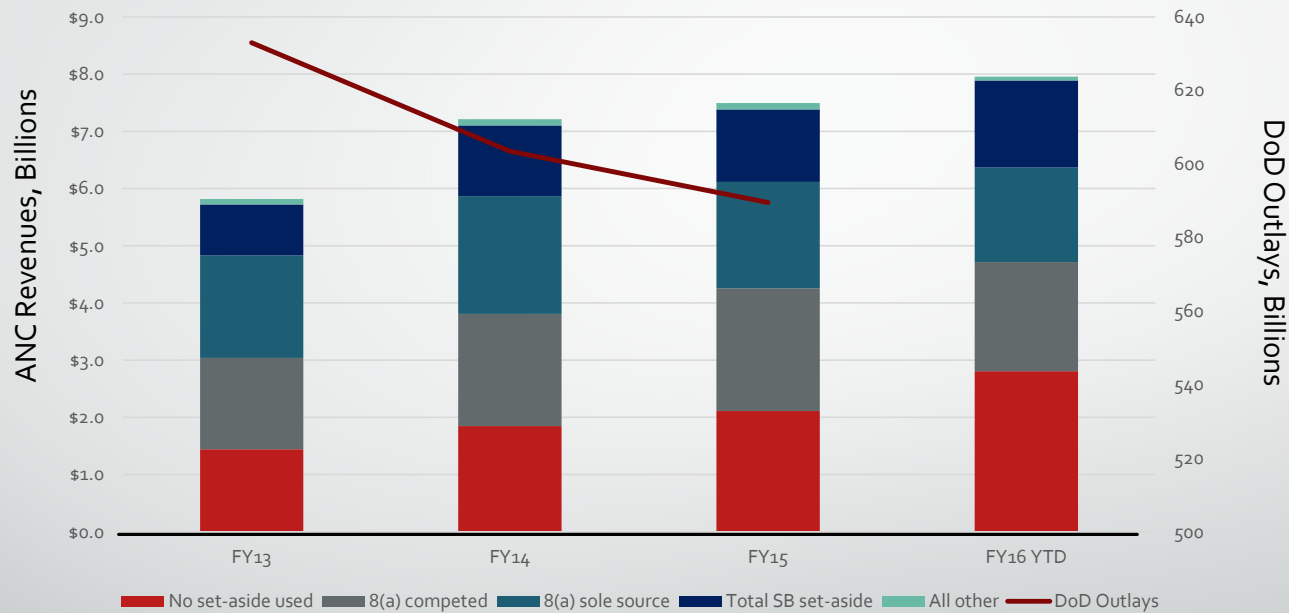


Source: Bloomberg Government proprietary contracts database

Erosion of the Contingency Services Industrial Base

- » Only a handful of large companies are capable and willing to deploy forward to provide logistic and combat support services to troops in combat
- » Sufficient CONUS-based logistics and Base Support contracts must remain Full & Open to afford other-than-small businesses the opportunity to maintain their skill sets during draw-downs in OCONUS operations
- » The current trend of setting aside CONUS and OCONUS - based BOSS contracts for small business has the unintended consequence of eroding the industrial base for contingency services. Recent examples include:
 - » DoS DiPSS IDIQ - \$10B F&O, \$5B Set-Aside
 - » Air Force Caribbean FOL BOS (2) – converted to SB in 2014 - \$95M
 - » Vance AFB BOS – converted to SB in 2016 - \$22M
- » Protecting the industrial base for these contingency services contractors is paramount to maintaining a robust industrial base of contractors willing and able to accompany the force in future contested environments

ANC Competitively Awarded Revenues Grow from under 25% to over 35% FY13-FY16 YTD



Do ANCs really need continued protection and artificial set-asides?

GWAC/MAC IDIQs Facilitate Large Small Business Awards

- » MAC IDIQ Set-Asides more than doubled in the period FY12 – FY16 (237%)¹
- » “Code Shopping” has allowed bundling of requirements into the largest possible task orders
 - Some small business contractors are now lobbying procurement officials to open up their engineering services task orders to NAICS code 541712, Research and Development, Aircraft or Missile Exception

The image shows a slide from a presentation titled "Acquisition Strategy" for the U.S. Air Force. The slide is labeled "PRE-DECISIONAL" at the top and bottom. It features the U.S. Air Force logo and a list of bullet points detailing the EPASS MAC IDIQ program. The bullet points include: EPASS MAC IDIQ, Estimated Value: \$3B to \$5B (with a sub-bullet for Each contract award: minimum \$2,500 - maximum \$1B), NAICS Code: 541712 (size standard 1500 employees), Competitive Procurement – 100% Small Business Set-Aside (with sub-bullets for 5-Yr Ordering Period, 6-Yr Period of Performance, and LPTA), TOs – Fair Opportunity Selection Process (with a sub-bullet for LPTA to Full Trade Off allowed), and Use of On-Ramp and Off-Ramps (with a sub-bullet for Penalty Box and Off-Ramps for poor performers). The slide number "15" is visible in the bottom right corner.

PRE-DECISIONAL

U.S. AIR FORCE

Acquisition Strategy

- EPASS MAC IDIQ
- Estimated Value: \$3B to \$5B
 - Each contract award: minimum \$2,500 - maximum \$1B
- NAICS Code: 541712 (size standard 1500 employees)
- Competitive Procurement – 100% Small Business Set-Aside
 - 5-Yr Ordering Period, 6-Yr Period of Performance
 - LPTA
 - Past Performance acceptable/unacceptable
 - Technical Approach (pass/fail)
- TOs – Fair Opportunity Selection Process
 - LPTA to Full Trade Off allowed; specified in each TO
- Use of On-Ramp and Off-Ramps
 - Penalty Box and Off-Ramps for poor performers

PRE-DECISIONAL 15

» Engineering Services small business size standard is \$14M - \$35.5M

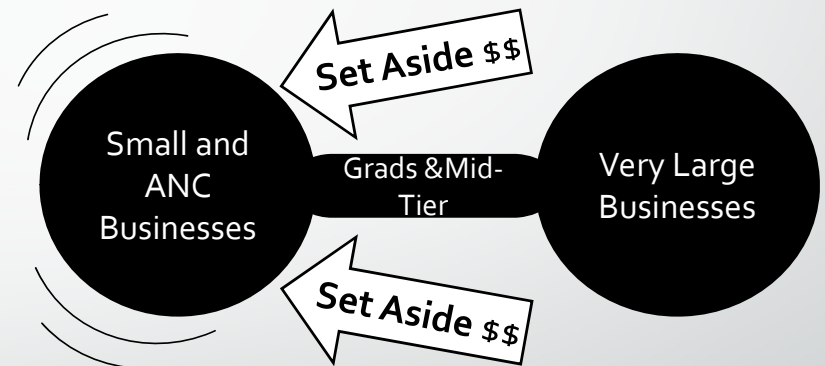
- » Source Selection Criteria for OASIS, Alliant, and other MACs resulted in selection of only the largest competitors in each pool
 - » Aggressive marketing of OASIS (One Acquisition Solution for Integrated Services) has left vast majority of contractors out of contention

When Large Opportunities are Set-Aside, No One Really Wins

- » Section 1633 of FY13 NDAA called for DoD to “take steps to ensure that members of the senior executive service . . . Assume responsibility for the agency’s success in achieving small business contracting goals.”
 - Meeting or exceeding small business goals is now a element of DoD incentive compensation and General Officer performance reports.
 - Resulted in setting aside ever-larger contracts and task orders. Examples:
 - » **GSA delivers huge IT opportunity to 43 small businesses** - IT product contract should grab millions in new business - \$1.7B each year (on average \$39M/year each)
 - » **6 win spots on \$11B Coast Guard contract** - The TABSS contract is large \$11 billion vehicle that will be used by Coast Guard for a variety of services. Domain one, valued at \$8B over five years, went to six small businesses and four 8(a) contractors. To date, 73% of the total spend in Domain one has been set-aside. (on average, \$25M/year each)
 - » **\$851M Air Force contract moved to small businesses** – Jacobs Engineering says good-bye to lucrative prime contract. Five small businesses have won an \$851 million Air Force contract that had previously been a single award to a large business (on average, \$28M/year each)
 - » **Lucky 13 win \$1.5B DHS Agile software contract**
 - » **Amyx tops seven companies to win \$189.3M OASIS task order**
 - » **CSRA protest raises questions about what should or shouldn't be a small business contract**
 - » “DHS is bundling several contracts into a single vehicle. CSRA is the incumbent on just one of those contracts. . .with the bundling of the work, the annual spend through the task order will likely be \$40 million-\$50 million a year over the four years of the contract.”

Graduating Small Businesses and Mid-Tier Firms Find a Slim Market

- » As more and larger contracts and task orders are set aside, the available market for recent graduates and highly-qualified mid-tier firms has been eroded
- » Sweeping up large contracts and task orders into small business set-asides has left a dearth of opportunities for mid-tier and graduating small businesses firms
- » Graduates face a daunting market, unable to re-compete for most of their backlog



Limited Mid-Tier Market Has “Downsized” Much of the Services Industrial Base

Few federal contractors grew enough over the past five years to break into a higher tier. More companies dropped to a lower tier as the government cut spending.

FY 2010 Vendors in these tiers...		...were counted in these tiers in FY2014			Tier to Tier	
		Large	Medium	Small	Grew	Shrank
Large	140	86	48	6		39%
Medium	1505	15	844	646	1.0%	43%
Small	67023	2	478	66,543	0.7%	

Large = \$500M

Medium = >\$25M - <\$500M

Small = <\$25M

Note: Size determined by annual revenue from federal contracts. These number do not account for new entrants, acquisitions or business failures.

Source: May 7, 2015 - Bloomberg Government proprietary federal procurement database

Cyber-Security Implications

- » A services contractor unable to completely defend its own network is a cyber threat to the program it supports
 - The mass of unclassified program information resident on a contractor's network can itself compromise a program
 - Every communication, encrypted or not, between the contractor's network and the program network is a gateway for a cyber-threat
- » Effective Cyber Defense requires three elements
 - Training – most breaches are caused by an employee responding to a “phishing” attempt
 - Investment – both specialized hardware and software are required
 - Effort – successful defense requires “eyes on the glass” 24/7. Many breaches are discovered when information is flowing out of the network, not in.
- » Every node is a weakness
 - » Replacing one services contractor with five greatly increases the likelihood of a successful intrusion

“As SMBs are often vendors to large enterprises, those large enterprises need to analyze the threats posed by connecting SMB systems to their greater and extended company IT infrastructures. While SMBs of course need to continue deploying solutions designed to protect their networks, they also need to invest in all three of these fundamental risk management functions” (Protect, Detect, and Correct)¹

1. Testimony of Steve Grobman, Intel Fellow and Chief Technology Officer – Intel Security Group, before House Committee on Small Business

Coalition Recommendations

- » Measure the real desired outcomes of the small business program
 - Health of the entire industrial base
 - Selection of contractor type based on government needs
 - Graduation rates, successful growth after graduation
 - Job creation beyond the government funded positions
- » Make Electronic Subcontractor Reporting System (ESRS) an effective reporting tool
 - Find out how much total budget actually goes to small businesses
- » Support Section 838 of FY17 Senate NDAA
 - Allows DoD to count first- and second-tier small business subcontractors toward agencies' small business prime contract goals
 - Based on current practice at DOE
 - Would shift some emphasis from services to hardware or product companies – strengthens industrial base
- » Ensure opportunities for all businesses to bid
 - Prohibit the use of “code shopping” to meet agency goals
 - No contract or task order, the annual revenue of which would exceed 60% of the respective business size should be set aside.

Coalition Recommendations (2)

- » Provide a path for growth
 - Small business winners in any MAC IDIQ should be allowed to bid on any unrestricted (large business) task order within the MAC, without triggering the “rule of two”
- » Promote access to financial capital for growing small businesses
 - Provide an SBA-directed program to assist in access to non-government financial and advisory resources
- » Ensure a robust Base Operations Support (BOS) industrial base to support large-scale OCONUS contingency operations
- » Market Research in support of contract decisions for both large and small businesses should include specific evaluation of cyber security capabilities as well as the cost and risk of compliance with cyber security requirements.

“One of the great mistakes is to judge policies and programs by their intentions rather than their results.” — Milton Friedman