THE SMALL BUSINESS IN GOVERNMENT PROCUREMENT: SOME PROBLEMS AND

R K BONNER

END
THE SMALL BUSINESS IN GOVERNMENT PROCUREMENT:
SOME PROBLEMS AND CAUSES

by

Robert Kabel/Bonner

Dec 1977

Thesis Advisor: J.W. Creighton

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The Small Business in Government Procurement: Some Problems and Causes

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Small Business
Contracting
Procurement

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then, small business could benefit more from government procurement than it does.

This paper examines several definitions of 'small business,' and discusses a number of characteristics which differentiate the small firm from the large. Economic, social and cultural contributions of small business are presented. Small business policy is presented in terms of the committee structure and legislative acts of the Congress. Utilization of the government contract to achieve socio-economic goals is described. Finally, a few problems that small business encounters are discussed in terms of their impact and causes.
The Small Business in Government Procurement: Some Problems and Causes

by

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ABSTRACT

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I. INTRODUCTION

Small Business is an institution that contributes greatly to the economy, society and culture of America. Consequently, maintenance of a vigorous small business community within the private sector is a concrete element of National policy.

The Federal government, over the years, has developed a number of ways to nurture small business. Agencies have been established to provide assistance. Financial assistance has been made available. Congress has studied the problems of small business and has passed legislation to correct or alleviate them.

Specifically, it is the declared policy of Congress that small business shall receive a fair proportion of government contract awards. This paper is concerned with the implementation of this fair proportion policy.

A. STATEMENT OF THE PROBLEM

Congress' determination to maintain a vigorous small business community is clearly stated in the Small Business Act:

The essence of the American economic system of private enterprise is free competition. ... It is the declared policy of the Congress that the Government should aid, counsel, assist and protect, insofar as possible, the interests of small-business concerns in order to preserve free competitive enterprise, to ensure that a fair
proportion of the total purchases and contracts for property and services for the Government ... be placed with small business enterprises. [PL 85-536]

This Act permanently established the Small Business Administration with a number of direct responsibilities to the small business community. Further, the "fair proportion" requirement added yet another socio-economic objective to be pursued through the government contract.

There are forces within the government procurement process which work to the greater detriment of small business. The small firm encounters a variety of problems which large firms either do not encounter or feel but a trivial impact. Consequently, small business participation in government contracting and the benefits derived from participation are less than they could otherwise be — Congressional policy is not being effected to the fullest extent possible.

The problem, then, is to determine the nature and causes of the problems small business faces in government contracting.

B. RESEARCH METHOD

The research performed for this paper was entirely of a secondary nature. No original data were collected. No new methods of analyzing existing data are introduced. Information was gathered from public documents, books, journals, miscellaneous publications and interviews. This paper collects and organizes this information into a single coherent body.
C. ORGANIZATION OF THE PAPER

"Small business" is not amenable to precise definition. Chapter II examines both quantitative and qualitative definitions, and also discusses a number of characteristics that most readily differentiate the small firm from the large. Contributions of small business to society are discussed to develop an appreciation of the significance of small business as an institution.

Chapter III traces the evolution of present day small business policy by examining the committee structure and legislative acts of Congress. Utilization of the government contract as a vehicle to pursue socio-economic objectives is discussed.

Some of the problems that small business encounters in government contracting and their causes are described in Chapter IV.
II. WHAT IS "SMALL BUSINESS"

Any discussion involving "small business" is immediately beset with the problem of definition. The concept of business size is not crystalline; it is very subjective. Both the business literature and the popular press, when they deal with the aspects of size, often settle on the dichotomy of "large" and "small." Infrequently, a third category of "medium sized" will be added. Often, the parameters and bounds of the spectrum of business size are not precisely defined (or even mentioned), and they are left to the reader's personal notions.

No generally accepted definition of small business exists, and it is quite obvious that the same criteria cannot be used in different segments of the economy. Whatever set of criteria may be chosen, the resulting numbers are to a certain degree arbitrary; the resulting definition of the universe is neither sharp nor unequivocal. ... Analysts who are careful to indicate what they mean by "small" business may simply be recording whatever definition they found it necessary to accept. [1, pp. 29ff]

Congress, too, has not been able to define "small business" to its satisfaction although they have been grappling with this problem since the very first days of their concern with small business per se. "In 1942, a member of a Congressional committee accurately predicted that failure to find a usable definition of small business would lead to difficulty in formulating small business programs." [28, p. 126]
Under current law, "... a small business shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation." Any refinement of this brief definition for governmental purposes is specifically assigned to the Administrator of the Small Business Administration. The Administrator is authorized to use such additional criteria as number of employees and dollar volume of business. [PL 85-536; 67 Stat 232; 15 USC 631]

This chapter will not presume to add yet another definition, but will discuss the nature and characteristics of the small firm in an effort to provide the reader with a more accurate though still subjective and imprecise understanding of "small business." Also, the contributions of small business to American society will be discussed.

A. QUANTITATIVE DEFINITIONS OF "SMALL BUSINESS"

Although, as noted previously, any quantitative definition of "small business" must be arbitrary, such definitions have of necessity been set down by the Small Business Administration under its statutory authority. Quantitative definitions were required for the development and implementation of the various Federal small business programs.

The Administration in its quantitative definitions generally deems a business to be small if (a) it employs fewer than a specified number of people, (b) its recent average annual receipts does not exceed a specified maximum,
(c) it does not produce more than some specified maximum percentage of world output, or (d) it satisfies some combination of these criteria. The most frequently used criteria is solely number of employees. While this may seem a somewhat superficial approach, a study of Air Force procurement by Deadmon et al concludes that for most purposes little would be gained by adding some measure of sales, assets or profits. [26, p. 61]

Actual values of the maximums vary with the area of industrial operations and with the purpose of the application of the definition. For example, for the purposes of set-aside eligibility, the size standard for a manufacturer of gypsum products is different from the standard for a manufacturer of asbestos products. Also the standards which govern the eligibility of a given firm to bid a contract as a small business may well be different from the standards which govern its eligibility to purchase government property as a small business. [31, p. 11] Consequently, the regulations containing quantitative definitions are quite voluminous. Section 1-701 of the Armed Services Procurement Regulation which contains some quantitative definitions is 12 printed pages long.

To illustrate the quantitative approach, Figures 1 and 2 are included. Figure 1 summarizes the standards that must be met to receive assistance from the Small Business Administration. Figure 2 extracts a few standards from the Armed Services Procurement Regulation.
<table>
<thead>
<tr>
<th>INDUSTRY</th>
<th>RANGE OF MAXIMUM SIZE STANDARD</th>
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</thead>
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<tr>
<td></td>
<td>(Varies with area of activity within industry.)</td>
</tr>
<tr>
<td>Construction</td>
<td>Receipts: $5 million to $12 million</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>Employees: 500 to 1500</td>
</tr>
<tr>
<td>Services</td>
<td>Receipts: $1.5 million to $9 million</td>
</tr>
<tr>
<td>Transportation</td>
<td>Employees: 500 to 1500 -or-</td>
</tr>
<tr>
<td></td>
<td>Receipts: $5 million in certain categories</td>
</tr>
<tr>
<td>Research, Development, or Testing</td>
<td>Employees: 500 if no manufactured product</td>
</tr>
<tr>
<td></td>
<td>Other: If manufactured product, standard</td>
</tr>
<tr>
<td></td>
<td>specific to that industry applies</td>
</tr>
</tbody>
</table>

Source: 31, p. 10

Summary of Quantitative Definitions of Small Business for Purposes of Assistance by the Small Business Administration

Figure 1.
<table>
<thead>
<tr>
<th>Classification Code</th>
<th>Industry</th>
<th>Employment Size Standard (Number of Employees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAJOR GROUP 20 - FOOD AND KINDRED PRODUCTS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2026</td>
<td>Milk, fluid</td>
<td>500</td>
</tr>
<tr>
<td>2032</td>
<td>Canned specialties</td>
<td>1000</td>
</tr>
<tr>
<td>2043</td>
<td>Cereal breakfast foods</td>
<td>1000</td>
</tr>
<tr>
<td>2046</td>
<td>Wet corn milling</td>
<td>750</td>
</tr>
<tr>
<td>2052</td>
<td>Cookies and crackers</td>
<td>750</td>
</tr>
<tr>
<td>2062</td>
<td>Cane sugar refining</td>
<td>750</td>
</tr>
<tr>
<td>2063</td>
<td>Beet sugar</td>
<td>750</td>
</tr>
<tr>
<td>2076</td>
<td>Vegetable oil mills, except cottonseed and soybean</td>
<td>1000</td>
</tr>
<tr>
<td>2079</td>
<td>Shortening, table oils, margarine and other edible fats and oils, not elsewhere classified</td>
<td>750</td>
</tr>
<tr>
<td>2085</td>
<td>Distilled, rectified, and blended liquors</td>
<td>750</td>
</tr>
<tr>
<td>MAJOR GROUP 34 - FABRICATED METAL PRODUCTS, EXCEPT MACHINERY AND TRANSPORTATION EQUIPMENT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3411</td>
<td>Metal cans</td>
<td>1000</td>
</tr>
<tr>
<td>3431</td>
<td>Enameled iron and metal sanitary ware</td>
<td>750</td>
</tr>
<tr>
<td>3482</td>
<td>Small arms ammunition</td>
<td>1000</td>
</tr>
<tr>
<td>3483</td>
<td>Ammunition except for small arms, not elsewhere classified</td>
<td>1500</td>
</tr>
<tr>
<td>3484</td>
<td>Small arms</td>
<td>1000</td>
</tr>
</tbody>
</table>

Source: ASPR, 1-701

Examples of Small Business Size Standards

Figure 2

14
Since the numerical values of the quantitative criteria have been, and will continue to be, subject to frequent change, it is apparent that a comprehensive quantitative definition of "small business" is an extremely complex undertaking. Fortunately, a quantitative definition is not required for the purposes of this paper; a subjective qualitative definition will suffice and its development will begin in the next section.

B. QUALITATIVE DEFINITIONS OF "SMALL BUSINESS"

When specific attempts are made in the literature to define "small business," the definitions are usually functional or qualitative. The definition given by Hollander is representative of this approach:

... "small business" refers mainly to enterprises that:
1. are businesses in the sense that they involve all or most of the business functions and decisions concerning production, financing, marketing, and management, and
2. do not exceed a size which, considering the nature of the business, permits personalized management in the hands of one or a few executives, as opposed to the institutionalized management characteristics of larger enterprises.

... Small business, thus defined, is self-initiated, largely self-financed, and self managed. The small firm exists by virtue of its personalized skills and its market adaptability. [4, pp. 4ff]

Nearly all qualitative definitions contain the following characteristics in some combination: (a) limited dollar volume of business, assets and/or employees, (b) owner-management, (c) equity provided by a small circle of
owner-managers and from retained earnings, not from the
general money market, and (d) operation that is local in
countact and dependent on the growth and well-being of
the local community.

A more succinct approach to the description of "small
business" which implicitly embodies nearly all of the above
characteristics has been offered by McGuire:

... a small business enterprise is a profit
oriented organization in which there can
be rationally only one profit center. This
definition conforms closely with both the
traditional economist's concept of the
small firm and to what the general public
conceives to be a small company. For
analytic purposes, it sets small companies
apart from large because it focuses directly
upon the unfractionated entrepreneurial
function. [16, p. 118]

This definition fails in one serious aspect. Many small
firms do indeed contain, and rationally so, more than a
single profit center — consider an automobile distributor-
ship with new car sales, used car sales, and service opera-
tions profit centers. However, it does contain an essential
notion, and it provides a convenient conceptual shorthand.

While these qualitative definitions of "small business,"
like all qualitative statements, suffer from statistical
imprecision and the vagaries of subjectivity on the parts
of both the writer and the reader, they nevertheless con-
tribute to a conceptualization satisfactory for the purposes
of this paper. The next section will discuss some of the
characteristics of the small firm that most distinguish it
from the larger firm and thereby amplify the concept as used herein.

C. CHARACTERISTICS OF SMALL BUSINESSES

This section will describe several characteristics of the small firm which differentiate it from the large firm. This discussion will provide amplification to the qualitative definitions of the previous section and will provide a framework for the later discussion of the problems that the small firm faces in dealing with the government.

These characteristics are not presented in any particular or significant order; the sequence of presentation is essentially random.

1. Small Business And The Law Of Large Numbers

Aside from the obvious potential advantages of lower cost of inputs such as materials and capital when procured in large quantities and other increasing economies of scale, the large firm has an advantage over the smaller firm that arises from the statistical law of large numbers. This advantage is stability. This enhanced stability of nearly every aspect of the larger business comes from (a) a more uniform sales level for a given product due to a larger number of unrelated customers, (b) diversification over a larger number of nonperfectly correlated products or services, and (c) the larger pool of capital (relative to the average amount risked) reduces the probability that a random run of losses will have serious consequences, such as complete failure of the firm. [9, pp. 50ff]
A stable environment results in many potential direct economies. Required levels of inventory and working capital decline as stability increases. Reduction of risk in a more stable environment reduces the cost of capital. In fact, if too much instability exists capital may not be available at any price. An indirect benefit of stability is the increased accuracy of planning. [9, pp. 49ff]

2. Small Business's Capitalization

Small firms tend to be marginally capitalized, and under capitalization is not rare. The reasons for this are twofold. First, if debt capital is available at all, its cost to the small firm is significantly greater than its cost to the larger firm. Second, equity investors usually demand substantial control of the firm, which the independent small businessman frequently finds unacceptable.

Short term bank financing is the primary source of external capital for the small firm. Perhaps this is because of the local nature of small business. However, it is an expensive source.

... bank credit has always been available to those small firms which could supply ample security.... Of course, they have to pay a higher rate of interest ... to compensate for the larger risk assumed to be involved. Nevertheless, when small firms seek credit in amounts beyond those which their assured cash flows clearly warrant, most banks will make it available only against the pledge of assets rather than take a slightly higher risk at a correspondingly higher rate of interest. [4, pp. 127ff]
The risk referred to here arises from the instabilities that are characteristic of the small firm as discussed previously.

Long term debt financing through the commercial market is not readily available to the small firm because of the lack of widely dispersed and distributed public information about the firm. The cost of preparation and distribution of such information can be substantial for the small firm. Even if the cost were not prohibitive, the small firm may not make such information public from fear of giving close competitors significant advantage. The commercial market also demands a risk premium in the form of higher interest. [9, p. 55]

Private debt financing is usually available only on terms intended to return a quick profit to the investor as well as recognize the risk: short term and high interest. [4, p. 127]

The owner managed aspect of the small firm alluded to previously acts to obstruct the alternative of equity financing.

Small firms owned by one individual or a small group of individuals may be loath to sell equity or ownership to outsiders because of the desire to retain control of management decisions. This lack of desire to share in the management frequently blocks out venture equity capital alternatives. [9, p. 55]

Clearly, the small firm has less access to the commercial capital markets. This relative isolation
affirms the "largely self-financed" aspect of small businesses noted previously. Limited access to capital not only reduces the firms' ability to cope with the instabilities that it will experience, it limits growth.

Since the small firm is largely dependent on internal financing for expansion, its growth rate is limited, compared with a larger firm able to tap outside as well as internal resources. [4, p. 16]

If any single characteristic of small businesses had to be identified as the one most nearly universal, shortage of capital would be a prime candidate. Most small firms are nearly always hungry for capital, whether it be working capital for operations or venture capital for expansion. Generally, there is a greater concern for financial matters in the small firm than in the large firm. [4, pp. 126ff]


It has been asserted that anyone who can manage one kind of business can manage any other kind. The obvious implication here is that there is a universal management practice which is sophistry at best. While the language and concepts of management may be regarded as universal, its practice is not. More specifically, "management practices cannot be the same in enterprises that are radically different in size." [2, p. 1]
the large firm. Perhaps it is best characterized as: the small businessman must be a generalist, whereas the executive in the large firm, with the exception of the highest levels, is often a specialist.

If the range and complexity of management decision and operations of a small business are less than those of a large one, the requirements of versatility, adaptability and discernment may be greater. ... managerial competence [in a small firm] demands a wider range of skills and abilities.... [4, pp. 92ff]

The small firm can rarely afford the luxury of staff specialists, and consulting specialists are frequently of limited value because of the need to understand the organization's goals and value systems to be fully effective.

An example of the diversity of managerial scope between the small and the large firm is that larger firms are often so "... compartmentalized ... that any given manager has only to deal with one or two government bureaucracies, whereas the small businessman has to deal with all of them." [17, p. 249]

Because of the generalist nature of small firm management and the absence of staff specialists, the decision making process tends to be more subjective -- the ability to perform or obtain suitable analysis is not present. [2, p. 2]

Although generalist management may adversely affect the small firm, it may not be without its blessings. This wider range of managerial activity may actually allow the
smaller firm an advantage in attracting good management by virtue of its greater challenge. [12, p. 8]

One of the essential elements of the generalist nature of the small firm is that it is **not** a bureaucracy in either form or philosophy. This may hinder the firm in its relationships with organizations which are bureaucracies.

4. Small Business's Less Structured Organization

Small firms tend to have less formal, less structured (if not minimal), and more flexible organizational characteristics. "They achieve the output and push the product out the door with a minimum of differentiation in job content." [2, p. 4] Nearly every person within the small firm's organization is required to accomplish a number of diverse tasks as a matter of course.

Another organizational aspect of the small firm, the shortened distance from the topmost to the lowest levels, leads to a more personalized environment for all personnel. Anthony Downs has offered a definition of a large organization as one "... in which the highest-ranking members know less than half of all other members...." [3, p. 24] It may be this more intimate personal association within the organization which results in greater employee identification with the firm, lower turnover and longer employee tenure at all organizational levels that are characteristic of the small firm. [2, p. 2]
5. **Small Business's Centralized Control**

Smaller firms tend toward more highly centralized decision making than do larger firms. Smaller size, owner-management and the relatively greater criticality of the decisions all tend to concentrate decision making power into the hands of a few individuals. In fact, many small firms are dominated by a single individual.

Another, perhaps trivial, aspect that encourages this tendency is the smaller number of people competing for decision making power in the small firm.

Once again, the small firm is not bureaucratic and in a very important sense. In the small firm, decisions are made by human beings as the need arises and in the exact situational context. In bureaucracies, on the other hand, most decisions are highly influenced by policy, rules and regulations which are either attempts to provide a solution to anticipated problems or codification of solutions to problems previously encountered.

6. **Small Business's Neglect of Planning**

Although there is substantial evidence that planning pays off in successful operations, the small businessman often only pays it lip service. [7, p. 159]

The length of nearly every cycle is shorter in the small firm (with the possible exception of accounts receivable).

As a result of the shorter cycle span, small companies usually do not conceptualize their situation from the viewpoint of their opportunities, expertise
or strengths. ... The longer cycles of the larger firm have probably made it possible and even necessary to use models unknown to small firms. The absence of models in turn is probably a significant reason for the deficiencies in planning that prevail in small firms. [2, p. 3]

As a consequence of this neglect of strategic planning, decision making in the small firm tends to be a reactive rather than an innovative process.

7. Small Business's Aversion To Risk

Smaller firms tend to be more conservative than larger firms. A nearly universal human trait is to avoid discomfort and to take increasingly conservative approaches as the significance of the stakes increases.

Many small businessmen are familiar with extreme discomfort from direct experience.

The nature of most small firms' origins — arising as they often do out of the gamble of one or two men — militates against the taking of risk again. There is something about the fear wracked period of seeing whether a venture will survive that turns the mind against a repetition of the experience. That is why most small firms become conservative about risk taking after they become successfully established. [2, p. 3]

Individual decisions in the large firm seldom have the relative significance that they have in the small firm.

The decision maker in the large firm seldom "bets the company," while this is not unusual in the small company.

Large corporations can absorb costly mistakes which might prove fatal to the small- or medium-sized enterprise. "The margin for error in a small business is slim," emphasizes one
management consultant. "The independent doesn't get three strikes before going out -- but usually has to hit a home run on the first pitch." [27, p. i]

While many small businesses appear to undertake very risky projects, they are either done in ignorance or with the firmly held belief that they are not indeed risky. This is not to imply that small firms are not opportunistic. They are!

8. Small Business' Dedication To Product

Although very few firms deal in a single product or service, even within the small business community, the smaller firm tends to be "... dominated by the things they make or the services they render." [2, p. 3] The small firm will find it more difficult to shift from their current product or service to others that are somewhat different.

This dedication to product, in turn, reinforces the conservative cast of small businesses. "Diversity is one of the great strengths of small business, but flexibility within any one of them is not." [17, p. 251]

The preceding factors which most significantly differentiate the small firm from the large are summarized in Figure 3. These characteristics should be kept in mind as causal factors during the following discussion of problems that small businesses face in dealing with the Government.

Now that a general notion of small business has been established, the role of small business in contemporary American society and its economy will be addressed.
1. Less stability: variations large compared with averages.

2. Marginal Capitalization: cost of capital is high.


4. Organizational flexibility: minimal formalism and job differentiation.

5. Centralized decision making: one man domination; people make decisions.


7. Conservatism toward risk: relative significance of stakes.

8. Product domination: reduced flexibility of product.

9. THE SMALL FIRM IS NOT BUREAUCRATIC.

Source: none

Common Characteristics of Small Firms which Differentiate them from Large Firms

Figure 3.
D. THE CONTRIBUTIONS OF SMALL BUSINESS

Small business is more than a simple expression of one type of economic endeavor — it is also an American cultural institution. As such, its contributions exceed the pure economic effects, and include political, social and cultural effects as well. The contributions of small business to American society will be discussed in the following pages.

1. The Economic Contributions of Small Business

The raw statistics that reflect the economic contributions of small business are impressive, but small business makes other significant economic contributions. The small business community is often the minimum cost source of some goods, and essentially the only source for other goods. The competitive effects of a healthy small business community act to check monopoly and to add to the diversity of the products available in the marketplace. A small business is a very important source of technological innovation, and is the nursery of all business.

Approximately 97 percent of all business enterprises in the United States are classified as small. They produce about 48 percent of the business gross national product. They provide about 55 percent of the private sector employment. They provide a livelihood for about 100 million Americans. [24, p. 9]

As for being a minimum cost source, it has been reported,
... that when an item to be purchased and the conditions of procurement are such that small business concerns can be included in the competition, these concerns offer the lowest prices on 70 percent of the procurements, measured in dollar value. [8, p. 16]

Some products and services are almost totally within the domain of small business. For example, the fashion and style goods industry is dominated by the small firm to the nearly complete exclusion of the larger firm. [4, pp. 14ff; 9, p. 50]

When the number of traders on either side of a market is small, the regulating forces of the free market are weakened: monopoly and monopsony appear. A healthy small business community, with its vast number of participants who have relatively great freedom to enter and exit any facet of a market at will, tends to provide anti-monopolistic and anti-monopsonistic forces. [11, p. 31]

A large small business population "... assures competition with all the concomitant advantages of a free enterprise system." [24, p. 9]

Small businessmen because of their great numbers, their competitive nature and their willingness to enter very limited or highly specialized market sectors add greatly to the diversity of goods and services available. They add spice to economic life. [11, p. 31]

The small firm, especially the technologically based firm, is widely recognized as a major source of
innovation. In fact, small business has been described as the "... fountainhead for new technologies and new procedures." [24, p. 9] Perhaps the larger firm is not quite so innovative because it "... has a huge investment in existing products and procedures that it would prefer not to write off too quickly." [15, p. 13]

A landmark study of 61 important twentieth century inventions found that fewer than one-third originated in large business organizations. [see Jewkes, et al.] Other studies have reported that as much as 74 percent of technological innovation originates in small companies. [13, p. 106] It has also been asserted that not only is the small firm more innovative, but on a research cost per patent issued basis, the small firm is likely to do so for lower cost. [19, p. 102]

The importance of small business as a source of innovation is leveraged by the import of technological innovation to the economy.

Sowell, in his pioneering work, found that between 1909 and 1949 about 81 percent of economic growth was attributable to technical change and changes in production practice. Dennison, in a more disaggregate study, found that 36 percent of the rise in output per worker was attributable to advances in technical knowledge. [19, p. 91]

Innovation is of little worth in and of itself; it must "be brought to market." Small business is at a disadvantage in this area.
The resources required to introduce an innovation commercially are much greater than those required to demonstrate its feasibility. ... No matter who the inventor, the advantage in commercial development, production and marketing is more frequently with those with large financial, technical and organizational resources, mainly large companies. [4, pp. 116ff]

One strategy that has been suggested to the small technological firm is that the firm stick to its innovation efforts and form joint ventures with larger firms to pursue the balance of the task of bringing the technology to market. [see Hlavacek]

The small business community breeds new industries and is a seedbed where new companies can germinate and grow to challenge the established leaders. Every business enterprise has its ultimate roots in the small business community. [11, p. 31]

2. The Non-Economic Contributions Of Small Business

Small business reflects American social ideals and values. It provides an economic forum for freedom of expression, diffuses economic and political power, supports economic and social mobility, and provides employment opportunities. It does these better than does big business. A report summarizing hearings before the Senate Select Committee on Small Business states:

Although the witnesses agreed that smallness in itself has no inherent virtue, there appeared to be a consensus that smaller organizations tend to support traditional
American values such as local independence, personal self-reliance, and self-expression more effectively than do large firms. [21, p. 179]

Small business as an institution makes a significant contribution to the vigor and wealth of American society.

Enterprising and energetic people find a productive outlet for their energies in small business; energies that might otherwise be frustrated and ultimately released in a destructive manner. [11, p. 31] Further, nearly all studies of the entrepreneur find that his

... primary motivation in setting up his own shop is seldom to achieve fame or gain fortune. Rather, it is to get away from having to work for someone else. Small businessmen, in other words, are an independent lot.... [17, p. 249]

Thus is small business the forum for free economic expression.

Small business, as a result of its variegated nature "... diversifies economic and political control."

This diversification is political, social and geographic in nature. [24, p. 9]

The small firm has not generally enjoyed large amounts of capital or ready access to the capital markets. It has therefore tended to be labor intensive rather than capital intensive. Consequently, "[s]mall business provides a substantially greater demand for personnel and provides greater employment opportunities." [24, p. 9]

Kristol has described the non-economic contributions of small business eloquently:
But small business is even more important politically than economically. It is integral to that diffusion of power and wealth, and to the economic and social mobility, which are the hallmarks of a liberal society. It is the small businessman who builds up those large fortunes which then sustain the not-for-profit sector—the universities, foundations, philanthropies—which is so important a buffer between the public and private sectors. (Corporate executives almost never accumulate that amount of capital, despite their high salaries.) It is the successful small businessman who maintains his roots in a local community, becomes a visible symbol of success to everyone, gives politicians in our smaller towns and cities their own access to funds (and therefore a greater independence from national organizations), supports all those local activities—social or cultural—which keeps community morale high. And it is in the small business sector that those who are discriminated against, whether it be for their politics, race or religion, can find, and have traditionally found, sanctuary. [15, p. 13]

Much more succinctly, but still carrying both the economic and the non-economic contributions implicitly, "... small business preeminently is the private sector." [15, p. 13]

In summary, then, a vigorous small business sector is vital because small businesses "... contribute to our society in ways that large corporations cannot." [6, p. 7]

In stronger words,

Small business is the foundation of the American economy and is essential to the preservation of our society. ... It is in the national interest to have a strong, dynamic small business sector of the economy. [24, p. 9]
E. CHAPTER SUMMARY

There is no generally accepted definition of small business, and the quantitative definitions promulgated by the Small Business Administration are exceedingly complex and cumbersome. Although qualitative definitions are fraught with subjectivity, a qualitative definition buttressed with descriptions of some salient characteristics that most readily differentiate between the large and the small firm will suffice for this paper. The contributions of the small business community to the American economy, society and culture are both pervasive and important.

In the next section, the Federal policy toward small business and its implementation will be discussed.
III. FEDERAL SMALL BUSINESS POLICY

Congress is a key source of Federal policy. Congressionally mandated policy appears in legislation and in the record of the legislative history. Non-legislative acts, such as oversight hearings, their records and the Congressional commentaries on them, can also be considered to be policy statements. Also, the very organizational structure of the Congress reflects (at least an implied) policy.

The Executive Branch is the link between promulgation and implementation. It puts the final coloration on the operation of policy; policy implementation can range from vigorous prosecution to neglect. Policy culminates in the acts of the Executive.

This chapter will discuss Federal Policy toward small business within this Congressional/Executive framework.

A. POLICY IN CONGRESSIONAL STRUCTURE

Congressional concern for small business is reflected in its structure. Currently, the Senate contains a Permanent Select Committee on Small Business, and the House contains a standing Committee on Small Business. The present nature and the evolutionary histories of these Committees gives some insight into this concern.

1. Senate

The Senate Select Committee on Small Business was established as a permanent select committee on 20 February
1950 (S Res 58, 81st Congress, 2nd session). As a select committee, it has oversight responsibilities only, and it cannot send legislation directly to the floor.

Since its inception, the Senate Committee has not undergone any evolutionary change. It has, however, survived, intact, extensive Congressional reorganization.

[20, pp. 1ff]

2. **House**

The history of the House small business committee structure is longer and more varied than is the Senate's.

On 12 August 1941, the House established a Select Committee on Small Business (H Res 294, 77th Congress, 1st session). This committee was not permanent. Its life was limited to the duration of that Congress; however, at each subsequent Congress, the House adopted a resolution to reestablish the Committee. It was, in effect, a permanent Committee, but its aegis did not carry the commitment that permanent stature would have implied. This was remedied on 22 January 1971 when it was made a permanent committee (H Res 5, 92nd Congress, 1st session).

As a select committee, its functions were limited to oversight — it had no direct legislative responsibilities — as is the case today with the Senate Committee.

The most recent structural action was the reformation of the Committee as a standing committee on 8 October 1974 (H Res 988, 93rd Congress, 2nd session). As a standing committee, the House Committee on Small Business gained
legislative responsibilities and has, in fact, become "... the legislative hub for small business legislation." [24, p. 1]

B. POLICY IN NONLEGISLATIVE CONGRESSIONAL ACTIONS

The small business committees of both the Senate and the House have held oversight hearings since their inception which have provided a public forum for the interests of small business. They also monitored and reviewed the implementation of legislation and the execution of various programs affecting the small business community. These hearings have often resulted in chastisement of components of the Executive Branch for policies and acts which were felt to be inimical to small business.

C. POLICY IN LEGISLATION

Legislative acts by the Congress which have affected the small business community may have their roots in the anti-trust statutes, the Sherman Act and the Clayton Act, whose principle concern was the preservation of free enterprise. The first attempt to create a governmental agency with specific responsibilities to assist the small businessman was the Reconstruction Finance Corporation, established in January, 1932 (PL 72-2). Direct financial assistance was provided in 1938 when Congress authorized the Reconstruction Finance Corporation to make loans to small business. [20, p. 6]
The first agency established specifically to assist the small businessman in the procurement area was the Smaller War Plants Corporation (PL 77-603). Soon after the war, however, the Corporation was disestablished by Executive Order, and its responsibilities were distributed among several other permanent agencies. The intended benefits to small business soon vanished as a result of the diffusion of responsibilities and their neglect. [25, p. 17]

With the Korean Police Action, Congress again recognized the need to aid the small businessman and established the Small Defense Plants Administration (PL 82-96). Its major responsibility was to assist small business obtain government contracts. [25, pp. 17ff]

As Korean Action activities came to a close, Congress felt that there was a continuing need to assist small business. Consequently, the Small Business Act was enacted (PL 83-163). This act established the Small Business Administration as a temporary agency. It also abolished the Small Defense Plants Administration and the Reconstruction Finance Corporation transferring their powers and responsibilities to other agencies — primarily to the Small Business Administration. [25, p. 20]

The life of the Administration was extended several times, and in 1958 it was established as a permanent agency by Public Law 85-536. This law contains the current formal statement of Congressional policy regarding small business:
The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for property and services for the Government (including but not limited to contracts for maintenance, repair, and construction) be placed with small-business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation.

It should be evident from the legislative history that Congress has long had an active (if somewhat inconstant) concern for the health of the small business community. Further, Congress intends that private sector shall contain a vigorous small business segment.

D. THE SMALL BUSINESS ADMINISTRATION

The Small Business Administration is specifically chartered to aid the small businessman in coping with the myriad problems he encounters daily. As such it is the most palpable embodiment of the Congressional determination to maintain a healthy and dynamic small business community.
Assistance to small businessmen is provided in three areas: financial, management and government procurement.

Financial assistance takes essentially two forms. The Administration can make loans directly to small businesses for a variety of purposes and reasons. It can also assist the small businessman obtain commercial loans by acting as a guarantor.

Managerial assistance is primarily carried out through a number of educational publications such as the "Management Aids" series, which are available free or at a very nominal cost. Direct assistance is provided through such programs as the Service Corps of Retired Executives and the Active Corps of Executives.

Assistance in the area of government procurement includes monitoring the set-aside and breakout programs of the procuring agencies and the Certificate of Competency program of the Administration. In the set-aside program, some procurements are designated for award only to a small firm. Under the breakout program, procurements may be factored into several parts, either distinct items or reduced contract quantities, to enhance the competitive position of small business. In the Certificate of Competency Program, the Agency acts as a "court of appeals" for the small firm whose bid was refused on the basis of inadequate capacity and credit. Upon appeal, the Administration will make a determination of capacity and credit based on its own inquiry, and this determination is binding on the procuring agency. This
program has alleviated the alleged abuse of the contracting officer's discretion in evaluating capacity and credit.

E. SOCIO-ECONOMIC PROGRAMS AND THE PROCUREMENT PROCESS

Government procurement has been used to accomplish socio-economic purposes since 1892 when standards for hours of work on government contracts were established. [28, p. 112] However, the Congressional and Executive proclivities to utilize Federal procurement as a vehicle for achieving social goals have their major roots in the depression.

During the 1930's when the United States was struggling to recover from the great economic depression, Congress began to show interest in and passed into law many socio-economic assistance programs. ... [The Supreme Court declared much of this legislation to be unconstitutional.] The Executive and Legislative Branches, feeling their power somewhat constricted, searched for other methods to effect their social and economic programs. They embraced the idea of the government contract. [25, pp. 15ff]

Since that time, both branches have made a conscious decision to utilize Federal procurement as a means to advance social and economic improvement and reform. Some of the considerations which underlie this decision are:

1. The enormous influence that can be exerted in view ... [of the tremendous sums] which are expended annually.

2. The concept that the nation's defense is bound up with the nation's welfare. Economic instability, a limited competitive and industrial base, and social unrest can threaten and undermine the security of the nation and reduce its military capability.
3. A belief that because public monies are involved the government has an obligation to promote the nation's welfare to the extent practicable.

4. A realization that while some socio-economic programs do not appear cost-effective from a particular agency's perspective, they often are quite cost-effective from an overall social cost standpoint. That is to say that the lowest cost procurement to an agency will not necessarily result in the lowest cost procurement to society as a whole. [31, p. 1]

Utilization of the procurement process to pursue socio-economic goals has mushroomed. The Commission On Government Procurement prepared a list of "several" social programs that were implemented through the procurement process. This list contains 39 programs, and it is by no means comprehensive. See Figure 4.

While the procurement process provides a potentially powerful vehicle for the implementation of socio-economic programs, this approach is not without its dangers. Some of these dangers are (a) the possibility of overloading the procurement process to the point that it becomes inefficient, (b) the likelihood that the socio-economic programs will conflict with each other thus imposing unwarranted confusion on the system, (c) the emergence of a multiplicity of enforcement authorities with overlapping jurisdiction, and (d) the possibility of overemphasis of socio-economic objectives to the detriment of the primary procurement mission: the timely acquisition of quality supplies and services at reasonable prices. [31, p. 2]
<table>
<thead>
<tr>
<th>Program</th>
<th>Authority</th>
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<tr>
<td>Buy American Act</td>
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<td>Preference for United States Manufacturers</td>
<td>22 U.S.C. 295a</td>
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<td>Preference for United States Manufacturers</td>
<td>16 U.S.C. 560a</td>
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<td>Preference for United States Products (Military Assistance Programs)</td>
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<td>Preference for United States Food, Clothing, and Fibers (Berry Amendment)</td>
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<td>Officials Not to Benefit</td>
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<td>Clean Air Act of 1970</td>
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<td>Davis-Bacon Act</td>
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<td>Contract Work Hours and Safety Standards Act</td>
<td>40 U.S.C. 328-332</td>
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<td>Prohibition of Construction of Naval Vessels in Foreign Shipyards</td>
<td>Public Law 91-171 (DOD Appropriation Act of 1970), title IV</td>
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<tr>
<td>Acquisition of Foreign Buses</td>
<td>Public Law 90-500, (DOD Appropriation Act of 1969), sec. 404</td>
</tr>
<tr>
<td>Release of Produce Information to Consumers</td>
<td>Exec. Order 11566</td>
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<tr>
<td>Prohibition of Price Differential</td>
<td>Public Law 83-179, sec. 644</td>
</tr>
</tbody>
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Figure 4.
Program Authority

Employment Openings for Veterans
Exec. Order 11598; 41 CFR 50-250, ASPR 12-1102

Covenant Against Contingent Fees
41 CFR 1-1.500-509

Gratuities
32 CFR 7.104-16

International Balance of Payment
ASPR 6-805.2, FPR 1-6.8

Prison-made Supplies
18 U.S.C. 4124

Preference to U.S. Vessels

Care of Laboratory Animals
ASPR 7-303.44

Required Source for Aluminum Ingot
ASPR 1-327, FPR subpart 1-5.10

Small Business Act
15 U.S.C. 631-647; see also 41 U.S.C. 252(b) and 10 U.S.C. 2301

Blind-made Products
41 U.S.C. 46-48

Duty-free Entry of Canadian Supplies
ASPR 6-605

Use of Excess and Near Excess Currency
ASPR 6-000 et seq., FPR 1-6.804-806

Purchases in Communist Areas
ASPR 6-401 et seq.

Nonuse of Foreign Flag Vessels Engaged in Cuban and North Vietnam Trade
ASPR 1-1410

Labor Surplus Area Concerns
Defense Manpower Policy No. 4, 32A CFR 33 (Supp. 1972)

Economic Stabilization Act of 1970
12 U.S.C. 1904 note

Humane Slaughter Act
7 U.S.C. 1901-1906

Figure 4 (Cont'd)
Program Authority
Miller Act 40 U.S.C. 270a-d
Convict Labor Act Exec. Order 325A,
ASPR 12-201 et seq.
Vietnam Veterans Readjustment Act Public Law 92-540

Source: 28, pp. 114, 115
Some Socio-Economic Programs Implemented Through
The Procurement Process

Figure 4 (Cont'd)
So long as the support given the socio-economic programs within the procurement process harmonizes with the tangible goals of the procurement process, there is no conflict, and the socio-economic programs are given full support. Problems arise, however, when the socio-economic programs conflict with economic and efficient procurement. The inevitable result is that the socio-economic programs suffer. [29, p. 5]

Support of the small business community is one of the socio-economic goals that is implemented in part by using the procurement process. It is explicitly so stated by the policy that small business shall receive its "fair proportion" of government procurement. [PL 85-536]

The procurement approach to providing assistance not only benefits the small business community by broadening its business base, but the whole of society benefits as well. Some of the benefits accruing to society are (a) lower procurement costs, (b) an improved and broadened competitive base, (c) additional sources of innovative technology, (d) industrial and geographic dispersion of procurement funds, and (e) a broadened base for industrial mobilization. While some of these benefits are intangible, others are not. [28, p. 126]

F. FAIR PROPORTION: A POLICY

The notion that small business should receive a "fair proportion" of government procurement is intuitively
appealing, but it, like "small business," is beset by definitional dilemmas. What is a fair proportion?

"Fair proportion" could be rigidly interpreted as a predetermined percentage of the total. One such 'fixed' number that has been discussed is that small business should participate in government procurement to the same extent that it contributes to gross national product. This proposal does not account for the fact that the government's procurement needs do not follow the production pattern that produced the national product. Predetermining an allocation for small business would be at least as arbitrary but far more complex and dynamic than defining small business. A horrendous task at best.

A somewhat different and far more pragmatic approach to defining "fair proportion" was given by a Lockheed Corporation executive in describing his company's subcontracting program which also required that small business get a fair proportion. "A fair proportion of total purchases is that portion which small business can win in open competition, provided they are given an equitable opportunity to bid." [25, p. 37]

What may, perhaps, be the best interpretation of "fair proportion" is that offered by the Commission On Government Procurement:

We believe fair proportion should be recognized as a working concept that expands or contracts from year to year with the types of procurement by the Government, state of the economy, and
fluctuations in particular industries. It should support and create a small business capability to meet the Government's needs and should express congressional intent to develop small business opportunities in Government Procurement. [28, p. 127]

G. IMPLEMENTATION

The procuring agencies of the Executive Branch bear the ultimate responsibility of implementing small business procurement policy: namely that the small business community be treated equitably and that it receive a fair proportion of the procurement dollar. Executive Branch interpretation of this policy is codified in the various regulations which govern government procurement. Consider, for example, the requirements of the Armed Service Procurement Regulations, Section 1, Part 7, which contains the policy regarding small business participation. The essence of the policy is:

1. Contracting opportunities shall be advertised in the Commerce Business Daily if at all possible. This is to provide advance notice to the public, including small businesses.

2. Solicitation shall be on a competitive basis to the maximum extent possible.

3. Any procurement where there are a sufficient number of qualified small business sources to assure reasonable prices shall be either totally or partially set-aside for award only to a small business.

4. Where feasible, components and spare parts shall be broken out for exclusive small business bidding.

5. Mandatory small business subcontracting will be required in certain classes of prime contracts.
This certainly appears to be a satisfactory regulatory interpretation of Congress's intent. Other regulatory interpretations are probably equally satisfactory.

However, the process of policy implementation is not completed with the promulgation of regulations — its culmination is in results. There is ample evidence that the desired results have not yet been obtained.

Publication of contracting opportunities in the Commerce Business Daily frequently does not provide small business (or any other firm) with an equitable opportunity. This point will be addressed in the next chapter.

Regarding the requirement to maximize competition, the House Select Subcommittee found

... that there is a continuing, increasing number of instances of alleged discriminatory practice which result in small business not being invited to bid. These include the use of unduly restrictive specifications, unwarranted sole source procurements, unreasonable use of the urgency and emergency exceptions to the statutory requirement for formal advertised bids, unreasonable conditions of eligibility to bid .... [23, p. 12]

Nor has the set-aside program fully achieved its objective. The small business community endorses the set-aside program and continually clamors for more set asides.

Congress responds by chastising procuring agencies for not letting more contracts to small business. Subject to these pressures, agency implementation of the set-aside program often reacts to near-term requirements while losing sight of the overall objectives....

Many procurement officials contend that the
small business set-aside program has become a "numbers game" in which improving the competitive posture of small business is secondary to the statistical record. [29, p. 21]

The House Select Subcommittee also reported allegations of discrimination against small business which included

... unnecessary consolidation of requirements normally within small business capability into a large volume single procurement beyond small business production capacity, and failure to break out components of systems or subsystems which could be produced and competed for by small business. [23, p. 12]

Such conduct is certainly not within the intent of Congress, nor is it within the letter of the regulatory requirements for breakout.

There are many means of diluting the impact of mandatory small business subcontracting; some of these will be addressed in the next chapter. Other means of encouraging small business subcontracting, such as the weighted guidelines of the Armed Service Procurement Regulation, have little effect. The guidelines are designed to determine the size of the fee on a cost reimbursable negotiated contract and thereby motivate the accomplishment of a number of objectives. However, small business subcontracting is lumped with eight other items for a maximum 2 percent increase in profits. "This dilutes the small business portion of the profit allowances to the point where there is no realistic economic motivation to favor small business....." [29, p. 34]
It appears that no implementation step between promul-
gation of regulation and results yet have been firmly taken.
Or, in summary, "... as far as the small business program
is concerned ... there is no evidence that the Federal
agencies have gone overboard promoting it. In fact, the
opposite appears to be the case." [31, p. 2]

H. CHAPTER SUMMARY

The nurture and protection of the small business community
is a concrete element of American national policy. This
fact is demonstrated within the Congress by its very struc-
ture and its legislative acts. Within the Executive
Branch, this policy is reflected by its structure, regu-
lations and programs.

Congress has, for more than three decades, had one or
more committees which have provided a forum for small
business interests and which served as advocate and spokes-
man for small business. Several Executive agencies have
come and gone whose missions have included some manner of
direct assistance to small business. These have culminated
in today's Small Business Administration.

One of the more cogent elements of the policy to pro-
tect small business is the Congressional mandate that small
business receive its "fair proportion" of the Federal
procurement dollar and the associated implementing regu-
lations and programs within the Executive. However, an
argument can be made that small business is not getting
its fair proportion simply by virtue of conscious (not to mention unconscious) discrimination on the part of government personnel. Further, small business is probably not getting the share it could if there were better mutual understanding by the parties. Some of small business's problems are of their own making, and many could be corrected with education. Other problems have their roots on the government side, and while many of them may be impervious of solution, some of them could be corrected or alleviated by better understanding of small business on the part of government personnel.

Some of the problems small business faces in dealing with the government and their possible causes will be discussed in the next chapter.
IV. PROBLEMS SMALL BUSINESS FACES IN GOVERNMENT CONTRACTING

The government is a difficult customer for any firm to deal with but especially for the small businessman. A report to the Commission On Government Procurement highlights some of the difficulties.

During the course of our study, we received widespread criticism of procurement regulations, especially from small businessmen. The chief complaints were over the multiplicity of systems and levels, volume and complexity of regulations, redundancy, frequency of changes, absence of standards and controls, and lack of uniformity in format and content. Also, small contractors find it difficult in dealing with different agencies to adjust their pricing, negotiating and contracting practices to the variable requirements and regulations of the different agencies. [29, p. 47]

There are many reasons why the government procurement process presents this distressing appearance to the business community. Three of the major contributing factors are (a) the government is a huge bureaucracy, (b) the public's money is involved requiring greater accountability, and (c) the procurement process has been enlisted to do more than simply acquire needed goods and services. These three factors should be kept in mind during the following discussions of particular problems small business faces in government contracting.
A. PROBLEMS OF POLICY

Government by virtue of its very nature represents a multitude of different interests, many of which have affected the procurement process. Because of this, there has never been a single source of procurement policy. The diversity of sources of procurement policy is illustrated in Figure 5, which is repeated from the Report of The Commission On Government Procurement. Not only has policy come from a variety of sources, there has been no concerted effort to ensure that it was coherent or consistent. Such considerations have been totally neglected. Consequently,

There is no single or consistent source of Government-wide procurement policy. ... There is no safeguard to assure consistent implementation of procurement policy. ... There is no Government-wide method for updating of procurement policy. ... There is no consistent approach to the receipt and consideration of suppliers' views on, or reaction to, policy development. [29, p. 48]

This uncoordinated formulation of policy has resulted in a miasmatic state of affairs.

There are more than 4000 statutes which affect Federal procurement and contracting transactions. The statutes are backed-up by ... policies reflecting the sense of the Congress, Executive Orders, and the regulations and implementing procedures. ... A complete understanding of all the inconsistent, duplicative and conflicting policies is impossible. Even if it could be made possible, there are changes being introduced every moment. [30, p. 15]
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<th>EXECUTIVE BRANCH</th>
<th>JUDICIAL BRANCH</th>
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<tr>
<td>Legislation - Government-wide or limited to particular agencies or programs</td>
<td>Executive orders</td>
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Source: 28, p. 10

Sources of Federal Procurement Policy

Figure 5.
Only recently has any attempt been made to integrate and coordinate procurement policy. In response to a recommendation of the Commission On Government Procurement, the Office of Federal Procurement Policy was established in the Executive Office of the President (PL 93-400). It is still too early to judge the impact this office will have.

Nearly every businessman is familiar with the Uniform Commercial Code and its role as the "single source of policy" governing commercial contracts. The transition from the reasonably neat and ordered commercial environment to the government policy jungle is only one of the reasons that all business finds the government to be a difficult customer. But since the government is the sovereign the game is played by its rules regardless of how cumbersome and confusing they may be.

The impact of this mass of confusing and conflicting policy and regulations on the small businessman is serious, for "... small businesses usually do not have the legal talent or manpower to comprehend all existing regulations." [29] As a result, the average small businessman when he encounters his first government contract probably has no idea of the nature and extent of the responsibilities and liabilities involved. And, because of the numerous sources for the requirements, there is no easy way for him to find out. Even a diligent effort on his part may not gain him an accurate understanding because simply asking the right question of the seemingly appropriate authorities is not
enough: he must be fortunate enough to receive the right answer. [10, p. 40; 17, p. 249]

B. PROBLEMS OF BUREAUCRACY

One of the problems small business encounters is the diverse nature of the contracting parties. A small business may be viewed as a flexible, dynamic Lilliputian whereas the Government is more like a plodding, insensitive Gulliver.

A private firm has great flexibility in its contracting practices, and the limits of discretion are extremely broad in the small business. It can pick and choose with whom it does business. If problems arise, its options cover the spectrum from complete exercise of its contractual rights to simply ceasing to do business with the other party. Its decision is based upon its evaluation of the injustice suffered, the limits to which it is willing to go to seek redress, and its assessment of the ultimate economic outcome.

The Government, on the other hand, must enforce its contractual rights to the hilt if for no other reason that it cannot pick and choose with whom it does business. Its range of options to apply to any particular problem is extremely narrow. Regulations exist to cover nearly every situation (at least those which are anticipated and those which have been encountered before), and these regulations essentially predetermine the government's response to problems. [18, p. 32]
The small businessman lives in a world of uncertainty and has adapted to it. The bureaucrat lives in a deterministic world and has adapted to it. Bureaucrats instinctively oppose change and new ideas, they follow the book and seldom exercise the few options allowed, and what they do is done with glacial slowness. These characteristics are in direct contrast to the flexible, opportunistic nature of the small businessman. [17, p. 253]

The upshot is that neither party can use himself as a predictive model for the other. Unfortunately, many problems arise from exactly this cause.

Governmental bureaucracy will not change. The size of the governmental organization alone requires the bureaucratic approach, and this is compounded by the government's public accountability.

C. PROBLEMS OF CONTRACT COMPLEXITY

Government procurement contracts are extremely complex documents — much more complex than are commercial contracts. A commercial contract has a single objective: timely acquisition of needed goods and services of suitable quality at a reasonable price. A government contract has this same objective, but it is not the sole objective; it is also burdened with a variety of socio-economic objectives.

It reflects social policy, business philosophy, moral tenets, and, in some cases, even foreign policy. In other words, this ostensibly simple document is not only expected to resolve the
material needs of the Federal community, but also contribute to the resolution of the many inequities in our society. [18, p. 31]

Multiplicity of objectives and policy sources means a multiplicity of sources for the governing contract law, and this constitutes another major difference between the government and commercial contract.

In commercial practice, the principles and laws governing contracts are contained in the Uniform Commercial Code. Therefore, the governing operational law is easily cited and accessible. Such is not the case for government contracts. Here, the governing law is neither easily cited nor readily accessible to the small businessman. [18, p. 32]

A government contract is a conglomeration of clauses citing myriad sources with little logical coherence. Frequently, the clauses are not even numbered sequentially. Nor do all the clauses appear explicitly in the contract.

Very often, even a small contract, ... will contain by reference perhaps as many as ninety clauses which the contractor must stipulate he is in compliance with. Under the intense time pressure the government typically imposes on bid preparation, few small businessmen would evaluate these clauses in any greater depth than simply reading their titles. And in any case, the inexperienced businessman has no way of knowing which of these ninety clauses are included simply pro forma, and which are of actual concern to the contracting authorities. [17, p. 250]

Also, frequently when clauses are included by reference, the procuring agency itself does not have copies of the
full text. The contractor must deal directly with the agency of jurisdiction.

Complexity is not limited to volume, logical incoherence and inclusion by reference. Language as used in government contracting clauses bears little resemblance to the English of commerce and social intercourse.

Lacking the pressure of having to explain their use of language, policy development personnel are free to use complex and often excessive language to close every possible loophole — no matter how remote — without considering readability of the contract. ... An easily understood contract would lead to increased competition, and presumably lower prices, on a broader array of Government purchased items. A clearer statement of contractor obligations in a broad stretch of Congress-enacted social and economic programs ... might significantly improve compliance with the laws and result in greater progress toward these difficult goals. [10, pp. 43ff]

This bizarre use of language may lead a layman to believe he understands the meaning of a clause when, in fact, his interpretation is quite different from the actual meaning.

During the bidding process, any attempt to have clauses modified or deleted will generally be useless, and unilateral action by the bidder will probably render the bid nonresponsive. Changes will probably not be considered at all after award, and certainly not without substantial consideration from the contractor. [30, p. 15]

Noncompliance with any contract clause during contract execution exposes the contractor to the possibility of
termination for default with severe, potentially fatal, penalties. It is therefore important that the contract be well understood: total compliance should be the outcome of more than mere good fortune. However, ... the government contract will continue to be a tool for achieving more than business needs of the nation. ... Improvements can be made to government contracts, but to think that it will ever be as simple to do business with the government as it is with a private company is wishful thinking. [18, p. 32]

D. PROBLEMS OF THE BIDDING PROCESS

A number of facets of the bidding process place the small business in a disadvantageous position. Two of the more important are (a) not receiving truely equitable treatment, and (b) the government's use of unduly restrictive specifications.

Most government contracting opportunities are synopsized in the Commerce Business Daily. However, it is claimed that this publication is of little use to the small businessman. Often, there is too little time available between receipt of the Daily and bid closing to prepare an adequate bid. Times as short as one week or less are not unusual. Within this interval, the businessman must obtain the bidset, determine the goods and services required and whether he can supply them, determine if he is in compliance with the other requirements, and finally prepare and submit a bid. A difficult task at best is made onerous in the compressed time frame. [17, p. 252]
While most businesses face these problems, the larger firms with their greater market intelligence resources are more likely to have become aware of the opportunity in advance of its advertisement. Also, their greater marketing intelligence provides them with better insight into exactly what is desired, where the emphasis will be placed in bid evaluation, and the procedural peculiarities of the procuring activity. The larger firm will be able to prepare a better, more "fine tuned" bid. [32]

Couple this enhanced intelligence with the brief bid preparation time and the disadvantageous position of the small firm becomes apparent. In fact, "... many small firms feel it is not worthwhile for them to bid." [14, p. 29]

Unduly restrictive specifications are frequently cited as an obstacle to the small businessman. Small firms seldom have the resources to either modify their products especially for the government market or to get the specifications modified to the point where they can compete. Small firms, therefore, find it unnecessarily difficult to sell their produce to the government. [23, pp. 12,22; 17, p. 251]

Even when a firm does encounter a restrictive specification and attempts to have it changed, the results may be disheartening. Thieblot recounts the case of a small engineering company who tried to sell their pushbutton padlock to the government. They "... discovered that padlocks are bought in accordance with a specification
which was so detailed that it substantially described a competitor's product in everything except name." They pursued their case with vigor — trying to get the specification rewritten. They failed to get the specification rewritten, but the government did agree to write a new specification for pushbutton padlocks. The company discovered "... that this new specification described its own product in such exhaustive detail that essentially no one else could offer a competing product to the government without infringing its patents." [17, p. 251]

E. PROBLEMS OF THE EVALUATION PROCESS

Small businesses also encounter disadvantageous situations in the source selection process. Included are: preference for larger firms, biased evaluation systems, biased evaluators and improper discriminatory actions by contracting officers.

The small business community perceives a definite tendency for contracting officials to select the larger firm over the smaller firm, especially in any procurement that involves development activity. The rationale offered for this alleged behavior arises from the bureaucratic imperative to survive and never be wrong. If a large firm fails to perform successfully, no stigma is seen to fall on the contracting officer — if the big firm couldn't do the job, nobody could have; that's just the breaks. On the other hand, if a small firm is selected and fails,
the fault and blame are seen to rest on the contracting officers shoulders – the company failed because it was small; the contracting officer should have known better. [32,33]

Even in situations where a formal source selection system involving other personnel is devised to advance, and therefore limits the contracting officer's discretion, the small firm is still often at a disadvantage. The reason is that such systems are frequently "... heavily weighted in favor of established, well staffed large business concerns." [23, p. 22]

Procurement personnel other than the contracting officer often contribute to the obstacles that the small firm must overcome in the evaluation process. Evaluators all too often look beyond the context of the contract under consideration. They are swayed by a firm's capabilities in excess of those required for contract performance. They tend to evaluate bidders in relation to each other rather than in relation to the requirements of the contract. This quite obviously places the small firm in a disadvantageous position. [32,33]

In addition to the unconscious acts and attitudes described, hearings before the House Select Committee developed...

... cases in which contracting officers inappropriately refused to award contracts to the small business low bidder on the grounds that the small businessman lacked the tenacity and perseverance.
necessary, in the contracting officer's sole opinion, to perform the contract. ... The application of such regulations calls for a very nebulous and subjective type consideration of the small businessman's ability to perform the contract for which he entered the low bid. In some cases, contracting officers have used this technique to base their decisions upon alleged lack of tenacity and perseverance or alleged lack of integrity instead of "capacity and credit," so their decisions would be immune from effective review... [23, p. 27]

and possible reversal by the Small Business Administration under the Certificate of Competency Program.

The net result is that the small businessman faces a hostile environment in the source selection process.

F. PROBLEMS OF CONTRACT EXECUTION

If a small firm is successful in bidding and receives a contract, it still faces problems during contract execution. Two of the more significant factors are apparently diffuse authority within the government, and insensitivity to the unique nature of the small firm.

The problem of diffuse authority has been described by a Study Group of the Commission on Government Procurement.

Procurement authority is distributed throughout countless regulations, statutes, and procedures which preempt or needlessly constrain the contracting officer. As a result, such specialists as the auditors and program managers have assumed an "equal" position with the buyer on their areas of specialty. The result of this functional competition raises the very real question of who is
in charge of the procurement and where is the focus of authority and responsibility. The small businessman, who may be confused by the maze of statutes and regulations, is often uncertain about who is the final authority on a specific problem during contract performance. [29, p. 50]

Such confusion can be dangerous, for if the right authority does not sign the correct form the small firm could face serious consequences for actions that it took in good faith and with the presumption of authorization.

One of the areas where government insensitivity takes on major significance is in the area of money. Specifically there is inadequate recognition of the small firm's continual thirst for funds. In any case where money is owed the government, it absolutely insists upon having, and therefore gets, the highest priority of any creditor, debt holder, supplier, or employee. Final payment of the completion set-aside portion of the contract price can proceed extremely slowly: "... it often takes three years or more before the final payments on government contracts are released." [17, p. 252]

G. PROBLEMS OF REMEDIES THAT AREN'T

While the procurement process contains a variety of methods and means for the contractors to obtain remedies to a variety of problems, these "remedies" are often of little relief to the small firm.
Small business often finds that, under the present remedial system, the amount required to pursue its claim equals or exceeds the amount of the claim. Frequently, it must continue work, usually financed with its own money, during long, complicated and expensive litigation to recover a claim on which no interest is earned. Contractors with enough money to finance litigation under the system may recover a claim; contractors without adequate resources cannot. Moreover, even if a small claim is recovered, the relative cost of that recovery represents a waste of resources that could be better utilized elsewhere. [29, p. 49)

A process where it costs more to effect the correction than to suffer the loss is no remedy.

H. PROBLEMS OF SUBCONTRACTING

Small business can participate in government procurement as a subcontractor, and thereby expand the base from which it may obtain its fair proportion. A number of government programs have been instituted to increase the participation of small business in subcontracting.

Subcontracting has its hazards and inequalities too.

It has been asserted that as a subcontractor, "... the small independent plant, more often than not, becomes nothing more than an appendage of the prime contractor, with all the managerial functions assumed by the latter on a take-it-or-leave-it basis." [6, p. 143] While this may be somewhat overstated, it indicates the presence of a possible consequence that the small businessman finds exceedingly distasteful.
The chance to compete on an equal basis, which is sometimes lacking in direct procurement, is even less present in the subcontracting arena. "Expense, trust, risk and familiarity ... emerge as pressures constraining against exclusive reliance on the competitive selection of subcontractors." [29, p. 36] A prime contractor, especially in a period of declining business will be inclined to give preference to a firm from which it may in turn receive subcontracts. [29, p. 36; 22, pp. 18ff]

It has also been alleged that large firms will often sole-source subcontracts to sister divisions rather than break them out for free competition. [32]

I. CHAPTER SUMMARY

The preceding discussion has tried to show that the small businessman encounters a totally different kind of customer and a different kind of environment when he begins to deal with the government. These differences, in turn, account for some of the difficulties the small business community experiences in its pursuit of the government procurement dollar.

Small business does indeed experience difficulties, some of which have been discussed. The extent of small business' problems has been dramatically described by Mr. Jack Lang of the Small Business Administration.

In the case of the commercially successful small business, its cost of learning to do business with the government will be
at least as great as its investment to learn the business in the first place. [33, paraphrased]

Many of the problems small businesses face are insoluble by virtue of the diverse nature of the parties involved and the environments they inhabit. However, a recognition of the causes of the problems by both the small business community and by government procurement personnel may reduce the impact of the problems (on both parties) and thereby better effect national small business policy.
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