

PSC Issue Paper on Mid-Sized Federal Contractors

The Professional Services Council (PSC)¹ intends to create better opportunities for the federal contractor community and their government customers to achieve mission success. As federal contracts become larger, more consolidated, and cross-cutting², PSC seeks to better define and advocate for a class of business that, in many cases, “graduates” from a small business designation and its associated set-aside structure only to face market forces that challenge their success.

There are scarce data that measure the success or utility of companies that are no longer small but are not large enough to benefit appreciably from large businesses’ economies of scale. As a result, the U.S. Government may not be adequately aware of barriers that inhibit full return on its small business investments and discourage mid-sized vendors from “leaving the nest”³: only 22 percent of *graduating* businesses *remain* mid-sized and only three percent of graduating businesses break through mid-sized to large.⁴ With appropriate definition and implementation of supportive policies, mid-sized companies exemplify successful avenues of growth for small businesses that more align with the federal government’s intent to promote business growth in return for more resourceful innovation. In this issue paper, PSC defines three immediate challenges to mid-sized businesses in federal contracting sector and offers potential solutions to help the government become a better buyer and to promote an effective, streamlined and competitive federal contracting system.

Problem Statement

The “Other-Than-Small” Conundrum

The federal government recognizes two categories of businesses – “small” and “other-than small.”⁵ The Small Business Administration (SBA) determines a certain dollar or employee size standard for each NAICS code that, if exceeded, renders a small business ineligible to win set-aside contracts, “graduating” a business out of the small pool into the big leagues. Professional services size standards are generally

¹ PSC is the voice of the government technology and professional services industry, representing the full range and diversity of the government services sector. As a trusted industry leader on legislative and regulatory issues related to government acquisition, business and technology, PSC helps build consensus between government and industry. Our 400 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social, environmental services, and more. Together, the trade association’s members employ hundreds of thousands of Americans in all 50 states.

² [Assessment of Government-wide Trends](#), Government Accountability Office, GAO-17-244SP, March 2017.

³ “Leaving the Nest: Challenges Facing Advanced Small Businesses” Roundtable, U.S. House Committee on Small Business (2018).

⁴ [Awards to Mid-Sized Businesses and Options for Increasing their Opportunities](#), Government Accountability Office, GAO-19-523, August 2019. GAO studied 104 graduating businesses over nine years, of whom 23 remained graduated, and three became large.

⁵ Girth, Amanda M. and Brown, Trevor, [Examining the Effects of Set Aside Policies on Competition and Growth for Small and Mid-Sized Suppliers](#), Naval Postgraduate School, SYM-AM-17-077, March 31, 2017.

based on annual revenue with the current cap of \$41.5 million.⁶ However, once a business is ineligible for small business set-asides, the SBA ceases to monitor progress.⁷ As stated in the House Report of the Small Business Runway Extension Act of 2018:

As such, potentially critical economic indicators remain uncaptured, such as: the success or failure rate of small businesses that grow out of their small status, the number of jobs created by growing small firms, industries that promote or inhibit middle-market growth, and many other factors.⁸

A clear definition for this mid-size category of business is necessary to better facilitate the federal government's procurement goals. As federal contracting momentum is trending toward implementation of category management and streamlining, Best-in-Class contracting, and multiple-award acquisition strategies, procurement officials seek to bridge the functional gap between large and small businesses through contract mechanisms such as continuous on-ramping and fully unrestricted contract vehicles. A commonly accepted definition of mid-size companies would support data collection for this type of business and would be a positive step in determining if program objectives are being met.⁹

Powerball Effect

Alongside the growing value of government contracts, set-aside contracts have increased in value such that small businesses may be catapulted beyond their size standards in one contract or task order. These small businesses face tough choices: to strategically stay small or to risk growth beyond small business programs in “full and open” competitions with larger companies.¹⁰ Mid-size market forces pressure small business to remain small, even if that requires stunted growth.¹¹ One industry representative coined a term for this conflict:

Small businesses face enormous infrastructure hurdles especially if they grow very quickly or win larger federal contracts with big task orders. Some refer to this as the Powerball Effect, leaving businesses scrambling to stay ahead of the demands of their growth and simultaneously trying to compete on the open market.¹²

This immediate change in dynamics often requires businesses to reinvent themselves to remain competitive in the federal market¹³. Often, businesses have limited choices: a small business graduate may choose to acquire or be acquired by a larger company with interest in the market

⁶ [Table of Small Business Size Standards Matched to North American Industry Classification System Codes](#), U.S. Small Business Administration, August 19, 2019.

⁷ “[No Man's Land: Middle-Market Challenges for Small Business Graduates](#)”, Hearing, U.S. House Committee on Small Business, Subcommittee on Contracting and Workforce, April 26, 2018.

⁸ [H.R. Report 115-939](#).

⁹ David J. Berteau, [Challenges Facing Advanced Small Businesses](#), Professional Services Council, (December 14, 2017)

¹⁰ “[No Man's Land: Middle-Market Challenges for Small Business Graduates](#)”, Hearing, U.S. House Committee on Small Business, Subcommittee on Contracting and Workforce, April 26, 2018.

¹¹ Girth, Amanda M. and Brown, Trevor, [Examining the Effects of Set Aside Policies on Competition and Growth for Small and Mid-Sized Suppliers](#), Naval Postgraduate School, SYM-AM-17-077, March 31, 2017.

¹² “[Cleared for Take-Off? Implementation of the Small Business Runway Extension Act](#)”, Hearing, U.S. House Committee on Small Business, Subcommittee on Contracting and Infrastructure. March 26, 2019.

¹³ *Supra* 11.

sector or on a specific contract vehicle.¹⁴ Market pressures may force a business to sell at a reduced value than they had previously held as a small company due to the loss of small size status.¹⁵ A business may choose to remain small for many reasons, such as to avoid acquisition or to retain their attractiveness as a contracting partner (i.e., support small business subcontracting goals).¹⁶ Another industry stakeholder said:

The federal government on one hand encourages us to grow, emphasizing the need for access to capital and entrepreneurial assistance. Many SBA programs emphasize, educate and support growth. But on the other hand, it structures policies that discourage growth such as its size standard structure and limitation on small business program participation.¹⁷

PSC believes a more structured path to mid-size growth is critical to disabling market inhibitors and enabling the natural progression of small business growth.

Quantitative Scoring

The trend of using large acquisition strategies with task order-level competition has produced an onboarding urgency in companies, creating numerous proposals for each new vehicle. The government has responded to this influx by mandating “self-scoring.” Self-scoring entails point scores that measure the number of contracts a firm has performed, as well as the size and type of those contracts.¹⁸ While large businesses often have volumes of past performance information and certifications, mid-size companies may not. Given small business utilization requirements, a small business is an attractive partner for a mentor protégé or teaming agreement. Large businesses have less incentive to team with mid-sized businesses. As one industry stakeholder notes: “If you are an industry leader, that is easy. If you are a recently graduated small business, however, all the teaming agreements and subcontracts in the world cannot help you compete.”¹⁹

PSC believes in providing opportunities for graduating small businesses to more accurately demonstrate performance through a balanced assessment that encourages consideration of qualitative skills and experience.

Potential Solutions

A Recommended Definition

Two prevailing studies have attempted to define the mid-size business category. In a 2018 Government Accountability Office report²⁰ to the House Committee on Small Business, GAO defined a mid-size category by adding a multiplier of five to the SBA annual revenue or number of employee size standard

¹⁴ Girth, Amanda M. and Brown, Trevor, [Examining the Effects of Set Aside Policies on Competition and Growth for Small and Mid-Sized Suppliers](#), Naval Postgraduate School, SYM-AM-17-077, March 31, 2017.

¹⁵ “Leaving the Nest: Challenges Facing Advanced Small Businesses” Roundtable, U.S. House Committee on Small Business (2018).

¹⁶ *Id.*

¹⁷ “[No Man’s Land: Middle-Market Challenges for Small Business Graduates](#)”, Hearing, U.S. House Committee on Small Business, Subcommittee on Contracting and Workforce, April 26, 2018.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ [Awards to Mid-Sized Businesses and Options for Increasing their Opportunities](#), Government Accountability Office, GAO-19-523, August 2019.

for each NAICS code and then assessed companies that fell into this range. Bloomberg Government also conducted a mid-size study with a more static definition (\$25 million-\$500 million in annual prime contract revenue).²¹ This approach, however, includes “big small” businesses that still qualify for set-asides under SBA size standards. **PSC would avoid any definition that has a static window, as SBA’s size standards often change.**

PSC would propose using elements of both GAO and BGov methodologies for a definition of mid-size. PSC’s recommended approach would define mid-size between the NAICS code size standards and a ten-times multiplier for the prevailing SBA size standard, at the time of this writing \$41.5 million x ten for most industries or 1,500 x ten for number of employees. This definition includes GAO’s methodology of a multiplier, though increases the multiplier since many PSC members identifying as mid-sized are above GAO’s threshold. This definition also sets a maximum cap like the BGov methodology, though PSC’s max cap recommendation instead scales as the prevailing size standard incrementally increases. This would ensure data collection and future policy consideration would capture high-performing outliers and all small businesses graduating from their respective size standards.

*Size Standard Classification Assessment – **Lowest Three Years of Revenue Instead of Average of Five***

Congress passed the Small Business Runway Extension Act of 2018 (SBREA) to “help advanced-small contractors successfully navigate the middle market as they reach the upper limits of their small size standard”.²² The bill called for SBA to assess contractor size standards on a five-year revenue/employee average, replacing SBA’s previous method of assessing a three-year revenue/employee average. The runway extension was regarded as beneficial to contractors in enabling further preparation for potential transition to the “other-than small” category, based on comments to SBA throughout implementation.²³ However, key stakeholder testimony from House Small Business Committee hearings and roundtables was absent from the language of this law and its subsequent implementation.

During these hearings, stakeholders described contractor growth to be mercurial, stating that some years growth could hover in single-digit percentages, while other years, contractors could experience explosive growth.²⁴ These ebbs and flows are accompanied by key staff gains and losses as well as capability modifications, especially in a downturn. SBA’s final rule acknowledges this drawback:

when annual revenues are declining, the 5-year average may be higher than the 3-year average. This would cause small businesses near the size thresholds to lose their small business status sooner under the 5-year average than under the 3-year average. This is more likely to happen during economic downturns.²⁵

²¹ “[The Mid-Tier Paradox: Too Small to Compete, Too Large to Survive?](#)” Bloomberg Government, May 13, 2016)

²² [H.R. Report 115-939](#).

²³ [Small Business Size Standards: Calculation of Annual Average Receipts](#), Federal Register, Final Rule, December 5, 2019.

²⁴ “[No Man’s Land: Middle-Market Challenges for Small Business Graduates](#)”, Hearing, U.S. House Committee on Small Business, Subcommittee on Contracting and Workforce, April 26, 2018.

²⁵ *Supra* 23.

One industry stakeholder remarked, “by extending the time period for the receipts calculation, the Committee may have assumed that revenues either remain stagnant or grow year-to-year at a steady rate. While this may be true for some companies, it is not true for all.”²⁶

The SBREA offered what was advertised – an extension to help contractors successfully navigate the middle market, yet not necessarily relief from the fluctuations often experienced by small, medium, and large federal contractors.

PSC would propose Congress revisit previous hearing testimony advocating assessment of size standards that allows companies to “use the (average of the) lowest three of the last five years of revenue to determine small business status”²⁷ or allow companies to address runway inequity by choosing which calculation is most favorable for their preparation – three years versus five years. Feedback in GAO’s mid-size company study was conclusive:

Nearly all stakeholders we interviewed noted that allowing businesses to choose their lowest 3 years of revenue in a 5-year period could prevent an outlier revenue year from causing small business to prematurely outgrow its size standard.” Noting a one-year award is not indicative of a business’s revenue over the long-term.²⁸

This solution would assist in mitigating the Powerball Effect for small business contractors by better enabling them to strategize upward trajectory with forward-looking approach, rather than being shanghaied into the “other-than small” category for outlier success. As one stakeholder stated, “The rationale behind this proposed change can be stated simply: competitiveness takes time to build. Revenue is not an indicator of present competitiveness; it is an indicator of future competitiveness.”²⁹

Balance Qualitative and Quantitative Scoring

PSC member companies in PSC-U.S. Government sessions on multiple award contract strategies often caution about over-implementation of quantitative methods because they often rely on past performance and requirements that categorically disqualify small-to-mid-size businesses from competition against large businesses.³⁰ While there is a necessary function for qualitative metrics such as the Contractor Performance Assessment Rating System and scorecards as tools in qualification assessment, PSC recommends agencies use a balanced approach by reasonably reducing quantitative barriers to entry and increasing consideration of past performance through qualitative experience. GAO’s report states, “Nearly all stakeholders interviewed said that lowering quantitative requirements would increase opportunities for mid-sized businesses, small businesses, or both.” Specifically, agencies could be advised to consider experience and skills of both prime contractors and significant subcontractors, which

²⁶ “[Cleared for Take-Off? Implementation of the Small Business Runway Extension Act](#)”, Hearing, U.S. House Committee on Small Business, Subcommittee on Contracting and Infrastructure. March 26, 2019.

²⁷ *Id.*

²⁸ [Awards to Mid-Sized Businesses and Options for Increasing their Opportunities](#), Government Accountability Office, GAO-19-523, August 2019.

²⁹ *Supra* 26.

³⁰ [PSC Services Mac Reverse Industry Day](#), Professional Services Council, June 7, 2021.

could broaden desirability of mid-size contractor experience and enable better teaming for large contract awards.³¹

Conclusion

The intent of this document is to initiate conversation and development of advocacy for mid-size companies, to continue working toward an effective definition so their success can be measured and enhanced, to identify the current state of market and challenges in their growth, and to develop a basis to determine next steps of action.

PSC welcomes your comments and looks forward to your discussion.

³¹ [Awards to Mid-Sized Businesses and Options for Increasing their Opportunities](#), Government Accountability Office, GAO-19-523, August 2019.