

Review of the Department of Defense Comprehensive Subcontracting Plan Test Program

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July 2002

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Executive Summary

In 1990, when Congress authorized the Department of Defense (DoD) to negotiate comprehensive small business subcontracting plans, it was responding to a Defense industry proposal to reduce subcontract reporting requirements as a way to increase subcontracting opportunities for small businesses. The Department was under considerable pressure from Congress to improve its small business (SB) subcontracting performance, especially that of small disadvantaged businesses. Previously—in 1987—Congress had established a 5 percent subcontracting goal for small disadvantaged businesses, and the large Defense contractors were having difficulty meeting it.

Using an incentive-based approach, Congress authorized the Secretary of Defense to establish the Comprehensive Subcontracting Plan Test Program (Test Program), under which participants would negotiate a comprehensive subcontracting plan that would apply to all subcontracts they awarded during the fiscal year.¹ Absent their participation in the Test Program, prime contractors are required to negotiate individual subcontracting plans for contract awards in excess of \$500,000 (\$1,000,000 for construction). Like individual subcontracting plans, the comprehensive plans have subcontracting goals defined for SB, small disadvantaged business (SDB), and women-owned small business (WOSB) categories.² The concomitant administrative savings resulting from the negotiation and administration of one subcontracting plan instead of many plans is intended to free participants to increase their outreach activities directed toward small businesses, thereby increasing opportunities for them under their DoD contracts.

¹ Section 834 of the National Defense Authorization Act for Fiscal Year 1990, Public Law 101-189.

² There are goals for other categories: Historically Black Colleges and Universities, Minority Institutions, HUBZone businesses, Veteran-Owned businesses, and Disabled-Veteran-Owned businesses. In this analysis, we limit our focus to the SB, SDB, and WOSB categories because most subcontracting occurs there. The Department recently required participants to develop goals for the Veteran and HUBZone categories. For that reason, there are insufficient data with which to make reliable assessments regarding performance in those categories.

When the program commenced in fiscal year (FY) 1991, there were eight participants. Over time, the roster of participants evolved as firms entered, withdrew, and/or merged with or were acquired by other firms—frequently fellow Test Program participants. The 20 current members participate at either a corporate level (whereby all of the participating firm’s subcontracting activity is covered under the comprehensive plan), a division level (whereby all of the subcontracting activity within a contractor’s division is covered by the comprehensive plan), or at an operating level (whereby all of the subcontracting activity within an operating element of a participating firm is covered by the plan).

SUBCONTRACTING PERFORMANCE

In its review, LMI found that Test Program results improved impressively between 1991 and 1996 but have declined since then. Table ES-1 illustrates the aggregate performance of Test Program participants.

Table ES-1. Aggregate Performance of Test Program Participants

FY91				
	Total (%)	SB	SDB	WOSB
DoD Total	\$57,053 (100)	34%	2.7%	N/A
8 Participants	\$11,916 (21)	12%	.9%	N/A
FY96				
DoD Total	\$47,353 (100)	41.8%	5.9%	3.3%
14 Participants	\$6,719 (14)	36.2%	5.2%	2.5%
FY00				
DoD Total	\$54,858 (100)	39.3%	5.3%	4.2%
20 Participants	\$17,522 (32)	29.4%	4.2%	2.7%

In FY91, DoD prime contractors awarded approximately \$57 billion in subcontracts to large and small businesses.³ The original eight participants accounted for 21 percent of the DoD total and awarded 12 percent of their subcontracts to small businesses and a miniscule 0.9 percent to small disadvantaged businesses. By

³ The Department did not report on subcontracts awarded to women-owned small businesses until 1996.

FY96, the 14 participants awarded 36.2 percent of their subcontracts to small businesses. This level reflects a three-fold increase over the FY91 performance. More importantly, SDB subcontracting grew impressively, exceeding the statutory 5 percent minimum. By FY00, the share of the DoD's total subcontracting owned by the now 20 participants rose from 14 to 32 percent, but their subcontracting performance declined. SB subcontracting as a percentage of the participants' total fell from 36.2 percent to 29.4 percent. The same relationship holds true for the SDB subcontracting performance, which declined from 5.2 to 4.2 percent.

FACTORS AFFECTING SUBCONTRACTING PERFORMANCE

It is LMI's view that this recent decline in the participants' subcontracting performance is largely attributable to several factors.

First, there is an insufficient supply of certified small disadvantaged and HUB-Zone businesses available to meet SDB and HUBZone subcontracting goals. Without an adequate supply of certified businesses, it is unlikely that subcontracting performance will improve in either of these subcontracting categories.

The DoD's use of systems integrators—prime contractors that manage major weapons systems development projects—has adversely affected subcontracting performance by increasing the number and size of large business subcontracts. Related to this shift toward the prime contractor acting as a systems integrator, are the rise in directed-source procurements and teaming agreements. These procurement practices adversely affect SB subcontracting performance by “fencing off” large portions of the competitive subcontracting dollars that otherwise might be available for small businesses.

Test Program participants also noted that the increasing complexity of the technology employed in weapons systems has exceeded the capabilities of small disadvantaged and HUBZone firms. The DoD implemented its Mentor-Protégé Program to address this concern, but Test Program participants reported that technological advances limit subcontracting opportunities for small businesses.

Test Program participants also indicated that their SB subcontracting performance suffers when corporate buyers consolidate requirements for products and services such as office supplies, janitorial services, and travel services, into nationwide contracts. This practice results in “corporate bundling,” with a single, large business source displacing SB subcontractors.

In addition, Test Program participants reported that mergers and acquisitions affected their SB subcontracting performance in several ways. First, turbulence ensues while corporate cultures meld, financial accounting systems merge, and procurement practices change as firms learn to act as one. Second, after a merger

or acquisition, the acquiring firm can be saddled with a much larger supply base with lower SB participation on DoD contracts.

RECOMMENDATIONS

To improve the subcontracting performance of Test Program participants, LMI makes the following recommendations.

LMI recommends that the DoD Small and Disadvantaged Business Utilization (SADBU) office consider a revision to the Test Program that would provide for greater involvement by the Program Management Offices (PMOs) that the Test Program participants have as customers. To effect this change, the DoD SADBU office may consider requiring that PMOs endorse the subcontracting plans as appropriate. A gradual introduction of this proposal—first requiring it of the PMOs of the consistently poor performers—may limit resistance to this initiative.

A second related initiative would require the major weapons systems PMOs to report on SB subcontracting performance on their systems. An annual report akin to the Standard Form (SF) 294 that provided visibility on SB subcontracting levels would enable the DoD SADBU office to identify which major weapons systems procurements were providing the fewest subcontracting opportunities for small businesses. By making this recommendation a Contract Data Requirements List (CDRL) item, the Test Program participants would not be reluctant to accommodate this additional reporting burden.

LMI recommends that the DoD SADBU office consider establishing a roundtable of stakeholders, to identify solutions to SDB and HubZone firm certification issues. To boost the number of certified firms, tax credits or signing bonuses might serve as incentives to Test Program participants. The certification of small disadvantaged and HUBZone firms is a perplexing problem that will require a collaborative solution from government, Test Program participants, small disadvantaged businesses, and HUBZone contractors. In addition, LMI recommends that Test Program participants report their minority business enterprise (MBE) data. In light of the decline in certified SDBs, this information will further enhance the DoD SADBU office's understanding of the extent of SB subcontracting performed by Test Program participants.

LMI recommends that the DoD SADBU office consider a thrust initiative for at least 5 percent of participants' teaming subcontract expenditures to be awarded to small businesses. Teaming partners differ from other subcontractors in that they have a special relationship with the prime contractor. They have greater access to acquisition specific information than non-teaming partners do and a higher probability of being awarded subcontracts. To the extent that SB participation boosts their past performance qualifications in future source selections, Test Program participants will benefit as well.

LMI recommends that the DoD SADBUs office consider requiring all participants to provide reasonable visibility of subcontracting performance information to the DoD SADBUs office and to the Defense Contract Management Agency (DCMA). At a minimum, participants should provide data on subcontracting performance at the division level (for corporate participants) and for major program activity (for division- or corporate-level participants). Any request from DoD for increased visibility should be reasonable and should not place any undue administrative burdens on Test Program participants.

To promote greater high-tech subcontracting opportunities for small businesses, LMI recommends that the DoD SADBUs office redirect the guidance regarding targeting two industry categories toward subcontracting in high-tech areas. LMI recommends that the DoD consider using the thrust initiative process to phase in this initiative. Furthermore, LMI recommends using the DoD SADBUs Mentor-Protégé Program as a vehicle to offset possible participant expenditures related to this initiative. Additionally, LMI recommends that Test Program participants be required to report the dollar value of their research and development subcontracts to small businesses. LMI believes that this information has great utility as a barometer of high-tech work performed by small businesses.

LMI recommends that the DoD SADBUs office establish guidance on the accounting of directed-source procurements on participants' SF295 reports. This guidance should permit program participants to deduct the dollar value of directed sources from their annual subcontracting baselines. LMI further recommends that justification for directed-source procurements be made in written form (e.g., in a letter, contract language, or drawings and specifications).

LMI recommends that the DoD SADBUs office consider a revision to the Test Program that would require the renegotiation of comprehensive subcontracting plans. This amendment provision would enable participants and the DoD to react to major contract awards that occur after completion of negotiations. The DoD SADBUs office should consider establishing procedures that mandate a renegotiation whenever "late" awards increase a participant's projected annual revenues by 15 percent.

LMI recommends that the DoD SADBUs office consider establishing an annual meeting with Test Program participants and DCMA representatives to vet thrust initiatives and other developments affecting Test Program Participants' performance prior to the negotiation of comprehensive subcontracting plans. This event would speed the dissemination of the initiatives, enable Test Program participants to implement the initiatives more quickly, and serve as a forum where DoD officials and Test Program participants could exchange ideas, best practices, and lessons learned.

LMI recommends that the DoD SADBUs office encourage the senior acquisition executives for the Department of the Army and the Department of the Navy to designate contracting activities to support the Test Program.

LMI recommends that the DoD SADBUs office consider a revision to the Test Program that would permit the removal of Test Program participants that perform poorly. Criteria defining what constitutes poor performance might include the repeated failure to attain SB subcontracting goals for three consecutive fiscal years as well as failure to implement thrust initiatives. The DoD SADBUs office should consider developing a notification process to afford participants the opportunity to reenergize their efforts and an appeals procedure to protect process integrity. The notification process should provide adequate time for affected participants to challenge the DoD's decision.

LMI recommends that the DoD SADBUs office consider requiring that participants track administrative savings (based on the number of SF294s that would have been completed) and the cost and results of their outreach activities. Participants should report these results annually in their subcontracting plans.

Finally, LMI believes that the DoD SADBUs office should limit enrollment to the existing 20 participants for the time being. Enrollment could be opened once changes have been made to improve the performance of the current Test Program participants.

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Chapter 1

Background, Objectives, and Approach

BACKGROUND

In 1990, when Congress authorized the Department of Defense (DoD) to negotiate comprehensive small business subcontracting plans, it was responding to an industry proposal designed to reduce administrative reporting requirements as a means of increasing Defense subcontracting opportunities for small businesses. The Department was under some pressure to improve its small business (SB) subcontracting performance, especially that of small disadvantaged businesses, which had been and still is proving to be a challenging problem for DoD. Several years earlier, Congress had established a 5 percent subcontracting goal for small disadvantaged businesses, and the large Defense contractors were experiencing tremendous difficulty meeting that 5 percent goal.

Using an incentive-based approach that would limit subcontract reporting requirements in exchange for greater outreach activities, Congress authorized the Secretary of Defense to establish the Comprehensive Subcontracting Plan Test Program (Test Program), under which participants would negotiate a comprehensive subcontracting plan instead of negotiating individual subcontracting plans for contract awards in excess of \$500,000 (\$1,000,000 for construction). Like individual subcontracting plans, the comprehensive plans have subcontracting goals defined for small businesses, small disadvantaged businesses, and women-owned small businesses. The concomitant administrative savings resulting from the negotiation and administration of one subcontracting plan instead of many plans would free participants to increase their outreach efforts, thereby increasing opportunities for small businesses under their DoD contracts.

When the program commenced in fiscal year (FY) 1991, there were eight participants. Over time, the roster of participants evolved as firms entered, withdrew, and/or merged with or were acquired by other firms—frequently fellow participants. The contractors elected to participate at a corporate level (whereby all of the participating firm's subcontracting activity would be covered under the comprehensive plan), the division level (whereby all of the subcontracting activity within a contractor's division would be covered by the comprehensive plan), or the operating level (whereby all of the subcontracting activity within an operating element of a participating firm would be covered by the plan). Table 1-1 identifies all participants, their tenure, and their participation status.

Table 1-1. Test Program Participants

Participant	Tenure		Status
	In	Out	
Litton—Ingalls Shipbuilding Division	FY91	FY97	Division
Unisys—Paramax Systems	FY91	FY95	Division
Martin Marietta Electronics and Missiles	FY91	FY95	Division
McDonnell Douglas Helicopter	FY91	FY95	Division
Boeing	FY91	N/A ^a	Corporate
Bell Helicopter Textron	FY91	N/A	Division
Lockheed Martin Aeronautics Company, Marietta	FY91	N/A	Division
General Electric Aircraft Engines	FY91	N/A	Division
Northrop Grumman Electronic Systems and Sensors Sector—Defensive Systems Division, Rolling Meadows	FY96	N/A	Division
Raytheon E-Systems, Greenville Division	FY96	FY98	Division
Hughes Aircraft	FY96	FY97	Division
Rockwell Collins	FY97	FY99	Division
Lockheed Martin Information Systems	FY96	N/A	Division
Lockheed Martin Missile and Fire Control, Orlando	FY96	N/A	Division
Harris Government Communications Systems Division	FY96	N/A	Division
Sikorsky Aircraft, a Division of United Technologies Corporation	FY96	N/A	Division
Pratt and Whitney Government Division of United Technologies Corporation	FY96	N/A	Division
Hamilton Sundstrand, a Division of United Technologies Corporation	FY96	N/A	Division
Lockheed Martin Aeronautics Company, Fort Worth	FY96	N/A	Division
Raytheon E-Systems, Garland Division	FY97	FY98	Division
Northrop Grumman Electronic Systems, Baltimore	FY97	N/A	Division
Lockheed Martin Missile and Fire Control, Dallas	FY97	N/A	Division
Textron Systems, a Textron Company	FY97	N/A	Division
TRW	FY97	N/A	Division
Honeywell Sensor Guidance Products, Guidance and Navigation Operation	FY97	N/A	Division
Northrop Grumman Air Combat Systems, El Segundo, California	FY98	N/A	Division
Lockheed Martin Missiles and Space	FY99	N/A	Division
Raytheon	FY99	N/A	Corporate

^a Firms with no designated "Out" years are currently participating in the Test Program.

OBJECTIVES

The principle objective of this review is to determine whether the negotiation and administration of comprehensive as opposed to individual SB subcontracting plans results in an increase in subcontracting opportunities for small businesses under DoD contracts. Specifically, the DoD Small and Disadvantaged Business Utilization (SADBU) office asked the Logistics Management Institute (LMI) to:

- Assess the Test Program legislative history and regulatory requirements;
- Review the subcontracting performance of Test Program participants;
- Correlate cost reductions to increased subcontracting opportunities;
- Compare subcontracting performance under the Test Program with prior performance;
- Analyze the factors that contribute to subcontracting performance under the Test Program; and
- Consider the appropriateness of extending the Test Program to non-test participants.

APPROACH

LMI, working under contract GS-35F-4871H, Task Order DSAW01-00-F-4530-Mod. 6, performed this independent review for DoD. In conducting the review, LMI had several objectives. First, we looked at the existing program to establish a baseline from which we could assess the performance of participants. Second, we examined the subcontracting performance of the participants before they entered the Test Program. This approach enabled us to ascertain whether performance improves because of program participation. Next, we looked at the performance of non-participants. Of special interest to us was whether non-participants performed better than participants did. We also addressed the potential administrative cost-avoidance savings to determine if increased outreach activities would result from comprehensive subcontracting plans replacing individual plans.

In conducting our study, we made extensive use of the comprehensive subcontracting plans that participants provide to DoD. These reports contain quantitative and qualitative data regarding subcontracting initiatives and progress toward subcontracting goals. We supplemented that information through interviews we conducted with participants as well as DoD personnel involved in the Test Program's management and oversight.

ORGANIZATION OF THIS REPORT

The report is organized into nine chapters and one appendix. Following this introductory chapter is Chapter 2, which briefly discusses the legislative history. Chapter 3 describes the aggregate performance metrics of Test Program participants. Chapter 4 identifies the most important factors that affect subcontracting performance. Chapter 5 estimates the administrative costs avoided by participants and describes their outreach activities. Chapter 6 describes the negotiation process and reviews program oversight mechanisms. Chapter 7 highlights “best practices.” Chapter 8 identifies our findings. Chapter 9 makes recommendations regarding ways to improve participant performance and Test Program administration. Appendix A details the individual performance of Test Program participants.

Chapter 2

Legislative History

INTRODUCTION

Legislative treatment of subcontracting plans commenced with Public Law 95-507, which amended the Small Business Act to require subcontracting plans for certain procurements. For contracts with an award value in excess of \$500,000 (\$1,000,000 for construction), this statute mandated that prime contractors develop subcontracting plans that included percentage goals for utilizing small, small disadvantaged, and women-owned small business concerns.¹ If the contracting officer determined that the proposed plan provided for the statutory “maximum practicable opportunity” to small businesses and the plan was approved, it was incorporated into the contract.² Before the passage of the Test Program legislation, Congress passed two other statutes that affected plans developed for Defense contracts.

Public Law 99-661, the National Defense Authorization Act for 1987, established a 5 percent subcontracting goal for small disadvantaged businesses, Historically Black Colleges and Universities (HBCUs), and Minority Institutions (MIs). With this statute’s passage, all subcontracting plans developed for Defense contracts included a 5 percent subcontracting goal. The statute required firms operating under approved subcontracting plans to make a “good faith” effort to provide business opportunities for small business subcontractors. While the act did not specifically penalize prime contractors for failure to meet their goals, a statute passed shortly thereafter, did provide for such penalties.

Congress passed Public Law 100-656, which mandated that a liquidated damages clause be included in all contracts that had approved subcontracting plans. In government contracts, a liquidated damages clause stipulates that the government will recover a sum of money in the event that the contractor fails to meet a specified contract delivery or performance requirement. With the passage of Public Law 100-656, prime contractors that failed to make a “good faith” effort to comply with subcontracting goals established in their subcontracting plans were subject to liquidated damages.

¹ Section 8(d) of Public Law 95-507. This statute exempts small business prime contractors, contracts below the threshold, prime contracts not offering subcontracting possibilities, and contracts performed entirely outside the United States.

² Incorporating the plan into the contract applied to sealed-bid procurements only.

With the objective of increasing the participation rate of small businesses in Defense subcontracting, Congress directed the Secretary of Defense in Section 834 of Public Law 101-189, the National Defense Authorization Bill for 1990, to establish a Test Program for Negotiation of Comprehensive Small Business Subcontracting Plans. Congress authorized the Test Program to determine whether the negotiation and administration of comprehensive small business subcontracting plans would increase subcontracting opportunities for small business concerns under DoD contracts. The test performance period was three years, commencing on October 1, 1990.

Section 834

As originally passed, Section 834 authorized each of the Military Departments and the Defense Logistics Agency to negotiate comprehensive subcontracting plans with Defense firms. Instead of establishing small business subcontracting goals on a contract-by-contract basis as was done before the passage of Section 834, participants negotiated annual goals for the entire firm or for one or more of its divisions or operating locations, depending on how the firm structured its participation. According to the legislation, the intent of the Test Program was to "...determine whether the negotiation and administration of comprehensive small business subcontracting plans will result in an increase in opportunities provided for small business concerns under Department of Defense contracts."³

With respect to candidate firms, the legislation required that, during FY89, they receive payment of at least \$25,000,000 on at least five Defense contracts. Upon acceptance of a negotiated plan, participants were exempt from developing subcontracting plans on individual Defense contracts. Finally, Section 834 subjected participants to liquidated damages for failure to make a good-faith effort to comply with their company-wide plan or the goals specified therein. Unfortunately, Section 834 did not define what was meant by the phrase "...increase in opportunities provided for small business concerns...".

THE TEST PROGRAM'S EVOLUTION

The first significant change to the Test Program occurred with the passage of Public Law 101-574.⁴ Section 402 of this statute suspended the payment of liquidated damages under comprehensive subcontracting plans. Defense prime contractors had been reluctant to participate in the Test Program given the potential for a sizable damages award under a corporate- or division-wide plan.⁵

³ Section 834 of the National Defense Authorization Act for Fiscal Year 1990, Public Law 101-189.

⁴ Section 402 of the Small Business Administration Reauthorization and Amendments Act of 1990, Public Law 101-574.

⁵ Interview with Small and Disadvantaged Business Utilization staff, October 26, 2001.

Section 805 of Public Law 102-484 was the first of several legislative extensions to the program.⁶ This section extended the test performance period for one year, from September 30, 1993 to September 30, 1994. Subsequently, the Federal Acquisition Streamlining Act of 1994⁷ extended the Test Program performance period again. Section 7103 of this statute added four more years to the program, extending the performance period to September 30, 1998.⁸ Section 811 of Public Law 104-106 ushered in more changes to the Test Program.

The original statutory language of Section 834 described the program's purpose as "...demonstration projects to determine whether the negotiation and administration of comprehensive small business subcontracting plans will result in an increase in opportunities provided for small business concerns under Department of Defense contracts." In contrast, the Defense Authorization Act of 1996 expressed the program's purpose as "...demonstration projects to determine whether the negotiation and administration of comprehensive subcontracting plans will reduce administrative burdens on contractors while enhancing opportunities provided under Department of Defense contract for small business concerns..."⁹ This restatement of the program's purpose imposes an additional factor to assess—the reduction of administrative burden—in measuring the program's success.¹⁰ The statute lowered participation requirements as well. Prime contractors now needed to demonstrate that in the preceding fiscal year they had been awarded at least three contracts with a combined award value of \$5,000,000.

Two other statutes have altered the program. Section 822 of Public Law 105-85 extended contract coverage for participants to subcontracts entered into under Defense prime contracts as well as subcontracts.¹¹ After the passage of this legislation, Test Program participants were now also able to include subcontracts that they awarded to SBs under subcontracts that were awarded to them by other Test Program participants. Before the passage of this statute, such awards were excluded from reporting under the Test Program. This statute also extended the program's performance period to September 30, 2000. Finally, the National Defense Authorization Act for Fiscal Year 2000 extended the performance period to September 30, 2005.¹²

⁶ Section 805 of the National Defense Authorization Act for Fiscal Year 1993, Public Law 102-484.

⁷ Public Law 103-355.

⁸ Section 7103 of the Federal Acquisition Streamlining Act of 1994, Public Law 103-355.

⁹ Section 811 of the National Defense Authorization Act for Fiscal Year 1996, Public Law 104-106.

¹⁰ Unfortunately, this statute did not require Test Program participants to track their administrative cost savings.

¹¹ Section 822 of the National Defense Authorization Act for Fiscal Year 1998, Public Law 105-85.

¹² Section 817 of the National Defense Authorization Act for Fiscal Year 2000, Public Law 106-65.

CONCLUSION

Congress gradually has sought to boost small business participation in government contracting. First, legislation introduced the requirement for subcontracting plans. This was followed by legislation requiring percentage goals for small business categories. With the passage of Public Law 101-189, the National Defense Authorization Bill for 1990, a Test Program for the negotiation of comprehensive subcontracting plans replaced the negotiation of individual plans for Test Program participants. The Test Program's original intent was to determine whether the negotiation of comprehensive small business subcontracting plans would increase subcontracting opportunities for small business concerns under DoD contracts.

The Test Program has evolved through the passage of subsequent statutes. The liquidated damages clause was suspended, and the Program's performance period was extended four times—with the final extension setting September 30, 2005, as the end of the current performance period. The reduction of administrative burden was added to the Program's purpose, participation requirements were reduced, and contract coverage was extended to subcontracts entered under Defense prime contracts.

Chapter 3

The Subcontracting Performance of Test Participants

INTRODUCTION

The firms that participate in the Test Program develop annual subcontracting plans containing proposed percentage goals for subcontracting. The goals defined within these plans are for small, small disadvantaged, and women-owned small businesses. There are goals for other categories: Historically Black Colleges and Universities, Minority Institutions, HUBZone businesses, Veteran-Owned Businesses, and Disabled-Veteran-Owned Businesses. In this analysis, we limit our focus to the SB, small disadvantaged business (SDB), and women-owned small business (WOSB) categories because most subcontracting occurs there. The Department just recently required participants to develop goals for the Veteran and HUBZone categories. For that reason, there are insufficient data with which to make reliable assessments regarding performance under those categories.

Participating firms express their goals as percentages of their total planned subcontracting for the next fiscal year. By way of an example, a participant's plan may project that it intends to award \$500 million in subcontracts; of that total, the firm plans to award 25 percent, or \$125 million, in subcontracts to small businesses; 5 percent, or \$25 million, in subcontracts to small disadvantaged businesses; and 5 percent, or \$25 million, in subcontracts to women-owned small businesses.¹

The participants base these percentage goals on their past performance, their current workload, and the status of their major programs with respect to the production cycle. Their subcontracting opportunities are either increasing or decreasing depending on a host of economic, budgetary, contractual, and technical factors. The participants' counterparts within the Defense Contract Management Agency (DCMA) vet these goals and either approve or counter propose. It is through this negotiation process that DCMA eventually approves a participant's plan for the coming FY.

In this chapter, we assess the progress that Test Program participants have made toward achieving their negotiated goals.² We measure their performance in three ways. First, we compare their average SB-related subcontracting performance before entering the program to their average SB-related subcontracting performance since entering the program. This indicator indirectly measures goal attainment and

¹ The SDB and WOSB are subcategories of the SB category and therefore should not be added to the SB category to derive a total for SB-related subcontracting.

² As of FY00, there were 20 participants.

directly assesses whether a participant's SB-related subcontracting activity is increasing—the Test Program's objective. Second, we measure their actual performance against their negotiated goals. When a participant's actual subcontracting performance, expressed as a percentage, meets or exceeds its subcontracting goal, also expressed as a percentage, the participant has met its plan's objectives for that FY.³ To understand how successful the participants have been over time, we express their goal attainment in percentage terms. For example, if a participant meets or exceeds its SB goals in four out of five years, the participant has an 80 percent success rate. Third, we compare their subcontracting performance to the performance of non-participating firms. This aggregate measure addresses program effectiveness.⁴ In keeping with the legislative intent, we would expect that participants perform better than non-participants do, because under the Test Program they are excused from some of their subcontract-related reporting requirements. In exchange for this administrative relief, participants commit to increase their subcontracting opportunities.

Before turning our attention to aggregate performance measures, we briefly describe the data used in this analysis.

Data Used to Evaluate Performance

To measure whether the Test Program improves subcontracting performance, we evaluated the participants' performance against their negotiated goals, compared average performance before and after their entry into the Test Program, and measured their subcontracting performance against the performance of non-participants. The participants provided most of the data used to conduct our assessment. We obtained copies of the Comprehensive Subcontracting Plans negotiated annually by each participant and its DCMA or other departmental counterpart(s).

The plans contain percentage goals for SB, SDB, and WOSB subcontracting. Participants negotiate, with DCMA, mutually acceptable goals. The negotiated goals are usually greater than the statutory minimums, for DoD subcontracting, of 20 percent for SBs and 5 percent for SDBs and WOSBs. We derived subcontracting performance data (actual and historical) from several sources.

Participants frequently provide, in their plans, data tables that contain historical performance data. The Standard Form (SF) 295 that large Defense contractors use to report their annual subcontracting performance is an important source of sub-

³ Data reported by the participants does not support an evaluation of the types or quality of the subcontracting activities. Nor do participants record the number of opportunities that they provide to small businesses.

⁴ Mergers, acquisitions, and divestiture make the tracing of one participant's subcontracting performance during its tenure in the Test Program complex. LMI believes that goal attainment assessments, comparing a participant's current to past performance, and comparing aggregate performance of participants to non-participants are the three measures available from which DoD can assess Test Program progress.

contracting performance data as well. An important source of data on the non-participants is the *P14 Companies Participating in the Department of Defense Subcontracting Program (Quarterly)*, produced by the Directorate for Information Operations and Reports of the Washington Headquarters Services. This report summarizes subcontracting information submitted by DoD prime contractors and is a good source of aggregate performance data.

Evaluating Aggregate Performance

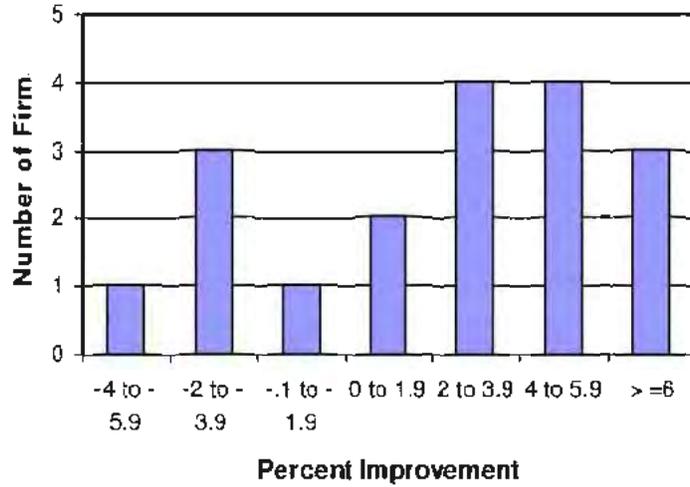
We expect the participants'—and by extension, the Department's—subcontracting performance to improve over time as a result of their participation in the Test Program. Comparing the participants' performance since entering the program to their performance before entering the program is the most straightforward means of measuring whether subcontracting increases because of program participation. On an annual basis, Test Program participants report their aggregate subcontracting performance on a SF295. This form contains aggregate performance data in dollar and percentage formats.

To develop the data employed in this analysis, we created an average of the percentages reported by the participants on their SF295s. If the member participated between FY97 and FY00, we develop averages of the participant's reported subcontracting percentages for the SB, SDB, and WOSB categories for those years; we used the period FY93 to FY96 to create comparable averages of its prior performance in these same categories. Next, we subtracted the current-year averages from the prior-year averages; these deltas represent the change in the participant's average performance over its tenure in the program. In the figures below, we present the results of this analysis.

Figure 3-1 portrays the results of this analysis for SB subcontracting. Of the 18 participants included in the analysis, 5, or 28 percent, experienced a decline in their average SB subcontracting performance.⁵ One firm declined by almost 6 percent. In contrast, 13 participants, or 72 percent, improved their SB subcontracting performance. Four participants improved, on average, between 2 and 3.9 percent; and 4 participants bettered their performance, on average, between 4 and 5.9 percent. Finally, 3 participants improved, on average, at least 6 percent, including one participant whose average performance improved by an impressive 16 percent.

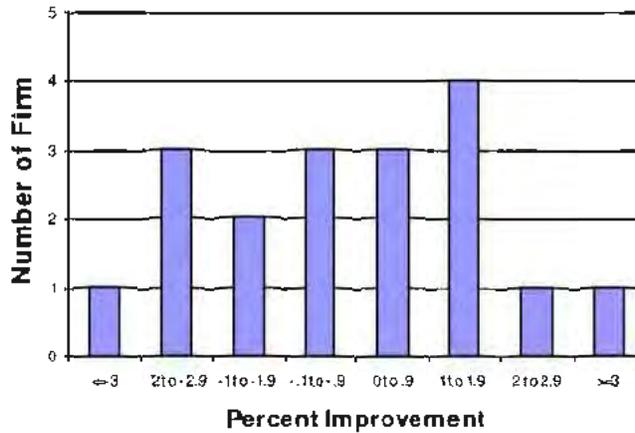
⁵ As of FY00, there were 20 participants. We exclude 2 from this analysis because their tenure is too short to permit a meaningful assessment of their past versus present performance.

Figure 3-1. Average Performance of Test Program Participants in the SB Subcontracting Category



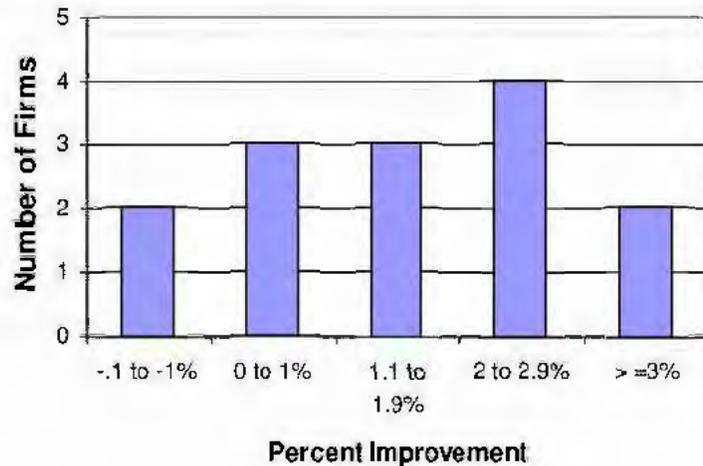
Using a similar approach, we analyzed the participants' performance in the SDB subcontracting category. Figure 3-2 depicts the results of our analysis of SDB subcontracting. Of the 18 participants included in the analysis, 9 participants improved their average performance. Three participants hettered their performance, on average, from 0 to 0.9 percent; four from 1 to 1.9 percent; one participant improved from 2 to 2.9 percent; and one by at least 3 percent. Unfortunately, nine participants experienced a decline in this category; however, one third of these declined over time by less than 1 percent. Participants uniformly complain that the SDB certification process is depleting the supply of eligible SDBs and consequently, is hampering their ability to meet their SDB goals. The results shown in Figure 3-2 may support this contention.

Figure 3-2. Average Performance of Test Program Participants in the SDB Subcontracting Category



The WOSB statistics are less informative for several reasons. First, before- and after-program participation statistics are not readily available because the WOSB reporting was inconsistent before FY96, when the Department first required a 5 percent goal. The number of participants included in the analysis is smaller, at 14, because reporting was inconsistent for this category and several firms did not exist in comparable configurations before and after entering the program. Figure 3-3 highlights the performance. Twelve out of 14 participants used in the analysis improved their WOSB performance.

Figure 3-3. Average Performance of Test Program Participants in the WOSB Subcontracting Category



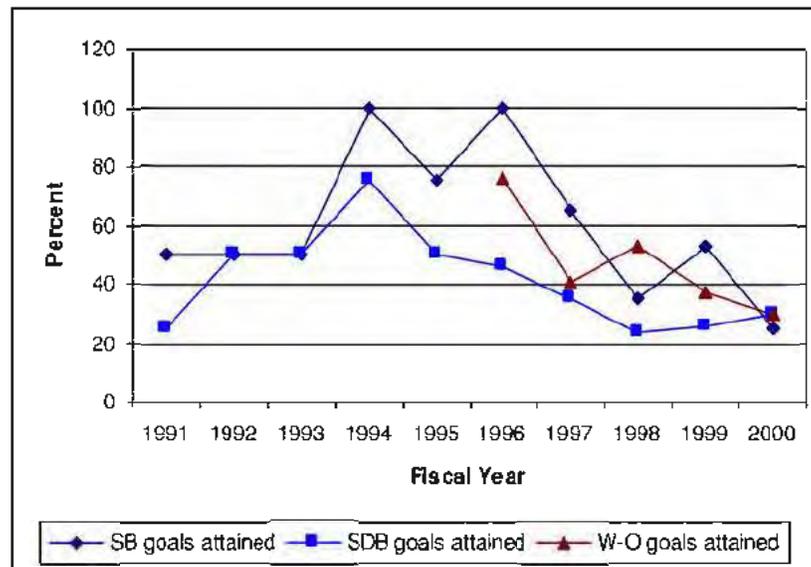
Evaluating Aggregate Goal Attainment

A second means of evaluating aggregate performance compares goal attainment across all firms. Each participant negotiates subcontracting goals for the SB, SDB, and WOSB categories. Participants commit to making “good faith” efforts to attain those negotiated goals. Past subcontracting performance is an important component in determining realistic goal levels, as are future business prospects and statutory minimum goal levels, which act as a threshold below which DCMA negotiators are wont to negotiate. We expect even poor performance will improve, as negotiations based on experience should lead to more achievable goals. Therefore, if the Test Program is effective, goal attainment should trend upward over time.

Regrettably, Figure 3-4 suggests that since FY96, participant performance has been trending downward. The three trend lines in Figure 3-4 depict the ratios of participants that have met their negotiated goals to the total number of participants, over time, across the three negotiated categories. The SB goal attainment, as shown in the graph, commenced at the 50 percent level; i.e., 50 percent of the

participants achieved their SB goals in FY91.⁶ This achievement trended upward and peaked in FY96. Since then, it has steadily declined. We observe the same results in the SDB and WOSB categories.

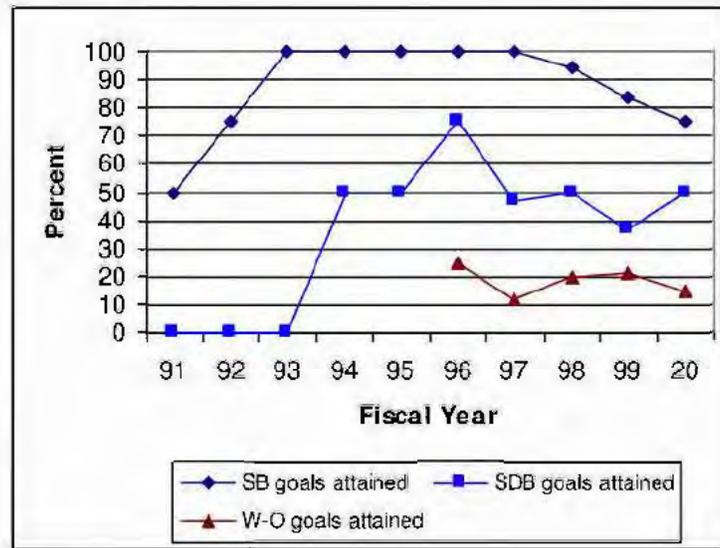
Figure 3-4. Aggregate Goal Attainment Based on Negotiated Goals



When we compare the participants' performance to statutory goals, which are lower than negotiated goals, the picture improves as Figure 3-5 suggests. Using these metrics, we see that participants met their SB goals 100 percent of the time between FY93 and FY97. While performance declined just as it has under the negotiated goals, the decline was not nearly as severe. Similarly, the decline in the SDB business trend line is not as steep. In the period FY97 through FY00, participants operating under negotiated goals met them less than 40 percent of the time. Using the statutory 5 percent goals for SDBs, the participants performed at or close to the 50 percent level. Interestingly, the relationship between the negotiated and statutory goals does not hold true for WOSB goals, because negotiated goals for WOSBs were initially set slightly lower than the 5 percent statutory minimum. Hence, using the statutory goal pushes the WOSB trend line down relative to the negotiated trend line for this category.

⁶ Only four of the original eight participants that are included in the FY91 cell were still in the program in FY00.

Figure 3-5. Aggregate Goal Attainment Based on DoD Statutory Goals



Comparing Participant and Non-Participant Performance

The third measure of program effectiveness compares the Test Program participants' performance to that of non-participants and to the combined performance of participants and non-participants—the DoD total. Since the Test Program is designed to increase subcontracting opportunities for small businesses, we would expect to find that participating firms perform better than non-participants do. Table 3-1 portrays our findings for FY91, FY96, and FY00.

Table 3-1. Aggregate Performance—Participants Compared to Non-Participants

FY91				
	Total (%)	SB	SDB	WOSB
DoD Total	\$57,053 (100)	34%	2.7%	N/A
8 Participants	\$11,916 (21)	12%	.9%	N/A
Non-Participants	\$45,137 (79)	40%	3.1%	N/A
FY96				
DoD Total	\$47,353 (100)	41.8%	5.9%	3.3%
14 Participants	\$6,719 (14)	36.2%	5.2%	2.5%
Non-Participants	\$40,633 (86)	42.7%	6%	3.4%
FY00				
DoD Total	\$54,858 (100)	39.3%	5.3%	4.2%
20 Participants	\$17,522 (32)	29.4%	4.2%	2.7%
Non-Participants	\$37,336 (68)	44%	5.9%	5%

In FY91, DoD prime contractors awarded approximately \$57 billion in subcontracts to large and small businesses. Thirty-four percent of the DoD total was subcontracts awarded to small businesses, and 2.7 percent of the total awards were subcontracts to small disadvantaged businesses. The Department did not report on subcontracts awarded to women-owned small businesses. The original eight participants accounted for 21 percent of the DoD total and awarded 12 percent of their subcontracts to small businesses and a miniscule 0.9 percent to small disadvantaged businesses. These results do not compare favorably to the performance of the non-participants. They awarded 79 percent of all subcontracts (in dollar terms), of which 40 percent flowed to small businesses and 3.1 percent to small disadvantaged businesses.

The Test Program's most successful year was FY96, when the then 14 participants awarded 36.2 percent of their subcontracts to SBs. This level reflects a three-fold increase over the FY91 performance. More importantly, SDB subcontracting grew impressively, exceeding the statutory 5 percent minimum. Unfortunately, the participants' performance did not exceed the non-participants', nor did it exceed the DoD total. The FY00 performance is even less encouraging.

By FY00, the share of the total subcontracting activity owned by the now 20 participants rose from 14 to 32 percent, but their subcontracting performance declined. SB subcontracting as a percentage of the participants' total fell from 36.2 percent to 29.4 percent. The same relationship holds true for the SDB subcontracting performance, which declined from 5.2 to 4.2 percent. The participants did not do as well as non-participants, whose overall performance continued to improve.

CONCLUSION

Table 3-1 above suggests that while participants' performance improved between FY91 and FY00, they performed poorly relative to non-participants. Their performance is particularly problematic because their share of total subcontracting activity increased by almost 50 percent. Indeed, it is difficult to imagine how the participants, given their program-derived advantages, business size, and importance to DoD's programs and missions, did not achieve better results. However, since there are uncontrolled differences in the composition and configuration of the business bases between participants and non-participants, we do not consider this evaluation to be as meaningful a gauge of program effectiveness as measuring goal attainment and participant improvement. Unfortunately, the participants' performance in those areas mirrors the disappointing results flowing from the participant to non-participant performance comparison.

Thirteen out of 18 participants included in the analysis, or 72 percent, improved their subcontracting performance after entering the Test Program. That is a good record but not a great one. It would be fair to attribute this improvement to their association with the program, had we not learned from our assessment of non-participant performance over the same 10-year period that subcontracting increased across the board and increased even more among non-participants. It seems likely that subcontracting performance would have improved even without the Test Program.

Finally, there is the question of goal attainment. While participant performance is inconsistent over the 10-year period, it has been trending downward since FY96. As we indicated, comparing actual performance to statutory minimum goals reduces this decline but does not eliminate it. Appendix A of this report briefly summarizes the progress of the 20 participants that were Test Program participants in FY00. There are many successful examples of the "good faith" efforts made by these participants that are obscured in the present aggregate analysis. In the next chapter of this analysis, we discuss some of the barriers hampering goal attainment among participants. It is LMI's view that the participants face a challenging business environment that contributes in part to the average performance described here.

Chapter 4

Factors Affecting Participants' Subcontracting Performance

INTRODUCTION

In Chapter 3, we noted that the Test Program participants' share of all subcontracting increased while their SB, SDB, and WOSB subcontracting performance declined.¹ In this chapter, we cite some of the business decisions, regulatory practices, and other factors that have contributed in some measure to this decline. Some of these are external; i.e., they are part of the DoD business environment. Others are internal; i.e., they are corporate practices that affect a participant's subcontracting performance. Additionally, we discuss how these factors affect the subcontracting performance of Test Program participants.

First, we discuss how certification requirements for SDBs and HUBZone businesses have decreased the number of businesses in these categories, which makes it increasingly difficult for Test Program participants to meet their subcontracting goals in these categories. Next, we describe how procurement practices such as using the prime contractor as a systems integrator; directed-source procurements and teaming agreements tend to increase subcontracts awarded to large businesses, reducing subcontracting opportunities for all types of small businesses. The increasing complexity and specialized nature of DoD weapons systems requirements also has contributed to a reduction in subcontracting opportunities for the SB community. Customer-driven initiatives also impact Test Program goal attainment because firms are not always adequately prepared to address them. Next, we describe how corporate-wide procurements may displace SB suppliers. Finally, we address merger and acquisition activity and its potential impact on SB subcontracting performance.

SDB CERTIFICATION

One of the most challenging problems facing Test Program participants is the lack of certified SDBs that can meet their subcontracting requirements. This shortfall in certified firms contributes to the decline in SDB goal attainment that most Test Program participants are experiencing. The requirement for SDBs to certify as "small and disadvantaged" originated from a 1995 Supreme Court decision—

¹ In FY00, their share of all DoD subcontracting was 32 percent; 29.4 percent of this total was awarded to small businesses. In FY96, their share of all DoD subcontracting was 14 percent; 36.2 percent of this total was awarded to small businesses.

Adarand Constructors Inc. v. Peña.² The court ruled affirmative-action programs must be “narrowly tailored” to counter actual discrimination. Before this ruling, small businesses could self-certify and be counted as small disadvantaged businesses on subcontracting reports. Under the new procedures introduced in October of 1999, Test Program participants cannot take credit for SDB subcontracts unless these subcontracts are awarded to certified firms.

Since October 1, 1999—the first year of the SDB certification requirement—one Test Program participant saw the number of SDB suppliers fall from 3,200 to 900, a 72 percent drop. Another participant reported that two-thirds of the previously self-certified SDBs remain uncertified. During this same period, one participant realized a 92 percent drop in SDB dollars because of the lack of certified small disadvantaged businesses.

Some participants have yet to experience significant declines in their SDB supplier base or reported subcontracting dollars because they can still report self-certified small disadvantaged businesses, for prime contracts awarded before October 1, 1999. As these older contracts expire, these participants expect to see their SDB subcontracting performance deteriorate further. All but one participant have continued to do business with good performers, regardless of their certification status. Participants that have continued to do business with uncertified small disadvantaged businesses are now accounting for them under the SB category rather than as small disadvantaged businesses.

Unfortunately, the certification process is so burdensome that small businesses often are reluctant to become certified. LMI’s interviews with participants surfaced numerous complaints and problems with the certification requirement as well. They ranged from “too difficult, time consuming, and costly,” to “too painful, intrusive, and discriminatory.”³ Some participants observed that uncertified small disadvantaged businesses must bear all certification costs, and many small businesses do not perceive certification as a good investment. When they ask “what’s in it for my firm?” most Test Program participants respond that SDB certification does not guarantee more business. This response, in the words of one participant, “does not provide an incentive to uncertified SDBs to spend the time and money to become certified.”

A few participants were critical of the Small Business Administration (SBA) for not doing more to inform small businesses about certification requirements. Moreover, some questioned the \$750,000 net worth requirement⁴ imposed on SDBs as being too low. Indeed, some participants noted that there is an inherent business risk associated with firms having such a low net worth.

² Adarand Constructors, Inc. v. Peña, 515 US 200 (1995).

³ LMI believes that an unknown percentage of these small disadvantaged businesses do not undergo certification because they cannot meet the certification requirements.

⁴ See 13 CFR Part 124, subpart B. The net worth of each individual upon whom the certification is based does not exceed \$750,000 after taking into account the applicable exclusions set forth.

The HUBZone certification program causes similar problems and results for Test Program participants.

HUBZONE CERTIFICATION

The HUBZone certification requirement also has contributed to a decline in Test Program participants' subcontracting performance. Like SDB certification, the HUBZone program attempts to increase the subcontracting opportunities for small businesses located in distressed urban and rural areas.⁵ Participants believe that, like SDB subcontracting goals, HUBZone goals will not succeed because there is an insufficient number of certified HUBZone firms, and Test Program participants have difficulty identifying HUBZone firms with capabilities that match their requirements.

In FY00, the DoD began requiring certain negotiated HUBZone goals for Test Program participants. As noted above, this created a second category in which participants are performing poorly for reasons largely outside their control. On December 2, 1997, Congress enacted the HUBZone Act of 1997 as Title VI of the Small Business Reauthorization Act of 1997 (Public Law 105-135). The act provides a program of federal contracting assistance for qualified SB concerns located in distressed communities. The program is an effort to increase employment opportunities, investment, and economic development in these communities.

To qualify a firm as a HUBZone small business, the SBA must certify that the firm meets certain criteria—one of which is that 35 percent of the SB's employees reside in a HUBZone. Test Program participants assert that the 35 percent requirement is too restrictive and reduces the number of qualified HUBZone businesses. This, in turn, contributes to a mismatch between participant requirements and the capabilities of small businesses currently certified as HUBZone firms.⁶

SYSTEMS INTEGRATOR ROLE

Using the prime contractor as a systems integrator is a dramatic shift in weapons systems procurement strategy that can obscure SB subcontracting performance and increase the dollar value of subcontracts awarded to large businesses. When acting as a systems integrator, the prime contractor is responsible for the devel-

⁵ The HUBZone Act of 1997 established a program to promote assistance in securing federal contracts to small businesses in urban and rural counties in which low income levels or high unemployment rates qualify them as economically distressed. Federally recognized Indian reservations are also HUBZones.

⁶ Similar to the concerns with HUBZones is the participants' belief that there is a mismatch between their requirements and the availability of Service-Disabled Veteran-Owned businesses. Effective October 22, 2001, the Small Business Act was amended to require prime contractors to establish a 3 percent subcontracting goal requirement for Service-Disabled Veteran-Owned SB concerns. While the participants viewed this as a worthy cause, the majority believes the 3 percent goal is beyond their reach. That there are too few Service-Disabled Veteran-Owned small businesses to achieve 3 percent is a major roadblock, according to the participants.

opment, management, and eventual delivery of a large weapons system. Shifting these management responsibilities from the government to the prime contractor represents a significant departure from traditional procurement strategies employed by DoD until the late 1980s. While LMI does not attribute the diminution in SB subcontracting entirely to this practice, it is apparent that this shift has affected the results that Test Program participants report.

First, for the system integrators among the Test Program participants (Boeing, Lockheed Martin, Northrop Grumman, and Raytheon), the size of the contract awards has increased substantially. Before this shift, the prime contractor was responsible for a major systems component such as the avionics package or the propulsion system—the contract awarded for that component could be large but not as large as the contracts awarded for the entire system. Since the adoption of the systems integrator strategy, the contract awards to the prime contractors are much larger, and some of the subcontracts awarded under these contracts are large as well because they are for major subsystems (avionics, engines, airframes, etc). This approach makes goal attainment more difficult for system integrators because their subcontracting base balloons with each large award.

A second consequence resulting from the use of the systems integrator approach to contracting is that the size and the complexity of the first-tier requirements (the major subsystems), result in subcontract awards to other large businesses, Test Program participants such as Harris Corporation, Honeywell, and Hamilton Sundstrand. These awards further complicate goal attainment for the systems integrator while diminishing opportunities for small businesses. Finally, Test Program participants are required to accept each other's comprehensive plans instead of developing specific subcontracting plans tailored to the subcontract awards made under these systems integration contracts. This approach obscures the SB subcontracting activity because Test Program participants acting as first-tier subcontractors do not report SF294 data to the prime contractor.

DIRECTED-SOURCE PROCUREMENTS

The majority of Test Program participants cited the practice of directed-source procurements as another factor reducing subcontracting opportunities for small businesses. This practice occurs when the DoD directs a prime contractor to use a particular subcontractor's—usually a large business subcontractor's—product or service. The net result for the participating contractor is a reduction in available subcontracting opportunities for small businesses. FY02 is the first year in which participants have had the option of identifying, in their comprehensive subcontracting plans, directed-source procurements and their impact on participants' SB subcontracting performance. Only 3 of the 19 participants took advantage of this option. One participant submitted a plan showing 40 percent of its SB dollars affected by directed-source procurements; a second participant reported a 39 percent impact; while a third participant reported a 25 percent impact.

Some participants tracked directed-source procurements but did not report them in their comprehensive subcontracting plans. Test Program participants report little or no written documentation for most directed-source procurements.⁷ Several participants described directed-source procurements as originating from DoD awards to a single contractor to develop a new product during research and development, which becomes a requirement and ultimately results in a sole-source procurement.⁸ Others described directed-source procurements as stemming from the technical requirements spelled out in DoD specifications and drawings, restricting them to a single source. In addition, participants described “follow on” orders they received from the DoD as contributors to directed-source procurements. Follow-on business, they contended, locks them into single-source arrangements because, among other reasons, the DoD prefers supplier continuity because it simplifies logistics support.

Most participants pointed to teaming arrangements as a major by-product of directed-source procurements, particularly for major weapons system contracts where the prime contractor acts as a systems integrator. Participants believe a primary factor in selecting teaming partners is the DoD's preferences for a certain product mix that favors large businesses. The DoD usually conveys its preferences for products to prime contractors via drawings and specifications.

TEAMING AGREEMENTS

In large, weapons-systems procurements, Defense contractors frequently propose solutions involving teaming arrangements whereby the prime contractor and its teaming partners all contribute to the final product. If awarded the contract, the prime contractor usually contributes a considerable portion of the technical solution and acts as the system integrator. Teaming partners, usually other large Defense firms acting as subcontractors, provide technologically sophisticated subassemblies such as radar, antennae, and solid rocket motors.

Usually, Defense firms team for business reasons. They maintain specific core competencies and use teaming partners to augment their capabilities. Using this strategy to obtain a competitive advantage in a procurement evaluation, firms will propose solutions that combine their own talents with the strengths of their teaming partners. Alternatively, the Department may direct firms (usually implicitly in a request for proposal) to incorporate into their proposed solutions a specific product or technology as a means of recouping an earlier research and development investment.

The teaming approach limits competition. Significant portions of the future subcontracting dollars are committed during the proposal development process to

⁷ Contracting without providing for full and open competition is permissible but requires written justification. See FAR 6.302 and 6.303.

⁸ “Sole source” refers to a contractor that is the only firm tooling to manufacture a particular product or qualified to provide a particular service.

teaming partners; leaving limited opportunities open for competitive procurements. For example, one participant reported that only 8.9 percent of one of its system's subcontracting dollars were available for competitive subcontracting because of prior teaming agreements, and only 23 percent of this participants subcontracting opportunities are competitive. The result for Test Program participants is that teaming arrangements can have an adverse impact on a participant's SB subcontracting performance.

PROGRAM MANAGEMENT OFFICE INVOLVEMENT

Related to directed-source procurements and teaming arrangements is the role that the participants' primary customers—the program management offices (PMOs)—play in fostering goal attainment. To the detriment of the Test Program, the PMOs do not appear to be sufficiently interested in the performance of Test Program participants, as perhaps they need to be, to ensure that participants meet or exceed program goals. Participants mentioned repeatedly that their focus was their customers' requirements and that their customers never asked them about their Test Program performance. As one participant pointedly stated, "My customer never said that he would not buy more of my products, if I did not make my Test Program goals." If one accepts the premise that businesses survive by responding to the needs of their customers, it is not difficult to imagine how instrumental the PMOs could be in maximizing the performance of Test Program participants.

TECHNOLOGICALLY COMPLEX REQUIREMENTS

According to participants, the continued evolution of complex technology is making it more difficult to subcontract with small businesses. New weapons systems and aviation technologies continue to evolve, but participants assert that the supply of small businesses capable of supporting these technologies has not kept pace. While these problems are common among the Test Program participants, the DoD faces similar problems when awarding contracts at the prime level, participants say. Participants also believe HUBZone SBs, SDBs, WOSBs, and Service-Disabled Veteran-Owned SBs are the most likely to suffer from the DoD's increasingly complex and specialized requirements.

DoD THRUST PROGRAM INITIATIVES

DoD Thrust Program Initiatives⁹ impinge on subcontracting performance, participants say, because they "arrive too late in the negotiation process." Participants contend that the earlier they know what the thrust initiatives are, the better their position to finalize their subcontracting plan negotiations. And, they argue, the better their position to implement these initiatives at the start of the fiscal year.

⁹ The thrust initiatives vary but usually include new activities or subcontracting categories that the Department wants Test Program participants to address in their subcontracting plans. The most current Thrust Program Initiatives can be viewed at <http://www.acq.osd.mil/sadbu/csp/initiatives.html>.

Several participants also asserted that some thrust initiatives are not practical for their local business environments. For example, one participant noted that the thrust initiative to “solicit one SDB and one WOSB on every competitive solicitation” is impossible to meet in that participant’s business environment. The participant emphasized that, while there are SDBs and WOSBs in the surrounding communities, there are not enough of these firms with the right capabilities to adequately address this thrust initiative. This firm recommended that thrust initiatives should be tailored to the local environment.

SUPPLY-BASE REDUCTION

Some division-level participants noted the trend in the private sector to reduce their supply base. Referred to as contract consolidation by the federal government, this private-sector trend to achieve efficiencies began in the 1980s and is now a prerequisite to becoming a “world-class” supplier. Test Program participants contended that their subcontracting performance suffers when corporate buyers consolidate requirements for office supplies, janitorial services, travel agent and temporary clerical services, etc. into nationwide contracts. This results in “corporate bundling” with a single large business source, while small businesses are displaced locally. Because of a mandate from their corporate headquarters, most division-level buyers must shift their indirect expense¹⁰ requirements from local suppliers—often-small businesses—to a nationwide contract, typically run by a large business. This corporate-driven bundling contributes to a decrease in the participants’ performance.

MERGERS AND ACQUISITIONS

The reduction in the DoD’s procurement budget that began in the mid 1980s has increased, along with other factors, the number of mergers and acquisitions occurring in the Defense industry. The affects of these mergers and acquisitions on subcontracting performance vary by participant, but all participants involved in an acquisition realize an increase in their subcontracting base. Usually, a period of turbulence ensues while corporate cultures meld, financial accounting systems merge, and procurement practices change as merged firms learn to act as one. For instance, some participants had an enterprise-wide system for tracking SB data before their merger, while after the merger they had multiple accounting systems, unable to interface with one another, making tracking more time consuming and complex.

Another potential problem for Test Program participants affects the performance of the acquiring firm, especially if the acquirer buys a company with a poor subcontracting performance record. After the acquisition, the acquiring firm’s reported subcontracting base will increase by the size of the acquired firm’s

¹⁰ Indirect expenditures may be used in formulating subcontracting goals, which are charged as indirect costs allocable to DoD contracts under the participant’s cost accounting system.

subcontracting base. If the acquired firm's SB subcontracting performance is strong, the acquirer's division- or corporate-wide reporting will show positive results. On the other hand, if the acquired firm's subcontracting performance is weak, it will diminish the acquirer's reported SB subcontracting performance.

Merger and acquisition activity may impact subcontracting reporting in other ways as well. An inter-company agreement—a contract to provide products/services between separate business units within the same firm—may impact subcontracting performance as a result of merger and acquisition activity. For instance, using an inter-company agreement, one business unit may supply a second with avionics subassemblies. Test Program participants do not report transactions under an inter-company agreement because they are internal and not directly related to the firm's subcontracting performance. However, if the firm sells the business unit that provided the subassemblies to another large business and now buys them from this large business, the buyer's SF295 report must show this activity as an increase in its large business subcontracting. This is due to the business unit's change from an in-house supplier to a business unit in a different large business.

CONCLUSION

Several factors may affect participant's subcontracting performance in the Test Program. SDB certification is the most challenging external problem. Because of the requirement for SDBs to certify, participants see little chance in reversing the deterioration in SDB subcontracting performance. Some participants have not yet begun to experience this decline—because they may still report on awards to SDBs that self-certified before October 1999. For similar reasons, HUBZone certification also contributes to a decline in Test Program participants' subcontracting performance.

The DoD's use of systems integrators, prime contractors that manage major weapons system's development projects has adversely affected subcontracting performance by increasing the size of the participant's subcontracting base and the number and size of large business subcontracts as well.

Often DoD directs work to large contractors, participants say, but SBs seldom get work directed their way. Thus, according to participants, directed-source procurements are harming their SB subcontracting performance.

Teaming agreements also have affected participants' SB subcontracting performance. Because such agreements increase subcontracts to large businesses and leave fewer opportunities for small businesses.

Another concern participants raised pertains to the problem of matching their requirements with the capabilities of SDBs, HUBZone, and other SB contractors. While the DoD has programs in place to address this concern, participants said technology nonetheless is advancing faster than these firms can keep up.

DoD thrust initiatives help foster SB participation on DoD contracts. Participants believe thrust initiatives should be introduced earlier in the fiscal year—to provide for a more efficient negotiation process and execution of comprehensive subcontracting plans.

The private-sector trend of supply-base reduction is at least two decades old; but, according to participants, it remains a problem. SB suppliers are likely to be displaced when corporations seek to reduce the supplier base for certain commodities or services to one supplier. This problem affects divisional participants more than corporate ones because divisional buyers often lose local SBs when requirements are consolidated nationwide with a large supplier.

Finally, participants' say mergers and acquisitions affect their SB subcontracting performance. This happens in several ways. First, they can wreak havoc for those responsible for tracking SB data. Second, an in-house supplier may become a large business if, after a merger or acquisition, they are no longer part of the participants' corporation and the participant continues to subcontract work to them. This, participants say, can have a considerable affect on SB subcontracting performance. Third, sometimes a merger or acquisition can result in a much larger supply base with lower SB participation on DoD contracts.

Chapter 5

Estimating Program Benefits

INTRODUCTION

The Test Program is intended to reduce participating contractors' administrative burden of negotiating individual subcontracting plans and reporting on subsequent subcontract performance. Without the Test Program, for each qualifying contract (i.e., those in excess of \$500,000 or \$1,000,000 for construction), prime contractors are required to submit to the DoD (1) a subcontracting plan specifying the goals for various categories of subcontractors, (2) a biannual SF294 report on subcontracting performance, and (3) a final report upon contract completion.

Both the contractor and the government incur administrative costs to satisfy these requirements. Contractor costs for this activity generally are reflected in the contract price paid by the government. Government administrative costs are incurred by the DoD's contracting and oversight functions. However, direct segregation and measurement of the costs for these activities generally are not available from either contractors or the government. Test Program benefits come largely from avoiding these costs.

When a contractor participates in the Test Program, a division-wide or company-wide plan replaces the need for an individual subcontracting plan. Administrative savings resulting from this consolidation occur for the following activities and functions:

- o The contractor's contracting function negotiates fewer individual subcontracting plans.
- o The contractor's SBLO processes fewer SF294 reports.
- o The government's contracting function negotiates fewer individual subcontracting plans.
- o The DCMA oversight function reviews fewer individual subcontracting plans and conducts fewer subcontracting performance audits.

A major objective of the Test Program is that participants devote program savings to increasing opportunities for small, small-disadvantaged, and women-owned small businesses. LMI estimates the costs avoided by Test Program participants using the procedures described below because Test Program participants are not required either in statute or by regulation to capture and retain data that would permit us make such a determination.

ESTIMATING COST AVOIDANCE SAVINGS FOR TEST PROGRAM PARTICIPANTS

We estimated contractor savings from the Test Program by calculating the costs avoided by submitting a comprehensive subcontracting plan and biannual SF295s versus individual subcontracting plans and related SF294s for each qualifying contract award. The essential data required to make this estimate are the number of SF294s and subcontracting plans that the Test Program participants would file in a year absent the Test Program and the effort (person hours) and the associated hourly cost required to complete each submission via the report form SF294.

To estimate the costs avoided by participating in the Test Program, we determined:

- o The number of qualifying contract actions for each participating contractor in FY00,¹ and
- o The number of individual subcontracting plans and biannual SF294 reports associated with those qualifying contract actions, that each participating contractor avoids because of its participation in the Test Program.

We also made a “steady state” assumption; i.e., equal numbers of qualifying contract actions occurred in the fiscal years preceding FY00. Qualifying contract actions in prior fiscal years give rise to required SF294 submissions in FY00 and in subsequent years, depending on the duration of the contract’s performance period. Hence, a contract that commenced in FY99 and had a 36-month performance period would generate contract-reporting activity in FY99, FY00, and FY01.

Once we estimated the contract reporting avoided by all Test Program participants, we applied an hourly report-preparation factor and cost to derive overall program savings (cost avoidance).

Estimating Report Preparation Time

Through interviews with participating contractors, we attempted to obtain data on the effort involved to submit a subcontracting plan and subsequent reporting re-

¹ In FY00, there were 20 participants. We could have chosen any fiscal year between FY91 and FY00 for this analysis. The term “contract actions” refers to awarded contracts and contract modifications. We expand on this definition later in this chapter.

quirements. In most instances, contractors were unable to provide precise values for these factors. However, we did learn some rough factors from a number of interviewees. These factors help corroborate the estimate found on the SF294.

- o Contractor A has 250 to 300 contracts eligible for SF294s. These contracts would generate about 1,000 annual submissions, requiring 4 to 5 hours each to complete.
- o Contractor B would submit 200 separate SF294s, requiring from 2.5 to 3.5 person years of effort. Using the midpoint 3 person years, this implies 30 hours of effort per SF294.
- o Contractor C estimates that each subcontracting plan required 8 person hours to estimate subcontracting goals.
- o Contractor D estimates 120 contracting plans would cost one person year of effort, or 16 hours per plan.
- o Contractor E estimates that eliminating 50 SF294s would save \$6,000, or about \$125 per form—which equals 5 hours of effort at \$25 per hour.
- o Contractor F reports that they would process about 1,500 plans and SF294s annually. Each plan requires 8 to 16 hours to negotiate.
- o Contractor G estimates that one-person year would be required to complete SF294s for 120 contracts. Thus, 240 semiannual SF294s would each consume 8.67 hours of effort.

Thus, using the information provided by the participants, we developed an average of 12.7 hours, which is reasonably close to the 9 hours per SF294 response estimated by the government and reported on the SF294 as the amount of time required to complete an SF294. We concluded that the 9 hours per SF294 response is reasonable and consistent with the results of our interviews and used it as a conservative factor for our analysis.

Estimating the Number of Contract Actions Avoided

Next, we estimated the number of contract actions occurring in FY00 that are not subject to subcontract reporting by the Test Program participants. (As participants are in the Test Program, they are not required to submit subcontracting plans and biannual SF294 reports for these FY00 contract actions.) This number forms the basis for our estimate of the costs avoided by all Test Program participants. We used information about the participants reported in the DD350 database to devel-

op our estimates.² Table 5-1 contains the data used for our estimate. We explain how we derived these data in the next section of this chapter.

METHODOLOGY

The total number of contract actions that could be subject to subcontract reporting are shown in the “Total Contract Actions” column (A) of Table 5-1. We derived our estimate from FY00 contract award data reported in the DD350 database, using the following assumptions:

- o We included the following individual DoD contract actions over \$500,000:
 - Definitive contracts superseding letter contracts
 - New definitive contracts
 - Individual basic ordering agreement (BOA) orders
 - Contract modifications (mods)
 - FY00 indefinite delivery/indefinite quantity (IDIQ) contracts (counted once per contract, not per action) if the total amount of orders placed against the FY00 IDIQ contract exceeded \$500,000. Orders awarded in FY00 against IDIQ contracts from prior years were not counted since it is assumed that any subcontracting plan would have been prepared in the year the basic contract was awarded.

Most of the actions included in our estimate of contract actions are mods, BOAs, or definitive contracts. There were only a few IDIQs compared to the other transactions. Ten of the companies had no IDIQs.

The “All Mods” column (B) is the total number of modifications that are included in Column A. The “Unique Contracts” column (C) is the count of contracts in column (A) having one or more mods in FY00.

The number of required reports is estimated on the conservative assumption that each mod does not result in an additional reporting requirement. The “Adjusted Total Actions” column (D) makes this calculation by eliminating all actions that represent multiple modifications to any one contract; i.e.:

$$\text{Column (A) - Column (B) + Column (C).}$$

² Since the participant interviews provided imprecise estimates of the number of contract actions bypassed and amount of reporting time avoided, we estimated the number of contract actions that would have required reporting but for the fact that the firm participates in the Test Program. The DD350 database lists all DoD contract actions in excess of \$25,000 every fiscal year.

We based our estimate of the number of subcontracting plans and SF294s (Column F) upon “action and completion dates” found in the individual contract action reports.³ We assumed for our estimate that each contract action included in Column D requires a subcontract plan at time of award and biannual SF294 reports during the performance period of each Column (D) contract action. For example, if the completion date information provided in the DD350 database indicates a 36-month performance period for a particular action, we assume that six SF294s will be avoided by that participant:

$$(36 \text{ months} \div 12 \text{ months}) \times 2 \text{ annually.}$$

Column E shows the number of SF294s based on two SF294 reports every 12 months for the associated periods of performance.⁴ Column F adds the requirement for a plan at the time of award to the results of Column E.

Table 5-1. FY00 Contract Actions Subject to SF294 Reporting

Company	Total Contract actions (A)	All Mods (B)	Number of Unique Contracts with Mods (C)	Adjusted Total Actions (Total - All Mods + Unique Contracts with Mods) (D)	Estimated SF294s Resulting from Adjusted Total Actions (E)	Estimated Plans Plus SF294s Resulting from Adjusted Total Actions (F)
(b)(4)	50	22	11	39	269	308
(b)(4)	142	49	20	113	812	925
(b)(4)	152	60	30	122	461	583
(b)(4)	856	663	204	397	2,164	2,561
(b)(4)	57	51	18	24	147	171

³ These data are located in action and completion date fields in the DD350 database.

⁴ LMI calculated the values in Column E by inspecting the period of performance for each contract action in Column D.

Table 5-1. FY00 Contract Actions Subject to SF294 Reporting (Continued)

Company	Total Contract actions (A)	All Mods (B)	Number of Unique Contracts with Mods (C)	Adjusted Total Actions (Total - All Mods + Unique Contracts with Mods) (D)	Estimated SF294s Resulting from Adjusted Total Actions (E)	Estimated Plans Plus SF294s Resulting from Adjusted Total Actions (F)
(b)(4)	49	25	5	29	113	142
(b)(4)	26	18	9	17	39	56
(b)(4)	65	36	15	44	144	188
(b)(4)	5	2	2	5	30	35
(b)(4)	40	16	8	32	104	136
(b)(4)	54	36	17	35	163	198
(b)(4)	66	56	16	26	147	173
(b)(4)	65	43	19	41	346	387

Table 5-1. FY00 Contract Actions Subject to SF294 Reporting (Continued)

Company	Total Contract actions (A)	All Mods (B)	Number of Unique Contracts with Mods (C)	Adjusted Total Actions (Total - All Mods + Unique Contracts with Mods) (D)	Estimated SF294s Resulting from Adjusted Total Actions (E)	Estimated Plans Plus SF294s Resulting from Adjusted Total Actions (F)
(b)(4)	84	62	16	38	146	184
(b)(4)	19	5	4	18	68	86
(b)(4)	45	33	14	26	190	216
(b)(4)	88	61	22	49	186	235
(b)(4)	82	39	17	60	305	365
(b)(4)	27	21	6	12	52	64
(b)(4)	1,264	897	264	631	3,048	3,679
TOTAL				1,758	8,934	10,692

Now that we have established the number of qualifying contract actions that participants do not report on because of their membership in the Test Program, we turn our attention to developing cost avoidance estimates for this same figure.

Estimating Benefits

We estimated program benefits assuming that the level of activity found in FY00 is representative of preceding and future years (our steady-state assumption). Using this assumption, we can apply what we learn about FY00 in Table 5-1 to all other fiscal years.

First, we have 1,758 unique contracts and mods (the Column D total), each of which would have required a subcontracting plan in the year of the award, as well as 8,934 SF294s that would have been submitted by Test Program participants over the next several years (the Column E total). The Column F (subcontract plans plus SF294s required over the life of the contract actions in Column D) total represents the workload avoided by the participants because they are in the plan.

Next, we calculated an average of the period of performance (in years) for all contract actions. We performed this calculation by first dividing the Column E total by the Column D total ($8,934 \div 1,758$). We took this result (5.08) and divide it by two, since there are two SF294s required annually. We rounded down our quotient of 2.54 to 2.5 years, which is the average period of performance for all contract actions found in Column D.

Then, we applied this average performance period of 2.5 years to our estimated SF294 workload. To do this calculation, we assumed that the Column E total represents 100 percent of the SF294 workload that participants avoid by being in the program. We know that the average period of performance of that workload is 2.5 years, so we divided 100 percent by 2.5 years to derive the workload percentage that can be accomplished in a fiscal year:

$$100 \text{ percent} \div 2.5 = 40 \text{ percent.}$$

This implies that 40 percent of the SF294s, or 3,574 SF294s, are avoided in FY00; another 40 percent are avoided in FY01; and 1,787 SF294s, or the remaining 20 percent, in FY02.

Using this logic and assuming similar activity in all preceding years (our steady-state assumption), in FY00 the number of avoided SF294s is 3,574 from activity in FY00; plus 3,574 (or 40 percent) from activity in FY99 that—because of the 2.5 year average performance period—is still being reported on, plus 1,787 SF294s (or 20 percent) from contract actions originating in FY98, for a total of 8,935 avoided SF294s in FY00.⁵ The steady-state assumption enables us to apply the results for one fiscal year to all fiscal years.

Finally, we added the Column E total, 8,934, to the 1,758 subcontracting plans, for 10,692 reporting actions that the participants avoid because of their participation in the Test Program.

⁵ 8,935 is greater than Column E total of 8,934 because of rounding.

At 9 hours per submission (the time factor obtained from the back of the SF294 form), the annual cost avoidance would be 96,228 hours, or 46.3 person years. At \$50,000 to \$100,000 per person year (\$25 to \$50 per hour), the annual cost avoidance by the participants would amount to between \$2.315 million and \$4.63 million. This range (\$2.315 million to \$4.63 million) represents steady-state savings (i.e., it is applicable to all fiscal years), assuming that the requirements seen in FY00 occur in all years prior to and subsequent to FY00.⁶

PARTICIPANTS' OUTREACH AND ENHANCEMENT EFFORTS

Introduction

In accordance with the objectives of the Test Program, participating contractors should devote the resources saved from reduced reporting requirements to various efforts aimed at the small, small-disadvantaged, and women-owned small businesses. Some of these efforts are internal to the participants, such as improved buyer training and incentives, procedures to increase subcontract awards to the targeted communities, and documentation of when the targeted small businesses are not selected for subcontract opportunities. Additional external efforts aim at increasing the awareness of the potential subcontractors to subcontracting opportunities through improving communications, enhancing the capabilities for the communities to participate in the contracted work effort, and publicizing current capabilities to other DoD prime contractors.

We reviewed the performance of the participants to assess outreach and enhancement efforts. The discussion below presents our findings, based on a review of recent comprehensive plans submitted to the DoD by the participants. The discussion is organized into internal policy/procedure initiatives and external activities that involve the target community.

Internal Initiatives

BUYER TRAINING AND INCENTIVES

Most participants conduct internal training programs to familiarize their buyers with program goals and objectives, and tools and techniques available to identify qualified subcontractors. Several participants reward buyers for achieving or surpassing goals—usually with awards and recognition and occasionally as a factor

⁶ Our cost avoidance savings estimate is a little high because we neglect to reduce these savings by the cost of preparing a single comprehensive plan by each of the 20 participating contractors. A single annual plan is required in lieu of individual plans and SF294 reports. These costs might amount to 20–25 person weeks, or approximately half a person year, out of 46.3 person years of estimated gross savings.

in annual performance reviews or as monetary incentives such as credits to purchase items in the company store.

POLICY AND PROCEDURES TO ENHANCE PARTICIPATION

Participants maintain records to ensure that policies and procedures are implemented. Primary among these records are those that relate to whether desirable contractors are solicited and, if not, why they have not been asked to participate. Thus, buyers are obligated to report whether they included small, small-disadvantaged, and women-owned small businesses in solicitations. In addition, they usually are required to report why an award was not made when such businesses are solicited.

Most Test Program participants document whether subcontractors were included in a solicitation for subcontract awards anticipated to exceed \$100,000. There were several cases of participants with significantly different thresholds. One participant documents whether subcontractors are included for awards as small as \$5,000. Another does only when the award is anticipated to exceed \$1 million.

Finally, we found one Test Program participant who employed an extremely stringent policy. All subcontract awards anticipated to be less than \$100,000 are set aside for small, small-disadvantaged, and women-owned small businesses. When three or more subcontractors are capable of satisfying the requirement, the solicitation does not include large businesses. In the event small and large businesses compete, the former are given a 10 percent price preference.

Another participant will restrict competition to SDBs and WOSB suppliers when a sufficient number of such qualified suppliers are available.

External Initiatives

Outreach to the target communities involves several initiatives designed to make those communities aware of subcontracting opportunities, make Test Program participants aware of qualified small, small-disadvantaged, and women-owned small businesses, and enhance the capabilities of subcontractors from these categories. These efforts are described below.

PUBLICIZING SUBCONTRACTING OPPORTUNITIES

All Test Program participants engage in efforts to publicize subcontracting opportunities. Generally, these efforts include attendance at conferences, trade fairs, and related functions and meetings with local minority purchasing councils and small business development centers. Most Test Program participants have Web sites listing pending subcontracting opportunities. Company sites often are linked to relevant DoD Web sites.

IDENTIFYING POTENTIAL SOURCES

All Test Program participants maintain lists of small, small-disadvantaged, and women-owned small businesses so that buyers can identify qualified small business sources. These databases typically come from SBA's Pro-Net on-line database, Aerospace Industries Association's SDB source list, and databases maintained by local Minority Supplier Development Councils. When a contractor has multiple divisions, each participating in the Test Program, information on sources often is shared across divisions.

ENHANCING SUPPLIER CAPABILITIES

Most Test Program participants also participate in the DoD Mentor-Protégé Program. Nearly all indicated the intent to add a new protégé in the year reviewed (FY00).

A second approach is for the Test Program participants to provide technical and business management assistance to enable the small, small-disadvantaged, and women-owned small businesses to perform pursuant to contract requirements. Only one participant indicated that such assistance is a broad-ranging company policy. Technical assistance includes corrective actions to resolve quality assurance deficiencies and improve production yields, and assistance to clarify and interpret drawings and specifications. Management assistance helps ensure compliance to solicitation requirements and resolve administrative shortfalls.

CONCLUSION

The Test Program replaces the individual planning and reporting of subcontracts with a single comprehensive plan and biannual SF295s. Program benefits arise as contractor administrative savings from reduced reporting burdens, concomitant savings to the DoD in terms of reduced oversight burdens, and additional contractor outreach to SBs, SDBs, and WOSBs using resources freed because of reduced planning and reporting. We were able to quantify only the first type of program benefit—contractor savings from reduced administrative burdens. These estimated cost avoidance savings among participants range from \$2.315 million to \$4.63 million annually.

We were unable to quantify benefits from reduced DoD oversight. Data on workload devoted to oversight of subcontracting plans and reports are not available. It seems reasonable to assume, however, that DoD's cost avoidance savings in oversight negotiation and review functions are at least great as those estimated for contractors.

We were unable to quantify outreach benefits and/or results in terms of new business opportunities resulting from enhanced outreach. Participants' small business plans address processes rather than results from outreach activities. Nor did interviews reveal quantifiable information on outreach results. Instead, many outreach

efforts increase the capabilities of small, small-disadvantaged, and women-owned small businesses already doing business with the prime contractor. This is consistent with an industry trend to work with fewer suppliers.

Chapter 6

Comprehensive Subcontracting Plan Negotiation and Oversight

INTRODUCTION

In this chapter, we describe the negotiation and oversight functions for comprehensive subcontracting plans under the Test Program. We begin by explaining the roles and responsibilities of the major players. Then, we describe the negotiation process and the steps in DCMA's review process. This chapter also discusses concerns raised, by the major players, about the negotiation and oversight functions.

MAJOR PLAYERS

Negotiation and oversight of the Test Program are coordinated efforts by the government and participants. The major players are discussed below.

DoD Office of Small and Disadvantaged Business Utilization

The DoD Office of Small and Disadvantaged Business Utilization (SADBU) administers the Test Program. Each year the SADBU establishes thrust initiatives for the program. The FY01 initiatives for each participant are as follows:

- u Solicit at least one small disadvantaged business, one women-owned small business, one HUBZone small business, and one Service-Disabled Veteran-Owned small business on every competitive solicitation for which such qualified firms can be identified.
- u Consider advertising competitive solicitations on generally accessible electronic media, such as the SBA's SUB-Net (<http://web.sba.gov/subnet/>), particularly when qualified SB firms can not be identified in the foregoing targeted categories.
- u Maintain a Web site dedicated to providing procurement opportunities and other information to potential small business sources. Linking the site to the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) [OUSD(AT&L)] SADBU Web site (www.acq.osd.mil/sadbu), and provide the Web site address to the Director, Office of SADBU, OUSD(AT&L).

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- o Pursue at least one new subcontract award with an eligible Indian-Owned entity in accordance with the Indian Incentive program provisions of FAR Subpart 26.1.
 - o Enter into at least one new mentor-protégé agreement with a protégé that currently is not part of the program.
 - o Pursue at least one Minority Institution or Historically Black College or University to perform as a subcontractor.
 - o Increase outreach to each of the targeted areas in which the goal was not achieved in the previous year.
 - o Establish a system for addressing small business subcontractors complaints that invoices are not being paid promptly¹

Service Acquisition Executives

Section 811 of Public Law 104-106 (c) authorized service acquisition executives (SAEs) to designate at least three but not more than five DoD contracting activities to oversee the Test Program. Since the inception of the Test Program one contracting activity, the Air Force's Aeronautical Systems Center (ACS), Wright-Patterson AFB, has taken on the oversight role.

The DCMA

The DCMA is responsible for negotiating and monitoring the subcontracting performance of the program participants. Participating contractors are assigned to either DCMA East or -West, depending on their location. ASC, the contracting activity, provides this authority via a delegation memorandum. It requires DCMA to:

- o Establish negotiating teams led by administrative contracting officers (ACOs) and include a Small Disadvantaged Business Utilization Specialist from ASC to review all plans and provide comments to the ACO.
- o Solicit proposed comprehensive subcontracting plans from current and new participants.
- o Review, negotiate, and approve comprehensive plans by the end of the DoD's fiscal year.
- o Maintain and distribute copies of approved plans.
- o Issue change orders to substitute the approved subcontracting plans for current or new participants.

¹ See DoD SADBUs Web site at <http://www.acq.osd.mil/sadbu/>.

- o Review each participant's performance; document and review findings.
- o Determine, during annual performance reviews, whether each participant made a good-faith effort to meet its goals; and take appropriate action.

Military Department SADBUs Offices

The Military Department SADBUs offices sponsor contractors that desire to become participants in the program. They also review and provide comments on participants' proposed comprehensive subcontracting plans. In cases where a participant's performance is eroding, they work in collaboration with the DoD SADBUs and DCMA to offer solutions.

When we interviewed them, the Military Department SADBUs expressed varying opinions on the usefulness of the Test Program. Most thought the program was not achieving its original intent. Some of the Military Department SADBUs pointed to poor communications between the Military Departments and DCMA. At times, some SADBUs said, they have not been invited to provide input to proposed comprehensive subcontracting plans. In addition, they receive little to no information on results of negotiations. Others expressed concern about the comprehensive subcontracting plans' lack of visibility at the program level.

One Military Department SADBUs director voiced frustration over the lack of visibility for a major contract recently awarded to one of the participants. The director maintained that the lack of visibility makes it difficult to manage inquiries about subcontracting opportunities. Inquiries come from SBs and all subsets, advocacy groups, members of Congress, and others. According to this director, the comprehensive subcontracting plan provides no useful information to respond to these inquiries.

Another problem revealed by a Military Department SADBUs director is the lack of an amendment process for major awards made after the negotiation of the comprehensive plan. Unlike other types of subcontracting plans, there is no process for amending the comprehensive subcontracting plan. Furthermore, by the time major awards are factored into the participants' subsequent comprehensive subcontracting plans, it is already too late for meaningful government involvement.

The Small Business Liaison Officers

The Small Business Liaison Officers (SBLOs) are the participants' primary point of contact with DoD on Test Program implementation. Generally, they are appointed by senior management and responsible for the participants' SB programs. Their duties typically include the following:

- o Develop and negotiate subcontracting plans related to all SB categories.

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- υ Prepare SF294 and SF295 reports as required.
 - υ Act as a liaison with DCMA, SBA, agency small business representatives, other customer representatives, and small business associations.
 - υ Interface with internal functional departments on small business issues.
 - υ Train buyers on small-business-related issues.
 - υ Perform outreach to identify new small business sources.
 - υ Participate in “make or buy” reviews.
 - υ Counsel and discuss subcontracting opportunities with current and prospective small businesses.

COMPREHENSIVE SUBCONTRACTING PLAN NEGOTIATIONS

The comprehensive subcontracting plan negotiation period starts 45 days before October 1 of each year. During this 45-day period, the participants submit their proposed plans to the ACOs. The ACOs distribute copies of participants’ proposed plans internally and to sponsoring agencies for review and comment.

The DoD’s SADBUs office forwards thrust initiatives to DCMA for incorporation into negotiations and ultimately the participant’s subcontracting plans.

After ACOs resolve all outstanding issues and obtain approvals, they execute plans and distribute them accordingly.

Almost all players that have a role in the negotiating process expressed dissatisfaction that “thrust initiatives come too late in the negotiation process.” They contended that the lack of timeliness of their submission has caused setbacks in negotiations and comprehensive subcontracting plan execution.

Thrust initiatives sometimes are mandatory (e.g., goals for HUBZones, HBCU/MIs, and Veteran-Owned SBs) but mostly negotiable. Several participants want initiatives that are more tailored to their local environments. A DCMA representative pointed out that the “flexibility to tailor initiatives works if participants use this flexibility to address specific deficiencies in their plans.” An example is tailoring initiatives to areas like HUBZones where participants are performing poorly.

DCMA Review Process

DCMA’s review process begins with an assessment of the participant’s small business program administration. DCMA uses Form 640 to evaluate individual

subcontracting plans and master subcontracting plans, as well as comprehensive subcontracting plans.² DCMA answers the following questions from Part II of their Form 640:

1. Has the company-wide SB program policy statement been issued by current senior management and disseminated throughout the company?
2. Has the SBLO been formally appointed by senior-level management?
 - a. Are the duties and responsibilities defined?
 - b. Is the SBLO appointed at an appropriate level to effectively administer the program?
 - c. To whom does the SBLO report?
3. Are procedures that implement the SB program being followed?
4. Does the participating contractor perform outreach and supplier assistance?
 - a. Are source lists, guides, and data used to identify suppliers?
 - b. Are organizations contacted for additional SB, SDB, and WOSB suppliers?
 - c. Did the participating contractor attend or sponsor procurement conferences or seminars?
 - d. Are successes documented in locating, utilizing, and developing new SB sources?
 - e. Are examples documented of counseling, management, technical, and financial assistance provided to suppliers?
 - f. Are examples documented of mentoring, teaming, and developing SBs (including Mentor-Protégé Program, National Industries for the Blind/NISH, HBCU/MIs, and WOSB programs)?
5. Are management and staff briefed regularly on achievements and/or program deficiencies?
 - a. What does the participating contractor do to improve program performance if overall program objectives are not being met?
 - b. Do the participating contractor's practices ensure accurate reporting?

² Therefore, some of the questions in this form may not apply to comprehensive subcontracting plans.

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6. Does the participating contractor flow down the subcontract plan requirement to subcontractors as required under FAR clauses 52.219.8 and 52.219-9?
 - a. Do the participating contractor's large subcontractors have a subcontracting plan in place?
 - h. Are records maintained for purchases over \$100,000 in accordance with FAR 52.219-9(d)(11)(iii)?
 - c. Have at least 10 purchase orders over \$100,000 to large businesses been sampled, including, if appropriate, some purchase orders over \$500,000, for SB consideration and flow-down?
 - d. Are records maintained by the participating contractor to evidence current supplier business size and status?
 7. Does the participating contractor have an effective training program for all employees that have procurement requirements and source selection responsibilities, as well as management?
 - a. Is there an effective recognition program that includes all functional elements of the organizations involved in the program?

RATING LEVELS

Part III of Form 640 requires the DCMA reviewer to assess the participant's overall subcontracting performance and past performance. In Part IV of the form, the reviewer rates and provides a summary of, and recommendations for, performance. DCMA's³ five performance rating levels are described in the sections below.

Outstanding

In addition to meeting all of the elements for the "highly successful" rating, the contractor must have made exceptional extra contractual effort to assist, promote, and utilize SB, SDB, WOSB, and HUBZone businesses in its program. The contractor must be an active participant and have demonstrated a record of success in one or more optional socioeconomic programs and/or initiatives, such as the Mentor-Protégé Program, Indian Incentive Program, HBCU/MI, and Javits-Wagner-O'Day (JWOD) Program (subcontracting to nonprofit agencies that are affiliated with NIB or NISH).

³ These descriptions are taken from DCM Orlando and St. Petersburg, "Small Business Liaison Officer Training SBLO 101" January 24, 2001.

Highly Successful

In addition to meeting all the elements for the “acceptable” rating, the contractor must have made significant extra contractual efforts to assist, promote, and utilize SB, SDB, WOSB, and HUBZone business concerns in its subcontracting program. Additionally, the contractor must be an active participant and have demonstrated a record of success in one or more optional socioeconomic programs and/or initiatives, such as the Mentor-Protégé Program, Indian Incentive Program, HBCU/MI, and JWOD Program.

Acceptable

An “acceptable” rating indicates that the contractor is meeting the contractual requirements of the DFARS and FAR 52.219-8 and 52-219-9. This rating is given when the contractor meets or exceeds the plan goal objectives or has demonstrated efforts in achieving the plan and overall goal objectives, has complied with the reporting requirements, and has complied with all other features of the subcontracting plan. An “acceptable” rating may be given to a contractor that previously was rated marginal or unsatisfactory and has corrected the noted deficiencies. When determining the acceptability of a contractor’s program, the subcontracting performance is the primary factor and should be given more weight.

Marginal

A program review determined by the specialist to have at least one but not more than three deficiencies should be considered “marginal.” This rating is given when the contractor is not meeting the contractual requirements of the DFARS and FAR 52.219-8 and 52.219.9 or any feature of the subcontracting plan requirement. A follow-up review will be scheduled.

Unsatisfactory

A program review determined by the specialist to have more than three deficiencies should be considered “unsatisfactory.” This rating is given when the contractor is not meeting the contractual requirements of the DFARS and FAR 52.219-8 and 52.219-9, or any feature of the subcontracting plan requirement, or has not developed a corrective action plan or made efforts to implement a corrective action plan as agreed to previously in writing. An “unsatisfactory” rating is kept in effect until all deficiencies are corrected. A follow-up review will be scheduled. If the unsatisfactory performance results from a lack of good-faith effort to comply with the terms of the subcontracting plan, the contractor should be considered for recommendation of liquidated damages to the procuring contracting officer.

PERFORMING THE RATINGS

DCMA-East and -West perform the participating contractors’ annual reviews and rate their performance. DCMA-East and -West follow the same review process; however, because performance metrics are subjective, ratings vary. Some review-

ers for DCMA rated performance based on a strict interpretation of the performance measure, while others took into consideration mitigating circumstances (e.g., mergers and acquisitions or directed-source procurements) that may have affected a participant's subcontracting performance. Under these conditions, participants are required to state in writing why they were unable to meet a particular goal.

According to SBLOs, DCMA's ratings could affect their performance evaluations and salary bonuses. They explained that any change, for example, from a rating of "outstanding" to "marginal" or "unsatisfactory" could potentially affect their salaries.

As noted previously, DCMA also expressed a need for more visibility of participating contractors' subcontracting activities. DCMA would like to see visibility down to the major divisions or buying activities of participants. This is particularly true for participants that have corporate plans. Some participants have perceived DCMA's request for greater visibility as going beyond the requirements of the Test Program—others have complied, providing subcontracting data at the program or division level. For corporate plans, DCMA believes they are better able to manage subcontracting performance when the performance results are broken out by line of business. This, according to DCMA, allows them to better understand how the individual units are performing and make suggestions for improvement.

CONCLUSION

The major players of the comprehensive subcontracting plan include the DoD and Military Department SADBUs, SAEs, DCMA, and the participants' SBLOs. The DoD SADBUs administer the overall subcontracting program for the Department. Each year, they establish thrust initiatives for the Test Program. These initiatives serve to enhance small business subcontracting. Thrust initiatives usually are a combination of statutory requirements and innovative ideas to increase participation by all SB categories on DoD contracts. The timeliness of the submission of thrust initiatives is a major concern for the parties involved in the negotiation process.

Military Department SADBUs are sponsors for contractors that want to participate in the Test Program. They assist them with performance issues, review their comprehensive subcontracting plans, and provide comments to DCMA. Concerns raised by Military Department SADBUs include the lack of visibility into comprehensive subcontracting plans, the lack of a process to amend these plans, and in some cases poor communications between the Military Department SADBUs and DCMA.

SBLOs are the DoD's main point of contact for comprehensive subcontracting plan matters. Senior management generally appoints SBLOs to manage their pro-

grams for all SB categories and implement the program within their respective corporations.

The negotiation period for comprehensive subcontracting plans starts 45 days before October 1 of each year. ACOs coordinate with other major players and negotiate plans. Participants prefer some flexibility that would allow them to tailor initiatives to local environments.

DCMA uses its Form 640 to conduct reviews of the participants' comprehensive subcontracting plans. They use a subjective process to annually rate participants' performance.

Chapter 7

Participating Contractor Best Practices

INTRODUCTION

In this chapter, we summarize the participants' best practices for managing their SB subcontracting under the Test Program. Identified through interviews with participating contractors, these practices reflect the participants' views as to what has worked best for them within the Test Program

Not all participants have implemented the best practices we discuss in this chapter. The practices of early involvement and tracking purchase card expenditures are not widely used. However, we found that the most successful participants practice early involvement, and most participants expect to track purchase card expenditures in the near future. In addition, most—and in some cases, all—participants have implemented the other practices discussed below.

PARTICIPATION IN THE TEST PROGRAM

During LMI's interviews, several participants made the point that participating in the Test Program is, in and of itself, a best practice. According to these participants, the Test Program gives their SB program high visibility within the division or corporation. They explained that, because the "chairman has to sign off on the plan," the importance of the program is elevated throughout the division or corporation.

SENIOR MANAGEMENT SUPPORT

While senior management support is not a new practice, participants considered it the single most important factor for achieving and maintaining a successful subcontracting program. Without it, participants said, their Test Programs would fail.

The majority of the participants have received some form of senior management support. This ranged from sending letters to managers encouraging their support of the SB program, to chairing company meetings of SB advocates, to mandating support for small businesses. Some participants particularly stressed the need to get a buy-in from senior management "before you leap into the program."

SMALL BUSINESS COMMITTEES

To further their SB initiatives, some participants have established SB councils and/or steering committees. These SB committees generally set small business goals for the division or corporation. Through these committees, senior management from each operating and common resource group (e.g., human resources, public relations, legal, treasury, and purchasing) meet periodically to monitor their participants' progress toward SB goals. Small business councils and steering committees also are excellent forums for discussion of company-wide goals.

EARLY INVOLVEMENT

Some participants emphasized that, in order to be successful, the consideration of a SB plan must begin "upstream" in the "make versus buy" process, or during the engineering and design cycles. This is particularly true for identifying high-tech requirements that participants say are hard to pin down for small businesses.

INTERNAL OUTREACH

Even with senior management support, many participants believe they must keep SB objectives high on their functional organization's "to do list," for fear of losing their backing. Most participants achieve this focus on SB objectives through "internal outreach" (e.g., providing training to functional groups, introducing new SB sources, and promoting opportunities for small businesses).

One internal outreach approach suggested by some participants is to place "missionaries" in key functional areas. These missionaries are individuals that champion small businesses. One participant recommends its process of assigning champions for each SB goal (e.g., small disadvantaged business, Women-Owned Small Business, and Veteran-Owned Small Business goals).

REALISTIC GOALS

Almost all participants believe that the basis on which SB goals are set must be realistic information, rather than speculation. Setting realistic goals, participants contended, is the first step to managing a successful program. Participants typically set their goals using past performance and firm commitments. One participant assigns goals down to the major divisions and buying activities.

TRACKING PURCHASE CARD EXPENDITURES

Purchase card expenditures have continued to rise as a percentage of overall expenditures for most participants. Many small businesses are accepting purchase cards, even though they lose part of each such sale to bank fees. By accepting

purchase cards, small businesses gain a faster turnaround time on payment collection, as well as gaining business they otherwise might lose. While the use of purchase cards is growing, sufficient systems have not been put into place to provide complete reporting information at that level. Therefore, a small number of participants have begun tracking their purchase card expenditures. Through arrangements with the issuing banks, these participants receive detailed information on their SB expenditures. This information improves the visibility of their successes, as they can use it to report their SB expenditures to the DoD.

CAMARADERIE

In almost every other area of business, the participants operate at arms' length from one another. SB matters are an exception. Some participants benchmarked the best practices of existing participants and sought out their advice before participating in the Test Program. Many participants share information, network, refer small businesses to one another, and help each other with their programs. Some small businesses have even broadened their customer base as a result of the networking among participants. Almost all participants consider this spirit of camaraderie to be a best practice.

ANNUAL MEETINGS

Participants expressed a desire to implement a best practice of holding annual meetings as a group. In the past, meetings with stakeholders helped to set the tone for new plans. At those meetings, attendees discussed upcoming thrust initiatives and other relevant SB issues.

LINKING RESULTS TO PERFORMANCE EVALUATIONS, SALARIES, AND BONUSES

Most participants' SBLOs and buyers are accountable for ensuring that certain SB results are achieved. These results are linked directly to SBLO and buyer performance evaluations. For example, most buyers begin each fiscal year with goals for the number and percentage of dollars they expect to spend on each SB category. Shortfalls in the results could affect the buyers' performance evaluations and ultimately their salaries or bonuses. SBLOs similarly must ensure certain SB subcontracting results are achieved. Any gap in that performance could likewise affect their performance evaluations, salaries, and/or bonuses. This practice provides a strong incentive for SBLOs and buyers and helps keep them focused on achieving SB subcontracting results.

PROVIDE RECOGNITION AND REWARDS

In addition to linking results to the performance evaluations, salaries, and bonuses for buyers and SBLOs, most participants provide recognition to managers who exemplify role-model behavior in supporting small businesses. Plaques, certificates, and even cash awards are examples of recognition and rewards offered to managers. The result is a greater incentive to support SB goals.

CUSTOMER-DRIVEN INCENTIVES

The majority of participants said customer-driven incentives are helpful motivators for achieving SB subcontracting results. Participants favor the use of incentives, because they are business drivers that motivate for-profit firms.

Some of the participants singled out the National Aeronautics and Space Administration's (NASA's) use of past performance and incentives¹ as a best practice. In comparison to the DoD, NASA's approach to SB subcontracting was described as more business oriented. For example, in the preaward stage NASA relies heavily on the prospective contractor's past performance. NASA's policy provides for an evaluation credit (15 percent of the evaluation, or 150 points out of 1000) to prime contractors that utilize small disadvantaged businesses in targeted areas. Participants say this puts offerors on notice that if they want to be successful in winning NASA awards, they must demonstrate superior past performance. In the post award phase, NASA uses an award-fee incentive in its cost-plus contracts to encourage subcontracting. Five of the Test Program participants are included on NASA's top-ten-contractors list.

CONCLUSION

The best practices described above can be helpful in the successful execution of comprehensive subcontracting plans. Participating in the Test Program is considered a best practice because it provides much-needed visibility to small business initiatives. Senior management support is critical for successful participation in the Test Program—without it, the program is likely to fail.

Senior management support includes participation in small business council or steering committees with senior management. These groups work best when they include participation from all functional organizations, including common resource groups like human resources, public relations, legal, and purchasing. Early involvement in identifying subcontracting opportunities for small businesses is

¹ Participants in the DoD Comprehensive Subcontracting Test Program are required to delete FAR 52.219-10, "Incentive Subcontracting Program for Small and Small Disadvantaged Business Concerns," and DFAR 252.219-7005, "Incentive Program for Subcontracting with Small and Small Disadvantaged Business Concerns, Historically Black Colleges and Universities, and Minority Institutions."

another important practice. If SB subcontracting opportunities are identified during the make-or-buy decision process, participants have a better chance of finding meaningful work for small businesses.

Providing for internal outreach to promote small business initiatives, setting realistic goals, and tracking purchase card expenditures are additional best practices that can improve the management and execution of the program. The camaraderie among Test Program participants, which is unique for private-sector firms that are usually unwilling to share information, is helpful to both participants and small businesses. Annual meetings of stakeholders, is a practice that can build on camaraderie among participants while setting the tone for new plans.

Best practices also include the use of methods for motivating and reinforcing behaviors that are critical to the program's success. By linking results to performance evaluations, salaries, bonuses, recognition, awards, and customer-driven incentives, the parties involved are motivated to do their part to increase subcontracting performance.

Chapter 8

Findings

INTRODUCTION

The previous chapters have highlighted a number of LMI's findings regarding the results of the Test Program. Some findings are based on our analyses of the program and its participants, while others stem from our interviews with various players in the program. In this chapter we summarize the findings that we believe directly influence Test Program performance.

The DoD and military SADBUs have program management responsibilities for SB subcontracting. However, the Test Program participants' primary customers—the PMOs—are in a better position to influence the participants regarding their subcontracting performance. From numerous interviews with program participants, LMI finds that the PMOs are not using this influence to create greater subcontracting opportunities for small businesses. We believe that this lack of customer pressure is the most important factor that helps to explain the recent decline in subcontracting performance by Test Program participants. However, there are others; for instance:

- o There are no processes to remove poor performers from the Test Program.
- o There is a need for more visibility of subcontracting data.
- o There is no Test Program guidance on directed-source procurements.
- o There is a need for a timelier introduction of DoD thrust initiatives.
- o Communication lines between DCMA and the Military Departments are broken.
- o Comprehensive subcontracting plans do not provide for amendments.
- o Certification requirements affect SDB and HUBZone performance.
- o Small businesses generally play a minimal role in meeting high-technology requirements.
- o Small businesses seldom are selected as teaming partners.
- o Comprehensive subcontracting plans lack data on the results of outreach activities.

PMO Involvement

“My customers never ask me about the Test Program, so why should I care about it?” The president of one of the participating firms posed that question to the firm’s SBLO. LMI believes that the message underlying that question is the key to understanding the recent decline in the participants’ SB subcontracting performance.

The PMOs have significant control over the work participants perform, their funding levels, and any follow-on or new business they receive. Given this relationship, if participants perceive that Test Program goal attainment has become a necessary precondition to receiving follow-on business from the PMOs, they will make a business decision to either satisfy this requirement or withdraw from the program. This decision may be costly and therefore difficult because it may force participants to adjust their “make/buy” allocations. However, if they perceive that their Test Program success is a high priority with their customers, they are likely to make such adjustments, even those that may affect their short-term profitability. LMI believes that until the PMOs impress upon the participants that subcontracting goal attainment is important to their future livelihoods, SB subcontracting performance is not going to improve.

Removal for Consistently Poor Performance

As we discussed in Chapter 1, the first significant change to the Test Program occurred with the passage of Public Law 101-574, Section 402, which suspended the payment of liquidated damages under comprehensive subcontracting plans. Since then, there have been no significant penalties aimed at correcting poor performance under the Test Program. In addition, there are no procedures in place for removing participants from the Test Program. Consequently, the consistently poor performance of several participants offsets the positive achievements of successful participants and adversely impacts aggregate performance reporting.

Greater Visibility of Subcontracting Data

We found DCMA representatives do not have access to data on some participants’ subcontracting performance at lower levels within the corporation (e.g., division or program). According to DCMA, improved visibility of such data would provide them with a greater opportunity to assess each participant’s goal attainment potential. Furthermore, DCMA believes greater data visibility would allow it to understand how each participant’s lines of business are performing. In turn, DCMA could use this information to identify potential subcontracting opportunities.

Visibility of lower-level subcontracting performance also is important because it would help the DoD and Military Department SADBUs respond to inquiries regarding various contracts. SB subcontracting performance is an area that

continues to draw questions. Inquiries come from small businesses, their advocacy groups, and even members of Congress. But, according to the SADBUs, the Test Program does not provide enough useful information from which they can respond to such inquiries.

Guidance on Directed-Source Procurements

In Chapter 4, we described how directed-source procurements often limit opportunities for small businesses because the DoD directs a prime contractor to use a particular subcontractor's—usually a large business subcontractor's—product or service. The net result for Test Program participants is a reduction in available subcontracting opportunities for small businesses, which may severely limit the participants' ability to attain their SB goals. Policy guidance outlining what constitutes a directed source for Test Program subcontract reporting purposes may reduce the adverse affect that directed-source procurements have on the participants' subcontracting performance.

Timeliness of DoD Thrust Initiatives

We found DoD thrust initiatives come too late in the negotiation process, unsettling negotiations and slowing the execution of these initiatives. Participants contend that the earlier they can prepare, the better their position to finalize subcontracting plan negotiations and execute initiatives in support of those plans.

Communications Between DCMA and the Military SADBUs

As we described in Chapter 6, some Military Department SADBUs complained that they are out of the communications loop with DCMA. We believe this problem stems in large part from the fact that one contracting activity—the Air Force's ASC—has the contracting lead for the Test Program. While Section 811 of Public Law 104-106(c) authorized the SAEs to designate at least three (but not more than five) contracting activities to participate in the Test Program, the ASC currently is the only participating contracting organization. If the other Military Departments were to participate per this authorization, communications would improve between those departments and DCMA.

Amendment Procedures for Comprehensive Subcontracting Plans

As we described in Chapter 3, negotiations between the participants and DCMA representatives occur annually to develop their Test Program plans. However, existing Test Program guidance does not address the amendment of Test Program subcontracting plans. Without this policy guidance, plans cannot be amended to reflect contract awards made after the negotiation of a plan. Nor can they reflect changes in participants' business circumstances caused by merger and acquisition activity.

For DoD contractors not participating in the Test Program, any new awards in excess of \$500,000 (non-construction) or \$1,000,000 (construction) require an amendment to the contractor's subcontracting plan. Under this circumstance, the contracting officer is required to renegotiate SB goals before awarding any new business to the contractor. In contrast, if a major award is made after the negotiation of a comprehensive subcontracting plan under the Test Program, the participant can determine unilaterally what its SB goals will be for the new award. By the time the new award is factored into the next year's comprehensive subcontracting plan, it is too late for any meaningful government negotiations or oversight of the prior year's results.

SDB and HUBZone Certification Requirements

The government's certification requirements for small disadvantaged businesses pose limitations that reduce the number of such businesses available to subcontract with Test Program participants. LMI's interviews with participants surfaced numerous complaints and problems with the certification requirement. Participants believe that certification requirements have limited SDB participation. Some participants have seen significant drops (up to 72 percent) in the amount of SDB subcontracting they can report on their SF295. Most participants attribute the current decline in their reportable SDB dollars to the federal government's certification requirements. Still others have not yet seen significant declines in this area, partly because they have contracts that were awarded before October 1, 1999 and therefore are not affected by the new law.

Participants perceive the certification requirements for HUBZone firms to be a similar problem. They believe the government has established unrealistic requirements and goals for HUBZone firms.

Subcontracting for High-Technology Requirements

Anecdotal evidence drawn from our interviews with Test Program participants suggests that SB firms receive few subcontract awards for high-tech work. This impression was strengthened by our review of the Test Program subcontracting plans in which participants describe potential subcontracting work for small businesses. The participants' "target industry" categories defined in these plans serve as a window into the types of work they may subcontract to small businesses. Each participant is required under the Test Program to identify two industry categories where small businesses were not previously utilized, and develop and execute strategies to increase subcontracting awards to small businesses in these areas. While participants have usually met and sometimes exceeded their goals for their "target industry" categories, awards to small businesses have been mostly for the requirements listed in Table 8-1. The table provides a sampling of the industry categories for some current and past participants.

Table 8-1. Industry Categories Targeted by Program Participants

Sample Number	Category 1	Category 2
1	Temperature and pressure sensors	Engine cables
2	Material management	Machining
3	Electrical aircraft manufacturing	Paper and allied products
4	Composite fabrication	Tooling
5	Fabrication and machining	Telecom networking equipment
6	Offload machining	Flight safety designations
7	Passive devices	Wire and cable
8	Precision moldings	Wire and springs
9	Magnetics	Detectors
10	Sheet metal	R&D
11	Machined parts	Printed circuit boards
12	Forging	Sheet metal fabrication
13	Wire harnesses	Facilities
14	Power components	Castings
15	Wire and cable harness assemblies	Flight hardware
16	Electronic subsystems	Composite parts
17	Simulation	Circuit card assemblies
18	Fasteners	Electrical supplies
19	Electrical components	Engineering services
20	Flight safety parts	Environmental control
21	Optics and coatings	Power components
22	Sheet metal fabrication	Electronic components

It is not clear whether small businesses are manufacturing some or all of these products, or merely providing them to participants as distributors.

Small Businesses as Teaming Partners

Not only did we find many small businesses not participating in high-tech areas, we also found that few were ever teaming partners with participants.¹ While this study did not focus on the reasons for small businesses having a minimal role in teaming, we suspect that there are economic, risk, and other factors that may limit their participation in this area.

¹ LMI's study did not assess teaming relationships when small businesses are the prime contractor in the relationship. Under this circumstance, small businesses that have access to set-asides are desirable to large contractors because they provide access to business opportunities that otherwise would be foreclosed to them.

Because of economic factors such as access to capital, many small firms are unable to attract the kind of financing they need to expand their operations. Furthermore, entry into some of the more complex weapons system markets may be prohibitive to most small businesses. Moreover, to enter these markets small businesses might not qualify as “small” by SBA standards. As a final point, small businesses can be perceived as a higher risk because they do not have the financial wherewithal relative to large businesses. Despite these limitations, a few small businesses have been selected as teaming partners—but generally, participants and the requirements organizations have a bias that favors large contractors for teaming relationships.

Results of Outreach Activities

The majority of the participants’ comprehensive subcontracting plans lacked data on both the cost and results of their outreach activities. In their plans, participants describe what events they attend and/or host to identify small businesses with which they might contract. They also describe their internal efforts to train and educate employees and develop funding to assist small businesses, but they do not report on the outcome of these activities.

Reporting outcomes would benefit both the Department and participants because both can focus their efforts on those outreach activities that produce the best results. In addition, Test Program participants could share these successful practices with their counterparts.

CONCLUSION

Through interviews and analyses we have identified a number of issues leading to poor SB subcontracting performance by Test Program participants. Some are external, related to the DoD’s management of the program; while others are internal, related to the participants’ management of their comprehensive plans.

Probably the most important finding related to the DoD’s management of the program is the PMOs’ lack of accountability for SB results. Others include the need for a process to oust poor performers, more visibility of subcontracting data, and a clear definition of directed-source procurements. Thrust initiatives need to be introduced earlier in the negotiation process, and the lines of communication between some Military Departments and DCMA could be strengthened. Further, the Test Program needs processes to amend the comprehensive subcontracting plans. A final external issue is declining performance due to certification issues for small disadvantaged businesses and HUBZone firms.

Our findings related to participants’ management of their comprehensive subcontracting plans include the issue that participants subcontract few high-tech requirements to small businesses. In addition, they seldom select small businesses as teaming partners and do a poor job of describing the results of their outreach.

Chapter 9

Recommendations

INTRODUCTION

In the preceding chapters, we laid the groundwork for the recommendations we make in the sections below. In Chapter 1, we discussed the Test Program's background, approach, and organization. In Chapter 2, we discussed the legislative framework that is the basis for the Test Program. In Chapter 3, we discussed the Test Program participants' aggregate performance and augmented that discussion with an assessment of the 20 firms that participated in the Test Program in FY00. In Chapter 4, we highlighted some of the factors that affect participant performances and discussed recommendations for improvement of the Test Program. In Chapter 5, we estimated administrative cost avoidance savings and presented an assessment of outreach activities. In Chapter 6, we discussed negotiations and oversight processes, followed by best practices in Chapter 7. Next, in Chapter 8, we outlined our findings. Here we make recommendations based on those findings, and we present them below in our perceived order of importance relative to improving the Test Program's results.

INCREASE PMO INVOLVEMENT

LMI recommends that the DoD SADBUs office consider a revision to the Test Program that would provide for greater PMO involvement. To effect this change, the DoD SADBUs office may wish to consider requiring that PMOs endorse the subcontracting plans as appropriate. A gradual introduction of this proposal—first requiring it of the PMOs of the consistently poor performers—may limit resistance to this initiative.

A second related initiative would require the major weapons systems PMOs to report on SB subcontracting performance for their systems. An annual report akin to the SF294 that provided visibility on SB subcontracting levels would enable the DoD SADBUs office to identify which major weapons systems procurements were providing the fewest subcontracting opportunities for small businesses.

ADDRESS CERTIFICATION ISSUES/REPORT MINORITY BUSINESS ENTERPRISE DATA

LMI recommends that the DoD SADBUs office consider establishing a roundtable of stakeholders, to identify solutions to the SDB and HubZone firm certification issues discussed in earlier chapters. Increasing certification is a perplexing prob-

lem that will require collaboration from government, Test Program participants, small disadvantaged businesses, and HUBZone contractors. At a minimum, to boost the number of certified firms, tax credits or signing bonuses might serve as incentives to Test Program participants. In addition, LMI recommends that Test Program participants report their minority business enterprise (MBE) data. In light of the decline in certified SDBs, this information will further enhance the DoD SADBUs understanding of the extent of SB subcontracting performed by Test Program participants.

ENCOURAGE TEAMING AGREEMENTS WITH SMALL BUSINESS

LMI recommends that the DoD SADBUs office consider a thrust initiative for at least 5 percent of participants' teaming subcontract expenditures be awarded to small businesses. Teaming partners differ from other subcontractors in that they have a special relationship with the prime contractor. Also, teaming partners usually participate in the formulation of the prime contractor's acquisition strategy, further enhancing the business relationship.

INCREASE VISIBILITY OF SUBCONTRACTING DATA

LMI recommends that the DoD SADBUs office consider requiring all participants to provide reasonable visibility of subcontracting performance information to the DoD SADBUs office and to the DCMA. At a minimum, participants should provide data on subcontracting performance at the division level (for corporate participants) and for major program activity (for division- or corporate-level participants). Any request from the government for increased visibility should be reasonable and should not place any undue administrative burdens on participants.

ENCOURAGE HIGH-TECH WORK FOR TARGETED INDUSTRY CATEGORIES/REPORT R&D

To promote greater high-tech subcontracting opportunities for small businesses, LMI recommends that the DoD SADBUs office redirect the guidance regarding targeting two industry categories toward subcontracting in high-tech areas. LMI recommends that the DoD consider a thrust initiative for phasing in this transition. Furthermore, LMI recommends using the DoD SADBUs Mentor-Protégé Program as a vehicle to offset possible participant expenditures related to this initiative. Additionally, LMI recommends that Test Program participants report the dollar value of research and development subcontracts to small businesses. LMI believes that this information has great utility as a barometer of high-tech work performed by small businesses.

PROVIDE NEW GUIDANCE FOR DIRECTED-SOURCE PROCUREMENTS

LMI recommends that the DoD SADBUs office establish guidance on the accounting of directed-source procurements on participants' SF295 reports. This guidance should permit program participants to deduct the dollar value of directed-source procurements from their annual subcontracting baselines. We further recommend that justification for directed-source procurements be made in written form (e.g., in a letter, contract language, or drawings and specifications).

ESTABLISH PROCESS TO AMEND PLANS

LMI recommends that the DoD SADBUs office consider a revision to the Test Program that would permit the renegotiation of comprehensive subcontracting plans. This amendment provision would enable participants and the DoD to react to major contract awards that occur after completion of negotiations. The DoD SADBUs office should consider establishing procedures that mandate a renegotiation whenever "late" awards increase a participant's projected annual revenues by 15 percent.

IMPROVE TIMELINESS AND UTILITY OF THRUST INITIATIVES

LMI recommends that the DoD SADBUs office consider establishing an annual meeting with Test Program participants and DCMA representatives to vet thrust initiatives prior to the negotiation of comprehensive subcontracting plans. This would help to make the initiatives available in time for participants to implement them in their plans.

DESIGNATE ADDITIONAL CONTRACTING ACTIVITIES

LMI recommends that the DoD SADBUs office encourage the SAEs for the Department of the Army and the Department of the Navy to designate contracting activities to support the Test Program.

INSTITUTE PROCEDURES TO REMOVE POOR PERFORMERS

LMI recommends that the DoD SADBUs office consider a revision to the Test Program that would permit the removal of ineffective participants. Criteria defining what constitutes poor performance might include the repeated failure to attain SB subcontracting goals for three consecutive fiscal years as well as failure to im-

plement thrust initiatives. The DoD SADBUs office should consider developing a notification process to afford participants the opportunity to reenergize their efforts and an appeals process where necessary. The notification process should provide adequate time for affected participants to challenge DoD's decision.

REQUIRE PARTICIPANTS TO TRACK ADMINISTRATIVE SAVINGS AND RESULTS OF OUTREACH ACTIVITIES

LMI recommends that the DoD SADBUs office consider requiring that participants track administrative savings (based on the number of SF294s that would have been completed) and the cost and results of their outreach activities. Participants should report these results annually in their subcontracting plans.

LIMIT ENROLLMENT IN TEST PROGRAM

Given some of the findings identified in the previous chapter and the related recommendations discussed above, LMI believes that the DoD SADBUs office should limit enrollment to the existing 20 participants for the time being. Enrollment could be opened once changes have been made to improve the performance of the current Test Program participants.

Appendix A

Performance of Test Program Participants

When the Department inaugurated the Test Program in FY91, there were 8 participants. As of FY00,¹ there were 20. Section 834 of PL 101-189 allowed firms to aggregate their subcontracting activities at the factory, division, or corporate level. This approach meant that participants negotiated and executed their plans at that level of aggregation and reported on their accomplishments at that same level. In FY91, there were 7 division-level participants and one corporate participant; as of FY00: there were 18 divisional and 2 corporate.²

Table A-1 lists the Test Program participants alphabetically.

Table A-1. Test Program Participants FY00

Participant	Entered
Bell Helicopter Textron	FY91
Boeing	FY91
General Electric Aircraft Engines	FY91
Hamilton Sundstrand, a Division of United Technologies Corporation	FY96
Harris Government Communications Systems Division	FY96
Honeywell Sensor Guidance Products, Guidance and Navigation Operation	FY97
Lockheed Martin Aeronautics Company, Fort Worth	FY96
Lockheed Martin Aeronautics Company, Marietta	FY91
Lockheed Martin Information Systems	FY96
Lockheed Martin Missile and Fire Control, Dallas	FY97
Lockheed Martin Missile and Fire Control, Orlando	FY96
Lockheed Martin Missiles and Space	FY99
Northrop Grumman Air Combat Systems, El Segundo, California	FY98
Northrop Grumman Electronic Systems and Sensors Sector—Defensive Systems Division, Rolling Meadows	FY96
Northrop Grumman Electronic Systems, Baltimore	FY97
Pratt and Whitney Government Division of United Technologies Corporation	FY96

¹ Currently, the Test Program will terminate on 30 September 2005. We limited our analysis to the 10-year period FY91 to FY00.

² Lockheed Martin Corporation reports that it proposes to consolidate certain of its participating divisions along business unit lines. If the Department accepts this proposal, the number of division-level participants will decrease and corporate-wide will increase. One argument for consolidation is that it enables a participant to offset the chronically poor performance of one of its divisions with the strong performance of another. To ensure that consolidation does not impair its visibility into aggregated performers, the Department should strengthen its reporting requirements.

Raytheon	FY99
Sikorsky Aircraft, a Division of United Technologies Corporation	FY96
Textron Systems, a Textron Company	FY97
TRW	FY97

In next sections of this appendix, we discuss each participant's performance relative to the Test Program objective of increasing subcontracting opportunities for small businesses. We begin by providing a brief description of each participant's Defense business. Then, we examine their goal attainment; finally, we compare their past to current performance. We begin with Bell Helicopter Textron and proceed alphabetically through to TRW.

(b)(4)



Pgs 83-124 withheld pursuant to
FOIA exemption b(4)