



Executive Summary

Background and Purpose

- The government's Small Disadvantaged Business (SDB) Program was established to help mitigate the effects of discrimination on the performance of businesses owned by minorities and other socially and economically disadvantaged individuals.
- This comprehensive report assesses the impact of the SDB Program on minority-owned businesses and examines the contribution of SDBs to national output and employment.
- A major section of the report is devoted to exploring how the SDB Program's \$750,000 personal net worth (PNW) ceiling affects SDBs.
- After determining that the PNW ceiling is too low and that it adversely affects the operation of SDBs, a new PNW ceiling and several other program changes are proposed.
- The recommendations are designed to increase the capacity of SDBs so they will become more competitive in federal procurement and in corporate supply chains.¹
- The results are based on an examination of 47,254 Small Business Concerns (SBCs)² listed with the

¹ As used in this report, capacity is synonymous with the three- year average revenue of a firm.

² A Small Business Concern (SBC) means any for-profit business that meets the industry and employment size standards as determined by the Office of Small Business Standards of the Small Business Administration (See Federal Acquisition Regulation FAR 19.101, at: <http://acquisition.gov/far/current/html/FARTOCP19.html>). This report does not examine SBCs that register with CCR as Women-owned Small Business Concerns, Veteran-owned or Disabled Veteran-owned Small Business Concerns.

government's Central Contractor Registration (CCR) in 2006.

What the Reader can Expect

The report has thirteen sections. These sections describe the current status of minority-owned businesses, document the critical importance of government contracting to minority business viability, and examine the plight of more than 10,000 minority-owned SBCs that are listed in the CCR but have never participated in the SDB program. The report considers how the U.S. Supreme Court Adarand Decision has changed the SDB Program. It measures the impact of the SDB Program on minority business performance and analyzes how the \$750,000 PNW ceiling has affected SDB capacity. Finally, it estimates the influence of the SDB Program on national output and employment and it analyzes where minority and non-minority-owned firms are located in relation to the most distressed areas of central cities.

Findings³

In 2006, the SDB Program had an economic impact of \$5.5 billion on U.S. final demand and created over 124,000 jobs.

Minority-owned small businesses also contributed to the economic development of distressed central cities. In 2006, 31% of minority-owned businesses listed in CCR were located in high poverty areas of central

³ The study used regression analysis and decomposition analysis extensively to explain the differences in performance between minority-owned firms that never entered the SDB Program (10,513), active SDBs (6,758) and other small business concerns that were not minority-owned in 2006 (27,087). A multivariate propensity score matching procedure was used to measure performance differences between firms with identical characteristics that were SDBs and non-SDBs.

cities as compared to 24% of non-minority-owned companies.⁴

In some central cities a very high percentage of minority-owned businesses were located in high poverty areas: In Baltimore (69%), Philadelphia (60%), Detroit (50%) and Boston (48%).

Despite the significant contribution that minority-owned businesses make to the U.S. economy, they still encounter large disparities in private sector business transactions. Consequently, they depend more heavily upon government contracting because access to government contracts is usually more equal than is access to private sector opportunities. While minority-owned businesses comprised 18% of all U.S. small businesses, they made up 35% of the 47,254 small businesses listed in CCR in 2006.

Between 2004 and 2006 the SDB program had a significant effect on the performance of SDB certified firms. The average revenue of SDBs was \$2.8 million greater than the average revenue of identical firms that did not participate in the SDB Program.

SDBs experienced an annual disparity in revenue of \$0.9 million in comparison to non-minority-owned small-business concerns with similar characteristics.

There were 10,513 minority-owned small businesses listed in CCR in 2006 that had never been SDB certified. These firms experienced the greatest disparities of all small businesses that sought federal government contracting.

The \$750,000 personal net worth (PNW) ceiling of the SDB Program has not been adjusted for inflation in nine years. Therefore, the current real value of the ceiling is \$558,070. Yet innovations in corporate supply chains and the increasing use of contract bundling in government procurement require SDBs to have greater capacity.

The capacity of SDBs and the personal net worth of their owners is closely related. When capacity increases by 10%, PNW increases by 4%. Therefore, if the PNW ceiling is too low, it is impossible for SDBs to reach their optimum capacity. In a marketplace free of discrimination we estimated that the average capacity of SDBs would be \$4.1 million. The current

PNW ceiling prevents SDBs from achieving this average capacity.

A PNW ceiling that is set too low causes other economic hardships. For example, in February of 2007 seventeen firms were graduated out of the Georgia Department of Transportation Disadvantaged Business Enterprise Program when an audit revealed that their PNW surpassed the \$750,000 ceiling. We interviewed the owners of these firms and tracked their monthly financial performance. The owners felt that they were being penalized for being successful and they complained that very few corporations solicited or engaged their services after they were de-certified. They also stated that the low PNW ceiling had not allowed them to build sufficient bonding capacity to compete successfully as prime contractors. During the first five months of 2007, their average monthly revenue decreased by 45% in comparison to 2005 and 2006.

Many large businesses are incorrectly registered in CCR as small businesses. In a recent Congressional hearing, SBA Inspector General Eric Thorson stated that, "The number 1 management challenge facing the SBA is that large firms are receiving small business contracts and federal agencies are receiving credit for these awards."⁵ This report identified 442 companies registered as small businesses that exceeded the small-business size standard for their industry. In 2006, the average revenue of these 442 companies (\$172 million) was forty-four times larger than the average revenue of legitimate small business concerns.

Recommendations

- 1) The PNW ceiling should be increased from \$750,000 to \$1,017,000. This would adjust PNW for inflation and allow SDBs to attain the level of capacity that would be expected in a discrimination-free business environment. Also, the PNW ceiling should be adjusted annually for inflation. SDBs that are de-certified as a result of PNW audits should be allowed a two-year transition period during which they remain eligible for program benefits.

⁴ High poverty areas are defined as census tracts where poverty was 20% or greater in 2000.

⁵ Chapman, Lloyd. 2006. "SBA Reauthorization Lacks Provisions to stop Fraud and Abuse." American Small Business League, July 20, 2006: Accessed at: <http://www.asbl.com/showmedia.php?id=275>

- 2) The SBA Inspector General should audit the CCR yearly to search for and penalize large businesses that self-certify as small business concerns (SBCs).⁶
- 3) The SBA should establish race-neutral monitoring procedures and annually report to Congress on the state of minority-owned small business concerns that are not SDB certified. It is important to know why so many potentially eligible businesses are not SDB certified and why they suffer large disparities in income.⁷ To help in monitoring these firms, an additional minority-business category should be added to the Standard Form 295 (Summary Subcontract Report). This category would enable

corporations to note their use of minority businesses that are not SDB certified. The use of these firms in government prime contracting can be monitored through the FPDS-NG (Federal Procurement Data System Next Generation) databases.

- 4) Given that SDBs add significant value to the nation, especially to distressed areas, and because they still face inequality in business transactions, we recommend that Price Evaluation Adjustments (PEAs) be restored especially for SDBs located in HUBZones.⁸

⁶ House of Representative Bill H.R. 1873: "Small Business Fairness in Contracting Act" passed the House on May 10, 2007 and has been sent to the Senate for consideration. Sec. 301-303 of the bill contains language specifying penalties for large businesses that fraudulently certify as small business concerns.

⁷ Some business owners have indicated that the costs and paperwork involved in certification serves as a deterrent.

⁸ If enacted, H.R. 1873, Sec. 214 would provide financial support to conduct of a study on the "feasibility and desirability" of providing financial incentives to contractors for meeting subcontracting utilization goals. PEAs allowed SDBs to receive a price benefit of up to 10% in specified industries. They expired in 2004. The HUBZone Empowerment Contracting Program is part of the Small Business Reauthorization Act of 1997. It is designed to stimulate economic development and create jobs in hard-pressed urban and rural communities. Contracting preferences are given to small businesses that are located in a HUBZone and that hire employees who live in a HUBZone.