

House Small Business Committee Hearing

On Contracting and Technology

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Introduction

Chairman Braley, Ranking Member Davis, and Members of the Committee, my name is Charles Day and I am the Senior Member of Charles F. Day & Associates LLC, a small business headquartered in Davenport, Iowa. It is my privilege to be here today and to have the opportunity to share my views on the small business environment.

I wish to give insight into the small business environment as I see it, and the challenges and risks that we deal within our small business in providing services to the Department of Defense. I will move from general comments to specific issues we have experienced. In my closing I will outline what I believe to be appropriate issues for this committee to address in making improvements in support to small businesses.

Background

As background information, our small business provides services in program management and acquisition logistics support to the Department of Defense. We currently provide various services and levels of support to seven programs and twenty five projects. Our principle customers are the US Army and the US Marine Corps. We are HUB Zone certified and a veteran and SDVOB owned business.

General business environment

I believe how correctly and fully a company is able to define its business environment is the first determinant in its success. Without first having a clear understanding of the environment, it is not likely that a company can survive. It must have a fundamental understanding of the business functions that must be performed, then it must have and an ability to provide for those functions. I see training and education outreach as a critical role of the SBA.

A company must have access to capital. As this committee is aware, more and more new businesses finance startup costs, and to some extent working capital, through the use of credit cards. New businesses are generally seen as having higher risk than established businesses. The cost of capital is higher, and during periods of unusual risk adversity by lending institutions, capital may not be available at all to new or small businesses. Awareness and access to SBA guaranteed loans is critical.

A company must also have social capital and social networks. In recent years researchers from several disciplines have become increasingly aware of the importance of the structure and strength of interpersonal relationships and strength of interpersonal relationships in social systems. It is widely maintained that the development of social capital within an organization is likely to be a source of competitive advantage for the firm. Social capital is valuable because it solves problems of coordination, reduces transaction costs, and facilitates the flow of information between and among individuals. Researchers have also found that diverse ties in a network facilitate the business start-up process. Findings support the contention that heterogeneous networks and greater social capital serve as an important resource for business owners and persons who are seriously attempting to start a business.

Status also has an impact on potential success. A core sociological perspective is that there is a distinction between an actor and an actor's position in the social structure and that rewards are largely a function of position. Status has business implications in two ways. A producer's status, or more accurately, the association with that status, is generally valued in its own right by consumers and investors. A more critical aspect is that market status acts as a signal of the underlying quality of a firm's products. The producer's status based on the producer's ties within networks becomes their quality signal.

Putting these together, there are three types of ties that serve as quality signals based on market status; ties to prominent buyers, ties to third parties, and ties to other producers. Social capital and networks in and of themselves become leading indicators of quality and may act independent of actual quality to influence business success.

Research studies of organizational failures often point to personal deficiencies of the founders like lack of experience in the field or managerial incompetence. Many new start-ups are by people who have certain technical skills but don't have the full range of managerial skills – or the knowledge of what skills they're missing – to be successful. They don't have a good understanding of the complete environment.

Shortfalls in any of these areas increase the likelihood of failure. This committee is well-versed in the challenges and risks faced by small businesses in today's environment which I have outlined above. Issues of access to capital, business assistance, the

social and business networks, and the government programs available to help mitigate risk are routinely examined and improved through the work of this committee.

Emerging technological requirements

There are emerging competencies that are less well understood in the small business environment. The more important of them, in my view, is the ability to perform and thrive in the digital environment. A second competency of growing global importance is in understanding and applying quality tools, techniques and methodologies and integrating them into the digital environment.

Our small business is net – centric. We have gone to a paperless office with the exception of hardcopy documents with original signatures that we are required to maintain. The majority of the labor hours of our overhead staff are performed by telecommuting. Our total workforce is distributed among seven states. We use collaborative tools and techniques such as webcasts, webexes, instant messaging, voice over IP, blogs, and share point. Our webpage is out portal from the web to our servers for our employees. Our invoices are now submitted electronically, our payroll is dispersed electronically, and at least 50% of our routine accounts payable outside of payroll are processed electronically. Unfortunately, along with net centricity goes net dependency.

A major concern we have deals with Information Security and Information Assurance. Our leading concern is with information security. We have employee records that must be protected from unauthorized access. We require a password to access our server, and have created restricted access areas for HR records and security clearance records. But, with the increasing threat of hackers, viruses, and spoofing, we need continual updating of our internet and intranet security measures. We are not content we are keeping up with the threat of our data shields being breached. The cost of research to keep current is restrictive in time and money

We have not been able to quantify our risk from net-dependency. The cost of researching potential hardware and software solutions often prevents us from pursuing improvements. We recognize we need redundancy; redundant servers, redundant network access points, redundant communications modes, and a good continuity of operations plan to pull it all together. We can't put the business case together because there are too many variables and the cost of the market research is more than we can bear at our size.

The second area I believe is underappreciated and generally not provided for by new and small business is the global competition in quality. I have sent employees to the lean manufacturing class, certified by NIST and provided through the local community college. I also sent a senior manager to Motorola University for Six Sigma Black Belt

certification. We are prompted to do these things now, regardless of cost, because our customers within the DoD are all moving to lean / Six Sigma as part of their transformation efforts. We also face market pressures to be equally competitive in quality performance in the digital environment. We must continue to streamline our business in the digital environment to stay competitive. We have performed Kaizan events to our Information Systems architecture. We have performed Six Sigma processes to measure, track and improve our knowledge management in the digital environment. I believe we are the exception rather than the rule in our accomplishments for businesses of our size. Small businesses need expertise to assist them in performing these increasingly critical activities to become and remain competitive.

The real core competency of small businesses and challenges from the DoD

After having considered the environmental factors that must be addressed for a small business to succeed, we come to ultimate tasks, and arguably core business competencies of small businesses, winning contracts and managing the cash flows.

Winning contracts

Selling to the government can be traumatic for small businesses because of the complexities of the contracting laws and regulations in the federal sector. Past surveys of small business owners concerning the perceived barriers to participation in the government market report that doing work for the federal government was more costly than working in the private sector. The prime reasons found were higher cost for making proposals, higher cost to produce goods and services, and, less profitability from revenues.

In my opinion, the best vehicle for contracting with the federal government should be the GSA schedule. The GSA schedule allows a business to perform work on a task order award basis. A GSA schedule may not be an appropriate vehicle for a growing business because the prices negotiated for award are based on past prices. There are no allowances for future cost structures to support the company's growth. A very small business has limited overhead because the small staff wears many hats. As the company grows and they respond to increased requirements, their overhead cost structure changes. Large businesses have a Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Technology Officer, Chief of Contracting, and a Director of Marketing. Small businesses do not generally have the luxury of carrying such expertise individually on staff and must be able to program costs for this higher level of expertise into their future rates. We have been informed by the GSA contracting office that the prices negotiated with GSA will bind our company for 10 years. This can have the effect of limiting growth opportunities of the small business.

A critical restriction placed on new businesses trying to enter the DOD market is that contracting officer and source selection boards do not accept an individual's past experience in lieu of company past performance. Without consideration of an

individual's past performance, if it is a new company with no company performance, the best rating the company receives for past performance is neutral. Often times the individual entrepreneur has a wealth of technical experience in the service they wish to provide but, without credit for that personal expertise, they stand little chance of winning contract awards.

As an example, my years of experience as a systems manager for Department of the Army are not given any consideration when my company is competing to perform the same or related services. I have the business systems manager with 17 years experience as a Certified Quality Engineer who spent years in the automotive industry as a quality manager performing lean manufacturing and who is a certified Six Sigma black belt from Motorola University. This in-house expertise cannot be included when we compete for lean/Six Sigma services to DOD clients. The same is true for a management analyst on my staff who is a certified ISO auditor. This expertise is treated as irrelevant to our company's ability to perform in that area.

In another case, we are preparing to compete on a solicitation that is scheduled to be issued this summer. We've made a significant effort to identify and recruit the skill sets to be able to perform this effort. We are bringing subject matter experts on board, both to help write our proposal and to perform key managerial tasks upon award. None of the expertise we bring on board will be given consideration in terms of our company's ability to perform, only our limited past performance as a small business will be considered.

DFAS

My second discussion concerns managing cash flows; how DFAS measures, how gaps in measures create an appearance of higher performance of their part, and how the gaps adversely affect small businesses.

In our business model, the value stream is: listening to the voice of the customer, identifying the value proposition, providing the value proposition, and expansion or creation of additional assets to improve the value proposition. The bookkeeping and accounting function, which includes submission of invoices and receive payment is an enabling process, it is not a value added process. The true metrics should be based on the enabling process linkage to the value stream. From this value stream view there are only two appropriate metrics. The first is, time from the invoice submission to the government, to payment received from the government. The second metric is time from the date of completion of the services to receipt of payment by the service provider from the government. A portion of that is outside the government's control, but that should be the true metric for the enabling process.

I take exception to the DFAS metrics discussed in GAO – 06 – 385 titled, "DOD payments to small businesses: implementation and effective utilization of electronic invoicing could further reduce late payments."

For each of our contracts there is a contracting officer representative assigned to who we are directed to provide our invoices. When in the paper environment, we submitted

paper invoice by hand or by fax to the Contracting Officer Representative (COR), and followed up with a telephone call to confirm receipt. Under our interpretation of the prompt payment act, the point at which we gave the government agent our invoice should be the time at which the clock starts for determination of net 30 or 14, whichever the contract calls for. We found in the paper environment that DFAS does not enter the invoice into their system in a timely manner. We also found that if there is any error, on our part or on their part, *they will cancel the invoice out*. It is left up to the service provider to track acceptance by DFAS and to continuously track that the payment is still scheduled to be made. In other words, if DFAS chooses to cancel an invoice, they do not inform you. They leave it to you to make the discovery and initiate the replacement invoice. And of course, the clock is reset for payment.

Another major issue we have had which is not reflected in the DFAS metrics, is the availability of the appropriate government agent to receive the invoice. The time between the assigned government agent receiving the invoice to the invoice being entered into the DFAS system is not included in the DFAS metrics. On those occasions when the COR is not available due to their travel requirements, personal leave, or sick leave, the invoice sits waiting for acceptance signatures. The month of December has proved to be the worst month for submission of invoices because most of the CORs we have for our contracts take two to three weeks at Christmas for leave.

2007 was a particularly painful year for us in terms of collection of payment. Approximately 90% of all our invoices were not paid within the contract terms of net 14 or net 30 from the date the invoice was received by the government. Roughly half of those that were late were late only because of the lag time between when the invoice was received by the government agent and when that invoice was actually accepted by DFAS to start their clock. The other half had late days for the receipt to acceptance lag, but also had other, exceptional causes for additional days of delay.

The worst impact we suffered was because DFAS arbitrarily changed our payment office twice without prior notice. The first move was from DFAS Rock Island to DFAS St. Louis. The second move was to DFAS Columbus. DFAS Columbus closed all of our invoices out and refused to accept new invoices. They informed our small business that the government would not make any payments on invoices until we had the government contracting officer's modify the contracts to reflect DFAS Columbus was the new vendor pay site. And, of course, they reset the clock for all invoice resubmissions after we were able to work through getting the contract mod in place with the government.

A related point of discussion is about direct travel reimbursements, and the risks and costs that are pushed to the contractor.

There are three hidden costs to our debt collection and timing experience last year. First, between 15% and 20% of invoices values were for direct travel reimbursements. We can only be paid the direct cost of travel performed for the contract and cannot recover the carrying costs associated with funding the travel up front. We estimate the carrying costs, with were not billable back to the government, were approximately \$3,500. That is .16 % of labor revenues for the year. The second and more drastic cost

was the cost of internal resources that went to collection of debt. We estimate our total cost for invoicing and debt collection exceeded \$75,000 for the year on \$2.4M in labor revenues. That's 3.2% of labor revenues going to invoicing and debt collection for the year. Our total estimated costs for invoicing and debt collection, and "fronting and floating" the reimbursable travel was 3.4% of total labor revenues for the year. The third hidden cost is the financing costs for the "invisible days" between government receipt and DFAS acknowledged acceptance of the invoice. We have not attempted to calculate that cost for last year.

I can go into detail about specific cases but prefer to tell you what we did to resolve the issue. We informed our customers, the CORs specifically, that we were required by law to use the Wide Area Work Flow (WAWF). The chief of contracts in our organization walked each of our CORs through the WAWF training multiple times until each of them was felt comfortable with WAWF. When we submitted invoices into WAWF, we then contracted the COR and walked them through the receipt process until they were all comfortable. None of our CORs had attempted to use WAWF prior to this.

When everyone operated under paper invoices conveyed by mail, NET 30 made sense. It established a reasonable time for all of the computations, invoice verification, and delivery transactions to occur. Now, when transactions are electronic, if not executable in the same day, they are at least executable in two days. NET 30 no longer makes sense except as a policy transferring the cost of capital from the government to the business to who it owes a debt. Along with this transfer of the cost of capital is a creation of risk for the business in the form of increased capital requirements. This is an unjust burden to place on small businesses.

Recommendations

PTACs can play a more central role by:

- Increasing their ability to provide specialized expertise with continuously refreshed knowledge of the emerging digital environment.
- They should have increased visibility to entrepreneurs.
- They should assist in planning and development of social networks and increasing social capital for the entrepreneurs.
- The PTACs should be a central point for bring established businesses and new businesses together.

The DoD should allow small business owners to use their personal experience in lieu of corporate experience in contract solicitation responses.

The DFAS should pay electronically submitted invoices based on the invoice submission into WAWF instead of basing the payment date on internal government processes of receipt acknowledgement and acceptance acknowledgement.

DFAS should pay electronically submitted invoices to small businesses NET 10 days.

Conclusion

First, providing services to the federal government is more difficult and costly than provision of services in the commercial market. The government should actively work to reduce the barriers and open itself to the full market. Instead of creating difficulties in a small businesses ability to manage cash flows, it should expedite payment to reduce risk to small businesses. Second, the competitive landscape is changing with increased use of the digital environment. For small businesses to remain competitive, they need assistance staying current with Information Systems architecture, Information Assurance, Information Security, and Knowledge Management. The SBA can play a pivotal role in providing this expertise to small businesses.

Again, thank you for the opportunity to address the House Small Business Committee.