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# Small Business Size Standards: A Historical Analysis of Contemporary Issues

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# Summary

Small business size standards are of congressional interest because they have a pivotal role in determining eligibility for Small Business Administration (SBA) assistance as well as federal contracting and, in some instances, tax preferences. Although there is bipartisan agreement that the nation's small businesses play an important role in the American economy, there are differences of opinion concerning how to define them. The Small Business Act of 1953 (P.L. 83-163, as amended) authorized the SBA to establish size standards to ensure that only small businesses receive SBA assistance. The SBA currently uses two types of size standards to determine SBA program eligibility: industry-specific size standards and alternative size standards based on the applicant's maximum tangible net worth and average net income after federal taxes.

The SBA's industry-specific size standards determine program eligibility for firms in 1,037 industrial classifications in 23 sub-industry activities described in the 2017 North American Industry Classification System (NAICS). The size standards are based on one of four measures: (1) number of employees, (2) average annual receipts, (3) average asset size as reported in the firm's four quarterly financial statements for the preceding year, or (4) a combination of number of employees and barrel per day refining capacity. Overall, about 97% of all employer firms qualify as small under the SBA's size standards. These firms represent about 30% of industry receipts.

The SBA conducts an analysis of various economic factors, such as each industry's overall competitiveness and the competitiveness of firms within each industry, to determine its size standards. However, in the absence of precise statutory guidance and consensus on how to define small, the SBA's size standards have often been challenged, typically by industry representatives seeking to increase the number of firms eligible for assistance and by Members concerned that the size standards may not adequately target assistance to firms that they consider to be truly small.

This report provides a historical examination of the SBA's size standards and assesses competing views concerning how to define a small business. It also discusses the following legislation:

- P.L. 111-240, the Small Business Jobs Act of 2010, which authorized the SBA to establish an alternative size standard using maximum tangible net worth and average net income after federal taxes for both the 7(a) and 504/CDC loan guaranty programs; established, until the SBA acted, an interim alternative size standard for the 7(a) and 504/CDC programs of not more than $15 million in tangible net worth and not more than $5 million in average net income after federal taxes (excluding any carry-over losses) for the two full fiscal years before the date of the application; and required the SBA to conduct a detailed review of not less than one-third of the SBA's industry size standards every 18 months beginning on the new law's date of enactment (September 27, 2010) and ensure that each size standard is reviewed at least once every five years.
- P.L. 112-239, the National Defense Authorization Act for Fiscal Year 2013, which directed the SBA not to limit the number of size standards and to assign the appropriate size standard to each NAICS industrial classification. This provision addressed the SBA's practice of limiting the number of size standards it used and combining size standards within industrial groups as a means to reduce the complexity of its size standards and to provide greater consistency for industrial classifications that have similar economic characteristics.

- P.L. 114-328, the National Defense Authorization Act for Fiscal Year 2017, which authorizes the SBA to establish different size standards for agricultural enterprises using existing methods and appeal processes. Previously, the small business size standard for agricultural enterprises was set in statute as having annual receipts not in excess of $750,000.
- P.L. 115-324, the Small Business Runway Extension Act of 2018, which directs federal agencies proposing a size standard (and, based on report language accompanying the act, presumably the SBA as well) to use the average annual gross receipts from at least the previous five years, instead of the previous three years, when seeking SBA approval to establish a size standard based on annual gross receipts.
- Legislation introduced during recent Congresses (including H.R. 33, the Small Business Regulatory Flexibility Improvements Act of 2017, and its Senate companion bill, S. 584, during the 115th Congress) to authorize the SBA's Office of Chief Counsel for Advocacy to approve or disapprove a size standard requested by a federal agency for purposes other than the Small Business Act or the Small Business Investment Act of 1958. The SBA's Administrator currently has that authority.

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# What Is a Small Business?

The Small Business Act of 1953 (P.L. 83-163, as amended) authorized the U.S. Small Business Administration (SBA) and justified the agency's existence on the grounds that small businesses are essential to the maintenance of the free enterprise system.[1] In economic terms, the congressional intent was to assist small businesses as a means to deter monopoly and oligarchy formation within all industries and the market failures caused by the elimination or reduction of competition in the marketplace. Congress decided to allow the SBA to establish size standards to ensure that only small businesses were provided SBA assistance.

Specifically, the Small Business Act of 1953 defines a small business as one that

- is organized for profit;
- has a place of business in the United States;
- operates primarily within the United States or makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials, or labor;
- is independently owned and operated; and
- is not dominant in its field on a national basis.[2]

The business may be a sole proprietorship, partnership, corporation, or any other legal form.

The SBA conducts an analysis of various economic factors, such as each industry's overall competitiveness and the competitiveness of firms within each industry, to determine its size standards. The analysis is designed to ensure that only small businesses receive SBA assistance and that these small businesses are not dominant in their field on a national basis.

The SBA currently uses two types of size standards to determine SBA program eligibility: (1) industry-specific size standards and (2) alternative size standards based on the applicant's maximum tangible net worth and average net income after federal taxes. The SBA's industry-specific size standards are also used to determine eligibility for federal small business contracting purposes.

The SBA's industry-specific size standards determine program eligibility for firms in 1,037 industrial classifications (hereinafter industries) in 23 sub-industry activities described in the 2017 North American Industry Classification System (NAICS). Given its mandate to promote competition in the marketplace, the SBA includes an economic analysis of each industry's overall competitiveness and the competitiveness of firms within the industry in its size standards methodology.[3] The size standards are based on four measures: (1) number of employees (505 industries), (2) average annual receipts (527 industries), (3) average asset size as reported in the firm's four quarterly financial statements for the preceding year (5 industries), or (4) a

[1] P.L. 83-163, the Small Business Act of 1953, §202.

[2] 15 U.S.C. §632(a) and 13 C.F.R. §121.105. Affiliations between businesses, or relationships allowing one party control or the power of control over another, generally count in size determinations. Businesses can thus be determined to be other than small because of their involvement in joint ventures, subcontracting arrangements, or franchise or license agreements, among other things, provided that their employment or income, plus those of their affiliate(s), exceed the pertinent size threshold. 13 C.F.R. §121.103.

[3] U.S. Small Business Administration (SBA), Office of Government Contracting and Business Development, "Size Standards Methodology White Paper," April 11, 2019, at https://www.sba.gov/document/support—size-standards-methodology-white-paper.

combination of number of employees and barrel per day refining capacity (1 industry). Overall, about 97% of all employer firms qualify as small.[4] These firms represent about 30% of industry receipts.[5]

The SBA also assesses the impact of inflation on its monetary-based size standards at least once every five years. If the SBA does not make an inflation adjustment after the assessment, it continues to monitor inflation on an annual basis until an adjustment is made.[6]

In the absence of precise statutory guidance and consensus on how to define small, the SBA's size standards have often been challenged, typically by industry representatives seeking to increase the number of firms eligible for assistance. The size standards have also been challenged by Members of Congress concerned that the size standards may not adequately target federal assistance to firms that they consider to be truly small.

This report provides a historical examination of the SBA's size standards and assesses competing views concerning how to define a small business. It also discusses the following legislation:

- P.L. 111-240, the Small Business Jobs Act of 2010, which authorized the SBA to establish an alternative size standard using maximum tangible net worth and average net income after federal taxes for both the 7(a) and 504/CDC loan guaranty programs; established, until the SBA acted, an interim alternative size standard for the 7(a) and 504/CDC programs of not more than $15 million in tangible net worth and not more than $5 million in average net income after federal taxes (excluding any carry-over losses) for the two full fiscal years before the date of the application;[7] and required the SBA to conduct a detailed review of

[4] SBA, "SBA's Size Standards Analysis: An Overview on Methodology and Comprehensive Size Standards Review," power point presentation, Khem R. Sharma, SBA Office of Size Standards, July 13, 2011, p. 4, at https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=2ahUKEwjVqOSyvezjAhXxYd8KHUh7CJgQFjAAegQIABAC&url=http%3A%2F%2Fwww.gtscoalition.com%2Fwp-content%2Fuploads%2F2011%2F07%2FSize-Stds-Presentation_Dr.-Sharma-SBA.pdf&usg=AOvVaw2rawMGp_M2Uv4zOb-gin3G.

[5] SBA, "Small Business Size Standards: Adjustment of Monetary-Based Size Standards for Inflation," 84 *Federal Register* 34266, July 18, 2019.

[6] The SBA adjusted its monetary based size standards for inflation in 1975, 1984, 1994, 2002, 2005, 2008, 2014, and 2019. The SBA added the five-year assessment of inflation's impact on the SBA's monetary based size standards to its regulations in 2002 (interim final rule). See SBA, "Small Business Size Standards Regulation," 40 *Federal Register* 32824-32826, August 5, 1975; SBA, "Small Business Size Standards; Revision," 49 *Federal Register* 5024-5048, February 9, 1984; SBA, "Small Business Size Standards; Inflation Adjustment to Size Standards," 59 *Federal Register* 16513-16537, April 7, 1994; SBA, "Interim Final Rule: Small Business Size Standards, Inflation Adjustment to Size Standards," 67 *Federal Register* 3041-3057, January 23, 2002 (see pages 3041 and 3045 for the addition of the five-year assessment of inflation); SBA, "Small Business Size Standards: Inflation Adjustment to Size Standards," 67 *Federal Register* 65285-65290, October 24, 2002; SBA, "Interim Final Rule: Small Business Size Standards, Inflation Adjustment to Size Standards; Business Loan Program; Disaster Assistance Loan Program," 70 *Federal Register* 72577-72595, December 6, 2005; SBA, "Small Business Size Standards: Inflation Adjustment to Size Standards, Business Loan Program, and Disaster Assistance Loan Program," 73 *Federal Register* 41237-41254, July 18, 2008; SBA, "Interim Final Rule: Small Business Size Standards: Inflation Adjustment to Monetary Based Size Standards," 79 *Federal Register* 33647-33669, June 12, 2014; SBA, "Small Business Size Standards: Inflation Adjustment to Monetary Based Size Standards," 81 *Federal Register* 3949-3956, January 25, 2016 (this final rule finalized the changes made by the 2014 interim final rule without any further changes); and SBA, "Small Business Size Standards: Adjustment of Monetary-Based Size Standards for Inflation," 84 *Federal Register* 34261-34281, July 18, 2019 (effective August 19, 2019).

[7] On December 20, 2010, the SBA announced that it planned to issue a notice of proposed rulemaking concerning the new alternative size standard in February 2011. It did not do so. On January 8, 2013, the SBA announced that it would issue an interim final rule, to be effective when published, establishing an alternative size standard for the 7(a) and 504/CDC programs by October 2013. See SBA, "Small Business Jobs Act: Small Business Size Standards; Alternative

not less than one-third of the SBA's industry size standards every 18 months beginning on the new law's date of enactment (September 27, 2010) and ensure that each size standard is reviewed at least once every five years.[8]

- P.L. 112-239, the National Defense Authorization Act for Fiscal Year 2013, which directs the SBA not to limit the number of size standards and to assign the appropriate size standard to each NAICS industrial classification. This provision addressed the SBA's practice of limiting the number of size standards it used and combining size standards within industrial groups as a means to reduce the complexity of its size standards and to provide greater consistency for industrial classifications that have similar economic characteristics.[9]
- P.L. 114-328, the National Defense Authorization Act for Fiscal Year 2017, which authorizes the SBA to establish different size standards for agricultural enterprises using existing methods and appeal processes. Previously, the small business size standard for agricultural enterprises was set in statute as having annual receipts not in excess of $750,000.
- P.L. 115-324, the Small Business Runway Extension Act of 2018, which directs federal agencies proposing a size standard (and, based on report language accompanying the act, presumably the SBA as well) to use the average annual gross receipts from at least the previous five years, instead of the previous three years, when seeking SBA approval to establish a size standard based on annual gross receipts.[10]
- Legislation introduced during the 112th Congress (H.R. 585, the Small Business Size Standard Flexibility Act of 2011), 113th Congress (H.R. 2542, the Regulatory Flexibility Improvements Act of 2013, and included in H.R. 4, the Jobs for America Act), 114th Congress (H.R. 527, the Small Business Regulatory Flexibility Improvements Act of 2015, and its Senate companion bill, S. 1536),

Size Standard for 7(a) and 504 Business Loan Programs," 75 *Federal Register* 79868, December 20, 2010, and SBA, "Small Business Jobs Act: Small Business Size Standards; Alternative Size Standard for 7(a) and 504 Business Loan Programs," 78 *Federal Register* 1638, January 8, 2013. The SBA also indicated in its notice of proposed rulemaking on January 8, 2013, that "the amendments will increase the current alternative standard for applicants for 504 loans." On December 15, 2015, the SBA announced that it would issue a notice of proposed rulemaking concerning the new alternative size standard by November 2016. See SBA, "Small Business Size Standards; Alternative Size Standard for 7(a), 504, and Disaster Loan Programs," 80 *Federal Register* 78045, December 15, 2015.

[8] For congressional intent concerning the need for updated size standards, see S. 2989, the Small Business Contracting Revitalization Act of 2010; and U.S. Congress, Senate Committee on Small Business and Entrepreneurship, *Small Business Contracting Revitalization Act of 2010*, report to accompany S. 2989, 111th Cong., 2nd sess., September 29, 2010, S.Rept. 111-343 (Washington: GPO, 2010), p. 9 ("…The Committee has heard testimony that the current size standards are in dire need of a comprehensive update").

[9] SBA, "Small Business Size Standards: Professional, Scientific and Technical Services," 76 *Federal Register* 14327, March 16, 2011.

[10] The act amended Section 3(a)(2)(C) of the Small Business Act, which references requirements for federal agencies proposing a small business size standard. The SBA subsequently indicated that it had "long-interpreted" that section of the Small Business Act as not applying to the SBA. However, "to promote consistency government-wide," the SBA's receipts based size standards (other than for the SBA's business and disaster loan programs, which will be subject to separate SBA rulemaking) and other federal agency's proposed receipts based size standards will be based, effective on January 6, 2020, on average annual receipts over five years, instead of over three years. Firms will have the option, through January 6, 2022, to choose between using three-year averaging or five-year averaging. See SBA, "Small Business Size Standards: Calculation of Annual Average Receipts," 84 *Federal Register* 29399-29400, June 24, 2019; and SBA, "Small Business Size Standards: Calculation of Annual Average Receipts," 84 *Federal Register* 66561, December 5, 2019.

and 115th Congress (H.R. 33, the Small Business Regulatory Flexibility Improvements Act of 2017, and its Senate companion bill, S. 584, and included in H.R. 5, the Regulatory Accountability Act of 2017) to authorize the SBA's Office of Chief Counsel for Advocacy to approve or disapprove a size standard requested by a federal agency for purposes other than the Small Business Act or the Small Business Investment Act of 1958. The SBA's Administrator currently has that authority.

# How Big Is Small?

In 2016 (the most recent available data), there were over 5.95 million employer firms, and in 2017 (the most recent available data), there were over 25.7 million nonemployer (self-employed) firms.[11]

As **Table 1** indicates, there were 5,954,684 employer firms in the United States employing 126,752,238 people and providing total payroll of $6.43 trillion in 2016.

Most employer firms (61.6%) had 4 or fewer employees, 78.6% had fewer than 10 employees, 89.1% had fewer than 20 employees, 98.1% had fewer than 100 employees, and 99.7% had fewer than 500 employees in 2016. The table also provides data concerning other economic factors that might be used to define a small business: an employer firm's number of employees as a share (cumulative percentage) of the total number of employer firms, as a share of employer firm total employment, and as a share of employer firm total annual payroll.

As will be discussed, the SBA has traditionally applied economic factors to specific industries, not to cumulative statistics for all employer firms, to determine which firms are small businesses. Nonetheless, the data in **Table 1** illustrate how the selection of economic factors used to define small business affects the definition's outcome. For example, for illustrative purposes only, if the midpoint (50%) for these three economic factors was used to define what is a small business, three different employee firm sizes would be used to designate firms as small:

- Businesses would be required to have no more than 4 employees to be defined as small if the definition for small used the midpoint (50%) share of the total number of employer firms (employer firms with no more than four employees accounted for 61.6% of the total number of employer firms in 2016).
- Businesses would be required to have no more than 999 employees to be defined as small if the definition for small used the midpoint (50%) share of employer firm total employment (employer firms with no more than 999 employees accounted for 52.6% of employer firm total employment in 2016).
- Businesses would be required to have no more than 1,999 employees to be defined as small if the definition for small used the midpoint (50%) share of

[11] U.S. Census Bureau, "Statistics of U.S. Businesses: U.S. & States, totals," at https://www.census.gov/data/tables/2016/econ/susb/2016-susb-annual.html; and U.S. Census Bureau, "Nonemployer Businesses Increased in 2017," at https://www.census.gov/newsroom/press-releases/2019/nonemployer-businesses.html.

Nonemployer firms have no paid employees, annual business receipts of $1,000 or more ($1 or more in the construction industries), and are subject to federal income tax. Most nonemployers are self-employed individuals operating very small unincorporated businesses, which may or may not be the owner's principal source of income. Nonemployer firms account for less than 4% of business annual sales or receipts and are usually excluded from most business statistics. See U.S. Census Bureau, "Nonemployer Statistics (NES)," at https://www.census.gov/programs-surveys/nonemployer-statistics/technical-documentation/methodology.html.

employer firm total annual payroll (employer firms with no more than 1,999 employees accounted for 51.8% of employer firm total annual payroll in 2016).

Other economic factors that might be used to define a small business include the value of the employer firm's assets or its market share, expressed as a firm's sales revenue from that market divided by the total sales revenue available in that market or as a firm's unit sales volume in that market divided by the total volume of units sold in that market.

**Table 1. Number of Employer Firms, Employer Firm Employment, and Employer Firm Annual Payroll, by Employment Size, 2016**

| Number of Employees | Number of Employer Firms | Cumulative Percentage of Total Number of Employer Firms | Employment | Cumulative Percentage of Employer Firm Total Employment | Employer Firm Annual Payroll ($1,000) | Cumulative Percentage of Employer Firm Total Annual Payroll |
|---|---|---|---|---|---|---|
| 0-4[a] | 3,665,182 | 61.6% | 5,923,452 | 4.7% | $268,039,737 | 4.2% |
| 5-9 | 1,013,878 | 78.6% | 6,681,968 | 9.9% | $248,985,263 | 8.0% |
| 10-19 | 626,900 | 89.1% | 8,432,521 | 16.6% | $329,388,425 | 13.2% |
| 20-99 | 538,283 | 98.1% | 21,093,550 | 33.2% | $899,265,224 | 27.1% |
| 100-499 | 90,742 | 99.7% | 17,783,726 | 47.3% | $870,788,396 | 40.7% |
| 500-999 | 9,757 | 99.8% | 6,737,348 | 52.6% | $351,887,538 | 46.1% |
| 1,000-1,999 | 4,795 | 99.9% | 6,667,171 | 57.8% | $365,291,105 | 51.8% |
| 2,000-4,999 | 3,045 | 99.9% | 9,351,314 | 65.2% | $553,579,614 | 60.4% |
| 5,000+ | 2,102 | 100.0% | 44,081,188 | 100.0% | $2,547,916,753 | 100.0% |
| Total | 5,954,684 | | 126,752,238 | | $6,435,142,055 | |

**Source:** U.S. Census Bureau, "Statistics of U.S. Businesses: U.S. & States, totals," at https://www2.census.gov/programs-surveys/susb/tables/2016/us_state_totals_2016.xlsx?#; and U.S. Census Bureau, "Statistics of U.S. Businesses: U.S., NAICS sectors, large employment sizes," at https://www2.census.gov/programs-surveys/susb/tables/2016/us_state_naicssector_large_emplsize_2016.xlsx?#.

a. Employment is measured in March, thus some employer firms (start-ups after March, closures before March, and seasonal firms) will have zero employment and some annual payroll.

# Who Makes the Call?

The Small Business Act of 1953 (P.L. 83-163, as amended) authorized the SBA to establish size standards for determining eligibility for SBA assistance. More than 60 years have passed since the SBA established its initial small business size standards on January 1, 1957.[12] Yet, decisions made then concerning the rationale and criteria used to define small businesses established precedents that continue to shape current policy. Moreover, as mentioned previously, the SBA relies on an analysis of various economic factors, such as each industry's overall competitiveness and the competitiveness of firms within each industry, in its size standards methodology to ensure that businesses receiving SBA assistance are not dominant in their field on a national basis. However, in the absence of precise statutory guidance and consensus on how to define small, the SBA's size standards have often been challenged, typically by industry representatives seeking to

[12] SBA, "Part 103 - Small Business Size Standards," 21 *Federal Register* 9709-9714, December 7, 1956.

increase the number of firms eligible for assistance and by Members of Congress concerned that the size standards do not adequately target the SBA's assistance to firms that they consider to be truly small.

Over the years, the SBA typically reviewed its size standards piecemeal, reviewing specific industries when the SBA determined that an industry's market conditions had changed or the SBA was asked to undertake a review by an industry claiming that its market conditions had changed. On five occasions, in 1980, 1982, 1992, 2004, and 2008, the SBA proposed a comprehensive revision of its size standards. The SBA did not fully implement any of these proposals, but the arguments presented, both for and against the proposals, provide a context for understanding the SBA's current size standards, and the rationale and criteria that have been presented to retain and replace them.

As mentioned previously, P.L. 111-240 requires the SBA to conduct a detailed review of not less than one-third of the SBA's industry size standards during the 18-month period beginning on the date of enactment (September 27, 2010) and during every 18-month period thereafter.[13] The act also requires the SBA to review each size standard at least once every five years. The SBA completed its first five-year review of all SBA industry size standards in 2016.[14] As a result of its five-year review, the SBA estimates that more than 72,000 small businesses gained SBA eligibility.[15]

# Early Definitions of Small Business Vary in Approach and Criteria

There is no uniform or accepted definition for a small business. Instead, several criteria are used to determine eligibility for small business spending and tax programs.[16] This was also the case when Congress considered establishing the SBA during the early 1950s. For example, in 1952, the House Select Committee on Small Business reviewed federal statutes, executive branch directives, and the academic literature to serve as a guide for determining how to define small businesses.

The select committee began its review by asserting that the need to define the concept of small business was based on a general consensus that assisting small business was necessary to enhance economic competition, combat monopoly formation, inhibit the concentration of economic power, and maintain "the integrity of independent enterprise."[17] It noted that the definition of small businesses in federal statutes reflected this consensus by taking into consideration the

[13] P.L. 111-240, the Small Business Act of 2010, §1344. Updated Size Standards.

[14] SBA, "A Report on the First Five-Year Comprehensive Review of Small Business Size Standards Under The Small Business Jobs Act of 2010," April 2017, at https://www.sba.gov/sites/default/files/articles/Size_Standards_Review_Report_to_Congress_Final_With_Cover_Letters.pdf.

[15] Ibid., p. 34.

[16] According to one source, the Internal Revenue Code contains at least 24 different definitions of a small business. See Douglas K. Barney, Chris Bjornson, and Steve Wells, "Just How Small Is Your Business?," *The National Public Accountant*, August 2003, pp. 4-6, cited in CRS Report RL32254, *Small Business Tax Benefits: Current Law and Arguments For and Against Them*, by Gary Guenther.

[17] U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H.Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), pp. 5, 13, 14, 78, and 136.

firm's size relative to other firms in its field and "matters of independence and nondominance."[18] For example, the War Mobilization and Reconversion Act of 1944 defined a small business as either "employing 250 wage earners or less" or having "sales volumes, quantities of materials consumed, capital investments, or any other criteria which are reasonably attributable to small plants rather than medium- or large-sized plants."[19] The Selective Service Act of 1948 classified a business as small for military procurement purposes if "(1) its position in the trade or industry of which it is a part is not dominant, (2) the number of its employees does not exceed 500, and (3) it is independently owned and operated."[20]

The select committee also found that, for data-gathering purposes, the executive branch defined small businesses in relative, as opposed to absolute, terms within specific industries. For example, the Bureau of Labor Statistics "defined small business in terms of an average for each industry based on the volume of employment or sales. All firms which fall below this average are deemed to be small."[21] The U.S. Census Bureau also used different criteria for different industries. For example, manufacturing firms were classified as small if they had fewer than 100 employees, wholesalers were considered small if they had annual sales below $200,000, and retailers were considered small if they had annual sales below $50,000. According the Census Bureau, in 1952, small businesses accounted for "roughly 92 percent of all business establishments, 45 percent of all employees, and 34 percent of all dollar value of all sales."[22]

The select committee also noted that in 1951, the National Production Authority's Office of Small Business proposed defining all manufacturing firms with fewer than 50 employees as small and any with more than 2,500 employees as large. Manufacturers employing between these numbers of employees would be considered large or small depending on the general structure of the industry to which they belonged. The larger the percentage of total output produced by large firms, the larger the number of employees a firm could have to be considered small. Using this definition, most manufacturing firms with fewer than 50 employees would be classified as small, but others, such as an aircraft manufacturer, could have as many as 2,500 employees and still be considered small.[23]

For procurement purposes, the select committee found that executive branch agencies defined small businesses in absolute, as opposed to relative, terms, using 500 employees as the dividing line between large and small firms. Federal agencies defended the so-called 500 employee rule on the grounds that it "had the advantage of easy administration" across federal agencies.[24]

In reviewing the academic literature, the select committee reported that Abraham Kaplan's *Small Business: Its Place and Problems* defined small businesses as those with no more than $1 million in annual sales, $100,000 in total assets, and no more than 250 employees. Applying this

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[18] Ibid., p. 3.

[19] Ibid., p. 2.

[20] Ibid.; and U.S. Congress, Conference Committee, *Selective Service Act of 1948*, conference report no. 2438, 80th Cong., 2nd sess., June 19, 1948 (Washington: GPO, 1948), p. 24.

[21] U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H.Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), p. 3.

[22] Ibid.

[23] Ibid., p. 4.

[24] U.S. Congress, House Select Committee on Small Business, Subcommittee No. 2, *Definition of "Small Business" Within Meaning of the Small Business Act of 1953, as Amended*, hearing on H.Res. 114, 84th Cong., 2nd sess., July 5, 1956 (Washington: GPO, 1956), p. 19.

definition would have classified about 95% of all business concerns as small, and would have accounted for about half of all nonagricultural employees.[25]

Based on its review of federal statutes, executive branch directives, and the academic literature, the select committee decided that it would not attempt "to formulate a rigid definition of small business" because "the concept of small business must remain flexible and adaptable to the peculiar needs of each instance in which a definition may be required."[26] However, it concluded that the definition of *small* should be a relative one, as opposed to an absolute one, that took into consideration variations among economic sectors:

> This committee is also convinced that whatever limits may be established to the category of small business, they must vary from industry to industry according to the general industrial pattern of each. Public policy may demand similar treatment for a firm of 2,500 employees in one industry as it does for a firm of 50 employees in another industry. Each may be faced with the same basic problems of economic survival.[27]

# The Small Business Act of 1953's Definition of Small Provides Room for Interpretation

Reflecting the view that formulating a rigid definition of small business was impractical, the Small Business Act of 1953 provided leeway in defining small businesses. It defined a small firm as "one that is independently owned and operated and which is not dominant in its field of operation."[28] The SBA was authorized to establish and subsequently alter size standards for determining eligibility for federal programs to assist small business, some of which are administered by the SBA.[29] The act specifies that the size standards "may utilize number of employees, dollar volume of business, net worth, net income, a combination thereof, or other appropriate factors."[30] It also notes that the concept of small is to be defined in a relative sense, varying from industry to industry to the extent necessary to reflect "differing characteristics" among industries.[31]

The House Committee on Banking and Currency's report accompanying H.R. 5141, the Small Business Act of 1953, issued on May 28, 1953, provided the committee's rationale for not providing a detailed definition of small:

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[25] U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H. Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), p. 4. See Abraham David Hannath Kaplan, *Small Business: Its Place and Problems* (NY: McGraw-Hill Book Co., 1948), pp. 21, 22.

[26] U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H.Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), p. 4.

[27] Ibid., p. 5.

[28] 15 U.S.C. §632(a)(1).

[29] Initially, the SBA size standards applied only to its own programs. Other federal agencies used the SBA size standards for procurement purposes on a voluntary basis. The Regulatory Flexibility Act of 1980 directed federal agencies to use SBA size standards or establish their own definitions after conferring directly with the SBA's Bureau (now Office) for Advocacy. U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 18. Also, see 5 U.S.C. §601(3).

[30] 15 U.S.C. §632(a)(2).

[31] 15 U.S.C. §632(a)(3).

> It would be impractical to include in the act a detailed definition of small business because of the variation between business groups. It is for this reason that the act authorizes the Administration to determine within any industry the concerns which are to be designated small-business concerns for the purposes of the act.[32]

The report did not provide specific guidance concerning what the committee might consider to be small, but it did indicate that data on industry employment, as of March 31, 1948, "reveals that on the basis of employment, small business truly is small in size. Of the approximately 4 million business concerns, 87.4% had fewer than 8 employees and 95.2% of the total number of concerns, employed fewer than 20 people."[33]

# Industry Challenges the SBA's Initial Size Standards, Claiming They Are Too Restrictive

Initially, the SBA created two sets of size standards, one for federal procurement preferences and another for the SBA's loan and management training services. At the request of federal agencies, the SBA adopted the then-prevailing small business size standard used by federal agencies for procurement, which was no more than 500 employees. The SBA retained the right to make exceptions to the no more than 500 employee procurement size standard if the SBA determined that a firm having more than 500 employees was not dominant in its industry.

For the SBA's loan and management training services, the SBA's staff reviewed economic data provided by the Census Bureau to arrive at what Wendell Barnes, SBA's Administrator, described at a congressional hearing in 1956 as "a fairly accurate conclusion as to what comprises small business in each industry."[34] Jules Abels, SBA's economic advisor to the administrator, explained at that congressional hearing how the SBA's staff determined what constituted a small business:

> There are various techniques for the demarcation lines, but in a study of almost any industry, you will find a large cluster of small concerns around a certain figure.... On the other hand, above a certain dividing line you will find relatively few and as you map out a picture of an industry it appears that a dividing line at a certain point is fair.[35]

On January 5, 1956, the SBA published a notice of proposed rulemaking in the *Federal Register* announcing its first proposed small business size standards.[36] During the public comment period, representatives of several industries argued that the proposed standards were too restrictive and excluded too many firms. In response, Mr. Abels testified that the SBA decided to adjust its figures to make them "a little bit more liberal because there was some feeling on the part of certain industries that they were too tight and that they excluded too many firms."[37] The SBA

[32] U.S. Congress, House Committee on Banking and Currency, *Small Business Act of 1953*, report to accompany H.R. 5141, 83rd Cong., 1st sess., May 28, 1953, H.Rept. 83-494 (Washington: GPO, 1953), p. 3.

[33] Ibid., p. 4.

[34] U.S. Congress, House Select Committee on Small Business, Subcommittee No. 2, *Definition of "Small Business" Within Meaning of the Small Business Act of 1953, as Amended*, hearing on H. Res. 114, 84th Cong., 2nd sess., July 5, 1956 (Washington: GPO, 1956), p. 24.

[35] Ibid., p. 39.

[36] SBA, "Small Business Size Standards," 21 *Federal Register* 79-80, January 5, 1956.

[37] U.S. Congress, House Select Committee on Small Business, Subcommittee No. 2, *Definition of "Small Business" Within Meaning of the Small Business Act of 1953, as Amended*, hearing on H. Res. 114, 84th Cong., 2nd sess., July 5, 1956 (Washington: GPO, 1956), p. 40.

published its final rule concerning its small business size standards on December 7, 1956, and they became effective on January 1, 1957.[38]

The SBA decided to use number of employees as the sole criterion for determining if manufacturing firms were small and annual sales or annual receipts as the sole criterion for all other industries. Mr. Abels explained at the congressional hearing the SBA's rationale for using number of employees for classifying manufacturing firms as small and annual sales or annual receipts for all other firms:

> in the absence of automation which would give one firm in an industry a great advantage over another, roughly speaking if the firms were mechanized to the same extent, a firm with 400 employees would have an output which would be twice as large as the output of a firm with 200 employees.... However when you depart from the manufacturing field and go into, say, a distributive field or trade, it then becomes necessary to discard the number of employees, because it is a matter of judicial notice, that one man for example in the distributive trades can sell as much as 100 men can sell. One small construction firm possibly can do a lot more business than one with a lot more employees. A service trade again has its volume geared to something other than the number of employees. So I think that one can say with reasonable certainty that it is only within the manufacturing field that the employee standard is the uniform yardstick, but that other than manufacturing the dollar volume is the appropriate yardstick.[39]

The SBA's initial size standards defined most manufacturing firms employing no more than 250 employees as small. In addition, the SBA considered manufacturing firms in some industries (e.g., metalworking and small arms) as small if they employed no more than 500 employees, and in some others (e.g., sugar refining and tractors) as small if they employed no more than 1,000 employees. To be considered small, wholesalers were required to have annual sales volume of $5 million or less; construction firms had to have average annual receipts of $5 million or less over the preceding three years; trucking and warehousing firms had to have annual receipts of $2 million or less; taxicab companies and most firms in the service trades had to have annual receipts of $1 million or less; and most retail firms had to have annual sales of $1 million or less.[40]

Mr. Abels testified that the SBA experienced "continual" protests of its size standards by firms denied financial or support assistance because they were not considered small. He also testified that in each case, the SBA denied the protest and determined, in his words, that the standard was "valid and accurate."[41]

# GAO and Several Members of Congress Challenge the SBA's Size Standards, Claiming They Are Too Broad

In 1977, the U.S. General Accounting Office (GAO, now the U.S. Government Accountability Office) was asked by the Senate Select Committee on Small Business to review the SBA's size

[38] SBA, "Part 103 - Small Business Size Standards," 21 *Federal Register* 9709-9714, December 7, 1956.

[39] Ibid., p. 41.

[40] Ibid., p. 3. In the retail sector, department and variety stores, grocery stores with fresh meats, and new and used automobile stores were considered small if they had annual sales volume of $2 million or less. In the service trades sector, hotels and power industry firms were considered small if they had annual receipts of $2 million or less.

[41] Ibid., p. 40.

standards. At that time, most of the SBA's size standards remained at their original 1957 levels, other than a one-time upward adjustment for inflation in 1975 for industries using annual sales and receipts to restore eligibility to firms that may have lost small-business status due solely to the effect of inflation.[42]

GAO's report, issued in 1978, found that the SBA's size standards "are often high and often are not justified by economic rationale."[43] Specifically, GAO reported that

> many size standards may not direct assistance to the target group described in SBA regulations as businesses "struggling to become or remain competitive" because the loan and procurement size standards for most industries were established 15 or more years ago and have not been periodically reviewed; SBA records do not indicate how most standards were developed; and the standards often define as small a very high percentage of the firms in the industries to which they apply.[44]

GAO recommended that the SBA reexamine its size standards "by collecting data on the size of bidders on set-aside and unrestricted contracts, determining the size of businesses which need set-aside protection because they cannot otherwise obtain Federal contracts" and then consider reducing its size standards or "establishing a two-tiered system for set-aside contracts, under which certain procurements would be available for bidding only to the smaller firms and others would be opened for bidding to all businesses considered small under present standards."[45]

Citing the GAO report, several Members objected to the SBA's size standards at a House Committee on Small Business oversight hearing conducted on July 10, 1979. Representative John J. LaFalce, chair of the House Committee on Small Business Subcommittee on General Oversight and Minority Enterprise, stated that "what we have faced from 1953 to the present is virtually nothing other than acquiescence to the demands of the special interest groups. That is how the size standards have been set."[46] Representative Tim Lee Carter, the subcommittee's ranking minority member, stated that "it seems to me that we may be fast growing into just a regular bank forum not just to small business but to all business."[47] At that time, approximately 99% of all firms with employees were classified by the SBA as a small business.[48]

Roger Rosenberger, SBA's associate administrator for policy, planning and budgeting, testified at the hearing that the SBA would undertake a comprehensive economic analysis of industry data to determine if its size standards should be changed. However, he also defended the validity of the

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[42] U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 3. GAO reported that adjustments to the size standards had been made to "only 81 of the 534 industries covered by the special standards" from January 1, 1968, through April 25, 1978. The upward inflation adjustments for industries using annual sales or receipts ranged from 10.3% to 92.9% depending on the date when the standards were adopted. See SBA, "Small Business Size Standards," 40 *Federal Register* 24210-24215, June 5, 1975, and SBA, "Small Business Size Standards Regulation," 40 *Federal Register* 32824-32826, August 5, 1975.

[43] U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 3. Also, see GAO, *What Is a Small Business? The Small Business Administration Needs to Reexamine Its Answer*, CED-78-149, August 9, 1978, at http://www.gao.gov/assets/130/123644.pdf.

[44] GAO, *What Is A Small Business?*, p. 3.

[45] Ibid., p. 4.

[46] U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 9.

[47] Ibid., p. 6.

[48] U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 14.

SBA's size standards, arguing that the task of setting size standards was a complicated and difficult one because of "how market structure and size distribution of firms vary from industry to industry."[49] He testified that some industries are dominated by a few large firms, some are comprised almost entirely of small businesses, and others "can be referred to as a mixed industry."[50] He argued that each market structure presents unique challenges for defining small businesses within that industry group. For example, he argued that it was debatable whether the SBA should provide any assistance to any of the businesses within industries where "smaller firms are flourishing."[51]

# SBA Proposes More Restrictive Size Standards Based on Industry Competitiveness

On March 10, 1980, the SBA issued a notice of proposed rulemaking designed to "reduce administrative complexity" by replacing its two sets of size standards, one for procurement preferences and another for its loan and consultative support services, with a single set of size standards for both purposes.[52] The SBA also proposed to use a single factor, the firm's number of employees, for definitional purposes for nearly all industries instead of using the firm's number of employees for some industries, the firm's assets for others, and the firm's annual gross receipts for still others. The SBA argued that

> when size standards are denominated in dollars, i.e., annual revenues, its ability to help the small business sector is undermined by inflation. Using employment, as opposed to dollar sales, will provide greater stability for SBA and its clients; will remove inter-industry distortions generated by differential inflation rates; and reduce the need for SBA to make frequent revisions in the size standards merely to reflect price increases.[53]

In setting its proposed new size standards for each industry (ranging from no more than 15 to no more than 2,500 employees), the SBA first placed each industry into one of three groups: concentrated (characterized by a highly unequal distribution of sales among the firms in the industry), competitive (characterized by a more equal distribution of sales in the industry), or mixed (industries that do not meet the criteria of competitive or concentrated industries).[54]

The SBA determined that there were 160 concentrated industries, 317 competitive industries, and 249 mixed industries.[55] The SBA argued that establishing a size standard for the 160 concentrated industries was a "straight-forward task—simply identify and exclude those few firms which account for a disproportionately large share of the industry's sales."[56] For competitive industries, the SBA argued that the size standard should be set "relatively low, so as to support entry and

[49] U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 17.

[50] Ibid.

[51] Ibid., p. 28.

[52] U.S. Congress, House Committee on Small Business, *Small Business Size Standards*, hearing, 96th Cong., 2nd sess., March 13, 1980 (Washington: GPO, 1980), p. III.

[53] Ibid., p. 50.

[54] Ibid., p. 48.

[55] U.S. Congress, House Committee on Small Business, *Small Business Size Standards*, hearing, 96th Cong., 2nd sess., March 13, 1980 (Washington: GPO, 1980), p. 48.

[56] Ibid., p. 49.

moderate growth."[57] The SBA argued that mixed industries require "relatively high size standards ... to reinforce competition and offset the pressures to increase the degree of concentration in these industries."[58]

The proposed new SBA size standards would have had the net effect of reducing the number of firms classified as small by about 225,000.[59] In percentage terms, the number of firms classified as small would have been reduced from about 99% of all employer firms to 96%.[60]

Over 86% of the more than 1,500 public comments received by the SBA concerning its proposed new size standards criticized it. Most of the criticism was from firms that would no longer be considered small under the new size standards.[61] In addition, several federal agencies indicated that the proposed size standards in the services and construction industries were set too low, reducing the number of small firms eligible to compete for procurement contracts below levels they deemed necessary to ensure adequate competition to prevent agency costs from rising.

On October 21, 1980, Congress required the SBA to take additional time to consider the consequences of the proposed changes to the size standards by adopting the Small Business Export Expansion Act of 1980 (P.L. 96-481). It prohibited "the SBA from promulgating any final rule or regulation relating to small business size standards until March 31, 1981."[62] In the meantime, the Reagan Administration entered office, and, as is customary when there is a change in Administration, replaced the SBA's senior leadership.

The SBA's new Administrator, Michael Cardenas, was sympathetic to the concerns of federal agencies that the proposed size standards in the services and construction industries were set too low to meet those agencies' procurement needs. As a result, he indicated that the SBA would modify its size standards proposal by (1) increasing the proposed size standards for 51 industries, mostly in the services and construction industries; (2) lowering the proposed size standards in 157 manufacturing industries (typically from no more than 2,500 employees to no more than 500 employees) to prevent one or more of the largest producers in those industries from being classified as small; and (3) increasing the SBA's proposed lowest size standard from no more than 15 employees to no more than 25 employees (affecting 93 service and trade industries).[63] The net effect of these changes would have restored eligibility for approximately 60,000 of the 225,000 firms expected to lose eligibility under the previous Administration's proposal.[64]

The SBA subsequently met with various trade organizations and federal agency procurement officials to discuss the proposal. As these consultations took place, the SBA experienced another turnover in its senior leadership.

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[57] Ibid.

[58] Ibid.

[59] U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 11.

[60] Ibid., p. 25.

[61] Ibid., pp. 4, 10, 16.

[62] Ibid., p. 5; and P.L. 96-481, the Small Business Export Expansion Act of 1980.

[63] U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 12.

[64] Ibid., p. 11.

The SBA, headed by the new appointee, James C. Sanders, issued a notice of proposed rulemaking concerning its size standards on May 3, 1982.[65] The proposal differed from its March 10, 1980, predecessor in three ways:

> First, the range of size standards was narrowed to a range of 25 employees to 500 employees. This reflected a widespread view that 15 employees was too low a cutoff while 2,500 employees was too high. Second, SBA proposed a 500-employee ceiling, focusing on smaller firms. Third, SBA responded to sentiments within many procurement-sensitive industries that the proposed size standards in some cases were too low to accommodate the average procurement currently being performed by small business. Therefore, SBA proposed higher size standards in a number of procurement-sensitive industries, while maintaining the 500-employee cap.[66]

The SBA received over 500 comments on the proposed rule, with about 72% of those comments opposing the rule.[67]

Taking those comments into consideration, the SBA reexamined its size standards once again, and, after a year of further consultation with various trade organizations and federal agency procurement officials, issued another notice of proposed rulemaking on May 6, 1983.[68] The 1983 proposal (1) replaced the use of two sets of size standards, one for procurement and another for the SBA's loan and consultative support services, with a single set for all programs; (2) retained most of the size standards that were expressed in terms of average annual sales or receipts; (3) adjusted those size standards for inflation (an upward adjustment of 81%); (4) retained most of the size standards for manufacturing; and (5) made relatively minor changes to the size standards in other industries, with a continued emphasis on a 500-employee ceiling for most industries. The SBA received 630 comments on the proposed rule, with almost 70% supporting it.[69]

SBA Administrator Sanders characterized the SBA's revised size standard proposal as "a fine-tuning of current standards which has the basic support of both the private sector and the Federal agencies that use the basic size standards to achieve their set-aside procurement goals."[70] He also added that "since almost no size standard is proposed to decrease, and most will in fact increase, very few firms will lose their small business status. We estimate that about 39,000 firms will gain small business status."[71] He testified that in percentage terms, in 1983, 97.9% of the nation's 5.2 million firms with employees were classified by the SBA as small. Under the SBA's proposal,

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[65] SBA, "Small Business Size Standards; Size Standards Revisions," 47 *Federal Register* 18992-19011, May 3, 1982.

[66] U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *Size Standards*, hearing, 98th Cong., 1st sess., October 20, 1983 (Washington: GPO, 1983), p. 17. Congress created the Small Business Investment Company (SBIC) program in 1958 to provide small businesses enhanced access to equity capital, long-term loans, and consultative management assistance.

[67] U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *H.R. 1178: Small Business Size Standards*, hearing, 99th Cong., 1st sess., July 30, 1985 (Washington: GPO, 1985), p. 198.

[68] SBA, "Small Business Size Standards; Revision," 48 *Federal Register* 20560-20590, May 6, 1983.

[69] U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *Size Standards*, hearing, 98th Cong., 1st sess., October 20, 1983 (Washington: GPO, 1983), p. 18.

[70] Ibid.

[71] Ibid.

98.6% of all firms with employees would be classified as small.[72] The final rule was published in the *Federal Register* on February 9, 1984.[73]

Representative Parren J. Mitchell, chair of the House Committee on Small Business, expressed disappointment in the SBA's final rule, stating at a congressional oversight hearing on July 30, 1985, that "the government and the business community are still victimized by that same ad hoc, sporadic system that the SBA promised to fix some six years ago."[74] He introduced legislation (H.R. 1178, a bill to amend the Small Business Act) that would have required the SBA to adjust its size standard for an industrial classification downward by at least 20% if small business' share of that market equaled or exceeded 60%, and at least 40% of the market share was achieved through the receipt of federal procurement contracts. The bill also mandated a minimum 10% increase in the SBA's size standard for an industrial classification if small business' share of that market was less than 20% and less than 10% of the market share was achieved through the receipt of federal procurement contracts.[75] The bill was opposed by various trade associations, the SBA, and federal agency procurement officials, and was not reported out of committee.[76]

# SBA Proposes to Streamline Its Size Standards

On December 31, 1992, the SBA issued a notice of proposed rulemaking "to streamline its size standards" by reducing the number of fixed size standard levels from 30 to 9.[77] The nine proposed size standards were no more than 100, 500, 750, 1,000, or 1,500 employees; and no more than $5 million, $10 million, $18 million, or $24 million in annual receipts. The annual receipts levels reflected an upward adjustment of 43% for inflation. The SBA argued that the proposed changes would make the size standards more user-friendly for small business owners and restore eligibility to nearly 20,000 firms that were no longer considered small solely because of the effects of inflation. The proposed rule was later withdrawn as a courtesy to allow the incoming Clinton Administration time to review it.[78] The SBA ultimately decided not to pursue this approach because it felt that converting "receipts based size standards in effect at that time to one of four proposed receipts levels created a number of unacceptable anomalies."[79]

Over the subsequent decade, the SBA reviewed the size standards for some industries on a piecemeal basis and, in 1994, adjusted for inflation its size standards based on firm's annual sales or receipts (an upward adjustment of 48.2%). The SBA estimated that the adjustment would restore eligibility to approximately 20,000 firms that lost small-business status due solely to the effects of inflation.[80]

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[72] Ibid.

[73] SBA, "Small Business Size Standards; Revision," 49 *Federal Register* 5024-5048, February 9, 1984.

[74] U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *H.R. 1178: Small Business Size Standards*, hearing, 99th Cong., 1st sess., July 30, 1985 (Washington: GPO, 1985), p. 4.

[75] Ibid., pp. 237-250.

[76] Ibid., pp. 6, 8, 53, 153, 181, 244, 245, 261.

[77] SBA, "Small Business Size Standards: Fixed Size Standard Levels," 57 *Federal Register* 62515, December 31, 1992.

[78] U.S. Congress, House Committee on Small Business, Subcommittee on Minority Enterprise, Finance, and Urban Development, *SBA's Efforts to Streamline Size Standards*, hearing, 103rd Cong., 1st sess., May 25, 1993 (Washington: GPO, 1993), pp. 5, 6.

[79] SBA, "Small Business Size Standards: Restructuring of Size Standards," 69 *Federal Register* 13130, March 19, 2004.

[80] SBA, "Small Business Size Standards: Inflation Adjusted Size Standards," 59 *Federal Register* 16513-16538, April

In 2002, the SBA adjusted for inflation its annual sales and receipts based size standards for the fourth time (an upward adjustment of 15.8%). The SBA estimated that the adjustment would restore eligibility to approximately 8,760 firms that lost small-business status due solely to the effects of inflation. The rule also included a provision that the SBA would assess the impact of inflation on its annual sales and receipts based size standards at least once every five years.[81] Then, on March 19, 2004, the SBA, once again, issued a notice of proposed rulemaking to streamline its size standards.[82]

The proposed rule would have established size standards based on the firm's number of employees for all industries, avoiding the need to adjust for inflation size standards based on sales or receipts.[83] At that time, the SBA size standards consisted of 37 different size levels: 30 based on annual sales or receipts, 5 on the number of employees (both full- and part-time), 1 on financial assets, and 1 on generating capacity. Under the proposed rule, the SBA would use 10 size standards, 5 new employee size standards (adding no more than 50, 150, 200, 300, and 400 employees), and the existing 5 employee size standards (no more than 100, 500, 750, 1,000, and 1,500 employees).[84]

The proposed rule would not have changed any existing size standards based on number of employees. The SBA argued that the use of a single size standard would "help to simplify size standards" and "tends to be a more stable measure of business size" than other measures.[85] It added that the proposed rule would change 514 size standards and that, after the proposed conversion to the use of number of employees, of the "approximately 4.4 million businesses in the industries with revised size standards, 35,200 businesses could gain and 34,100 could lose small business eligibility, with the net effect of 1,100 additional businesses defined as small."[86]

A majority (51%) of the more than 4,500 comments on the proposed rule supported it, but with "a large number of comments opposing various aspects of SBA's approach to simplifying size standards."[87] In addition, the chairs of the House Committee on Small Business and Senate Committee on Small Business and Entrepreneurship opposed the proposed rule, largely because they were concerned about potential job losses resulting from more than 34,000 small businesses losing program eligibility.[88] The SBA withdrew the proposed rule on July 1, 2004.

In 2005, the SBA adjusted for inflation size standards based on firms' annual sales or receipts (an upward adjustment of 8.7%). The SBA estimated that the adjustment restored eligibility to

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7, 1994.

[81] SBA, "Small Business Size Standards: Inflation Adjustment to Size Standards," 67 *Federal Register* 65285-65290, October 24, 2002.

[82] SBA, "Small Business Size Standards: Restructuring of Size Standards," 69 *Federal Register* 13129-13164, March 19, 2004.

[83] Ibid.

[84] Ibid., p. 13130.

[85] Ibid., pp. 13131, 13132.

[86] Ibid., p. 13138.

[87] SBA, "Small Business Size Standards: Selected Size Standards Issues," 69 *Federal Register* 70197, December 3, 2004; and SBA, "Small Business Size Standards: Selected Size Standards Issues," 70 *Federal Register* 2976, January 19, 2005.

[88] Rep. Donald A. Manzullo and Rep. Nydia M. Velázquez, "Small Business Size Standards; Restructuring of Size Standards," 69 *Federal Register* 13,130 (March 19, 2004); Letter to Gary M. Jackson, SBA Assistant Administrator for Size Standards, July 8, 2004; and U.S. Newswire, "Snowe Hails SBA's Withdrawal of New Size Standards Proposal; Decision Spares Small Firms Costly Disruptions," July 1, 2004, p. 1, at http://proquest.umi.com/pqdweb?did=657675071&sid=1&Fmt=3&clientId=45714&RQT=309&VName=PQD.

approximately 12,000 firms that lost small-business status due solely to inflation. In 2008, the SBA made another adjustment for inflation to its annual sales and receipts based standards (another upward adjustment of 8.7%). The SBA estimated that the adjustment restored eligibility for approximately 10,400 firms that lost small-business status due solely to inflation.[89]

# SBA Adopts a Targeted Approach and Reduces the Number of Receipt Based Size Standards

In June 2008, the SBA announced that it would undertake a comprehensive, two-year review of its size standards, proceeding one industrial sector at a time, starting with Retail Trade (NAICS Sector 44-45), Accommodations and Food Services (NAICS Sector 72), and Other Services (NAICS Sector 81).[90] The SBA argued that it was concerned that "not all of its size standards may now adequately define small businesses in the U.S. economy, which has seen industry consolidations, technological advances, emerging new industries, shifting societal preferences, and other significant industrial changes."[91] It added that its reliance on an ad hoc approach "scrutinizing the limited number of specific industries during a year, while worthwhile, leaves unexamined many deserving industries for updating and may create over time a set of illogical size standards."[92]

The SBA announced that it would begin its analysis of its size standards by assuming that "$6.5 million [later increased to $7.5 million] is an appropriate size standard for those industries with receipts size standards and 500 employees for those industries with employee size standards."[93] It would then analyze the following industry characteristics: "average firm size; average asset size (a proxy for startup costs); competition, as measured by the market share of the four largest firms in the industry; and, the distribution of market share by firm size—that is, are firms in the industry generally very small firms, or dominated by very large firms."[94] Then, before making its final determination on the size standard, it would "examine the participation of small businesses in federal contracting and SBA's guaranteed loan program at the current size standard level. Depending on the level of small business participation, additional consideration may be given to the level of the current size standard and the analysis of industry factors."[95]

In April 2009, the SBA announced that was simplifying the administration and use of its size standards by reducing the number of receipts based size standards from 31 to 8 when establishing a new size standard or reviewing an existing size standard:

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[89] SBA, "Small Business Size Standards, Inflation Adjustment to Size Standards; Business Loan Program; Disaster Assistance Loan Program," 70 *Federal Register* 72577, December 6, 2005; and SBA, "Small Business Size Standards: Inflation Adjustment to Size Standards; Business Loan Program, and Disaster Assistance Loan Program," 73 *Federal Register* 41237-41254, July 18, 2008.

[90] SBA, "Small Business Size Standards: Public Meetings on a Comprehensive Review of Small Business Size Standards," 73 *Federal Register* 30440-30442, May 27, 2008. Other Services (NAICS Sector 81) include repair and maintenance, personal and laundry services, and religious, grantmaking, civic, professional, and similar organizations.

[91] SBA, "Small Business Size Standards: Public Meetings on a Comprehensive Review of Small Business Size Standards," 73 *Federal Register* 30441, May 27, 2008.

[92] Ibid.

[93] SBA, "Size Standards Comprehensive Review," June 3, 2008.

[94] Ibid.

[95] Ibid.

> For many years, SBA has been concerned about the complexity of determining small business status caused by a large number of varying receipts based size standards (see 69 FR 13130 (March 4, 2004) and 57 FR 62515 (December 31, 1992)). At the start of current comprehensive size standards review, there were 31 different levels of receipts based size standards. They ranged from $0.75 million to $35.5 million, and many of them applied to one or only a few industries. The SBA believes that to have so many different size standards with small variations among them is unnecessary and difficult to justify analytically. To simplify managing and using size standards, SBA proposes that there be fewer size standard levels. This will produce more common size standards for businesses operating in related industries. This will also result in greater consistency among the size standards for industries that have similar economic characteristics.
>
> Under the current comprehensive size standards review, SBA is proposing to establish eight "fixed-level" receipts based size standards: $5.0 million, $7.0 million, $10.0 million, $14.0 million, $19.0 million, $25.5 million, $30.0 million, and $35.5 million. These levels are established by taking into consideration the minimum, maximum and the most commonly used current receipts based size standards.[96]

These eight receipts based size standards were increased to $5.5 million, $7.5 million, $11.0 million, $15.0 million, $20.5 million, $27.5 million, $32.5 million, and $38.5 million in 2014 to account for inflation.[97]

The SBA also announced that it would

- use eight employee based size standards when establishing a new size standard or reviewing an existing size standard (no more than 50, 100, 150, 200, 250, 500, 750, and 1,000 employees) instead of seven (no more than 50, 100, 150, 500, 750, 1,000, and 1,500 employees);[98] and
- continue to use one asset based size standard, one megawatt hours size standard (based on electrical output over the preceding fiscal year), and one size standard based on a combination of the number of employees and barrel per day refining capacity.

The SBA also announced that "to simplify size standards further" it "may propose a common size standard for closely related industries."[99] The SBA argued

> although the size standard analysis may support a separate size standard for each industry, SBA believes that establishing different size standards for closely related industries may not always be appropriate. For example, in cases where many of the same businesses operate in the same multiple industries, a common size standard for those industries might better reflect the Federal marketplace. This might also make size standards among related industries more consistent than separate size standards for each of those industries.[100]

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[96] SBA, "Small Business Size Standards Methodology," April 2009, pp. 21, 22, at http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

[97] SBA, "Small Business Size Standards: Inflation Adjustment to Monetary Size Standards," 79 *Federal Register* 33647-33669, June 12, 2014; and SBA, "Small Business Size Standards: Inflation Adjustment to Monetary Based Size Standards," 81 *Federal Register* 3949-3956, January 25, 2016.

[98] SBA, "Small Business Size Standards Methodology," April 2009, p. 23, at http://www.sba.gov/sites/default/files/size_standards_methodology.pdf. The SBA stopped using the no more than 1,500 employee size standard when establishing a new or reviewing an existing size standard, noting that only three manufacturing industries had a no more than 1,500 employee size standard at that time.

[99] Ibid., pp. 22, 23.

[100] Ibid., p. 23.

Because SBA size standards remain in force until after they are reviewed, the number of size standards did not immediately drop from 41 to 19 in 2009. Instead, the number of size standards began to decline gradually as new size standard final rules were issued. In addition, from 2010 through 2016, the SBA decided, in most instances, not to lower size standards (which would have made it more difficult for businesses to qualify) even if the data supported lowering them because unemployment at that time was relatively high and doing so would "run counter to numerous Congressional and Administration's initiatives and programs to create jobs and boost economic growth."[101] As a result of this policy decision, several size standards that would have otherwise been eliminated remained in place. Also, in 2016, the SBA added a new employee based size standard (no more than 1,250 employees) and reinstated the use of another (no more than 1,500 employees) when establishing a new, or revising an existing, size standard.[102]

The SBA's decisions in 2009 to reduce the number of receipts based size standards and to propose a common size standard for closely related industries were opposed by some industry groups. They argued that these policies could lead to the SBA to classify an industry "for the sake of convenience" into a size standard that the agency's own economic analysis indicates should be in a different (easier to qualify) size standard.[103] Congress adopted legislation in 2013 (P.L. 112-239, National Defense Authorization Act for Fiscal Year 2013) that included provisions directing the SBA not to limit the number of size standards and to assign the appropriate size standard to each NAICS industrial classification.[104]

The SBA currently has 27 SBA industry size standards in effect (16 receipts based size standards, 9 employee based sized standards, 1 asset based size standard, and 1 size standard based on a combination of the number of employees and barrel per day refining capacity).[105] That number is expected to increase given the SBA's directive not to limit the number of size standards.

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[101] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2018, p. 27, at https://www.sba.gov/sites/default/files/2019-04/SBA%27s%20Size%20Standards%20Methodology%20White%20Paper%20%28April%202018%29.pdf; SBA, "Small Business Size Standards: Retail Trade," 75 *Federal Register* 61598, October 6, 2010; SBA, "Small Business Size Standards: Accommodations and Food Service Industries," 75 *Federal Register* 61605, October 6, 2010; and SBA, "Small Business Size Standards: Other Services," 75 *Federal Register* 61592, October 6, 2010.

The SBA's only exception to this practice was if lowering the size standard was necessary to exclude dominant firms from becoming eligible for SBA assistance.

[102] SBA, "Small Business Size Standards for Manufacturing," 79 *Federal Register* 54150, September 10, 2014; SBA, "Small Business Size Standards for Manufacturing," 80 *Federal Register* 78044, December 15, 2015; and SBA, "Small Business Size Standards for Manufacturing," 81 *Federal Register* 4469-4492, January 26, 2016. On September 10, 2014, the SBA announced its intention to eliminate its no more than 150 employee based size standard in its proposed rule for industries with employee based size standards not part of the manufacturing, wholesale trade, and retail trade industries. However, the SBA decided to retain the no more than 150 employee-size standard in the size standard final rule for those industries, which was issued on January 26, 2016. See SBA, "Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade," 79 *Federal Register* 53647, September 10, 2014; and SBA, "Small Business Size Standards: Industries With Employee Based Size Standards Not Part of Manufacturing, Wholesale Trade, or Retail Trade," 81 *Federal Register* 4436-4469, January 26, 2016.

[103] U.S. Congress, House Committee on Small Business, *Small Business Protection Act of 2012*, report to accompany H.R. 3987, 112th Cong., 2nd sess., December 21, 2012, H.Rept. 112-724 (Washington: GPO, 2012), p. 4.

[104] The SBA subsequently decided not to implement this provision until the first five-year review cycle mandated by P.L. 111-240, the Small Business Jobs Act of 2010, was completed.

[105] Since August 19, 2019, the SBA's receipts based size standards have been no more than $1.0 million, $6.0 million, $8.0 million, $12.0 million, $16.5 million, $19.5 million, $20.5 million, $22.0 million, $27.0 million, $30.0 million, $32.0 million, $34.5 million, $35.0 million, $39.5 million, $40.5 million, and $41.5 million in average annual receipts over the most recently completed three (soon to be five) fiscal years or average annual receipts on a pro rata basis if the

# Congress Requires Periodic Size Standard Reviews

As mentioned previously, P.L. 111-240 requires the SBA to conduct a detailed review of not less than one-third of the SBA's industry size standards during the 18-month period beginning on the date of enactment (September 27, 2010) and during every 18-month period thereafter.[106]

The act directs the SBA to "make appropriate adjustments to the size standards" to reflect market conditions, and to report to the House Committee on Small Business and the Senate Committee on Small Business and Entrepreneurship and make publicly available "not later than 30 days" after the completion of each review information regarding the factors evaluated as part of each review, the criteria used for any revised size standard, and why the SBA did, or did not, adjust each size standard that was reviewed. The act also requires the SBA to ensure that each industry size standard is reviewed at least once every five years.[107]

On July 7, 2011, the SBA announced that its "comprehensive review of all small business size standards" would begin with the following six industries:

- Educational Services (final rule was issued on September 24, 2012);
- Health Care and Social Assistance Services (final rule was issued on September 24, 2012);
- Real Estate Rental and Leasing (final rule was issued on September 24, 2012);
- Administrative and Support, Waste Management and Remediation Services (final rule was issued on December 6, 2012);
- Information (final rule was issued on December 6, 2012); and
- Utilities (final rule was issued on December 23, 2013).[108]

The SBA subsequently completed size standard reviews for all industries in January 2016 (listed by when the final rule was issued):

- Professional, Scientific and Technical Services (final rule was issued on February 24, 2012);
- Transportation and Warehousing (final rule was issued on February 24, 2012);
- Agriculture, Forestry, Fishing and Hunting (final rule was issued on June 20, 2013);
- Arts, Entertainment, and Recreation (final rule was issued on June 20, 2013);
- Finance and Insurance (final rule was issued on June 20, 2013);
- Management of Companies (final rule was issued on June 20, 2013);
- Support Activities for Mining (final rule was issued on June 20, 2013);

firm has been in business for less than three (soon to be five) years. The employee based size standards are no more than 100 employees, 150 employees, 200 employees, 250 employees, 500 employees, 750 employees, 1,000 employees, 1,250 employees, and 1,500 employees. The assets based size standard is $600 million as reported by the institution's four quarterly financial statements for the preceding year. The combined size standard is no more than 1,500 employees or no more than 200,000 barrels per calendar day total Operable Atmospheric Crude Oil Distillation capacity.

[106] P.L. 111-240, the Small Business Act of 2010, §1344. Updated Size Standards.

[107] Ibid.

[108] SBA, "Semiannual Regulatory Agenda," 76 *Federal Register* 40140-40142, July 7, 2011.

- Construction (final rule was issued on December 23, 2013);
- Wholesale Trade (final rule was issued on January 25, 2016);
- Industries with Employee Based Size Standards not Part of Manufacturing, Wholesale Trade, or Retail Trade (final rule was issued on January 26, 2016); and
- Manufacturing (final rule was issued on January 26, 2016).

A summary of the final rules issued for each industry is provided in **Table A-1**.

During the first five-year review cycle, the SBA increased 621 size standards, decreased 3 (to exclude potentially dominant firms from being considered small), and retained 388 at their pre-existing levels.[109] Of the 388 retained size standards, 214 were retained based on the results of the SBA's economic analysis and 174 were retained based on the SBA's policy of generally not lowering any size standard, even though the results of the economic analysis supported lowering them, due to national economic conditions.[110]

The SBA has started its second five-year review of its size standards and anticipates issuing its first final rules in the second five-year review cycle in 2020, using new size standard methodology proposed in April 2018 and finalized in April 2019 (discussed in the next section).[111] The SBA also announced in April 2018 (and again in April 2019) that its policy of generally not lowering size standards when the analysis indicates that a lower standard is justified would no longer be in force, at least initially, during the second five-year review cycle:

> the decision to raise, lower, or retain a size standard will primarily be driven by analytical results, with due considerations of public comments, impacts of changes on the affected businesses, and other factors SBA considers important. All of these decisions will be detailed in individual rulemakings. It will take several years to complete the five-year review of all size standards … during which the state of the economy may change. It is, therefore, not possible to state now … what impact, if any, the future economic environment would have on the SBA's policy decision regarding size standards.[112]

# SBA's Definitions for Small Business

As mentioned earlier, the SBA, relying on statutory language, defines a small business as a concern that is organized for profit; has a place of business in the United States; operates

[109] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2018, p. 9, at http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

[110] Ibid.

[111] In addition, effective October 1, 2017, the SBA amended its small business size standards to incorporate the U.S. Office of Management and Budget's (OMB's) 2017 NAICS designations. NAICS 2017 created 21 new industries by reclassifying, combining, or splitting 29 existing industries designated under NAICS 2012. The SBA's size standards for the industries affected by OMB's revisions increased size standards for six NAICS 2012 industries and part of another, decreased size standards for two others, changed the size standards measure from average annual receipts to number of employees for another, and resulted in no change for 20 industries and parts of another. See SBA, "Small Business Size Standards; Adoption of 2017 North American Industry Classification System for Size Standards," 82 *Federal Register* 18253, April 18, 2017; and SBA, "Small Business Size Standards; Adoption of 2017 North American Industry Classification System for Size Standards," 82 *Federal Register* 44886-44895, September 27, 2017.

[112] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2018, p. 27, at https://www.sba.gov/sites/default/files/2019-04/SBA%27s%20Size%20Standards%20Methodology%20White%20Paper%20%28April%202018%29.pdf. Also, see SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 11, 2019, pp. 26, 27, at https://www.sba.gov/document/support—size-standards-methodology-white-paper.

primarily within the United States or makes a significant contribution to the economy through payment of taxes or use of American products, materials, or labor; is independently owned and operated; and is not dominant in its field on a national basis. The business may be a sole proprietorship, partnership, corporation, or any other legal form.[113]

The SBA uses two measures to determine if a business is small: industry specific size standards or a combination of the business's net worth and net income. For example, the SBA's Small Business Investment Company (SBIC) program allows businesses to qualify as small if they meet the SBA's size standard for the industry in which the applicant is primarily engaged, or an alternative net worth and net income based size standard which has been established for the SBIC program. The SBIC's alternative size standard is currently set as a maximum net worth of not more than $19.5 million and average after-tax net income for the preceding two years of not more than $6.5 million.[114] All of the company's subsidiaries, parent companies, and affiliates are considered in determining if it meets the size standard. The SBA decided to apply the net worth and net income measures to the SBIC program "because investment companies evaluate businesses using these measures to decide whether or not to make an investment in them."[115]

Businesses participating in the SBA's 504/Certified Development Company (504/CDC) loan guaranty program are to be deemed small if they did not have a tangible net worth in excess of $8.5 million and did not have an average net income in excess of $3 million after taxes for the preceding two years.[116] As discussed below, P.L. 111-240 increased these threshold amounts on an interim basis to not more than $15 million in tangible net worth and not more than $5 million in average net income after federal taxes for the two full fiscal years before the date of the application. All of the company's subsidiaries, parent companies, and affiliates are considered in determining if it meets the size standard. Also, before May 5, 2009, businesses participating in the SBA's 7(a) loan guaranty program, including its express programs, were deemed small if they met the SBA's size standards for firms in the industries described in NAICS.[117]

## Alternative Size Standards

Using authority provided under P.L. 111-5, the American Recovery and Reinvestment Act of 2009, the SBA temporarily applied the 504/CDC program's size standards as an alternative for 7(a) loans approved from May 5, 2009, through September 30, 2010.[118] Firms applying for a 7(a) loan during that time period qualified as small using either the SBA's industry size standards or

[113] 13 C.F.R. §121.105. Affiliations between businesses, or relationships allowing one party control or the power of control over another, generally count in size determinations. Businesses can thus be determined to be other than small because of their involvement in joint ventures, subcontracting arrangements, or franchise or license agreements, among other things, provided that their personnel numbers or income, plus those of their affiliate(s), are over the pertinent size threshold. 13 C.F.R. §121.103. For further analysis, see CRS Report R44844, *SBA's "8(a) Program": Overview, History, and Current Issues*, by Robert Jay Dilger.

[114] 13 C.F.R. §107.700; 13 C.F.R. §107.710; 13 C.F.R. §301(c)(2); and 13 C.F.R. §301(c)(1).

[115] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2009, p. 8, at http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

[116] SBA, "SOP 50 10 5(C): Lender and Development Company Loan Programs," (effective October 1, 2010), p. 266, at http://www.sba.gov/sites/default/files/serv_sops_50105c_loan_0.pdf; and SBA, "SOP 50 10 5(E): Lender and Development Company Loan Programs," (effective June 1, 2012), p. 92, at http://www.sba.gov/sites/default/files/SOP%2050%2010%205(E)%20(6-27-2013)%20change%20of%20ownership%20eff%20date%207-1-13%20clean.pdf.

[117] 13 C.F.R. §121.201.

[118] SBA, "Small Business Size Standards; Temporary Alternative Size Standards for 7(a) Business Loan Program," 74 *Federal Register* 20577, May 5, 2009.

the 504/CDC program's size standard. The provision's intent was to enhance the ability of small businesses to access the capital necessary to create and retain jobs during the economic recovery.

P.L. 111-240 made the use of alternative size standards for the 7(a) program permanent. The act directs the SBA to establish an alternative size standard for both the 7(a) and 504/CDC programs that uses maximum tangible net worth and average net income as an alternative to the use of industry standards. The act also establishes, until the date on which the alternative size standard is established, an interim alternative size standard for the 7(a) and 504/CDC programs of not more than $15 million in tangible net worth and not more than $5 million in average net income after federal taxes (excluding any carry-over losses) for the two full fiscal years before the date of the application.[119]

## Industry Size Standards

The SBA Administrator has the authority to establish and modify size standards for particular industries. As mentioned previously, about 97% of all employer firms qualify as small under the SBA's size standards, and these firms account for about 30% of industry receipts.[120]

The SBA generally "prefers to use average annual receipts as a size measure because it measures the value of output of a business and can be easily verified by business tax returns and financial records."[121] However, historically, the SBA has used the number of employees to determine if manufacturing and mining companies are small.

Before a proposed change to the size standards can take effect, the SBA's Office of Size Standards (OSS) undertakes an analysis of the change's likely impact on the affected industry, focusing on the industry's overall degree of competition and the competitiveness of the firms within the industry. The analysis includes an assessment of the following four economic factors: "average firm size, average assets size as a proxy of start-up costs and entry barriers, the 4-firm concentration ratio as a measure of industry competition, and size distribution of firms."[122] The SBA also considers the ability of small businesses to compete for federal contracting opportunities and, when necessary, several secondary factors "as they are relevant to the

[119] P.L. 111-240, the Small Business Act of 2010, §1116. Alternative Size Standards. S. 3103, the Small Business Job Creation Act of 2010, introduced by then-Senator Olympia Snowe on March 10, 2010, and referred to the Senate Committee on Finance, and S. 2869, the Small Business Job Creation and Access to Capital Act of 2009, introduced by Senator Mary Landrieu on December 10, 2009, and reported favorably by the Senate Committee on Small Business and Entrepreneurship, would have authorized the SBA to establish an alternative size standard for the SBA's 7(a) and 504/CDC loan programs. Both bills would have used maximum tangible net worth of not more than $15 million and average net income after federal taxes of not more than $5 million for the two full fiscal years before the date of the application as an alternative to the use of the SBA's industry size standards. Senator Snowe stated on the Senate floor, on December 10, 2009, that the proposed alternative size standard in S. 2869 would "help more small businesses meet the SBA's requirements to access SBA-backed loans." Senator Olympia Snowe, "Statements on Introduced Bills and Joint Resolutions," remarks in the Senate, *Congressional Record*, daily edition, vol. 155, no. 185 (December 10, 2009), p. S12913.

[120] SBA, "SBA's Size Standards Analysis: An Overview on Methodology and Comprehensive Size Standards Review," power point presentation, Khem R. Sharma, SBA Office of Size Standards, July 13, 2011, p. 4, at http://www.actgov.org/sigcom/SIGs/SIGs/SBSIG/Documents/2011%20-%20Documents%20and%20Presentations/Size%20Stds%20Presentation_SIG%20Meeting.pdf; and SBA, "Small Business Size Standards: Adjustment of Monetary-Based Size Standards for Inflation," 84 *Federal Register* 34266, July 18, 2019.

[121] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2009, p. 8, at http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

[122] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2018, pp. 29, 30, at https://www.sba.gov/sites/default/files/2019-04/SBA%27s%20Size%20Standards%20Methodology%20White%20Paper%20%28April%202018%29.pdf.

industries and the interests of small businesses, including technological change, competition among industries, industry growth trends, and impacts of size standard revisions on small businesses."[123]

The specifics of SBA's size standards methodology have evolved over the years with the availability of new industry and federal procurement data and staff research. For example, the SBA previously presumed less than $7.0 million (increased to less than $7.5 million in 2014 to account for inflation) as an appropriate "anchor" size standard for the services, retail trade, construction, and other industries with receipts based size standards; 500 or fewer employees as an appropriate anchor size standard for the manufacturing, mining and other industries with employee based size standards; and 100 or fewer employees as an appropriate anchor size standard for the wholesale trade industries. These three anchor size standards were used as benchmarks or starting points for the SBA's economic analysis. To the extent an industry displayed "differing industry characteristics," a size standard higher, or in some cases lower, than an anchor size standard was used.[124]

In April 2018, the SBA indicated that it was replacing the "anchor" approach with a "percentile" approach, primarily because the anchors were no longer representative of the size standards being used (just 24% of industries with receipt-based size standards and 22% of those with employee based size standards had the anchor size standards) and the anchor approach entails "grouping industries from different NAICS sectors thereby making it inconsistent with section 3(a)(7) of the [Small Business] Act," which limits the SBA's ability to create common size standards by grouping industries below the 4-digit NAICS level.[125] The SBA finalized this change in April 2019.[126]

Specifically, when assessing the appropriateness of the current size standards, the SBA now

> evaluates the structure of each industry in terms of four economic characteristics or factors, namely average firm size, average assets size as a proxy of start-up costs and entry barriers, the 4-firm concentration ratio as a measure of industry competition, and size distribution of firms using the Gini coefficient. For each size standard type ... SBA ranks industries both in terms each of the four industry factors and in terms of the existing size standard and computes the 20th percentile and 80th percentile values for both. SBA then evaluates each industry by comparing its value for each industry factor to the 20th percentile and 80th percentile values for the corresponding factor for industries under a particular type of size standard.
>
> If the characteristics of an industry under review within a particular size standard type are similar to the average characteristics of industries within the same size standard type in the 20th percentile, SBA will consider adopting as an appropriate size standard for that industry the 20th percentile value of size standards for those industries. For each size standard type, if the industry's characteristics are similar to the average characteristics of industries in the 80th percentile, SBA will assign a size standard that corresponds to the 80th percentile in

[123] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2009, p. 1, at http://www.sba.gov/sites/default/files/size_standards_methodology.pdf.

[124] Ibid. The SBA established 500 employees as its anchor size standard for manufacturing industries at the SBA's inception in 1953. Shortly thereafter, the SBA established a receipt-based anchor size standard of $1 million in average annual receipts for nonmanufacturing industries. The receipt-based anchor size standard has been adjusted periodically for inflation.

[125] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2018, pp. 13, 14, at https://www.sba.gov/sites/default/files/2019-04/SBA%27s%20Size%20Standards%20Methodology%20White%20Paper%20%28April%202018%29.pdf.

[126] SBA, Office of Government Contracting and Business Development, "Size Standards Methodology White Paper," April 11, 2019, at https://www.sba.gov/document/support—size-standards-methodology-white-paper.

> the size standard rankings of industries. A separate size standard is established for each factor based on the amount of differences between the factor value for an industry under a particular size standard type and 20th percentile and 80th percentile values for the corresponding factor for all industries in the same type. Specifically, the actual level of the new size standard for each industry factor is derived by a linear interpolation using the 20th percentile and 80th percentile values of that factor and corresponding percentiles of size standards. Each calculated size standard will be bounded between the minimum and maximum size standards levels [see **Table 2**] ... the calculated value for a receipts based size standard for each industry factor is rounded to the nearest $500,000 and the calculated value for an employee based size standard is rounded to the nearest 50 employees for Manufacturing and industries in other sectors (except Wholesale and Retail Trade) and to the nearest 25 employees for employee based size standards for Wholesale Trade and Retail Trade.[127]

The SBA anticipates that its shift from using the anchor approach to the percentile approach will have minimal impact, both in terms of the direction and magnitude of changes, to its industry size standards.[128]

**Table 2. Minimum and Maximum Receipts and Employee Based Size Standards, Since 2019**

| Type of Size Standards | Minimum | Maximum |
|---|---|---|
| Receipts based size standards (excluding agricultural industries in NAICS subsectors 111 and 112) | $5 million | $41.5 million[a] |
| Receipts based size standards for agricultural industries in NAICS subsectors 111 and 112 | $1 million | $5 million |
| Employee based size standards for Manufacturing and other industries (excluding Wholesale and Retail Trade) | 250 employees | 1,500 employees |
| Employee based size standards for Wholesale and Retail Trade | 50 employees | 250 employees |

**Source:** U.S. Small Business Administration, Office of Government Contracting and Business Development, "Size Standards Methodology White Paper," April 11, 2019, p. 28, at https://www.sba.gov/document/support—size-standards-methodology-white-paper.

a. The Size Standards Methodology White Paper indicates that the maximum receipts-based size standard (excluding agricultural industries in NAICS subsectors 111 and 112) is $40.0 million. That figure was increased to $41.5 million on August 19, 2019, to account for inflation. See U.S. Small Business Administration, "Small Business Size Standards: Adjustment of Monetary-Based Size Standards for Inflation," 84 *Federal Register* 34261-34281, July 18, 2019 (effective August 19, 2019).

Any changes to size standards must follow the rulemaking procedures of the Administrative Procedure Act. A proposed rule changing a size standard is first published in the *Federal Register*, allowing for public comment. It must include documentation establishing that a significant problem exists that requires a revision of the size standard, plus an economic analysis of the

[127] SBA, Office of Government Contracting and Business Development, "SBA Size Standards Methodology," April 2018, pp. 29, 30, at https://www.sba.gov/sites/default/files/2019-04/SBA%27s%20Size%20Standards%20Methodology%20White%20Paper%20%28April%202018%29.pdf.

[128] Ibid., p. 2.

change. Comments from the public, plus any other new information, are reviewed and evaluated before a final rule is promulgated establishing a new size standard.

The SBA currently uses employment size to determine eligibility for 505 of 1,037 industries (48.7%), including all 360 manufacturing industries, 24 mining industries, and 71 wholesale trade industries. Since October 1, 2017,

- 98 manufacturing industries have an upper limit of 500 employees (27.2%); 91 have an upper limit of 750 employees (25.2%); 89 have an upper limit of 1,000 employees (24.7%); 56 have an upper limit of 1,250 employees (15.6%); and 26 have an upper limit of 1,500 employees (7.2%).[129]
- 3 of the 24 mining industries have an upper limit of 250 employees (12.5%), 7 have an upper limit of 500 employees (29.2%), 7 have an upper limit of 750 employees (29.2%), 2 have an upper limit of 1,000 employees (8.3%), 3 have an upper limit of 1,250 employees (12.5%), and 2 have an upper limit of 1,500 employees (8.3%).[130]
- 25 of the 71 wholesale trades industries have an upper limit of 100 employees (35.2%), 16 have an upper limit of 150 employees (22.5%), 21 have an upper limit of 200 employees (29.6%), and 9 have an upper limit of 250 employees (12.7%).[131]

The SBA currently has nine employee based industry size standards in effect (no more than 100, 150, 200, 250, 500, 750, 1,000, 1,250, and 1,500 employees).

The SBA uses average annual receipts to determine program eligibility for most other industries (527 of 1,037 industries, or 50.8%).[132]

Pursuant to P.L. 115-324, the Small Business Runway Extension Act of 2018, and SBA regulatory action (effective January 6, 2020), SBA's receipts based size standards (other than for the SBA's business and disaster loan programs, which will be subject to separate SBA rulemaking) and other federal agency's proposed receipts based size standards will be based on average annual receipts over five years, instead of over three years. Firms will have the option, through January 6, 2022, to choose between using three-year averaging or five-year averaging.[133]

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[129] SBA, "Small Business Size Standards for Manufacturing," 81 *Federal Register* 4469-4492, January 26, 2016.

[130] SBA, "Table of Small Business Size Standards," at http://www.sba.gov/content/table-small-business-size-standards.

[131] SBA, "Small Business Size Standards: Employee Based Size Standards in Wholesale Trade and Retail Trade," 81 *Federal Register* 3941-3949, January 25, 2016. Until February 26, 2016 (and since 1986), all industries in the Wholesale Trade Sector had an upper limit of 100 employees. See SBA, "Table of Small Business Size Standards," July 14, 2014, at http://www.sba.gov/content/table-small-business-size-standards. Also, for procurement purposes, the SBA's size standard is no more than 500 employees for all industries in both the Retail Trade and Wholesale Trade Sectors.

[132] SBA, "Table of Small Business Size Standards," at http://www.sba.gov/content/table-small-business-size-standards.

[133] SBA, "Small Business Size Standards: Calculation of Annual Average Receipts," 84 *Federal Register* 66561, December 5, 2019. Some commentators argued that requiring lenders to review an additional two years of tax returns or financial statements to establish eligibility for SBA's loan programs would "add costs to loan processing, increase turn-around times, and discourage small businesses from participating in the SBA's loan programs" and "this additional requirement increases the burden without any underlying benefit to the small business." As a result, SBA decided not to include SBA's business and disaster loan programs in the final rule establishing five-year averaging and to seek further public comment through a proposed rule for these lending programs at a later date. See ibid., pp. 66565-66566. Also, the final rule "does not affect existing non-SBA size standards that specify a 3-year averaging unless the responsible agency proposes and finalizes changes to the existing specification of a 3-year average." See ibid., p. 66569.

This change is expected to allow about 7,800 businesses to be deemed small that otherwise would not qualify as small and about 63,000 small businesses about to outgrow their status as a small business to retain that status.[134] According to the SBA, the final rule follows the intent of P.L. 115-324 by providing "small businesses more time to grow and develop competitiveness and infrastructure so that they are better prepared to succeed under full and open competition [for federal contracts] once they outgrow the size threshold."[135]

The SBA also uses average asset size as reported in the firm's four quarterly financial statements for the preceding year to determine eligibility for five finance industries, and a combination of number of employees and barrel per day refining capacity for petroleum refineries.[136]

The SBA currently has 16 receipts based industry size standards in effect (no more than $1.0 million, $6.0 million, $8.0 million, $12.0 million, $16.5 million, $19.5 million, $20.5 million, $22.0 million, $27.0 million, $30.0 million, $32.0 million, $34.5 million, $35.0 million, $39.5 million, $40.5 million, and $41.5 million).[137] In some instances, there is considerable variation in the size standards used within each industrial sector. For example, the SBA uses 11 different size standards to determine eligibility for 66 industries in the retail trade sector. In general,

- most administrative and support service industries have an upper limit of either $16.5 million or $22.0 million in average annual sales or receipts;
- most agricultural industries have an upper limit of $1.0 million in average annual sales or receipts;[138]
- most construction of buildings and civil engineering construction industries have an upper limit of $39.5 million in average annual sales or receipts, and most construction specialty trade contractors have an upper limit of $16.5 million in average annual sales or receipts;
- most educational services industries have an upper limit of either $8.0 million or $12.0 million in average annual sales or receipts;
- most health care industries have an upper limit of either $8.0 million or $16.5 million in average annual sales or receipts;
- most social assistance industries have an upper limit of $12.0 million in average annual sales or receipts;
- there is considerable variation within the professional, scientific, and technical service industries, ranging from an upper limit of $8.0 million in average annual sales or receipts to $41.5 million;

[134] Ibid., p. 66573.

[135] Ibid., p. 66571.

[136] SBA, "Table of Small Business Size Standards," July 14, 2014, at http://www.sba.gov/content/table-small-business-size-standards.

[137] The receipts based size standards in use from April 21, 2016, to August 19, 2019, were no more than: $0.75 million, $5.5 million, $7.5 million, $11.0 million, $15.0 million, $18.0 million, $19.0 million, $20.5 million, $25.0 million, $27.5 million, $29.5 million, $32.0 million, $32.5 million, $36.5 million, $37.5 million, and $38.5 million.

[138] P.L. 99-272, the Consolidated Omnibus Budget Reconciliation Act of 1985 (Title XVIII, Section 18016) inserted a requirement that notwithstanding any other provision of law, an agricultural enterprise shall be deemed to be a small business concern if it, including its affiliates, has annual receipts not in excess of $500,000. P.L. 106-554, the Consolidated Appropriations Act, 2001 (Title VIII, Section 806(b)), substituted "$750,000" for "$500,000." P.L. 114-328, the National Defense Authorization Act for Fiscal Year 2017, authorizes the SBA to establish different size standards for agricultural enterprises using existing methods and appeal processes.

- there is considerable variation within the transportation and warehousing industrial sector, ranging from an upper limit of $8.0 million in average annual sales or receipts to $41.5 million for 43 industries and from an upper limit of 500 employees to 1,500 employees for 15 industries); and
- most finance and insurance industries have an upper limit of $41.5 million in average annual sales or receipts.

The SBA also applies a $600 million average asset limit (as reported in the firm's four quarterly financial statements for the preceding year) to determine eligibility in five finance industries: commercial banks, saving institutions, credit unions, other depository credit intermediation, and credit card issuing.[139]

## Other Federal Agency Size Standards

Many federal statutes provide special considerations for small businesses. For example, small businesses are provided preferences through set-asides and sole source awards in federal contracting and pay lower fees to apply for patents and trademarks.[140] In most instances, businesses are required to meet the SBA's size standards to be considered a small business. However, in some cases, the underlying statute defines the eligibility criteria for defining a small business. In other cases, the statute authorizes the implementing agency to make those determinations.

Under current law, a federal agency that decides that it would like to exercise its authority to establish its own size standard through the federal rulemaking process is required to, among other things, (1) undertake an initial regulatory flexibility analysis to determine the potential impact of the proposed rule on small businesses, (2) transmit a copy of the initial regulatory flexibility analysis to the SBA's Chief Counsel for Advocacy for comment, and (3) publish the agency's response to any comments filed by the SBA's Chief Counsel for Advocacy in response to the proposed rule and a detailed statement of any change made to the proposed rule in the final rule as a result of those comments.[141] In addition, the federal agency must provide public notice of the proposed rule and an opportunity for the public to comment on the proposed rule, typically through the publication of an advanced notice of proposed rulemaking in the *Federal Register* and notification of interested small businesses and related organizations.[142] Also, prior to issuing the final rule, the federal agency must have the approval of the SBA's Administrator.[143] Under

[139] SBA, "Table of Small Business Size Standards," at http://www.sba.gov/content/table-small-business-size-standards; and SBA, "Small Business Size Standards: Adjustment of Monetary-Based Size Standards for Inflation," 84 *Federal Register* 34270-34280, July 18, 2019 (effective August 19, 2019).

[140] The federal government has a goal of awarding at least 23% of all small business eligible federal government procurement contracts to small businesses, including 5% for small disadvantaged businesses, 5% for women-owned small businesses, 3% for small businesses owned by service-disabled veterans, and 3% for small businesses located in a HUBZone. See U.S. General Services Administration, Federal Procurement Data System – Next Generation, "Small Business Goaling Reports," at https://www.fpds.gov/fpdsng_cms/index.php/en/reports. For further information and analysis concerning federal contracting preferences for small businesses, see CRS Report R41268, *Small Business Administration HUBZone Program*, by Robert Jay Dilger.

[141] 5 U.S.C. §601; 5 U.S.C. §603; and 5 U.S.C. §604. The SBA last published a list of size standards set by agencies other than the SBA in 1995. See SBA, "Small Business Size Standards," 60 *Federal Register* 57988-57991, November 24, 1995. For a related example (establishing a size standard for Regulatory Flexibility Act compliance), see U.S. Department of Commerce, National Oceanic and Atmospheric Administration, "Establish a Single Small Business Size Standard for Commercial Fishing Business," 80 *Federal Register* 81194-80872, December 29, 2015.

[142] 15 U.S.C. §632.

[143] Ibid. The SBA reports "that there have been approximately 25 requests by other agencies under the authority of

current practice, the SBA's Administrator, through the SBA's Office of Size Standards, consults with the SBA's Office of Advocacy prior to making a final decision concerning such requests.[144] The Office of Advocacy is an independent office within the SBA.

During the 112th Congress, H.R. 585, the Small Business Size Standard Flexibility Act of 2011, was reported by the House Committee on Small Business on November 16, 2011, by a vote of 13 to 8. The bill would have retained the SBA's Administrator's authority to approve or disapprove size standards for programs under the Small Business Act of 1953 (as amended) and the Small Business Investment Act of 1958 (as amended). The Office of Chief Counsel for Advocacy would have assumed the SBA Administrator's authority to approve or disapprove size standards for purposes of any other act.[145]

Similar legislative provisions have been introduced during the 113th Congress (H.R. 2542, the Regulatory Flexibility Improvements Act of 2013, and included in H.R. 4, the Jobs for America Act), 114th Congress (H.R. 527, the Small Business Regulatory Flexibility Improvements Act of 2015, and its Senate companion bill, S. 1536), and 115th Congress (H.R. 33, the Small Business Regulatory Flexibility Improvements Act of 2017, and its Senate companion bill, S. 584, and included in H.R. 5, the Regulatory Accountability Act of 2017).

Advocates of splitting the SBA Administrator's small business size standards' authority between the Office of Chief Counsel for Advocacy and the SBA's Administrator have argued that

> Should an agency wish to draft a regulation that adopts a size standard different from the one already adopted by the Administrator in regulations implementing the Small Business Act, the agency must obtain approval of the Administrator. However, that requires the Administrator to have a complete understanding of the regulatory regime of that other act—knowledge usually outside the expertise of the SBA. However, the Office of the Chief Counsel for Advocacy, an independent office within the SBA, represents the interests of small businesses in rulemaking proceedings (as part of its responsibility to monitor agency compliance with the Regulatory Flexibility Act, 5 U.S.C. 601-12, (RFA)) does have such expertise. Therefore, it is logical to transfer the limited function on determining size standards of small businesses for purposes other than the Small Business Act and Small Business Investment Act of 1958 to the Office of the Chief Counsel for Advocacy….
>
> the Administrator is not the proper official to determine size standards for purposes of other agencies' regulatory activities. The Administrator is not fluent with the vast array of federal regulatory programs, is not in constant communication with small entities that might be affected by another federal agency's regulatory regime, and does not have the analytical

amended §3 of the Small Business Act since the date of amendment in 1992." See U.S. Congress, House Committee on Small Business, *Small Business Size Standard Flexibility Act of 2011*, report to accompany H.R. 585, 112th Cong., 2nd sess., November 16, 2011, H.Rept. 112-288 (Washington: GPO, 2011), p. 7.

[144] Rep. Sam Graves, "Full Committee Hearing, Lifting the Weight of Regulations: Growing Jobs By Reducing Regulatory Burdens (III. H.R. 585—Small Business Size Standard Flexibility Act of 2011)," letter to House Committee on Small Business, June 8, 2011, p. 44, at http://smbiz.house.gov/UploadedFiles/6-15_Memo.pdf; U.S. Congressional Budget Office, "Congressional Budget Office Cost Estimate: H.R. 585—Small Business Size Standard Flexibility Act of 2011," p. 2, at https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/costestimate/hr5851.pdf; and U.S. Congress, House Committee on Small Business, *Small Business Size Standard Flexibility Act of 2011*, report to accompany H.R. 585, 112th Cong., 2nd sess., November 16, 2011, H.Rept. 112-288 (Washington: GPO, 2011), pp. 6-8. Also, see 13 C.F.R. §121.901-903.

[145] U.S. Congressional Budget Office, "Congressional Budget Office Cost Estimate: H.R. 585—Small Business Size Standard Flexibility Act of 2011," p. 2, at https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/costestimate/hr5851.pdf; and H.Rept. 112-288, the Business Size Standard Flexibility Act of 2011. CBO has estimated that the Office of Advocacy would ultimately need 10 additional staff positions to implement its new authority; and that the bill would cost $6 million over the 2012-2016 period.

> expertise to assess the regulatory impact of a particular size standard on small entities. Furthermore, the Administrator's standards are: very inclusive, not developed to comport with other agencies' regulatory regimes, and lack sufficient granularity to examine the impact of a proposed rule on a spectrum of small businesses.[146]

Opponents have argued that

> When an agency is seeking to use a size standard other than those approved by the SBA, the agency may consult with the Office of Advocacy. Such consultation is sensible, as the Office of Advocacy has significant knowledge of the regulatory environment outside of the canon of SBA law. However, the SBA's Office of Size Standards, with its historical involvement, expertise, and staff resources in this area, remains the appropriate entity to approve such size standards….
>
> While the legislation permits the SBA to continue to approve size standards for its enabling statutes, it removes SBA's authority to do so for other statutes. The result would be to create a duplicate size standard authority in both the SBA and the Office of Advocacy. Both the SBA and the Office of Advocacy would have personnel who would analyze and evaluate size standards. Through the bifurcation of these responsibilities, taxpayers would effectively be forgoing the economies of scale that are currently enjoyed by the operation of a single Office of Size Standards in the SBA….
>
> Having two such entities that have the same mission is not a transfer of function, but an inefficient and duplicative reorganization.… Instead of having one central office, there will now be two—further muddling small businesses' relationship with the federal government.[147]

## Other Recent Legislation

Two bills were introduced during the 114th Congress (H.R. 3714, the Small Agriculture Producer Size Standards Improvements Act of 2015, and H.R. 4341, the Defending America's Small Contractors Act of 2016) to authorize the SBA to establish size standards for agricultural enterprises not later than 18 months after the date of enactment. The size standard for agricultural enterprises was, at that time, set in statute as having annual receipts not in excess of $750,000.[148] H.R. 4341, among other provisions, would have also limited an industry category to a greater extent than provided under the North American Industry Classification codes for small business procurement purposes if further segmentation of the industry category is warranted.[149]

H.R. 4341 was introduced on January 7, 2016, and ordered to be reported with amendment by the House Committee on Small Business on January 13, 2016. H.R. 3714 was introduced on October 8, 2015, considered by the House under suspension of the rules on April 19, 2016, and agreed to by voice vote.

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[146] U.S. Congress, House Committee on Small Business, *Small Business Size Standard Flexibility Act of 2011*, report to accompany H.R. 585, 112th Cong., 2nd sess., November 16, 2011, H.Rept. 112-288 (Washington: GPO, 2011), p. 6.

[147] Ibid., p. 14.

[148] P.L. 99-272, the Consolidated Omnibus Budget Reconciliation Act of 1985, established the size standard for agricultural enterprises as annual receipts not in excess of $500,000. P.L. 106-554, the Consolidated Appropriations Act, 2001, increased the size standard for agricultural enterprises to annual receipts not in excess of $750,000.

[149] The bill would authorize the SBA Administrator to limit an industry category due to special capital equipment needs, special labor requirements, special geographic requirements (with specified limitations), or to recognize a new industry. See H.R. 4341, the Defending America's Small Contractors Act of 2016, Section 101. Plain Language Rewrite of Requirements for Small Business Procurements.

P.L. 114-328, the National Defense Authorization Act for Fiscal Year 2017, includes a provision which authorizes the SBA to establish different size standards for agricultural enterprises using existing methods and appeal processes.

In adition, as mentioned previously, P.L. 115-324 directs federal agencies proposing a size standard (and, based on report language accompanying the act, presumably the SBA as well) to use the average annual gross receipts from at least the previous five years, instead of the previous three years, when seeking SBA approval to establish a size standard based on annual gross receipts.[150]

The SBA asserts that P.L. 115-324's provision mandating the use of the average annual gross receipts from at least the previous five years, instead of the previous three years, in determining receipts based size standards does not apply to the SBA. However, "to promote consistency government-wide," the SBA announced that it will use the average annual gross receipts from the previous five years, instead of the previous three years (effective January 6, 2020), when establishing its receipts based size standards.[151] As mentioned previously, the SBA also adopted a transition period through January 6, 2022, allowing firms to choose between using a three-year averaging period and a five-year averaging period. The SBA will also retain three-year averaging for the SBA's business and disaster loan programs while it gathers additional public input through future proposed rulemaking concerning potential administrative burdens that moving from three-year averaging to five-year averaging may have on lenders and borrowers.

# Congressional Policy Options

Historically, the SBA has relied on economic analysis of market conditions within each industry to define eligibility for small business assistance. On several occasions in its history, the SBA attempted to revise its small business size standards in a comprehensive manner. However, because (1) the Small Business Act provides leeway in how the SBA is to define small business; (2) there is no consensus on the economic factors that should be used in defining small business; (3) federal agencies have generally opposed size standards that might adversely affect their pool of available small business contractors; and (4) the SBA's initial size standards provided program eligibility to nearly all businesses, the SBA's efforts to undertake a comprehensive reassessment of its size standards met with resistance. Firms that might lose eligibility objected. Federal agencies also objected. As a result, in each instance, the SBA's comprehensive revisions were not fully implemented.

The SBA's congressionally mandated requirement to conduct a detailed review of at least one-third of the SBA's industry size standards every 18 months was imposed by P.L. 111-240, the Small Business Jobs Act of 2010, to prevent small business size standards from becoming outdated.[152] More frequent reviews of the size standards were expected to increase their accuracy and, generally speaking, result in (1) increased numbers of small businesses found to be eligible

[150] U.S. Congress, House Committee on Small Business, *Small Business Runway Extension Act of 2018*, report to accompany H.R. 6330, 115th Cong., 2nd sess., September 12, 2018, H.Rept. 115-939 (Washington: GPO, 2018), p. 2.

[151] SBA, "Small Business Size Standards: Calculation of Annual Average Receipts," 84 *Federal Register* 29399-29400, June 24, 2019; and SBA, "Small Business Size Standards: Calculation of Annual Average Receipts," 84 *Federal Register* 66561, December 5, 2019.

[152] See U.S. Congress, Senate Committee on Small Business and Entrepreneurship, *Small Business Contracting Revitalization Act of 2010*, report to accompany S. 2989, 111th Cong., 2nd sess., September 29, 2010, S.Rept. 111-343 (Washington: GPO, 2010), p. 9. "The Committee has heard testimony that the current size standards are in dire need of a comprehensive update."

for SBA assistance and (2) an increase in the number and amount of federal contracts awarded to small businesses (primarily by preventing large businesses from being misclassified as small and by increasing the number of small businesses eligible to compete for federal contracts).[153]

As expected, the SBA's economic analyses during the recent five-year review cycle often supported an increase in the size standards for many industries. However, the SBA's economic analyses also occasionally supported a decrease in the size standards for some industries. Despite the SBA's decision to, in most circumstances, make no changes when their economic analyses indicated that a decrease was warranted, it could be argued that the increased frequency of the reviews has generally prevented the SBA's size standards from becoming outdated. This, in turn, has, at least to a certain extent, improved the accuracy of the size standards (as measured by the extent to which the size standard is in alignment with the SBA's economic analyses).

In a related matter, the SBA continues to adjust its receipts based size standards for inflation at least once every five years, or more frequently if inflationary circumstances warrant, to prevent firms from losing their small business eligibility solely due to the effects of inflation. The most recent adjustment for inflation took place on August 19, 2019.[154] The SBA also continues to review size standards within specific industries whenever it determines that market conditions within that industry have changed.

Congress has several options related to the SBA's ongoing review of its size standards. For example, as part of its oversight of the SBA, Congress can wait for the agency to issue its proposed rule before providing input or establish a dialogue with the agency, either at the staff level or with Members involved directly, prior to the issuance of its proposed rule. Historically, Congress has tended to wait for the SBA to issue proposed rules concerning its size standards before providing input, essentially deferring to the agency's expertise in the technical and methodological issues involved in determining where to draw the line between small and large firms. Congress has then tended to respond to the SBA's proposed rules concerning its size standards after taking into consideration current economic conditions and input received from the SBA and affected industries.

Waiting for the SBA to issue its proposed rule concerning its size standards before providing congressional input has both advantages and disadvantages. It provides the advantage of insulating the proposed rule from charges that it is influenced by political factors. It also has the advantage of respecting the separation of powers and responsibilities of the executive and legislative branches. However, it has the disadvantage of heightening the prospects for miscommunication, false expectations, and wasted effort, as evidenced by past proposed rules concerning the SBA's size standards that were either rejected outright, or withdrawn, after facing congressional opposition.

Another policy option that has not received much congressional attention in recent years, but which Congress may choose to address, is the targeting of the SBA's resources. When the SBA reviews its size standards, it focuses on the competitive nature of the industry under review, with the goal of removing eligibility of firms that are considered large, or dominant, in that industry.

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[153] See Sen. Mary Landrieu, "Statements on Introduced Bills and Joint Resolutions: S. 2989 A bill to improve the Small Business Act, and for other purposes," remarks in the Senate, *Congressional Record*, vol. 156, part 17 (February 4, 2010), p. S487 "… The Committee has heard from a number of small businesses about large businesses parading as small businesses. It is imperative that small business contracts go to small businesses. Small businesses may be losing billions of dollars in opportunities because of size standard loopholes."

[154] SBA, "Small Business Size Standards: Adjustment of Monetary-Based Size Standards for Inflation," 84 *Federal Register* 34261-34281, July 18, 2019 (effective August 19, 2019).

There has been relatively little discussion of the costs and benefits of undertaking those reviews with the goal of targeting SBA resources to small businesses in industries that are struggling to remain competitive. GAO recommended this approach in 1978 and Roger Rosenberger, then SBA's associate administrator for policy, planning, and budgeting, testified at a congressional hearing in 1979 that it was debatable whether the SBA should provide any assistance to any of the businesses within industries where "smaller firms are flourishing."[155]

Revising the SBA's size standards using this more targeted approach would likely reduce the number of firms eligible for assistance. It would also present the possibility of increasing available benefits to eligible small firms in those industries deemed "mixed" or "concentrated" by the SBA without necessarily increasing overall program costs. Perhaps because previous proposals that would result in a reduction in the number of firms eligible for assistance have met with resistance, this alternative approach to determining program eligibility has not received serious consideration in recent years. Nonetheless, it remains an option available to Congress should it decide to change current policy.

[155] U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 28.

# Appendix. SBA Size Standard Reviews, 2011-2016

**Table A-1. Status of SBA Size Standard Reviews, By Issue Date, 2011-2016**

| NAICS Sectors | Notice of Intent to Review the Standard | Notice of Proposed Rulemaking | Recommended Change | Final Rule | Final Change |
|---|---|---|---|---|---|
| Professional, Scientific and Technical Services (NAICS Sector 54) | 75 *Federal Register* 21893, 21894, Apr. 26, 2010 | 76 *Federal Register* 14323-14341, Mar. 16, 2011 | Would increase size standards for 35 industries and 1 sub-industry | 77 *Federal Register* 7488-7515, Feb. 10, 2012 (effective Mar. 12, 2012) | Increased size standards for 34 industries and 3 sub-industries[a] |
| Transportation and Warehousing (NAICS Sector 48-49) | 75 *Federal Register* 21894, Apr. 26, 2010 | 76 *Federal Register* 27935-27952, May 13, 2011 | Would increase size standards for 22 industries | 77 *Federal Register* 10943-10950, Feb. 24, 2012 (effective Mar. 26, 2012) | Increased size standards for 22 industries |
| Educational Services (NAICS Sector 61) | 76 *Federal Register* 40140-40142, July 7, 2011 | 76 *Federal Register* 70667-70680, Nov. 15, 2011 | Would increase size standards for nine industries | 77 *Federal Register* 58739-58747, Sept. 24, 2012 (effective Oct. 24, 2012) | Increased size standards for 9 industries |
| Health Care and Social Assistance Services (NAICS Sector 62) | 76 *Federal Register* 40140-40142, July 7, 2011 | 77 *Federal Register* 11001-11017, Feb. 24, 2012 | Would increase size standards for 28 industries | 77 *Federal Register* 58755-58761, Sept. 24, 2012 (effective Oct. 24, 2012) | Increased size standards for 28 industries |
| Real Estate, Rental and Leasing (NAICS Sector 53) | 76 *Federal Register* 40140-40142, July 7, 2011 | 76 *Federal Register* 70680-70694, Nov. 15, 2011 | Would increase size standards for 20 industries and 1 sub-industry | 77 *Federal Register* 58747-58755, Sept. 24, 2012 (effective Oct. 24, 2012) | Increased size standards for 21 industries and 1 sub-industry |

| NAICS Sectors | Notice of Intent to Review the Standard | Notice of Proposed Rulemaking | Recommended Change | Final Rule | Final Change |
|---|---|---|---|---|---|
| Administrative and Support, Waste Management and Remediation Services (NAICS Sector 56) | 76 *Federal Register* 40140-40142, July 7, 2011 | 76 *Federal Register* 63510-63525, Oct. 12, 2011 | Would increase size standards for 37 industries | 77 *Federal Register* 72691-72702, Dec. 6, 2012 (effective Jan. 7, 2013) | Increased size standards for 37 industries |
| Information (NAICS Sector 51) | 76 *Federal Register* 40140-40142, July 7, 2011 | 76 *Federal Register* 63216-63229, Oct. 12, 2011 | Would increase size standards for 15 industries | 77 *Federal Register* 72702-72709, Dec. 6, 2012 (effective Jan. 7, 2013) | Increased size standards for 15 industries |
| Agriculture, Forestry, Fishing and Hunting (NAICS Sector 11) | NA | 77 *Federal Register* 55755-55768, Sept. 11, 2012 | Would increase size standards for 11 industries | 78 *Federal Register* 37398-37404, June 20, 2013 (effective July 22, 2013) | Increased size standards for 11 industries |
| Arts, Entertainment, and Recreation (NAICS Sector 71) | 77 *Federal Register* 8024, Feb. 13, 2012 | 77 *Federal Register* 42211-42225, July 18, 2012 | Would increase size standards for 17 industries | 78 *Federal Register* 37417-37422, June 20, 2013 (effective July 22, 2013) | Increased size standards for 17 industries |
| Finance and Insurance (NAICS Sector 52) | NA | 77 *Federal Register* 55737-55755, Sept. 11, 2012 | Would increase size standards for 37 industries and change the measure of size from total assets to annual receipts for 1 industry | 78 *Federal Register* 37409-37417, June 20, 2013 (effective July 22, 2013) | Increased size standards for 36 industries, and changed the measure of size from total assets to annual receipts for 1 industry |

| NAICS Sectors | Notice of Intent to Review the Standard | Notice of Proposed Rulemaking | Recommended Change | Final Rule | Final Change |
|---|---|---|---|---|---|
| Management of Companies (NAICS Sector 55) | NA | 77 *Federal Register* 55737-55755, Sept. 11, 2012 | Would increase size standards for 2 industries | 78 *Federal Register* 37409-37417, June 20, 2013 (effective July 22, 2013) | Increased size standards for 2 industries |
| Support Activities for Mining (within NAICS Sector 21) | NA | 77 *Federal Register* 72766, Dec. 6, 2012 | Would increase size standards for 3 industries | 78 *Federal Register* 37404-37408, June 20, 2013 (effective July 22, 2013) | Increased size standards for 3 industries |
| Construction (NAICS Sector 23) | 77 *Federal Register* 8024, Feb. 13, 2012 | 77 *Federal Register* 42197-42211, July 18, 2012 | Would increase size standards for 1 industry and 1 sub-industry | 78 *Federal Register* 77334-77343, Dec. 23, 2013 (effective Jan. 22, 2014) | Increased size standards for 1 industry and 1 sub-industry |
| Utilities (NAICS Sector 22) | 76 *Federal Register* 40140-40142, July 7, 2011 | 77 *Federal Register* 42441-42454, July 19, 2012 | Would increase size standards for 3 industries and convert 6 industries from no more than 4 million megawatt hours in electric output in the preceding fiscal year to no more than 500 employees | 78 *Federal Register* 77343-77351, Dec. 23, 2013 (effective Jan. 22, 2014) | Increased size standards for 3 industries and converted 10 industries from no more than 4 million megawatt hours in electric output in the preceding fiscal year to number of employees (varying by industry) |

| NAICS Sectors | Notice of Intent to Review the Standard | Notice of Proposed Rulemaking | Recommended Change | Final Rule | Final Change |
|---|---|---|---|---|---|
| Wholesale Trade (NAICS Sector 42)<br>and<br>Retail Trade (two industries with employee based size standards within NAICS Sector 44-45) | 78 *Federal Register* 1639, Jan. 8, 2013 | 79 *Federal Register* 28631-28647, May 19, 2014 | Would increase size standards for 46 industries in NAICS Sector 42, and 1 industry in NAICS Sector 44-45 | 81 *Federal Register* 3941-3949, Jan. 25, 2016 (effective Feb. 26, 2016) | Increased size standards for 46 industries in NAICS Sector 42, and 1 industry in NAICS Sector 44-45 |
| Industries with Employee Based Size Standards not Part of Manufacturing, Wholesale Trade, or Retail Trade (primarily within NAICS Sectors 51 and 54) | 78 *Federal Register* 1639, Jan. 8, 2013 | 79 *Federal Register* 53646-53666, Sept. 10, 2014 | Would increase size standards for 30 industries and 3 sub-industries, eliminate 2 sub-industry exceptions, and decrease size standards for 3 industries "to exclude dominant firms" | 81 *Federal Register* 4436-4469, Jan. 26, 2016 (effective Feb. 26, 2016) | Increased size standards for 30 industries and 3 sub-industries, eliminated 2 sub-industry exceptions, and decreased size standards for 3 industries to exclude dominant firms |
| Manufacturing (NAICS Sector 31-33) | 78 *Federal Register* 1639, Jan. 8, 2013 | 79 *Federal Register* 54146-54177, Sept. 10, 2014 | Would increase size standards for 209 industries in NAICS Sector 31-33<br>Would also increase the refining capacity component for Petroleum Refiners from no more than 125,000 barrels per calendar day to no more than 200,000 barrels per calendar day | 81 *Federal Register* 4469-4492, Jan. 26, 2016 (effective Feb. 26, 2016) | Increased size standards for 209 industries in NAICS Sector 31-33, and increased the refining capacity component for Petroleum Refiners from no more than 125,000 barrels per calendar day to no more than 200,000 barrels per calendar day |

**Source:** *Federal Register* as cited in the table.

a. Also increased one size standard (Computer and Office Machine Repair and Maintenance) in NAICS Sector 81, Other Services, which was not reviewed during the SBA's review of that sector in 2010.

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