

BizWatch

Small Companies Navigate Contract-Bundling Challenges

By **ZACHARY FRYER-BIGGS**

In 2008, U.S. Naval Sea Systems Command (NAVSEA) began recompeting a consulting contract that would support the organization's efforts to develop, acquire, modernize and maintain the Navy's submarine fleet.

Seeing an opportunity, Orbis, a small, veteran-owned consulting business, hired a program manager and invested at least \$100,000 to develop a proposal.

"It was our understanding that there would be multiple contracts set aside for small businesses," said Shauna Burrows, Orbis' business development director.

The opportunity was very appealing to the company, Burrows said, because of the contractor's knowledge of NAVSEA. "That's a business that we know very well because that's where our CEO comes from."

But NAVSEA opted to use an indefinite-delivery, indefinite-quantity (IDIQ) contract instead, a technique used to bundle a series of smaller contracts into a larger one that reduces the acquisition workload by passing on some program management responsibilities to prime contractors.

"The bandwidth required to execute one of these contracts is generally going to be beyond the capability of a small business," Burrows said. "We worked our butts off to put that proposal together."

Now, Orbis is paired with a larger prime as it competes for the NAVSEA contract.

Small businesses have been voicing concern about the increased reliance on bundling contracts, citing a number of factors that may hurt small business participation.

"I think it's a dire situation," Burrows said. "If we don't step up and we don't start screaming about it, then it's just going to continue and you're going to have a lot of small businesses that are no more in the next three years."

The companies point to three main problems raised by contract bundling: the contract size, which makes management impossible for small businesses with smaller staffs; the exclusive deals subcontractors are required to sign with a prime, making work dependent upon winning as a team; and the squeezing of subcontractor profit margins by primes.

"The primes keep pushing the small contractors to cut their costs to the point that small contractors are saying, 'Maybe it's not so good to do business with the government right now,'" said Linda Hillmer, CEO of Hillmer and chairman of the small businesses division at the National Defense Industrial Association. "I can tell you anecdotally that several small businesses have decided not to do business with the government any more."

However, the effects of bundling are not one-sided, said Steve Grundman, a fellow at the Atlantic Council.

"Bundling is the proverbial two-edged sword for small business," he said. "On the one edge is the concern that the scope and scale of a bundled contract is generally harder for a generally narrow-scope firm to be able to address by itself. But the other edge to the sword is that, at least in principle, there's no reason a small business cannot be a prime contractor for a larger-scale, broader-scope project, but they have to be good at task organizing a team."

Vocal concerns about bundling are not new, Grundman said. Plus, there is much uncertainty surrounding the actual cost savings, as the Defense Department is paying a premium for primes to manage larger programs, including pass-through costs that small businesses say impose a tax on their margins.

Quantifying the trends in IDIQ contracts is difficult. The House Armed Services Committee's Panel on Business

Challenges in the Defense Industry released a report last week that claimed bundling actions rose from 17 in fiscal 2009 to 63 in fiscal 2010, rising from a total value of \$1.6 billion to \$12.8 billion.

But experts said those numbers are suspect, citing difficulties defining contract bundling.

"The definitions have been changed in inappropriate ways because it misleads you," said Stan Soloway, president of the Professional Services Council, an industry group that represents large and small service contractors.

THE TROUBLE WITH BUNDLING

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- The contract size, which makes management impossible for small businesses with smaller staffs.
- The exclusive deals subcontractors are required to sign with a prime.
- The squeezing of subcontractor profit margins by primes.

For some contractors, such as 18-year-old software company Beacon Interactive Systems, the change has made government business far more perilous, especially the exclusive partnering agreements large primes are requiring.

Nine years ago, the company decided to transition from pure commercial work to government work, primarily for the U.S. Navy.

"We took a hard look at what our value was, who would appreciate it, and who would have the funds to pay for it, and we, with great effort, turned our focus to the federal government," Beacon CEO M.L. Mackey said.

So the need to pick winning teams can put a small company, such as the 20-employee Beacon, in a difficult position, Mackey said.

"It's a problem for small businesses to pick the right

team, it's a problem for when they're on a team to get the visibility so that they actually get a good amount of work," she said.

While it may provide some difficulties for small companies, exclusive arrangements can be helpful to the government in differentiating teams, Grundman said.

"It would be typical for a small business to try to partner with everybody who is competing, so that they can keep their people in place regardless of who wins," he said. "That is exactly the kind of conduct in the marketplace that [Deputy Defense Secretary] Ash Carter is trying to put an end to. That's a little bit too comfortable."

Grundman pointed to Carter's Better Buying Power initiative, which promotes increased engagement with small businesses and increased competition, as playing a key role in current acquisition policy.

"If you're good enough, if you're valuable enough as a partner, then even as a small business, you have the negotiating leverage to partner with more than one team," he said. "But if you're not differentiating enough relative to the offering, then you're likely to be left with having to commit to one team or another. That all feels to me like normal business."

The impact of bundling may soon change, as legislation is circulating that would apply greater demands for justification before IDIQ contracts are used, and existing legislation has been clarified in recent years to help avoid undue hazards for small businesses, Soloway said.

But when asked if she would make the same decision she did nine years ago to move her company into government contracting, Beacon CEO Mackey paused.

"Assuming we can figure out this acquisition challenge, and we can keep the market vibrant to keep small businesses engaged, I would imagine that small businesses like Beacon who are cutting-edge and want to deliver cool and forward-looking technology will continue to participate here." □

Email: zbiggs@defensenews.com.

The U.K. Royal Navy's submarine **Vengeance** departs for Devonport prior to refit.



U.K. MINISTRY OF DEFENCE

RANDOM NOTES

Vengeance Refit

The British Ministry of Defence has awarded Babcock a contract for a 350 million pound (\$555.6 million), 3½-year refit of the Trident missile-carrying submarine Vengeance, to be undertaken at Babcock's Devonport Royal Dockyard, the company announced.

Vengeance is the fourth and last of the Vanguard-class subs to undergo a long overhaul period and refueling. The submarine is at Devonport ready to dock down this month and will remain in dry dock until late 2014.

Work will include fitting Vengeance with the latest reactor core, which will fuel the submarine for life, and a number of updates and upgrades to its tactical and strategic weapon systems.

THAAD Development

The Pentagon's Missile Defense Agency has awarded Lockheed Martin a \$66 million follow-on contract to continue development of the Terminal High Altitude Area Defense (THAAD) weapon system, the company said.

The advanced capability development contract is a five-year, indefinite delivery/indefinite quantity award. The initial task order provides three years of engineering technical services including: flight test planning, maintenance of laboratory capability, and execution of ballistic-missile defense system studies and threat assessments.

Since 2005, the THAAD program has completed 12 flight tests, including nine-for-nine intercepts.

A400M Lands in Chile

The Airbus Military A400M new-generation airlifter landed last week at the FIDAE Airshow in Santiago, Chile, during its first visit to Latin America as part of the A400M flight test campaign.

Grizzly 2, one of the five de-

velopment aircraft, had arrived March 23 to perform high-altitude flight tests at Cochabamba, Bolivia, where the airfield is 8,360 feet above sea level. The flight from Cochabamba to the show was the A400M's 1,000th.

Mideast Radio Order

Harris said it has received \$14.3 million in orders to provide a transformational communications, command and control system to a country in the Middle East.

The country, which Harris would not name, is buying the system, consisting of Falcon III tactical radios and accessories, to deliver wideband networking capabilities to its security forces. Harris also will provide the customer with Falcon III RF-7800M multiband networking radios, RF-7800W high-capacity line-of-sight radios and RF-7800S secure personal radios, along with networking components and spares.

Contracts for Elta

Elta Systems, a subsidiary of Israel Aerospace Industries, said it has signed a series of orders for supplying its 3-D fire-control radars, SATCOM network system, air defense and air traffic control radar (AD-STAR) systems and its tactical short-range air defense radar. The contracts, worth a total of \$106 million, include:

■ A \$39 million contract to supply a foreign client with 3-D fire-control radars for its ground-based surface-to-air defense weapon systems.

■ A \$30 million contract to supply the ELK-1891 SATCOM satellite-based network system and the ELK-1894 wideband SATCOM Data Link system to a foreign customer.

■ A \$33 million contract from a foreign customer to supply an advanced 3-D long-range AD-STAR.

■ A \$4 million order for the ELM-2106NG 3-D tactical air defense radar designed to support ground forces in protecting themselves from attacks of heli-