



Testimony of

GovSmart, Inc.

House Committee on Small Business
Subcommittee on Contracting and Infrastructure

“Leveling the Playing Field: The State of Small
Business Contracting”

May 11, 2023

Chairman Lalota, Ranking Member Scholten, and Members of the Committee, I am pleased to submit the following testimony to the Subcommittee for the record. My name is Brent Lillard, and I am the CEO and co-founder of GovSmart, Inc., an Information Technology Value-Added Reseller (ITVAR) and HUBZone Small Business concern. In late 2009, my business partner and I started the company out of our kitchen in a rented house in the HUBZone of Charlottesville, VA. Today, GovSmart has successfully completed over \$1 billion dollars in federal prime contracts and hundreds of millions of dollars in federal subcontracts. We currently have 72 full-time employees and continue to grow thanks to the federal opportunities for small businesses.

Information technology presents the greatest advantage – and the greatest risk – to government operations, and not just any product can be used on government networks to store or process government data. Only the most well-built, heavily tested, and highly certified products meet current government standards. Accordingly, government agencies can only buy these industry-leading products – nearly all of which are manufactured by large businesses. Few small business products can qualify under the ever-more-stringent cybersecurity and supply chain risk management regulations applicable to these products.

One of the challenges to growing my business is due to the misunderstanding of IT resellers in the use of the Non-Manufacturer Rule (NMR). The NMR requires that any small business reseller bidding on a contract set-aside for small business be either the manufacturer of the goods it offers, or to supply only goods made by another small business.¹ At first glance, this statutory rule is important to support small business manufacturers against the encroachment of large businesses that could offer lower prices based on lower production costs. As applied to resellers of normal commodities, such as office chairs or military uniforms, this requirement makes intuitive sense – as does the possible penalties for violation. A violation of this rule carries with it a minimum fine of \$500,000 and potential debarment. One infraction could therefore be insurmountable for a small business. As applied to the ITVAR industry, the NMR has become increasingly irrelevant and problematic to companies like GovSmart.

This puts GovSmart in a tough position. Subject to the nonmanufacturer rule, we must either manufacture the computers we sell or offer to sell computers manufactured by another small business. However, our customer can only purchase computers made by large businesses that can ensure their products are tested and certified as safe. The same concern applies to software manufactured by large businesses. Increasingly, small business resellers cannot comply with the nonmanufacturer rule and still provide the products the Government needs.

Small businesses are not the only bearers of this risk. Federal agencies risk Government Accountability Office (GAO) protests if the agency awards the solicitation to an unqualified small business due to the NMR. Additionally, if there are not small business manufacturers who offer the products in the solicitation, then the GAO protests will find the small businesses awarded in violation of NMR and the solicitation award would likely be voided. If the solicitation award is voided, then the agency will be met with many administrative setbacks; a void to fulfill the solicitation requested products; and a lack of small business credit to support the agency's goal.

¹ 15 U.S.C. 637(a)(17) (2020).

The NMR issue has now been recognized by many Government agencies that are moving to address the problem. For example, the SBA itself issued in 2019 a waiver of the NMR with respect to laptop and tablet computers after research demonstrated conclusively that no small businesses make laptops and tablets in quality and quantities sufficient to supply the Federal market.² Two large Government Departments have now also recognized the inherent problems with enforcing the NMR against IT resellers. These agencies sought and obtained from the SBA waivers of the NMR for their information technology government-wide acquisition contracts (GWACs) known as First Source III (DHS)³ and Information Technology Enterprise Solutions – 4 Hardware (ITES-4H, Department of the Army).⁴ Together, resellers like GovSmart will sell close to \$20 billion in products to these agencies, but without the unnecessary threat of heavy fines and company-ending debarment.

IT resellers face a unique problem with respect to the NMR, and these organizations have recognized these challenges. I therefore respectfully request that this Committee examine the use and need of the NMR for all information technology procurements, especially those impacting IT resellers, across government. This would allow us to fulfill both our customer's needs and our duty to comply with all procurement laws and would be a welcome change across the IT reseller industry. With respect to other industries, there are two additional improvements to the NMR that would help other industries when it comes to compliance. First, the SBA should be required to provide justification if an NMR waiver is not granted. Second, the SBA should provide a list of elements to agencies that must be included in the waiver so that all parties are clear on the application of the waiver.

Another issue that continues to harm small business IT resellers is the misclassification of procurements under the North American Industry Classification System, or NAICS. GovSmart is a reseller of information technology goods and services. We perform a critical function for the government as an interface with the expertise and connections to assess a government technology requirement and match that need to quality products or services offered by literally thousands of manufacturers. With our help, the agencies do not need to directly survey the universe of available solutions to a given tech problem – they can instead pose the requirement to us and our competitors, and with our amassed knowledge and experience, we can compete to recommend the best technology solution. Resellers are not manufacturers, or, under most circumstances, direct service providers. We are more analogous to wholesalers, leveraging the benefits of volume and supplier relationships to provide prices to the government that are well below the manufacturer's suggested retail price (MSRP). We are also full-spectrum prime contractors with project management capability, ongoing customer support obligations, and expertise in architecting solutions that will meet our customer agency's needs.

The SBA currently prohibits the use of industry codes that are the most descriptive of our industry. For various reasons, including the need to track categories of government spending, the SBA requires us to classify ourselves as either manufacturers or service providers under the NAICS codes appropriate for those industries. For example, computer manufacturers are generally

² 85 Fed. Reg. 13692 (Mar. 9, 2020).

³ DHS Solicitation # 70RTAC21R00000003, available at www.sam.gov.

⁴ Solicitation # W52P1J-20-R-0082, available at www.sam.gov.

classified under NAICS code 334111, *Computer Device Manufacturing*. Computer service providers are generally classified under NAICS code 541519, *Other Computer-Related Services*. By forcing resellers to classify themselves falsely as either manufacturers or service providers, all procurement dollars awarded to resellers can be used to capture overall government spending on supplies and services. However important the benefit of such data, or however difficult it may be to acquire otherwise, this system results in very serious harm to the very small businesses the SBA is chartered to shepherd.

If a reseller classifies itself as a manufacturer, it falls under the rules applicable to manufacturers, including size standards that are formulated to be relevant to companies engaged in manufacturing, not resale. These are generally employee-based size standards. For services companies, small businesses must not exceed a specified amount of annual revenue. As a reseller is not a manufacturer or a service provider, neither yardstick properly measures companies in our industry. The SBA has attempted to fix this issue by creating an exception within the 541519 NAICS code for ITVARs, known as footnote 18, but this exception falls short of a wholistic solution. The footnote continues to deny the reality that resellers are primarily wholesalers and not service providers or manufacturers.

One of the biggest hurdles with respect to NAICS codes for ITVARs is the misassignment to procurements that are aimed at reaching our industry. Although NAICS codes in many cases do not entirely mirror their specific requirements, these codes have a substantial impact on federal procurements. Often, a contract for IT-related acquisitions may be mixed, involving both products and services. For these mixed procurements, however, the contracting officer still must assign a single NAICS code according to the “component that accounts for the greatest percentage of contract value.” This causes problems for ITVARs because in many cases these entities provide a combination of products and services not contemplated by traditional NAICS codes. The ITVAR exception under NAICS code 541519 is also unfortunately insufficient to categorize the products and services required in recent complex agency IT procurements.

The government regularly issues solicitations under inappropriate NAICS codes. Due to minimal compliance oversight, the onus has shifted to small businesses to use already scarce time and resources to hold government agencies accountable on proper NAICS utilization via protests. Relying on protests to check this frequent misuse is unrealistic, costly, and unfair for small businesses. The OMB Economic Classification Policy Committee (ECPC) should create a new, stand-alone NAICS code for IT value-added resellers to remedy this problem. Additionally, SBA should institute an appropriate employee-based size standard of 300 employees for this new NAICS. Recognizing that IT resellers typically operate on low margins even though their annual receipts may be high, the size standard should be based on employee count rather than annual revenue. With an information technology reseller industry in the billions of dollars annually, this harm affects many companies like mine, and their employees. I respectfully request that this Committee consider urging OMB to create an ITVAR-specific NAICS code and its subsequent size standard resulting from an honest evaluation of our industry. I would welcome the chance to discuss this issue more fully in a hearing focused on the NAICS code system, as I believe that is the only way to fully explore the complex consequences that follow from forcing the use of inaccurate codes.

Thank you for considering my testimony on these important matters. I applaud the Committee's effort to address these issues and look forward to future opportunities to share my input on ways Congress can continue to support small business federal contractors.