

THE IMPACT OF CONTRACT BUNDLING ON SMALL U.S. VENDORS

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ABSTRACT. The official U.S. government response to small business problems created by contract bundling is ineffective, primarily because the response is based on a very restrictive definition of bundling and inconsistent monitoring of bundling trends. This is no mere semantic debate. The government's current, narrow definition has caused small firms to lose billions in federal business and reduced diversity and competition in the federal marketplace. In the long run, this can only lead to a reduction in the quality of goods and services procured by the government and an increase in their price. Despite revisions to the definition of contract bundling adopted in final rules amending the U.S. Federal Acquisition Regulations (FAR) in October, 2003, the FAR Council, which oversees the approval of new procurement rules, rejected the concept of "accretive bundling." Accretive bundling involves adding diverse tasks to existing, primarily large contracts in order to speed the procurement process. Most federal marketers and procurement officials acknowledge the phenomenon, yet the FAR Council chose to restrict its definition of bundling to just those existing, small contracts that get consolidated in such a way as to make the new, larger requirement too big complex for small firms to bid on.

So, instead of addressing its new un-bundling rules to the approximately one-half of all procurement dollars spent on contracts bundled accretively, the FAR Council's recommendations deal primarily with new contracts and task/delivery orders accounting for one half of one percent of total procurement spending. The recommendations for addressing this much more limited view of bundling involve large commitments of time by agency small business officials who are expected to review information that is not reported systematically. Furthermore, officials are expected to obtain this information under difficult time constraints in time to determine whether there are viable alternatives to the bundling being proposed by their contract and program officers. The cost of these remedial activities appear to greatly outweigh their benefits and Congress is raising questions about their purpose. Furthermore, inconsistencies in officially reported bundled contract data seriously hampers an effective response to the problem.

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BACKGROUND

Contract bundling has emerged as an issue during a period of great change in the government's procurement workforce. The two biggest procurement-related changes in the last 15 years include the end of the Cold War and the implementation of the procurement reforms of the 1990s. The combined impact of reduced major weapons buying, various administrative reforms (FARA, FASA, ITMRA, etc.), the accelerating use of electronic procurement, credit cards and multiple award/indefinite-quantity contracts have led to major reductions in procurement-related employment. According to an April, 2002 General Accounting Office (GAO, 2002, p. p. 2) report, between 1989 and 1999 the DoD downsized its civilian acquisition workforce by nearly 50 percent, to 124,000.

Yet, overall procurement spending continues to rise. Between 1990 and 2004 reported prime contract spending grew from \$179 billion to \$290 billion. Not only has federal spending increased, but the acquisition workforce has had to simultaneously become familiar with new methods of contract evaluation such as Performance-Based Contracting and A-76 competitions. Anecdotal reports from acquisition workers indicate their work flow is as heavy as ever and the increased use of existing contracts is essential for simply getting work done in a timely manner. Contract bundling needs to be viewed in this context. It has become a critical administrative tool for agencies to buy their goods and services more quickly.

However, in such a high-pressure, task-oriented buying environment small businesses inevitably suffer for a variety of reasons. It could be because bundling often occurs on large, multiple award-type contracts or on contracts permitting restricted competition. It could be because agencies don't have the work force to find qualified, small vendors and manage numerous full and open competitions. Or it could simply be the result of agencies preferring known vendors over new marketplace entrants.

The existing definition of contract bundling fails to address these larger issues and as a result it does virtually nothing to curb the practice of bundling.

OFFICIAL BUNDLING DEFINITION

In October, 2003, the Federal Acquisition Council, consisting of senior procurement representatives from the Department of Defense (DoD), the General Services Administration (GSA) and the National Aeronautics and Space Administration (NASA), issued a final rule amending Title 48 of the Code of Federal Regulations (CFR). The rule, entitled "Contract Bundling and Small Entity Compliance Guide," added new wording about multiple award contracts to the existing definition of contract bundling but kept a fundamentally restrictive definition intact.

The new, amended definition is the seventh change dating from November, 1990, when the bundling issue first emerged in the SBA Reauthorization and Amendments Act of 1990 (SBA Office of Advocacy, 2002). Early definitions contained awkward wording and various, other shortcomings that led to the adoption of an expanded definition of bundling in the Small Business Reauthorization Act of 1997. The first two sections of the 1997 definition still serve as the basis the definition published in FAR Part 2.101, which explains bundling as:

- (1) Consolidating two or more requirements for supplies or services, previously provided or performed under separate smaller contracts, into a solicitation for a single contract that is likely to be unsuitable for award to a small business concern due to-
 - (i) The diversity, size, or specialized nature of the elements of the performance specified;
 - (ii) The aggregate dollar value of the anticipated award;
 - (iii) The geographical dispersion of the contract performance sites; or
 - (iv) Any combination of the factors described in paragraphs (1)(i), (ii), and (iii) of this definition.
- (2) "Separate smaller contract" as used in this definition, means a contract that has been performed by one or more small business concerns or that was suitable for award to one or more small business concerns (FAR, 2003).

The additional language added by the Federal Acquisition Council in 2003 states:

- (3) "Single contract" as used in this definition, includes-

- (i) Multiple awards of indefinite-quantity contracts under a single solicitation for the same or similar supplies or services to two or more sources (see FAR 16.504(c)); and
- (ii) An order placed against an indefinite quantity contract under a-
 - (A) Federal Supply Schedule contract; or
 - (B) Task-order contract or delivery-order contract awarded by another agency (*i.e.*, Governmentwide acquisition contract or multi-agency contract).
- (4) This definition does not apply to a contract that will be awarded and performed entirely outside of the United States (FAR, 2003).

This definition makes three fundamental assertions: (1) a bundled contract replaces separate, smaller contracts; (2) a bundled contract has performance elements that make it more difficult for small business to perform; and (3) there is consequently a reduced likelihood that small business can perform the contract.

A definition like this is operational in nature; it is geared to doing something about bundling on a case-by-case basis. Yet, in addressing such specific cases the definition ignores much larger, potential causes of bundling, such as:

- **New Technology.** In an age of rapid technological change it is extremely difficult to construct a contract genealogy when the functions performed by a single piece of hardware (eg, a supercomputer) could have been dispersed across numerous, separate contracts. Most contract officers will only be able to identify the smallest, simplest requirements as elements of a new, bundled contract.
- **New Requirements On Existing Contracts.** Only old, small, separate requirements can be bundled; new requirements added to existing contracts, large or small, are excluded from official bundling measures.
- **Existng, Large Requirements.** Existing, large contracts can't be bundled by definition. Large or small requirements combined into already large contracts are excluded by official bundling measures.

- **New Requirements on New Contracts.** Diverse, new requirements combined as part of new contracts can't be considered bundled, by definition;

There are at least two additional implications of the current definition of bundling. The first is, once a contract becomes bundled it is by definition inappropriate for small firms to bid on and therefore can't be considered bundled again. This means that over time, bundling might simply disappear on its own, by definition.

- **Small Firms Excluded.** By definition small firms are precluded from receiving bundled contracts. Small firms are therefore excluded from all official bundling measures.

Finally, there are these nettlesome questions:

- Who decides whether a new, combined contract will be “unsuitable for award to a small business,” and on what criteria? Are these criteria standard from agency to agency?
- How many contracts will an agency review annually to determine each contract's suitability for award small businesses? What if one agency with limited personnel reviews only 1% of its contracts while another agency with more small business officers reviews 6%? How reliable is the government's measure of bundling if the level of effort from agency to agency is not standardized?

The new wording adopted by the FAR Council in 2003 appears to broaden the definition of a bundled contract by including Multiple Award, GWAC, IDIQ and GSA Schedule contracts as potential bundling vehicles, but in fact the wording changes accomplish little. A startling May, 2004, report issued by the GAO (2004) recounts that 23 federal agencies designated as “accountable agencies” under the OMB's new, anti-bundling strategy could identify only 24 bundled contracts between them in FY 2002 using the new, official definition of contract bundling. This is an average of just one bundled contract per agency; in fact, the 24 contracts were reported by just four agencies. Sixteen agencies reported that no bundling occurred at all in FY 2002. Together, the 23 agencies accounted for over 85 percent of FY 2002 procurement spending.

The GAO report raises the additional problem of data standardization. Agencies researching their own bundled contracts for

the OMB found their numbers differed dramatically from statistics reported through the GSA's Federal Procurement Data Center. Most of the differences were found to be reporting errors in the GSA database, but the issue of interpretation remains over what is "unsuitable for award to a small business" and what conditions apply to "necessary and justified" contract bundling (GAO, 2004).

EAGLE EYE'S BUNDLING DEFINITION

Eagle Eye defines a bundled contract as any contract exhibiting dissimilar Product Service Codes (PSCs), Places of Performance (PoPs) or Contract Type codes in any one fiscal year or in the three prior fiscal years leading up to it. The idea here is to build a definition that focuses on likely bundled contract characteristics rather than on contracting history or contract outcomes. Dissimilar PSCs, PoPs and Contract Type codes spread across multiple contract transactions are the likeliest indicators that diverse tasks or delivery orders are being consolidated under one contract vehicle.

This kind of definition has a variety of advantages over the current, official definition of bundling. First, it captures bundling done by accretion, which is typical of the kind of bundling found in today's federal marketplace. New, diverse requirements are captured along with old, consolidated requirements without regard for judgments about contract outcomes. This promotes statistical consistency and comprehensiveness.

Second, this definition captures much of the bundling activity on newer, widely used vehicles like GSA Schedules, GWACs, IDIQs and Multiple Award-type contracts, including those held by small businesses. Although the current bundling definition is open to the inclusion of work performed on these kinds of contracts, in fact wording elsewhere in the definition excludes most of this work. Furthermore, the existing definition excludes bundled contracts that might be held by small firms.

Third, having a standard set of contract characteristics to define bundling makes identifying and tracking bundled contracts over time straightforward and efficient. The Eagle Eye bundling definition makes the current, cumbersome procedures for identifying and assessing bundled contracts unnecessary. This will greatly improve the ability of agencies to address bundling in its full context and in a timely manner.

Fourth, 16 reported bundled contracts issued by 23 of the largest federal agencies for all of FY 2002, as cited in the May 2004 GAO report, is simply unrealistic. The Eagle Eye definition captures the bundling actually being reported by company officials with first-hand experience in sales and marketing. The officially designated bundled contracts identified in the GAO Report constitute virtually no problem at all. Establishing a complex policy to address contracts that represent a tiny fraction of one percent of all federal procurement spending is a huge waste of time and money.

One of the shortcomings of Eagle Eye's bundling definition is that it may actually understate the amount of bundling that occurs throughout government. For example, contracts with only one transaction, no matter how large, cannot be included in Eagle Eye's definition. This eliminates 226,000 contracts worth \$40 billion from consideration as bundled vehicles in FY 2003.

Another potential weakness is the natural tendency over time for contract vehicles to show multiple criteria in the three, key bundled data indicators. The addition of multiple codes over time may simply be the result of a re-interpretation of the descriptors assigned to these contracts, not necessarily a change in the nature of the work performed.

SUPPORTING DATA

By virtually every key indicator the Eagle Eye measure of bundled contracts is larger, more consistent and more descriptive of the problems small firms face as a result of the bundling phenomenon. Here is just a sampling of figures contrasting official measures of bundling with Eagle Eye's measure. The contract totals below are all drawn from the GSA's Federal Procurement Data Center prime contracts database for Fiscal Year 2003 (Eagle Eye Publishers, 2004).

TABLE 1
Selected Official and Eagle Eye Bundled Contract Measures, FY
2003 (In Billions)

	Officially	EE	Officially	EE
All	Bundled	Bundled	Bundled	Bundled
Contract \$	\$	\$	%	%

All Contracts	290.423	1.454	118.671	0.50%	40.86%
Large Business	189.9	1.281	88.547	0.67%	46.63%
Small Business	59.813	0.104	13.66	0.17%	22.84%
Services	185.993	1.266	79.074	0.68%	42.51%
Manufacturing	104.43	0.188	39.597	0.18%	37.92%
Contracts > \$1 Million	265.235	1.425	116.395	0.54%	43.88%
Contracts > \$10 Million	208.442	1.23	97.592	0.59%	46.82%
Defense	198.393	0.552	86.678	0.28%	43.69%
Civilian	92.03	0.902	31.993	0.98%	34.76%
1 Offer	109.634	0.167	38.607	0.15%	35.21%
2-5 Offers	100.659	0.599	45.918	0.60%	45.62%
6-10 Offers	22.007	0.089	9.122	0.40%	41.45%
11-15 Offers	6.209	0.493	1.536	7.94%	24.74%
Competed	185.611	1.275	84.249	0.69%	45.39%
Not Competed	67.925	0.154	24.043	0.23%	35.40%
Modifications	144.603	0.987	61.724	0.68%	42.69%
IDIQs	43.156	0.171	21.147	0.40%	49.00%
GSA Schedules	20.171	0.002	18.485	0.01%	91.64%
MAS Contracts	22.384	0.111	11.498	0.50%	51.37%

The differences between the official and Eagle Eye bundled contract measures are sharp. Some of the key distinctions are:

- Overall, the Eagle Eye measure includes 41 percent of all federal spending, 82 times more money than the .5 percent accounted for by the official bundling measure
- The Eagle Eye bundled measure includes 91.6 percent of all GSA Schedule dollars, or 9,243 times more Schedule dollars than the official bundled measure
- Only .1 percent of officially bundled contract dollars were reported to have been awarded on GSA Schedule Contracts, while 15.6 percent of Eagle Eye bundled dollars appear on GSA Schedules
- 33.9 percent of all officially bundled dollars were reported to have been awarded on contracts with 11-15 bidders, while only 1.3 percent of dollars considered bundled by the Eagle Eye measure had that many bidders

- According to Eagle Eye's bundled measure, small firms won 20.1 percent of all federal prime contract dollars but just 11.5 percent of all bundled dollars

It stretches our conception of government policy making to believe that extensive protections for small business would need to be established for dollars accounting for one half of one percent of all federal procurement. Expanding existing incentive programs would be a far more productive use of agency staff to promote small business participation in the federal marketplace. One interesting note: official bundling figures show small firms receiving 7.2 percent of officially bundled dollars, which is illegal. Small firms officially cannot receive bundled contracts because these contracts are defined as being inappropriate for award to small firms.

With the rapid growth in the GSA Schedules program -- \$20.2 billion in reported dollars in FY 2003 -- a significant amount of bundling would reasonably be expected to occur on these vehicles. However, the official bundling measure captures a mere .1 percent of the official bundled contract dollar total. The Eagle Eye measure, by contrast, indicates that 15.6 percent of bundled dollars appear on GSA Schedules. The Eagle Eye bundled dollar total for GSA Schedules is 9,243 times larger than the official measure of bundled GSA contract dollars.

Bundling smaller requirements into larger contracts strongly suggests that fewer, not larger numbers of vendors would find the new, bundled opportunities appropriate to bid on as small vendors become excluded. Yet, official measures of bundling show just the opposite: over one-third of all the officially bundled dollars were awarded on contracts with 11-15 offers. This defies reasonable expectations. The Eagle Eye bundled measure indicates that just 1.3 percent of all bundled dollars had this many bidders.

The Eagle Eye FPC procurement database indicates that in FY 2003 a total of 778 contracts were bundled based on the official, Y/N bundling flag in the GSA's procurement reports. Does the government mean to suggest that between FY 2002, when agencies reported a total of just 24 bundled contracts according to the GAO, and FY 2003 the total number of bundled awards grew by 3,142 percent?

CONCLUSION

The current, statutory definition of bundling is overly restrictive and applied to just those contracts representing the most promising candidates for a limited number of procurement officials to address. This does little to solve the real problems associated with bundling and faced by small vendors in today's federal marketplace.

That bundling harms small firms is amply demonstrated by the fact that in FY 2003 the 11.5 percent small vendor share of bundled contracts is a full nine percentage points lower than the small firm share of contract spending overall. If in FY 2003 small firms won bundled contracts at the same rate they won contracts overall, their bundled dollar total would have been \$24.4 billion. Even this larger total, representing 20.6 percent of bundled dollars, falls far short of the government-wide 23 percent small business procurement goal.

Given the need to move important work off of the desks of a shrinking acquisition workforce, we must come to terms with the fact that bundling is not going to disappear soon. To mitigate the harmful consequences of bundling to small firms the government should consider:

- 1. Broadening the official bundling definition by incorporating commonly accepted bundling practices and trends.** The existing definition of bundling is largely outdated. Accretive bundling is how the vast amount of bundled dollars get spent in today's federal marketplace. Only when the problem of bundling is correctly defined will appropriate policies be developed to mitigate its harmful effects on small firms.
- 2. Eliminating Procurement Center Representative busy work and focus on comprehensive solutions to the bundling problem.** Forcing small business contract officials to make endless, qualitative judgments about individual contracts' suitability for award to small firms ties up valuable staff time that could be better spent doing small business market research, outreach and market training.
- 3. Conducting meaningful cost-benefit analyses for bundling vs. unbundling in situations where contracts are estimated to be worth over \$50 million.** In addition to factoring in the government's administrative costs saved by competing fewer individual contracts, include realistic estimates for a vendor's larger

administration costs, sub-contract markup rates, overall profit rates. Review selected bundled contracts upon performance to test and refine price and cost assumptions.

4. Applying established small business contracting goals to each agency's bundled contracts. Bundled contracts are not going away and unbundling may not be realistic in many contracting situations. At the least officials could use existing small business incentive programs to insure that small firms win their fair share of bundled contracts in light of each agency's overall goals for small business contracting.

5. Monitoring subcontracting commitments by large firms closely. Make commitments to subcontracting legally binding on the prime vendor by including their subcontracting commitments in specific contract clauses.

Furthermore, information in Eagle Eye's prime contracts database (based on official GSA procurement reports), indicates that agencies are confused about how to measure bundling. The small amount of bundled dollars reported contain inconsistencies and unusual trends that need closer scrutiny and correction.

The bottom line is that the accretion of diverse tasks on contracts is what is fueling bundling, and the current bundling definition ignores this. It is creating an array of problems, not just for small firms but potentially for the government's industrial base and the federal procurement system itself. Bundling reduces small firm participation, which in turn reduces diversity, competition and choice. Contract bundling may also be denying American citizens best value for their tax dollars, particularly in the growth area of Services which accounts for nearly two-thirds of all procurement spending.

The scope of the bundling problem cannot be fully recognized, and meaningful responses will not be implemented, until the problem of bundling is defined correctly and data to monitor the practice is properly and consistently reported.

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