

## Recommendation 79: Enable enhanced use of advanced payments, at time of contract award, to small businesses.

### Problem

Small businesses have limited cash flow, and DoD is very slow to pay invoices.<sup>1</sup> The costs incurred by small companies to borrow money to continue operations can be substantial. Without an initial upfront payment on contract awards, small businesses may not bid on government contracts because they cannot afford to buy the material, produce the product, and then wait to get paid by the government.<sup>2</sup> Additionally, the government pays after the invoice is officially *received* by the government, whereas industry pays at the invoice *creation* date.<sup>3</sup> This delay discourages small businesses from DoD contracts, creates a barrier to entry and decreases competition, potentially depriving warfighters of new and innovative solutions to their technology and innovation requirements. One solution is advance payments as covered in law and regulation under contract financing.<sup>4</sup>

### Background

Small businesses are incubators of innovation; they account for an average of 13 more patents per employee than large firms. The Small Business Act codifies the government's interest in obtaining innovation and solutions from small businesses. Large-scale DoD policy initiatives like Better Buying Power Initiative have made attracting small business entry into DoD contracting a major goal. Numerous laws and regulations exist to promote small business participation in government contracting:

- **Small Business Act (15 U.S.C. §§ 631-657):** Establishes mandatory small business contracting goals and small business programs applicable to all Federal agencies, including the DoD.
- **DoDI 5134.04 (Director of Small Business Programs):** Establishes the Director of SBP as the principal advisor to the USD(AT&L) and the Secretary of Defense on small business matters and provides small businesses the maximum practicable opportunity for contracts in accordance with the Small Business Act.
- **DoDI 4205.01 (DoD Small Business Programs):** Establishes DoD small business programs under the authority of the Director of SBP. DoD small business programs include small business; veteran-owned small business; service-disabled, veteran-owned small business; historically underutilized business zone small business; small, disadvantaged business; women-owned small business, DoD Mentor-Protégé Program; Indian Incentive Program; Small

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<sup>1</sup> GAO, *DOD Payments to Small Businesses: Implementation and Effective Utilization of Electronic Invoicing Could Further Reduce Late Payments*, GAO-06-358, May 2006, accessed November 5, 2018, <https://www.gao.gov/assets/260/250143.pdf>.

<sup>2</sup> The Small Business Administration's size standards for small businesses are based on average annual revenues and number of employees. A business must make between or below \$750,000 and \$35.5 million and have between or below 100 and 1,500 employees depending on the industry.

<sup>3</sup> "Collecting from the Federal Government," The Credit Research Foundation, accessed November 5, 2018, <https://www.cfonline.org/orc/cro/cro-6.html>.

<sup>4</sup> FAR Part 32,001, Definitions: Contract financing payment means an authorized Government disbursement of monies to a contractor prior to acceptance of supplies or services by the Government. ... Delivery payments are invoice payments for prompt payment purposes.

Business Innovation Research (SBIR); Small Business Technology Transfer; and all other small business programs in DoD.

- **The Small Business Innovation Development Act (SBIR) (15 U.S.C. § 638):** This section of the Small Business Act establishes the SBIR program as well as the rules governing the program.
- **10 U.S.C. § 2307, Contract Financing Section D, Security for Advance Payments:** Advance payments made under subsection (a) may be made only if the contractor gives adequate security and after a determination *by the head of the agency* that to do so would be in the public interest.
- **FAR Part 52.232-40 – Providing Accelerated Payments to Small Business Subcontractors:** As prescribed in 32.009-2, states that “upon receipt of accelerated payments from the Government, the Contractor shall make accelerated payments to its small business subcontractors under this contract, to the maximum extent practicable and prior to when such payment is otherwise required under the applicable contract or subcontract, after receipt of a proper invoice and all other required documentation from the small business subcontractor.”
- **FAR Part 32.402(b):** “Advance payments may be provided on any type of contract; however, the agency shall authorize advance payments sparingly. Except for the contracts described in 32.403(a) and (b), advance payment is the least preferred method of contract financing and generally they should not be authorized if other types of financing are reasonably available to the contractor in adequate amounts.”
- **FAR Part 32.402(c)(1)(iii):** The agency head or designee determines, based on written findings, that the advance payment—
  - (A) Is in the public interest (under 32.401(a) or (b)); or
  - (B) Facilitates the national defense (under 32.401(c)).
- **Section 852 of the FY 2019 NDAA:** Reinforces acceleration of payments to small business subcontractors.

Despite these laws, regulations, and policies, studies indicate small business participation in DoD is still not as robust as it could be, leaving DoD unable to tap potential innovation and solutions.<sup>5</sup>

## Discussion

Small businesses report the time required to receive payments impedes their ability to do business with DoD.<sup>6</sup> Unlike large companies, small businesses do not have cash flow available at contract execution

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<sup>5</sup> Ronnie Schilling, Thomas A. Mazzuchi, and Shahram Sarkani, “Survey of Small Business Barriers to Department of Defense Contracts,” *Defense Acquisition Research Journal*, Vol. 24, No. 1 (2017): 2-29, <http://dx.doi.org/10.22594/dau.16-752.24.01>, accessed November 5, 2018, [https://www.dau.mil/library/arj/Lists/PageContent/Attachments/2/ARJ80-Article01\\_Schilling.pdf](https://www.dau.mil/library/arj/Lists/PageContent/Attachments/2/ARJ80-Article01_Schilling.pdf).

<sup>6</sup> *Ibid.*

to cover expenses that arise before they can submit their first invoice. Small businesses need incentives to risk bidding on DoD contracts that advance contract payments can offer.<sup>7</sup>

DoD encounters obstacles when using the existing federal and departmental regulations that allow advance payments. Current regulations designate the head of an agency as the decision authority for advance payment use. Requiring this level of authority makes it impractical to get necessary approvals. Reaching the head of an agency requires, in most cases, eight to 12 independent reviews and approvals for a single document. In some cases, more layers of review may be required, depending on the size of the contracting activity. Because of the time and manpower required, acquisition personnel rarely consider routing a document up the chain of command seeking approval for advanced payments. Most of these types of actions involve contracts valued at less than the Simplified Acquisition Threshold (SAT) and are often small business set-asides. Many of these types of contract actions occur at the end of the fiscal year, which further constrains the amount of time personnel have to obtain this level of review and approval.

## **Conclusions**

Regardless of company size, emerging technologies and research and development move at a rapid pace, often much faster than federal procurement and payment timelines. Emerging small technology businesses often require capital in advance of performance to stay in the forefront of technological advances and cannot borrow operational capital for months at a time while awaiting contract payments from the government without jeopardizing their future viability as a business. A more flexible advanced payment policy that authorizes approval at lower levels than the head of the agency will encourage greater use of advanced payments to finance small businesses and provide the capital needed to develop innovative ideas and solutions.

The statute allows for advance payments up to the total price of the contract, but currently limits advance payments for commercial items to 15 percent of the contract price. Raising the advance payment threshold to 20 percent for small businesses offering commercial items in addition to the general authority up to 100 percent of the contract price will add even more flexibility in cases where innovation is dependent on the modification or integration of commercial products or services into a new product. Modifying existing regulations and guidance on advanced payments will also make it easier to identify and approve eligible small businesses and create more of a marketplace for small businesses to engage in DoD innovation.

## **Implementation**

### ***Legislative Branch***

- Modify 10 U.S.C. § 2307, Contract Financing, to (a) allow advanced payments when a cognizant approval authority or its delegate below the head of the agency determines that doing so would be in the public interest and to (b) provide an exception for small businesses supplying commercial items that would allow them to receive advanced payments of up to 20 percent of the contract price.

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<sup>7</sup> Information gathered during Section 809 Panel Enablers/Incentives Workshop, March 14, 2018.

***Executive Branch***

- Conduct training for relevant personnel on the ability to maximize use of FAR Part 32.403(g).

***Implications for Other Agencies***

- There are no cross-agency implications for this recommendation.