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Contractors Find Gains Hard to Hold

Federal Professional-Services Suppliers Run Into Trouble After Out-Growing Small Business Status

By EMILY MALTBY

A growing number of the businesses that provide professional services to the U.S. government say they struggle to compete against much bigger rivals once they successfully become mid-sized firms.

The businesses are caught in a Catch-22: After winning government contracts designated for small firms, most will expand and many become so big that they no longer qualify for the small-business contracts that enabled them to grow in the first place.

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Illustration by Eric Westbrook

Mid-Tier Advocacy, a Washington, D.C.-based lobbying group formed early last year to advocate for businesses that have outgrown the small-business size standards, hopes to make the transition easier. It has more than 1,000 members, many of which have revenues ranging from \$25 to \$100 million and have won government work for more than 15 years.

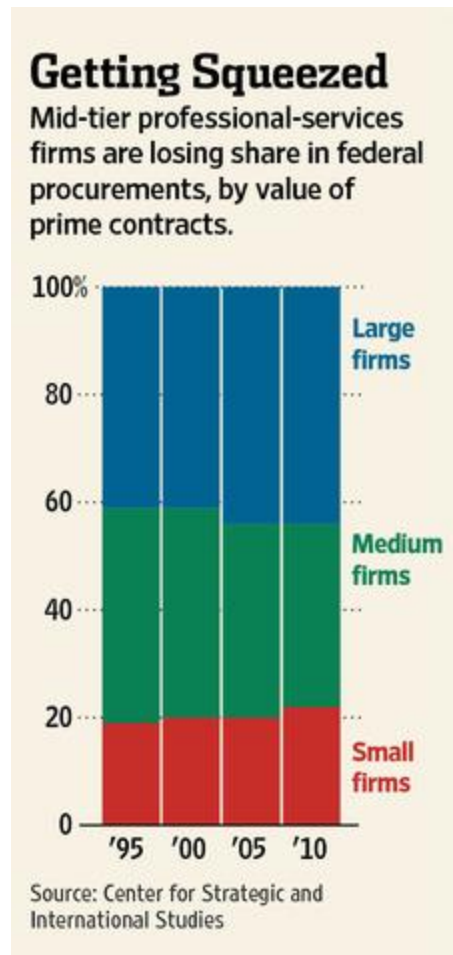
"There is no category or recognition of mid-sized firms," says Tonya M. Speed, the group's executive director. Many inevitably surpass the size limits, she adds, and consequently, "they are competing with companies that are sometimes more than 30 or 40 times their size."

Of course, the set-asides were not intended to be a permanent crutch for small companies. But making the competitive jump to medium-sized company from protected, small business has proven hard for many.

For instance, Deepak Hathiramani, founder of Vistrionix Inc., a Reston, Va., technology support services company, was so unprepared for the challenges of a mid-tier contractor that his company stumbled after growing to \$30 million in annual revenue.

Vistrionix had just 15 employees when it landed its first government contract in 1994. For nearly a decade after that, it thrived on winning so-called "set-aside" contracts providing computer-systems integration for civilian agencies. By 2003, it was going head-to-head with much larger corporations for government work.

Unable to make the transition successfully, it lost contract work to much bigger rivals. Its annual revenue plummeted to \$13.5 million in 2004 from the \$30 million peak two years earlier. Its workforce also declined to fewer than 200 employees, from 400. "It was a tough time," Mr. Hathiramani says.



He spent three years revamping the firm's services and replacing the management team with professionals who were better able to help it successfully grow and survive as a mid-sized firm. Since 2010, when the company jumped the small-business threshold for a second time, "our rate of growth has definitely slowed," he says. "In the mid-tier squeeze, there is a lot of pressure."

Indeed, firms above the small-business designation but which still had less than \$3 billion in annual revenue got 34% of government professional-services contracts in 2010, compared to about 40% in 1995, according to a report from the Center for Strategic and International Studies in Washington, D.C., to be released this month.

The gains in market share went to both small companies, which got roughly 22% in 2010, and large companies, which got 44%.

"We could see our revenues slip," says David E. Gardner, chief operating officer at Access Systems Inc., a government vendor that has \$65 million in revenue and about 300 employees. The firm is right on the cusp of becoming ineligible for government set-asides. "I don't have great optimism for the next couple of years," he says.

Rose Wang, owner of Binary Group Inc., of Arlington, Va., has a different strategy: Her information-technology management and strategy consulting firm outgrew the set-asides in the last 18 months. She is now looking to get a bite of the small-business contracts by collaborating with small contractors.

"I think we could stay flat or grow slightly," she says. "But we won't see the rapid growth we saw in the last couple of years."

Under a 1977 law, many federal agencies are required to set aside work for small businesses as a means of awarding 23% of all federal contracting dollars to them.

"There's only one line we can draw," says Michele Chang, senior advisor in the Office of Government Contracting and Business Development at the Small Business Administration, which sets the limits, generally based on revenue (currently from \$750,000 to \$35.5 million) or employee counts (from 50 to 1,500 employees). The limits are currently being reevaluated thanks to last year's Small Business Jobs Act.

"The government, perhaps inadvertently, has created a system that penalizes companies for being successful," says Robert Burton, a former deputy administrator of the Office of Federal Procurement Policy under the Bush administration, who is now a Washington, D.C., lawyer in private practice.

Dan Gordon, the current administrator of the procurement policy office, says the Obama administration is making efforts to help growing contractors, by increasing transparency about upcoming business opportunities and breaking up large contracts into multiple, smaller ones that are within a mid-tier's reach.

"There is a huge range of opportunity in government contracting for firms of all sizes," he says. "We want every company to get in there and have those companies be successful."

Mid-size firms face a broader range of challenges than the small-fry. About 55% of them say they don't have sufficient access to capital and 45% say they are challenged by international competition, according to research by Ohio State University and General Electric Co.'s GE Capital financial arm.

Rep. Gerald Connolly (D-Va.) recently proposed legislation that would give mid-size firms with less than 1,500 employees an opportunity to compete for select contracts before the competition is open to larger companies.

But several small-business groups oppose such changes. "Instead of creating a new program, take care of the problems we know exist today" such as meeting the 23% contracting goal for small firms, says Margot Dorfman, chief executive of the Washington, D.C.-based Women's Chamber of Commerce.