TechAmerica
WHERE THE FUTURE BEGINS

THE ASSOCIATION OF COMPANIES DRIVING INNOVATION WORLDWIDE

Testimony of

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Chairman Shuster, Ranking Member Larsen and Members of the Panel, my name is Trey Hodgkins and I am the Senior Vice President for National Security and Procurement Policy at TechAmerica. I want to thank you for the opportunity to testify before you on "Business Challenges within the Defense Industry" and note for you the unique position TechAmerica enjoys representing companies both within and as suppliers to the Defense Industrial Base. Technology is ubiquitous in all sectors of the economy and the majority of the population relies on technology in their everyday lives. It is also ubiquitous in the missions of the Department of Defense and we believe it is a significant differentiator in the success of those missions.

TechAmerica is the leading voice for the U.S. technology industry, which is the driving force behind productivity, growth and jobs creation in the United States and the foundation of the global innovation economy. Representing approximately 1,000 member companies of all sizes from the public and commercial sectors of the economy, it is the industry's largest advocacy organization. It is also the technology industry's only grassroots-to-global advocacy network, with offices in state capitals around the United States, Washington, D.C., Europe (Brussels) and Asia (Beijing). TechAmerica was formed by the merger of AeA (formerly the American Electronics Association), the Cyber Security Industry Alliance (CSIA), the Information Technology Association of America (ITAA) and the Government Electronics & Information Technology Association (GEIA).

I noted the unique positioning of TechAmerica in relation to the Defense Industrial Base. This is because our members range from traditional large defense industrial base companies to the most innovative and agile of small technology companies from across the Nation. While many of the large and mid-sized companies derive a significant portion of their business activity from the Federal government, a large number of our members are either suppliers or subcontractors to those large companies, direct suppliers to the Federal government or are completely outside of the public sector and are not currently supporting the Federal government market. Another unique aspect of many of the companies in this diverse group is that their business models are commercial in nature: offering commercial items distributed around the world that are developed and manufactured using a global supply chain. I'd like to relate for you today how these factors impact how we view challenges facing the defense industry and note for your attention how some of the elements of your agenda have a technology-specific perspective.

Commercial Companies and Commercial Items

As noted earlier, a significant portion of our member companies are either purely commercial in nature or have significant presences in the commercial market. This is important to note because these companies have come to rely upon 90s-era reforms found in the Clinger-Cohen Act, among others, that created a preference for commercial items in Federal government acquisitions. More importantly, the same statutes provide that these transactions should be conducted in the same fashion, as closely as possible, to commercial transactions for the same items and not include government unique requirements. These reforms gave the Federal government access to commercial technology and innovation and helped drive savings for the taxpayer. Prices for items fell to those that were asked in the commercial market, or better and the government could rely upon commercial investment and product development for innovation in a wide array of market sectors.

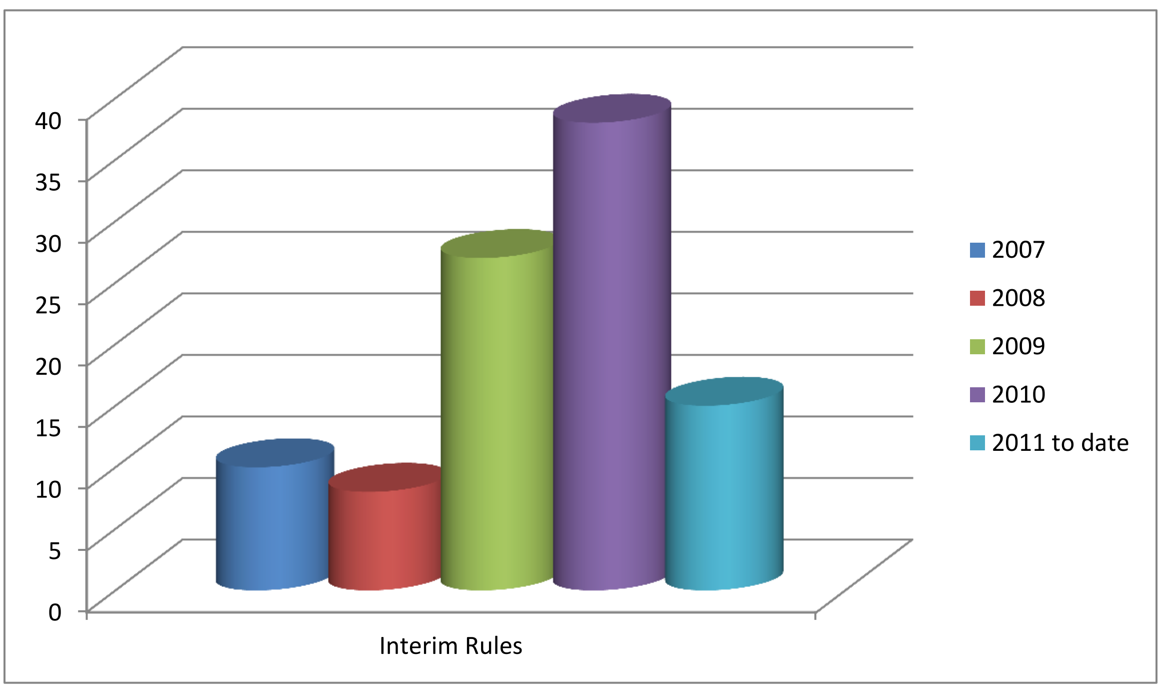
Unfortunately, many of those tenets have been forgotten or abandoned and, for commercial companies in particular, doing business with the Federal government no longer has any real resemblance to the commercial transactions for the same or similar items. Another marked change in this arena is that while the Federal government used to command a lion's share of the market for many items, it no longer enjoys that position for much of the technology sector. Most of the commercial technology companies find their Federal government market represents five-percent or less of the total global market for their business. With such conditions, companies find themselves in the situation where a relatively small portion of the market is imposing requirements that impact the vast majority of the commercial products and services they sell.

Our members are the U.S.-based elements of their companies and they are proud to support the Federal government. But, making the business case argument for accepting these conditions is increasingly difficult. Policymakers need to understand that condition and the impact it has on the Federal government's access to innovation, competition and mission success. When commercial companies find that doing business with the Federal government has become too burdensome or too risky, they either choose to stop selling directly to the Federal government or leave the market entirely. Equally as important, many commercial companies look at the challenges, hurdles and regulatory and legal burdens they would assume if they entered the public sector market and choose to stay out.

These distinctions are important to note because they alter the number and types of companies that are willing to enter and stay in the Federal government market at any level. This impacts who offers products and services directly, indirectly and as suppliers to the government and potentially means that some of our adversaries enjoy better access to innovation and technology than the U.S. Government and our warfighters.

Impact of Regulations on Business

Regulations have emerged in the last few years as an area of concern for TechAmerica and our member companies. If the panel wishes to identify and mitigate barriers to entry for technology or small businesses, or both, it does not need to look any further than the regulatory burden on companies providing their products in the Federal government market. For example, TechAmerica companies were concerned with the apparent growth in the use of interim rules with immediate enforcement requirements in the last several years. By reviewing acquisition regulations published in the *Federal Register*, TechAmerica discovered that there is a clear and pronounced trend line upwards in the use of interim rules. The chart below shows initial results of that research.



This means that companies and agencies have less time to react to these proposals, restructure as necessary and become compliant. Such compliance requirements are ultimately borne by the taxpayer, so finding better, more efficient and meaningful ways for industry to engage in regulatory promulgation and providing adequate time for implementation would help address some of the impact this increase in immediately enforceable regulatory requirements imposes.

Another trend TechAmerica has seen is the increase in general regulatory reporting burdens, as measured in the *Federal Register* requests for waivers from the requirements of the Paperwork Reduction Act. Such waivers have become commonplace and fail to acknowledge the significant cumulative burden these reporting requirements place on government contractors. The cumulative burden, as estimated by the *Federal Register* notices, is tens of millions of hours each year over the three year life of the waivers. TechAmerica also believes the methodology used by the Federal government to calculate the burdens is faulty. In calculating an estimate of the burden for compliance, the methodology only accounts for the time necessary to complete the appropriate form and does not account for the data collection activities necessary to monitor for compliance and aggregate the necessary data to complete any relevant forms. In FAR Case 2007-006, TechAmerica identified a challenge to this methodology that resulted in a 20x increase in the estimated reporting burden for that one acquisition reporting requirement. It is our recommendation that the committee further examine the cumulative impact that regulatory reporting burdens place on the public sectors companies and seek to find ways to more accurately reflect the correct burden for compliance.

Finally, DoD regulatory trends are not any better, with a marked increase in the use of guidance instead of what industry feels should be promulgated regulatory actions. These guidance efforts create additional burdens on companies that specifically wish to do business in the Defense Industrial base and are further barriers to successful entry and sustainment in the market.

Barriers to Defense Industrial Base Entry

Entering the public sector is a daunting undertaking, given the myriad of government unique requirements that are placed on any company engaged in the space. For example, while TechAmerica fully supports transparency in government contracting, we believe that there are limits where disclosing information would expose corporate proprietary information or, as part of a larger disclosure, vulnerabilities in our national security. Companies, particularly commercial companies, look at the levels of disclosure – everything from sensitive information about growth plans to executive compensation – and conclude with relative ease that they alone are a sufficient barrier to doing business with the Federal government. It is noteworthy that this apprehension is expanding in direct correlation to government expansion of reporting requirements for subcontractors and suppliers. Companies that previously were not subject to government reporting or other burdensome regulatory requirements are now subject in many areas to the same or similar requirements that prime contracts face. Many see those new and expanded requirements as further evidence that they should not enter the market, even as a subcontractor or supplier providing their innovations through integrators or others selling directly to the government.

Another barrier to entry for companies providing goods or services at any level of government is the three-percent withholding tax on government contractors. TechAmerica would commend the House Armed Services Committee for their leadership on Capitol Hill in developing information regarding the burdens on contractors and agencies alike and for calling for the repeal of the provision. Withholding three percent of almost all government payments to contractors has no relationship to the tax obligations of those same government contractors and presents itself as a significant barrier to business to enter or stay in the Federal market. The reduction in cash flow alone would foreclose any considerations many small businesses might have for bringing their innovations to government.

A final barrier to mention is the long procurement lead times typically encountered at DoD. Commercial companies are unaccustomed to such long lead times. Instead, they usually are engaged in agile development in incremental models that extend in short cycles of six-month to a year. The Department frequently had lead times of over 24 months in their procurement. Such a condition is not conducive to attracting the innovation that these companies could bring to bear.

Lack of Incentives to be Entrepreneurial and Innovative

Industry does not lack incentives to be entrepreneurial and innovative, particularly in the tech sector as noted above. What serves as a disincentive for bringing those innovations to the public sector are some of the government unique requirements placed on companies and the burdens of doing business with the government. Some of these have been discussed above, but one to embellish here is the recent increase in efforts to change the ownership of intellectual property when selling to the government. Proposals differ, but generally speaking, there is a real possibility that an entrepreneur could end up sharing ownership of his or her intellectual property with the government if they have an innovative new product that will be acquired and modified for government use using government funding. Governing laws and case decisions define specific points when ownership changes, but these new proposals would blur those lines and make the government a part owner for even relatively minor investments into an innovation for adoption by the government. This possibility is a real disincentive for many innovators and entrepreneurs.

Another barrier to effective adoption of technology and innovation at DoD and in the Federal government is the emphasis placed in acquisitions on "lowest priced, technically acceptable." While the members of TechAmerica understand the governments' need to get fair and reasonable pricing for the goods and services it acquires, the practice has become the preference and is a regulatory requirement now, forcing acquisitions to overlook better or more secure products to save a little on the price. Instead of seeking the historical criteria of "best value," which included not only a fair price, but also security, capability and total lifecycle costs, we have handcuffed the acquisition workforce into procuring only those items or services that are "lowest priced, technically acceptable" and require them to justify any acquisition that does not fit that criteria. The resultant aversion to products or services that are not "lowest priced, technically acceptable" means that even if the offering is more innovative and is the "best value," it is unlikely to be considered for final award. A good example where this policy is causing harmful, if unintended, consequences is in the assurance of the supply chain for the Department. TechAmerica members are on record supporting a change in policy to require that sourcing for acquisitions of information technology hardware, software and services are limited to original manufacturers or suppliers who are authorized by those manufacturers. Multiple cases exist where the pursuit of "lowest priced, technically acceptable" items drove behavior that resulted in the acquisition of untrusted or even counterfeit items.

Small Business Staying "Small"

TechAmerica hears from many of our members who are small, but growing or have just graduated and are now considered "medium" sized companies, that there are disincentives to being too successful in the government market. First and foremost, if they "graduate" they are left without any assistance or support and risk having to compete with large established companies or fail. Many have to define and then occupy a specific niche area of the market, even becoming subcontractors to small business prime contractors, to survive. TechAmerica has long supported revising the small business size standards to reflect sector differences, but also market differences. There should be an allowance to grow larger for companies engaged in the public sector, as opposed to a company only getting support as a small business in the commercial market. Such a distinction in the technology categories could serve as an incentive to both encourage market involvement and to attract innovation to the public sector space.

Funding Limitations to Transition Technology for DoD Deployment

There will always be innovations that, but for more funding and financial assistance, could be brought to a broader market. TechAmerica believes the Panel should focus more on how funding limitations frequently pose a far bigger problem for transitioning technology for use at the Department of Defense. Current funding processes require the acquirer to identify the technology that they want to deploy and then begin the multi-year process of building the request for funds, getting that request through Department and Administration approvals before being submitted to Congress for adoption. By the time the acquirer has funding approval to begin acquiring a new technology, the product is several generations old, if it has not been replaced entirely with a newer innovation. As TechAmerica recommended as part of the GTO-21 report and OMB proposed, Congress needs to examine the way it funds technology acquisition and deployment, because it is a real barrier to successful innovation adoption in the Department and across the Federal government.

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TechAmerica appreciates the opportunity to raise these issues for consideration and looks forward to further engagement with the Panel. I'd like to leave you with these thoughts about the tech sector from a recent editorial by Phil Bond, TechAmerica's President and CEO as a guide post for how you can improve tech sector involvement as an important part of the Defense Industrial Base:

> "The American technology sector was born here, flourished here and, with the proper attention and policy changes, can continue to thrive

here. Technology-driven innovation has long been the source of America's greatest strength, providing our nation with unparalleled economic and military advantages that have secured our leadership position in the world. It boosts all industry sectors and creates jobs.

On average, each tech job supports three jobs in other sectors of the economy. The multiplier effect for information technology jobs is even higher — nearly 5 to 1. Information technology has a proven track record of economic success, having recently accounted for more than a third of U.S. gross domestic product growth and nearly two-thirds of corporate capital investment.

Today, there are 375,000 information technology businesses in this country, employing more than 5.9 million workers at an annual average wage 86 percent higher than the current average private-sector wage. By 2018, information technology jobs are projected to grow by 22 percent, the fastest of all professional occupations.

Despite our current challenges, we are still the envy of the world. A diverse mix of entrepreneurs, scientists and skilled workers create and apply the technologies that are transforming our world and driving our economy, no matter what state it's in. But they need a favorable policy environment in this increasingly competitive world."