

(94.8%) opposed the 500 employee size standard for ITVAR. Twelve comments (4.1%) supported the proposed size standard. The remaining three comments either supported a higher size standard or addressed other issues related to the proposed rule.

#### Comments Opposing the Proposal

More than three-fourths of the 276 comments that strongly objected to the proposed ITVAR size standard submitted an identical or very similar comment. These comments stated that the average size of an ITVAR is 15 employees and 88% have 100 or fewer employees, based on data from the SBA and from a survey conducted by Computer News Reseller titled "State of the Market 2002 Research." Based on these facts, the comments contended that a 500 employee size standard is inconsistent with the Small Business Act and the foundation of the SBA. These comments further recommended that SBA also adopt a 100 employee size standard for nonmanufacturers under the industry of Computer and Computer Peripheral Equipment and Software Merchant Wholesalers, NAICS 423430 (formally NAICS 421430).

The other comments opposing the proposed ITVAR size standard cited similar data on ITVARs to argue that businesses with up to 500 employees are not small businesses in this industry and provided additional reasons for their position. Many of these comments argued that smaller IT businesses are not competitive against businesses with several hundred employees. Although smaller ITVARs may be competitive in terms of quality and service, the low margins in the industry make them uncompetitive with larger resellers. Under the proposed size standard, they argued that Federal agencies would tend to award contracts to the larger small businesses at the expense of much smaller businesses. Several comments considered a 500 employee ITVAR to be dominant in this field, and therefore, does not meet the Small Business Act's statutory definition of a small business which excludes dominant businesses as small (*see* 15 U.S.C. 632(a)(1)). Several comments also criticized the 500 employee size standard as merely an attempt to help Federal agencies to achieve their small business goals.

#### Comments Supporting the Proposal

The 12 comments supporting the proposed ITVAR size standard gave several reasons for their position. Many of these comments noted that many firms outgrow the \$21 million receipts-based IT industry size standards because a sizable proportion of receipts

on Federal contracts are for the purchase of hardware and software from manufacturers rather than strictly for services performed by ITVAR firms. Related to this point, one comment stated that the proposed ITVAR size standard allows larger small businesses to continue to operate in an industry category after they outgrow other IT industry size standards. Another comment supported the proposed size standard by comparing the activities of value added resellers with small businesses that function as an order processing or clearing house for the resale of computer and related products. The comment contended that small businesses that provide staff involved in engineering, re-configuration, systems integration, and turnkey operations must have a large number of employees to perform these functions and to grow to compete with large businesses. One of the supporting comments also recommended adding a receipts-size standard of \$50 million with the proposed 500 employee size standard to prevent large businesses from qualifying as small.

#### Comments on establishing an ITVAR Industry Category

The SBA received seven comments on the issue of establishing an industry category for ITVAR. All seven commented in support of the new category. Three of these were from comments that opposed the 500 employee size standard. One comment recommended changing the proposed service percentage range of 15% to 50% of contract value in the ITVAR definition to a range of 0% to 100% since contracts exclusively for hardware also include an implicit services component that contractors will provide to their customers.

#### The SBA's Response to Comments

The SBA agrees that 500 employees is not an appropriate size standard for ITVARs. As the comments pointed out, a large number of firms engaged in this activity are much smaller than 500 employees. A business can enter into the ITVAR industry at a relatively small size and grow into a highly competitive business well before it reaches 500 employees. The reasons given for comments in support of the proposed size standard support focused on being eligible as small businesses for large-sized contracts after firms have grown beyond the \$21 million computer services size standard.

While the SBA agrees that a size standard lower than 500 employees should be adopted, it does not agree that 100 employees is the appropriate size

standard. The reasons provided by those comments focused on the average employee size of ITVARs and the percent of ITVARs with 100 or fewer employees. As described more fully below, the SBA considers several industry characteristics to assess a size standard for an industry. Average firm size is one industry factor, which is compared to the average size firm in other industries. The percent of industry firms at various sizes is not used. This factor is not as useful as other industry characteristics in assessing a size standard. The statistic is overwhelmingly driven by the concentration of firms with only a few employees. These firms have much turnover and account for an insignificant proportion of industry employment and receipts. For example, ITVARs with less than five employees comprise 71% of industry firms but account for between 6% to 7% of industry employment and sales. A more useful measure to assess the economic significance of firms of varying sizes in an industry is the distribution of industry receipts by firm size. Data on this characteristic is discussed in the size standard analysis below.

Based on a review of ITVAR industry characteristics, the SBA is adopting a 150 employee size standard, which it believes more sufficiently considers the overall characteristics of the types of firms engage in ITVAR activities. In addition, 150 employees is equivalent to the average number of employees of firms under the \$21 million size standard for computer services (NAICS 5415 industry group). Since firms in these industries also act as ITVARs, the SBA believes that it is beneficial to firms in these industries to have a consistent size standard, even though the size standard measures differ. As discussed as options in the proposed rule, the SBA considered proposing the \$21 million receipts size standard and an employee equivalent of 150 employees. An employee size standard is considered a better measure of the size of ITVARs operation than receipts since a substantial proportion of their receipts merely reflect the dollar value of equipment and software sold.

The SBA does not agree with the comment recommending changing the percentage of services that must be present in an ITVAR contract range from 0% to 100%. It is unlikely that a contract for computer equipment would later include a significant amount of services. As explained in the proposed rule, the purpose of the ITVAR industry category is to treat computer contracts with a meaningful amount of computer services, but where the majority of