Government Contracts Update

August 2026

The $531 Million "Small" Business: SBA Proposes Massive Overhaul of Size Standards

Key Notes:

- SBA proposes new size standards for 338 industries that would add over 114,000 contractors to those with small business status, including more than 37,000 firms with fiscal year 2025 federal contracts worth approximately $71 billion.
- Size standards in several industries such as construction are shifting from receipts-based size standards to employee-based size standards.
- The expansion would reshape the small business contracting landscape for set-asides, teaming, and contract bundling.

The SBA recently published two proposed rules that would fundamentally redefine what qualifies as a "small" business. The first overhauls the methodology for setting size standards; the second applies that methodology to produce dramatically higher thresholds. In some NAICS codes, the increases exceed 1,400%. If adopted, firms in some industries could qualify as small even with average annual revenues exceeding $500 million, creating extended runway for some contractors while intensifying competition for others.

What the Proposed Rules Change

The rules would consolidate nearly 1,000 six-digit NAICS-based size standards into 338 standards based on four- and five-digit codes. It would also favor employee-based size standards over receipts-based standards. SBA would replace its current seven-factor analysis intended to identify segments of industry needing competitive assistance with a three-factor "average market size" formula based on national industry size, geographic markets, and a net imports adjustment, which seeks only to exclude the most dominant firms from the small business designation. The result: a single continuous formula with no explicit ceiling, setting floors at 500 employees or $30.6 million in average annual receipts. For the first time, receipts-based standards would adjust for productivity growth as well as inflation, creating an exponential increase in the size standards. Notably, SBA proposes not to reduce any existing standard, even where the new formula would call for a decrease, to avoid stripping current small businesses of their status.

The Immediate Effect: A Dramatic Increase in Small Businesses

The SBA estimates that the proposal would increase by approximately 114,541 the number of businesses qualifying as small. These newly small firms make up a significant share of the federal contractor marketplace. Approximately 37,002 firms holding fiscal year 2025 federal contracts worth about $71 billion would be requalified as small. The effect would be especially pronounced in the information technology and construction industries, where only the largest, most dominant firms may remain outside the small business category.

Selected examples illustrate the scale of the proposed increases:

- NAICS 541511 (Custom Computer Programming Services), NAICS 541512 (Computer Systems Design Services), and NAICS 541519 (Other Computer Related Services): Proposed to increase from $34 million to $531 million in average annual receipts, an increase of more than 1,400%.

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- NAICS 541611 (Administrative Management & General Management Consulting): Proposed to increase from $24.5 million to $295 million, an increase of more than 1,100%.
- NAICS 541330 (Engineering Services): Proposed to increase from $25.5 million to $252 million, an increase of more than 888%
- A subset of NAICS 541519 for Information Technology Value Added Resellers is currently subject to an exception to the $34 million size standard for this NAICS code, instead utilizing a 150-employee standard. SBA has proposed to remove all such exceptions, ostensibly changing this size standard to the proposed $531 million applicable to this NAICS code.
- NAICS 236220 (Commercial and Institutional Building Construction): Converting from the current $45 million receipts-based size standard to an employee-based size standard of 600 employees. All construction NAICS codes are moving to employee-based size standards.

The proposed rules could help address the "mid-tier cliff" that often troubles firms that outgrow their size standard but remain too small to compete on unrestricted contracts. However, if the proposed rules are implemented, current small businesses will face a similar challenge: facing competition from substantially larger businesses that nevertheless qualify as small.

Impact on Small Business Contracting Opportunities and Programs

A larger pool of small businesses is likely to reshape teaming and set-asides. Though the most obvious effect is to greatly expand the number of businesses qualifying as small, a related impact derives from the Federal Acquisition Regulation's (FAR) Rule of Two. Under this rule, an agency *must* set aside a contract opportunity for small businesses when its market research reveals that at least two small businesses are capable of performing the contract at fair market prices. With a greatly expanded pool of small business contractors, one would expect that substantially more contract opportunities will be issued as small business set-asides.

Conversely, higher standards may reduce what counts as "bundling" under FAR 2.101. Bundling is where an agency combines several small business contracts into a single contract which, as a result, is unsuitable for a small business. Now, with so many larger businesses qualifying as small, agencies could gain more latitude to combine requirements without the formal justifications and small business impact studies normally required under FAR 7.107, even when traditional small businesses cannot perform the resulting contract.

SBA programs will also feel the impact. Firms newly qualifying as small could become eligible for WOSB/EDWOSB, SDVOSB/VOSB, 8(a), HUBZone, SBIC, mentor-protégé, and SBA-backed loan programs. For example, a $531 million company could serve as a protégé and joint venture with a multibillion-dollar mentor. The flip side: current mentors may lose the incentive to partner with smaller protégés. Because a mentor that now qualifies as small can form a joint venture with any other small firm (without the mentor-protégé framework), it may opt for larger partners over its existing protégé.

Key Considerations for Contractors

Contractors seeking to challenge the proposed rules have several options: through the rulemaking process now and through legal and regulatory challenges after a final rule is issued:

- Contractors can submit comments to SBA by September 21, 2026, through regulations.gov (Docket No. SBA-2026-0199 for the revised size standards; Docket No. SBA-2026-0265 for the revised methodology).
- Contractors impacted by the revised size standards in the eventual final rule can challenge individual NAICS code adjustments under the SBA Office of Hearings and Appeals' (OHA) Size Standard Petition process. The procedures for these challenges were established in 2017 but have yet to be tested in any published decision. Still, OHA's rules provide for a process by which a contractor can challenge individual size standards, or the methodology they are based upon, on the basis that they are arbitrary, capricious, or not in accordance with applicable law, such as the Small Business Act.
- To the extent SBA runs afoul of applicable regulatory procedures, an action challenging the final rule in its entirety could be available through litigation in federal district court under the Administrative Procedures Act.

- Finally, contractors seeking to challenge the rule should consider contacting their congressional representatives. Congress has the ability to overturn regulations through the Congressional Review Act and may consider doing so here to protect traditionally small businesses.

There are also several steps contractors should consider taking to prepare for the impact of the final rule implementing what SBA has proposed:

- Map the proposed standards against every relevant NAICS code; determine whether the company is newly small, remains small, or faces a larger competitor pool. Do the same for major subcontractors, especially those under small business subcontracting plans.
- Revisit subcontracting, mentor-protégé, joint venture, and certification strategies, and examine the potential effects on existing arrangements and potential set-aside opportunities.
- Contact agency contracting officers and other officials to inquire whether the agency will take any action in response to the revised size standards such as any plans to bundle or consolidate current contracts.
- Assess exposure to larger competitors now qualifying as small and contract bundling or consolidation, then adjust pipeline, pricing, teaming, and advocacy plans.

Our Government Contracts group will continue to provide updates as this rulemaking progresses.

FOR MORE INFORMATION

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