

Date of Hearing: April 21, 2015

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Eduardo Garcia, Chair

AB 1125 (Weber) – As Introduced February 27, 2015

SUBJECT: State agency contracts: small business

SUMMARY: Increases the maximum financial value of an individual small business bid preference and reflects this additional value in the aggregate value that may be applied to a bid package that includes multiple preferences, when one of the preferences is a small business preference. The bill also modifies the base of that calculation from being the lowest responsible bidder to the lowest responsible non-small business bidder. Specifically, **this bill:**

- 1) Increases the maximum financial value of the 5% small business procurement preference from \$50,000 to \$100,000.
- 2) Increases the maximum financial value of all combined preferences from \$100,000 to \$150,000 for any bid that includes a small business preference, as specified.
- 3) Modifies the calculation of the small business 5% preference by basing it on the bid of the lowest responsible non-small business bidder rather than just the lowest responsible bidder. A responsible bid means a bid that is fully compliant with all contract requirements.

EXISTING LAW:

- 1) Designates the Department of General Services (DGS) as the administrator of the state Small Business Procurement and Contract Act (Small Business Procurement Act), which includes certifying and implementing targeted preference programs for certified small businesses, microbusinesses, and disabled veteran owned business enterprises (DVBEs).
- 2) Authorizes a 5% preference for state contract bidders that are either a certified small business, microbusiness, or a larger business that commits to using a certified small business or microbusiness in undertaking the contract. This 5% is calculated based on the bid of the lowest responsible bidder, which may be a small or non-small business.
- 3) Authorizes a 5% Target Area Contract Preference (TACPA) preference for a state contract bidder that agrees to perform the contract work in a designated "distressed area" and 1% to 4% workforce bidding preference in specified state service and commodity contracts valued in excess of \$100,000.
- 4) Authorizes contracting departments to offer a DVBE incentive. The application of an incentive varies from that of the small business and TACPA both when it is incorporated into competitive solicitations and how the incentive percentages are determined and calculated. Unlike preferences where there is a 5% standardized value included in competitive solicitations, discretion is left to departments to determine incentive percentages for a particular transaction based upon a business strategy to achieve their annual 3% DVBE procurement participation goal.

- 5) Defines a small business as independently owned, not dominant in its field of operation, domiciled in California, employing 100 or fewer employees, and earning \$10 million or less in average annual gross revenues for the three previous years.

FISCAL EFFECT: Unknown

POLICY ISSUE FRAME:

This bill increases the maximum dollar value of the 5% small business preference from \$50,000 to \$100,000 and adjusts the current aggregate financial value of all preferences within the bid package to reflect the increase.

The author advocates that the current financial limit does not allow small businesses to successfully compete for state contracting opportunities as either a prime or as a subcontractor. Evidence and commentary by DGS suggests that the \$50,000 limitation is too low given the increasing size of state contracts.

The Comment section of the analysis includes information on the role of small businesses within the California economy, the Small Business Act, and how procurement incentives are applied to state contracts. Comment 6 includes a recommendation for a technical amendment.

COMMENTS:

- 1) **Author's Purpose:** According to the author's statement, "Small businesses are the lifeblood of the economy in California. According to the Public Policy Institute of California, small businesses comprise more than 98.3% of all businesses, and are responsible for employing more than 57.9% of all workers in the state. Currently, California small businesses get a 5 percent preference when bidding on state contracts. However, currently the ceiling for the preference is \$50,000. This means that the preference starts losing its value for contracts valued over \$1 million. California small businesses have less-and-less benefit from the preference in higher value contracts, which are more difficult to prepare bids for, and where small businesses need the help most. AB 1125 increases the ceiling to \$100,000. This gives California small businesses a fighting chance at contracts up to \$2 million; a good size contract for a small business and supports the State's current commitment to enhance small business participation."
- 2) **The Role of Small Businesses within the California Economy:** California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.2 trillion economy. California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.2 trillion economy. Two separate studies, one by the U.S. Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among other advantages, small businesses are crucial in the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy.

Businesses with no employees make up the single largest component of businesses in California, 2.9 million out of an estimated 3.6 million firms in 2012, representing over \$149 billion in revenues with the highest number of businesses in the professional, scientific, and technical services industry sector. As these non-employer businesses grow, they continue to serve as an important component of

California's dynamic economy. Even if you exclude non-employer firms, businesses with less than 20 employees comprise nearly 90% of all businesses and employ approximately 18% of all workers. These non-employer and small employer firms create jobs, generate taxes, and revitalize communities.

In hard economic times, smaller size businesses often function as economic engines. In this most recent recession, the trend continued with the number of nonemployer firms increasing from 2.6 million firms (\$137 billion in revenues) in 2008 to 2.8 million firms (\$138 billion in revenues) during 2010. In the post-recession economy, small businesses are expected to become increasingly important due to their ability to be more flexible and better suited to meet niche market needs. Their small size, however, results in certain challenges in meeting regulatory requirements, accessing capital, and marketing their goods and services. California's network of technical assistance providers assist businesses with a range of services, including access to quality education, one-on-one counseling, mentoring, marketing data, and other business development resources.

- 3) **Small Business Procurement Act:** The Small Business Procurement Act, administered through DGS, was implemented more than 30 years ago to establish a small business preference within the state's procurement process that would increase the number of contracts between the state and small businesses. A disabled veteran owned business enterprise (DVBE) component was added in 1989. Today, approximately 90% of DVBEs have dual certification as a small business or microbusiness.

The Small Business Procurement Act states that it is the policy of the State of California that the state aid the interests of small businesses in order to preserve free competitive enterprise and to ensure that a fair portion of the total purchases and contracts of the state be placed with these enterprises. The statute further states that DVBE participation is strongly encouraged to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices of California's disabled military veterans. Statute sets an annual 3% DVBE procurement participation goal, and a 2006 executive order sets a 25% goal for small businesses and microbusinesses.

The charts below show small business and microbusiness aggregate procurement participation rates for fiscal years 2011-12, 2012-13, and 2013-14 for mandatory reporting agencies and total reporting agencies.

Small Business and Microbusiness Contracting Activity – Mandated Reporters				
Fiscal year	Total Contract Dollars	Total Small Business and Micobusiness Contract Dollars	Total Percent	Total Number of Contracts
2013-14	\$7,101,433,433	\$2,013,377,792	28.35%	90,784
2012-13	\$7,616,142,071	\$1,801,695,547	23.66%	105,617
2011-12	\$7,399,022,425	\$1,796,451,722	24.28%	165,523
Average	\$7,372,199,310	\$1,870,508,354	25.43%	120,641

2013-14 DGS Statewide Consolidated Annual Report

Small Business and Microbusiness Contracting Activity – Total Reporting				
Fiscal year	Total Contract Dollars	Total Small Business and Micobusiness Contract Dollars	Total Percent	Total Number of Contracts
2013-14	\$8,768,140,114	\$2,262,238,822	25.8%	102,480

2012-13	\$9,038,383,681	\$2,011,723,130	22.26%	123,668
2011-12	\$8,733,905,692	\$2,021,984,956	23.15%	179,471
Average	\$8,846,809,829	\$2,098,648,969	23.74%	135,206
2013-14 DGS Statewide Consolidated Annual Report				

Unfortunately, participation rates have not been as high as desired, with state agencies meeting the 25% small business goal in only five out of the last 15 report years. Further, in comparing year to year numbers, it is important to note that not all mandatory reporters provide annual data to DGS for inclusion in the report. As an example, only 80% of the mandatory reporters provided data for 2013-14.

- 4) **Increasing Small Business and DVBE Procurement Participation:** Every year, Members of the Legislature craft a range of bills to improve outreach, increase targeted preferences, and use their bully pulpit to advocate for small business participation in state contracting. Over the years, direct and innovative approaches have been added including mandating small business and DVBE liaisons at every agency, establishing official state-level Small Business and DVBE Advocates, and requiring the state join a national on-line contracting platform (BidSync), which is soon to be transferred back to a state-only web platform (F\$SCAL).

Among other challenges is the high concentration of contracting within just a few departments including several which bid contracts for specialized services. According to the 2013-14 Statewide Consolidated Annual Report by DGS, the top 10 contracting agencies awarded more than 83% of contract dollars in 2013-14. This data suggests that having department specific strategies to increase small business participation will be required to consistently meet the 25% goal.

In 2013-14, 61% of all state contracts were awarded by the Department of Corrections (SDCR), the Department of Transportation, and the Department of Health Care Services (DHCS). This means that regardless of the efforts of the California School Finance Authority (88.04% participation rate) and California Transportation Commission (89.44% participation rate), the state's largest contracting entities must do a better job in contracting with small and microbusiness if the state is going to consistently meet its mission of offering small businesses meaningful procurement opportunities. The chart below shows information on the contracting activities of the top 10 contracting departments for 2013-14.

Top 10 Contracting Agencies in 2013-14				
Departments	Total Contact Dollars	Percentage of Statewide Spending	Small Business and Microbusiness Participation Percentage	DVBE Participation Percentage
All Mandatory Reporters	\$7,372,199,310	100%	28.35%	3.67%
Corrections and Rehabilitation	\$2,196,722,703	30.93%	36.03%	3.60%
Transportation	\$1,0174,833,768	15.14%	28.24%	3.70%
Health Care Services (DHCS)	\$1,069,021,018	15.05%	2.36%	0.45%
State Hospitals	\$553,519,167	7.79%	49.17%	2.12%
Water	\$351,102,439	4.94%	19.79%	2.62%

Resources				
Highway Patrol	\$234,348,394	3.30	12.28	1.72
General Services	135,233,255	1.90%	42.23%	10.49%
Parks and Recreation	123,503,810	1.74%	31.49%	6.76%
Motor Vehicles	111,305,071	1.57%	25.09%	6.55%
Public Utilities Commission	\$99,350,011	1.40	12.34	3.34
Top 10 Total	\$5,975,205,480	83.77%	27.35%	3.02%

Source: 2013-14 Statewide Consolidated Annual Report prepared by DGS

According to DGS, the state's inability to reach its small business procurement goal in 2011-12 was directly attributable to DHCS' poor performance. In 2011, DHCS issued a multiyear contract for Medi-Cal Dental Services worth \$300 million per year without any small business or DVBE participation. Had DHCS met their small business goals on this one contract, DHCS would have had a 21% small business participation rate, instead of the reported 5%. DGS suggested that DHCS focus on certifying the individual dentists that will be subcontracting under the master Delta Dental contract, otherwise this single contract will continue to hold down the state's overall participation rates for years to come.

In 2013-14, as shown above, DHCS contracted with small business for only 2.36% of its contracting activities. In fact, the Health and Human Services Agency had the lowest overall small business and microbusiness participation rates (20.28%) among all other agencies in the state.

- 5) **How State Procurement Preferences Work:** In order to assist agencies in reaching state participation goals, bidders for state contracts may include procurement preferences. The value of any single 5% preference is limited to \$50,000 and the combined value of two or more preferences cannot exceed 15% or \$100,000, whichever is lower.

The state currently recognizes two preferences based on the type of business and one preference based on the location of the business. Business type preferences include a 5% preference for bids that include a small business or microbusiness as either a prime or subcontractor. The geographically-based TACPA provides a 5% preference for completing the contract in an economically distressed area and up to an additional 4% for hiring economically disadvantaged workers.

The state also offers a DVBE business incentive, which is similar to a preference, but the exact percentage value is determined by the contracting entity on a per bid basis and applied at a different point in the bid review process than the 5% procurement process. It is not uncommon for a bidder to apply a combination of preferences, as well as the DVBE incentive in his or her bid package.

When a small business preference is claimed, it is calculated as 5% of the net bid price of the lowest responsible bidder. As an example, Bidder A is the lowest responsible bidder with a \$5 million bid and does not qualify for the small business preference. The contracting agency would multiply \$5 million by 0.05 = \$250,000 to establish the maximum value of the preference. Because of the financial cap, the total value of the preference would be limited to \$50,000.

Bidder B is a certified small business and submits a \$5.1 million bid. In evaluating Bidder B's bid price, the contracting department would subtract the preference adjustment from the net bid price (\$5.2 million - \$50,000 = \$5.05 million). In this example, under existing law, the nonsmall business bidder, Bidder A, would be awarded the contract because the value of the incentive is insufficient to compete with the lowest bid.

AB 1125 proposes to change the procurement process by increasing the financial cap of the small business preference to \$100,000. Applying the AB 1125 proposed change to the example above, Bidder B would now be awarded the contract because a greater percentage of the 5% preference would be counted. More specifically, Bidder B's adjusted bid would be \$5 million, which is the same as Bidder A. All things being equal, the bid goes to the lowest responsible bid after applying preferences which is lower than Bidder A's \$5 million bid (\$5.2 million - \$250,000).

While a 5% preference was sufficient to have the small business be awarded the contract, sometimes the differences between bids are larger and existing law allows for the combining of preferences. If the small business bidder was in a low-income area, they could also apply the TACPA preference and/or DVBE incentive. Please note the preference and incentive do not change the actual bid price, the calculations are performed in order to compare and rank bids.

- 6) **Technical Amendments:** AB 1125 increases the maximum financial value of the small business preference including the higher preference value to bids that use more than one preference that include the small business preference.

Technical amendments may be needed to make a similar change to the TACPA preferences so that the higher value of the small business preference can be recognized in the bid evaluation process. These amendments would result in the maximum value of all preferences in a bid package to be \$150,000 to the extent that a small business preference was included.

- 7) **Related Legislation:** Below is a list of related legislation. While there has been an abundance of effort by the Legislature to increase small business and microbusiness participation in state contracting, a majority of the measures fail to advance from the fiscal committees.
- a) **AB 31 (Price) Public Contracts: Small Business Procurement and Contract Act:** This bill increased the maximum contract threshold amount for awards to small businesses (SME), including microbusiness, and disabled veteran-owned business enterprises (DVBE) under the states streamlined procurement process, from \$100,000 to \$250,000, as specified. It required contractors to report the contract amount allocated to SMEs and DVBEs with which they made contract commitments. Status: Signed by the Governor, Chapter 212, Statutes of 2009.
 - b) **AB 172 (Weber) State Contracting Microbusiness:** This bill would have increased the microbusiness procurement preference from 5% to 7% for state contracts to purchase goods, services, information technology, and construction of state facilities, and allowed the preference to be awarded to either a microbusiness bidder or a non-microbusiness bidder that uses a microbusiness subcontractor. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.
 - c) **AB 351 (Jones-Sawyer) 25% Small Business Goal:** This bill would have required each state agency to establish and achieve a 25% small business participation goal. Status: Scheduled to be

heard on April 21, 2015 in the Assembly Committee on Jobs, Economic Development, and the Economy.

- d) **AB 550 (Brown) State Procurement Procedures for Small Businesses:** This bill would have made key changes to state procurement procedures for the purpose of increasing small business, including microbusiness, and disabled veteran-owned business enterprise participation rates. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.
- e) **AB 1734 (Jones-Sawyer) Public Contracts and Small Business and DVBE Participation:** This bill would have required each state agency to establish and achieve a 25% small business participation goal and increases the annual procurement participation goal for disabled veteran business enterprises (DVBEs) from 3% to 5% of the value of state contracts: Status: Status: Held in the Assembly Committee on Appropriations, 2014.
- f) **AB 1783 (Perea) Streamlining Small Business Certification:** This bill required the Department of General Services to publish on the department's website, and make available to local agencies, a list of small businesses and microbusinesses that have been certified as such by the department. Status: Signed by the Governor, Chapter 114, Statutes of 2012.
- g) **AB 2278 (Weber) Small Business Procurement Preferences:** This bill would have revised the maximum small business bid preference amount and make related changes to the maximum value of all procurement preferences. Status: Held in the Assembly Committee on Appropriations, 2014.
- h) **SB 67 (Price) Small Business Participation in Public Contracts:** This bill would have authorized the Department of General Services to direct all state entities to establish an annual goal of achieving no less than 25% small business participation in state procurement contracts, as specified. Status: Held in the Assembly Committee on Appropriations, 2011.
- i) **SB 733 (Price) High Speed Rail:** This bill would have required the California High-Speed Rail Authority (HSRA) to include in its January 1, 2012 business plan a strategy for ensuring California-certified small business participation in contracts awarded with state and federal funds during all phases of the high-speed rail project. It also required the HSRA to have a strategy for working with the Employment Development Department to ensure that at least 25% of the project workforce at each worksite is from the local workforce. Status: Held in Senate Committee on Appropriations, 2011.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association for Micro Enterprise Opportunity
Natoma Technologies
Small Business California

Opposition

None received