

Date of Hearing: April 19, 2016

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Eduardo Garcia, Chair

AB 2905 (Committee on Jobs, Economic Development, and the Economy) – As Amended April 12, 2016

SUBJECT: Public contracting with small businesses

SUMMARY: Makes a number of changes to the reporting on state procurement activities with small businesses, including the reporting of prime and subprime contracting activity separately and expressing legislative intent that the state set and implement a 25% small business participation objective.

Specifically, **this bill:**

- 1) Expresses legislative intent that state government set and implement a 25% small business participation goal for state procurement and contracting.
- 2) Requires each state department to report on its internal small business procurement participation goal. This includes contracts for goods, information technology, services to the state, and the construction of state facilities.
- 3) Requires the reporting to be part of the department's pre-existing reporting requirements to DGS, relating to state contracts and small business and disabled veteran business enterprise (DVBE) participation.
- 4) Requires a state department to annually report small business participation based on prime and subprime contracts beginning with the 2017-18 contract period.
- 5) Modifies the categories of reporting for small businesses from 0-5, 26-50, 51-75, and 76-100 employees, to 0-5, 0-20, and 21-100 employees.
- 6) Makes other technical corrections.

EXISTING LAW:

- 1) Declares it is state policy that small businesses and microbusiness receive a fair portion of the total purchases and contracts or subcontracts for state goods, services, information technology, and construction.
- 2) 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 DVBEs.
- 3) Defines a small business, for the purpose of being eligible for state small business procurement contract bid preferences, 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.

- 4) Requires each state department to establish an annual goal for small business procurement participation, including contracts for goods, information technology, services to the state, and in the construction of state facilities.
- 5) Requires each department to annually report on its contracting activity for consultant services and its level of procurement participation by DVBEs, and small businesses. The information is aggregated and made public by DGS.
- 6) Defines a DVBE, for the purpose of being eligible for state procurement, as an entity meeting all of the following requirements:
 - a) The legal structure of the business is a:
 - i) Sole proprietorship with at least 51% owned by one or more disabled veterans;
 - ii) Publicly owned business with at least 51% of its stock unconditionally owned by one or more disabled veterans;
 - iii) Subsidiary that is wholly owned by a parent corporation, but only if at least 51% of the voting stock of the parent corporation is unconditionally owned by one or more disabled veterans; or
 - iv) Joint venture in which at least 51% of the joint venture's management, control, and earnings are held by one or more disabled veterans.
 - b) A disabled veteran is a veteran of the military, naval, or air service of the U.S. who has a service-connected disability of at least 10% and who is domiciled in the state;
 - c) The management and control of the daily business operations are by one or more disabled veterans. The disabled veterans who exercise management and control are not required to be the same disabled veterans as the owners of the business; and
 - d) It has a home office located in the United States, which is not a branch or subsidiary of a foreign corporation, foreign firm, or other foreign-based business.

FISCAL EFFECT: Unknown

POLICY ISSUE FRAME

Small businesses play an essential role within the California economy, contributing the most net new jobs, helping to link the California economy to manufacturing supply chains, and helping to disburse the financial advantages of the state's globally connected economy. In recognition of the sacrifices already made by California's disabled veteran community and the important economic role of small businesses, state agencies are mandated to take certain actions to include these two groups in state procurement opportunities. Unfortunately, participation rates have not been as high as desired with state agencies meeting the 25% small business procurement goal only five times in the last 15 years.

This bill includes several technical changes that are designed to enhance the state's procurement management practices as they relate to small businesses. As a first step, each state department will be required to disclose the small business procurement target when reporting on the outcomes of its state contracting activities. Next, the information on small business contracts will be standardized and better aligned with industry standards. Collectively, these changes should result in a more transparent and accountable tracking process.

The analysis includes background on the role of small businesses within the California economy and current state procurement practices.

COMMENTS:

- 1) **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 \$2.3 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 to the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy.

Nonemployer firms 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. Excluding nonemployer 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) for 2008 to 2.8 million firms (\$138 billion in revenues) for 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, competing for large-size contracts and marketing their goods and services.

- 2) **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 DBVE component was added in 1989. Today, approximately 90% of DVBEs have dual certification as small businesses.

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 participation goal, and a 2010 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.

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				

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 of the mandatory reporting agencies provide annual data to DGS for inclusion in the report. As an example, only 80% of the mandatory reports were provided for 2013-14.

- 3) **Increasing Small Business and DVBE Procurement Participation:** Every year, Members of the Legislature introduce a range of bills to improve outreach and expand targeted preferences to increase 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 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. The data suggests that having department specific strategies to increase small business participation will be required to consistently meet the 25% goal. AB 2905 establishes a first step by requiring the disclosure of the individual department's small business participation target, which is currently required to be set, but necessarily disclosed.

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% of the \$99.677 contracts awarded to small businesses) and the California Transportation Commission (89.44% of the \$14,291 in contracts awarded to small businesses), the state's largest contracting entities must do a better job of contracting with small businesses 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 Resources	\$351,102,439	4.94%	19.79%	2.62%
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 (20.285) among all other agencies in the state. If California is going to meet and exceed its small business and DVBE goals, high contract volume agencies like DHCS will need to meet their small business participation.

- 4) **Related Legislation:** Below is a list of the related bills by date.
- a) **AB 351 (Jones-Sawyer) Small Business Participation Goal in Public Contracts:** This bill would have required each state agency to establish and achieve a 25% small business procurement participation goal. Agencies that failed to meet the goal would have been required to develop and implement a corrective plan, as specified. Status: Held on Suspense in the Assembly Committee on Appropriations, 2015.
 - b) **AB 1734 (Jones-Sawyer) Public contracts: Small Business Participation: Disabled Veterans:** This bill would have required each state agency to establish and achieve a 25% small business participation goal and increased the annual procurement participation goal for disabled veteran business enterprises from 3% to 5% of the value of state contracts. Status: Held on the Suspense File in the Assembly Committee on Appropriations, 2014.
 - c) **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.
 - d) **SB 67 (Price) Small Business Participation in Public Contracts:** This bill would have authorized DGS 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 in 2011.
 - e) **AB 309 (Price) Public Contracts: Small Business Participation:** This bill would have required the establishment of a 25% small business participation goal for all state entities and directs DGS to monitor each agency's progress in meeting this goal. The bill would have required that the Office of the Small Business Advocate receive the same progress report information as state entities and directs DGS and the Office of the Small Business Advocate to work collaboratively to assist state entities in meeting their goal. Status: Held in the Assembly Committee on Appropriations in May 2010.

REGISTERED SUPPORT / OPPOSITION:

Support

None Received

Opposition

None Received

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