

Date of Hearing: April 9, 2013

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE
ECONOMY

Jose Medina, Chair

AB 550 (Brown) – As Amended: March 14, 2013

SUBJECT: State government: Office of Small Business and Disabled Veteran Business
Enterprise Services

SUMMARY: Makes several key changes to state procurement procedures for the purpose of increasing small business, including microbusiness, and disabled veteran-owned business enterprise (DVBE) participation rates. More specifically, the bill:

- 1) Expresses legislative intent that, among other things, state that:
 - a) California spends billions of dollars each year on state contracts;
 - b) Small businesses are the principal source of new jobs in the state;
 - c) Disabled veterans have made incomparable sacrifices while serving and protecting our country; and
 - d) Enhancing opportunities for small businesses to participate in state contracting is "good" business for California.
- 2) Increases the maximum contract threshold amount for awards to a small business and DVBE, under a specific streamlined procurement process, from \$250,000 to \$500,000.
- 3) Sets an annual 25% small business participation level for each state agency's contracting activity. State agencies that fail to achieve the participation rate are required to submit an explanation and remediation plan to the Governor's Office and the Legislature. Directs the Department of General Services (DGS) to provide guidance on the remediation plan.
- 4) Requires state agencies to promote the use of small businesses in state contracting, to review small business participation levels, and to develop a plan for increasing small business participation levels within 60 days if participation levels are low.
- 5) Requires DGS to research and examine best contracting practices for utilizing small businesses and present these findings and make recommendations to the Legislature.
- 6) Provides that the 25% small business participation requirements should not be construed to require an action that would violate a court order or result in the loss of federal funding.

EXISTING LAW:

- 1) Designates DGS to administer the state Small Business Procurement and Contract Act (Small Business Act), including a streamlined procurement process which is exempt from advertising, bidding, and protest provisions in the State Contract Act for the acquisition of goods, services, or information technology.

- 2) 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.
- 3) Defines a microenterprise as a small business that has on average annual gross receipts of \$250,000 or less during the previous three years or is a manufacturer with 25 or fewer employees.
- 4) Defines a DVBE as a business entity that is at least 51% owned or controlled by one or more disabled veterans, as specified.
- 5) Establishes the State Contract Act for the purpose of governing contract practices between state agencies and private contractors, covering, among other items, contracts for projects with a value of over \$250,000, adjusted biennially for changes in the California Construction Index, as specified.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's Purpose: According to the author, "In 2006, Governor Arnold Schwarzenegger issued Executive Order S-02-06 and in 2001, Governor Gray Davis issued Executive Order D-37-01, which, among other directives, called for California to lead the nation in creating an optimum environment which affords all business equal access to state agency contracting opportunities. Their orders, which required all state agencies to aggressively pursue an annual 25 percent small business participation level in state contracting, helped spur a state commitment to the success of small businesses and acknowledged that enhancing opportunities for these entities to participate in the state contracting process was "good business" for California.

AB 550 seeks to solidify the state's commitment to small businesses by codifying both Executive Order S-02-06 and Executive Order D - 37-01. Specifically, the bill requires state agencies and departments to aggressively pursue a 25% participation level in state contracting and increases the maximum amount under the Small Business Procurement and Contract Act from \$250,000 to \$500,000."

- 2) Framing the Policy Issue: The measure proposes a range of activities for improving state procurement practices relative to small business and DVBE contract participation. Given the significance of small businesses within the California economy and the significant contributions DVBEs have made to national security, the author proposes that the state must do a better job to ensure greater contract participation of small businesses and DVBEs.

The analysis includes more specific information on the role of small businesses in the California economy, the state's limited progress in meeting existing small business and DVBE mandates.

- 3) 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 \$1.9 trillion

economy. Businesses with less than 100 employees comprise nearly 98% of all businesses, and are responsible for employing more than 37% of all workers in the state.

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. California small businesses comprised 96% of the state's 60,000 exporters in 2009, which accounted for over 44% of total exports in the state. Nationally, small businesses represented only 31.9% of total exports. These numbers include the export of only goods and not services.

Historically, small businesses have functioned as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with fewer than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth. More recently, the federal Small Business Administration's Small Business Economy 2011 report, stated that small businesses nationally outperformed large firms in net job creation nearly three out of four times from 1992 through 2010 when private-sector employment rose.

- 4) **Income Disparity:** Policies that encourage small businesses access to state procurement opportunities can help to redirect the increasing income disparity dynamic. Unlike other forms of income, business income, as a proportion of total income, has continued to increase in value as other forms of income, such as wages, has remained relatively stagnant.

According to 2011 Congressional Budget Office report on after-tax incomes of American households between 1979 and 2007, income for households at the higher end of the income scale rose much more rapidly than income for households in the middle and at the lower end of the income scale. Most significantly, by the end of the report period (2005 and 2007), the after-tax income received by the top 20% exceeded the after-tax income of the remaining 80%. The chart below illustrates the Congressional Budget Office's findings in more detail.

After-Tax Income Growth 1979 to 2007			
Income Bracket	Income Earners	Percentile	Percentage Growth
1	Top 1%	100th	275%
2	Next 20%	81 st to 99 th	65%
3	Next 60%	20 th to 80 th	40%
4	Bottom 20%	1 to 19 th	18%

Source: "Trends in the Distribution of House Income Between 1979 and 2007," Congressional Budget Office, 2011

The two primary reasons for the increase in income disparities were the uneven distribution in the sources of household income and the differing economic circumstances of those sources during the 28-year report period. Households in the higher income brackets (1 & 2) received a majority of their income through capital gains and business income, which as a share of total income increased in value, while individuals in the bottom two brackets (3 & 4) received a majority of their income from labor income and capital income, which decreased in value. With the recession, this income disparity is expected to have continued to increase, in part, because of the impact of long term unemployment on wages, a core component of labor income, and rental rates, a core component of capital income.

- 5) The Small Business Act: The Small Business 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. In 1998, a disabled veteran-owned business enterprise component was added to state procurement practices.

The Small Business 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 Californians disabled during military service.

The state's success in obtaining small business and DVBE participation in state contracts has been inconsistent. Since 2001, when the first executive order set the 25% small business participation target, the state has met its goal only four times. In the most recent report on procurement, 2010-11, DGS reported that \$1.26 billion (22.12%) out of a total of \$5.72 billion of all state contracts were awarded to small businesses. The state has three times achieved its 3% DVBE participation goal, that being in 2007-08, 2009-10, and 2010-11. In 2010-11, \$272 million out of a total of \$5.64 billion (4.82%) was awarded to DVBEs.

- 6) Streamlined Procurement Process: Streamlined procurement process: In order to assist agencies in reaching state participation goals, contracting entities are authorized to use a streamlined procurement method. This method allows the process for awarding contracts to bypass the advertising, bidding, and protest provisions in the State Contract Act. Under the provisions of the Act, a contract may be made directly with a certified small business or DVBE at a contract price established by checking the proposed rate with two other small businesses or DVBEs.

Contracts offered under the streamlined procurement process are currently limited to contracts between \$5,000 and \$250,000. AB 550 would increase this amount to \$500,000 for contracts for goods, services, and information technology. In 2010-11, 12,302 contracts were initiated using this streamlined procurement process, which accounts for \$263.3 million (11%) of the total DVBE and small business contracts (112,276). The \$250,000 threshold was only instituted in 2010, pursuant to AB 31, Chapter 212, Statutes of 2009, and DGS has not publically reported its impact.

- 7) Removal of Streamline Process Provisions: Staff understands the author will be proposing the removal of the streamlined procurement process provisions.
- 8) Technical Amendments: AB 550 requires the head of state agencies to actively promote the use of small businesses and DVBEs. Technical amendments may assist in implementation.
- 9) Related Legislation: Below is a selected list of related legislation. While there has been an abundance of effort by the Legislature to increase small and microbusiness participation in state contracting, many 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 business (SME), including microbusiness, and disabled veteran-owned business enterprise (DVBE) under the states streamlined procurement process, from \$100,000 to \$250,000, as specified. Requires contractors to report the contract amount allocated to SMEs and DVBE 's with which they made contract commitments. Status: Signed by the Governor - Chapter 212, Statutes of 2009.
- b) *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 the Department of General Services to monitor each agency's progress in meeting this goal. The bill also would have required the Office of the Small Business Advocate to receive progress reports and DGS to work collaboratively with state entities in meeting their small business procurement goals. This goal is currently provided for in Executive Order (EO) D-37-01 and EO S-02-06. Status: Held under submission in the Assembly Committee on Appropriations in 2010.
- c) *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.
- d) *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 on the Suspense File of the Assembly Committee on Appropriations in 2011.
- e) *SB 1108 (Wright) Public Contracts: Small Business Participation:* This bill would have made three enhancements to the Small Business Procurement and Contract Act including authorizing the implementation of a 25% small business procurement goal, the development of specific administrative procedures for implementing the small business preference and requiring the state to take a more active role in promoting certification of small businesses. Status: Held on the Suspense File of the Assembly Appropriations Committee in 2010.

REGISTERED SUPPORT / OPPOSITION:

Support

The California Black Chamber of Commerce (Sponsor)
Antelope Valley African Chamber of Commerce
California Asian Pacific Chamber of Commerce
California Association for Micro Enterprise Opportunity
Central San Diego Black Chamber of Commerce
Coalition of California Welfare Rights Organization
Fresno Metro Black Chamber
Moreno Valley Black Chamber of Commerce

North Bay Black Chamber of Commerce
Regional Black Chamber of Commerce
Vallejo-Solano Black Chamber of Commerce

Opposition

None received

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